Testimony of Professor Peter B. Rutledge
Associate Professor of Law
Columbus School of Law, Catholic University of America
October 25, 2007

Hearing on: H.R. 3010, the "Arbitration Fairness Act of 2007"

House Judiciary Committee
Subcommittee on Commercial and Administrative Law

Chairwoman Sánchez, Ranking Member Cannon and Members of the Subcommittee. Thank you for the invitation to testify today. My name is Peter Rutledge, and I am an Associate Professor of Law at the Columbus School of Law at the Catholic University of America here in Washington, D.C. I am co-author of the book International Civil Litigation in the United States. I also have written several articles in the field of arbitration. I am pleased to offer my thoughts on H.R. 3010, the Arbitration Fairness Act.

SUMMARY

Allow me briefly to summarize the main points of my testimony:

- First, too much of the debate in this field has been dominated by anecdote, not data. The available empirical data on arbitration is growing, and, in important respects, either is inconsistent with or flatly contradicts, some of the anecdotes that appear to be driving the debate over arbitration reform. It is important to fill the gaps in the empirical record, before knowing whether and to what extent legislative action is necessary;

- Second, several of the findings upon which H.R. 3010 rests, found in Section 2 of the bill, are, based on the available empirical evidence, either erroneous or rest on criticisms not unique to arbitration;

- Third, to the extent there are problems with arbitration, several mechanisms already exist to regulate those problems;

- Fourth, eliminating predispute arbitration agreements may have significant negative economic effects and, ironically, make worse off the very parties whom defenders of H.R. 3010 are trying to protect;

- Fifth, post-dispute arbitration does not provide a viable alternative to the present system of enforceable predispute arbitration agreements.

With that summary, I will now elaborate on each of these points.

I. The State of the Empirical Research

The state of the empirical research in arbitration lags in comparison to that in other legal fields. The legal academy has been partly to blame for this. Many participants in the early debates brought preconceived notions about arbitration to the table. While they could argue about the proper direction of the legal doctrine, they were unprepared to engage in a systematic study of the empirical premises that underlay their positions.

More recently, the study of arbitration has begun to focus on those empirical premises, and researchers are slowly obtaining greater quantities of data about how arbitration operates.[1] For example, a series of studies by Lisa Bingham has helped to

[1] In addition, a number of governmental studies have looked at various aspects of arbitration. Some of these contain quite rich anecdotal information and policy perspectives, but the aggregate empirical analysis contained in these studies is limited. *See* GAO, Alternative Dispute Resolution: Employers' Experiences With ADR in the Workplace (1997); GAO, Employment Discrimination: Most Private Sector Employers Use ADR, 7 (1995); U.S. Commission on the Future of Worker-Management Relations, Final Report (1994); GAO, Securities Arbitration: How Investors Fare, 7-8 (May 1992). One government commissioned study did provide some valuable empirical evidence in the field of securities arbitration. *See*

assess whether there is a repeat player effect that benefits companies over employees.[2] Studies by scholars such as Elizabeth Hill, Theodore Eisenberg and Lewis Maltby have addressed the fundamental question whether arbitration leaves individuals better off or worse off than litigation.[3] Chris Drahozal at the University of Kansas recently edited a volume synthesizing the available empirical research in the field of international arbitration.[4] David Sherwyn at Cornell University is in the midst of seminal empirical research in employment arbitration,[5] and researchers at New York University have also made important contributions to the field.[6] In a forthcoming paper, I am attempting to measure the economic cost if Congress were to eliminate predispute arbitration.[7]

To be sure, there are gaps. The empirical record on employment arbitration is relatively more developed than that of consumer or franchise arbitration.[8] Moreover, the

---

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

[2] Lisa Bingham, *Employment Arbitration: The Repeat Player Effect*, 1 EMP. RTS. & EMP. POL'Y J. 189, 208-09 (1997); Lisa Bingham & Shimon Sarraf, *Employment Arbitration Before and After the Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of Employment: Preliminary Evidence that Self-Regulation Makes a Difference* in ALTERNATIVE DISPUTE RESOLUTION IN THE EMPLOYMENT ARENA: PROCEEDINGS OF THE NYU 53RD ANNUAL CONFERENCE ON LABOR 303 (Estreicher & Sherwyn eds. 2004).; Lisa Bingham, *On Repeat Players, Adhesive Contracts and the Use of Statistics in Judicial Review of Employment Arbitration Awards*, 29 MCGEORGE L. REV. 223, 234 (1998).

[3] Elizabeth Hill, *Due Process At Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO STATE J. ON DISP. RES. 777, 814-16 (2003); Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 DISP. RES. J. 44, 44 (Nov. 2003-Jan. 2004); Lewis Maltby, *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. REV. 105, 107 (2003); Lewis Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29, 56-58 (1998); Lewis Maltby, *Out of the Frying Pan, Into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 William Mitchell L. Rev. 313 (2003).

[4] *Toward a Science of International Arbitration: Collected Empirical Research*, Chris Drahozal, ed. (2005).

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

[6] Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate Over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RES. 559, 567-68 (2001).

[7] Peter B. Rutledge, *Whither Arbitration?*, __ Geo. J. Law & Pub. Pol'y __ (2008). In the interest of full disclosure, I should note that the Institute for Legal Reform provided funding for this study.

[8] For some of the available research on franchise and consumer arbitration, see Keith Hylton & Chris Drahozal, *The Economics of Litigation and Arbitration: An Application to Franchise Contracts*, 32 J

amount of available data varies with the arbitration provider. The American Arbitration Association has been especially willing to provide researchers access to their data; with respect to others the amount of publicly available data is more limited.

With the empirical record in this state, I would urge Congress to proceed cautiously. The risk is that the political rhetoric over arbitration will outpace the empirical reality, causing Congress to act on the basis of incomplete or, worse yet, erroneous information. Here is just one example. Arbitration is often criticized on the grounds that it leaves the party with the weaker bargaining position, whether the employee or the consumer, worse off.[9] In fact, nearly all of the available academic studies, most of which concern employment arbitration, demonstrate precisely the opposite outcome.[10] That is, by various measures, the party with the inferior bargaining

---

Legal Stud 549 (2003); Linda Demaine & Deborah Hensler, *Volunteering to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience*, 67 LAW & CONTEMP. PROBS. 55 (Winter/Spring 2004).

[9] While I recognize that H.R. 3010 also covers franchise agreements, I take issue with the notion that franchisees, who are at bottom, businesspeople are properly equated with consumers or employees in terms of their information and bargaining position in an arms-length transaction.

[10] Researchers use various methodologies to determine whether arbitration leaves the party with the inferior bargaining position "better off." For studies looking at raw win rates – that is, comparing how often each side wins, see Lewis Maltby, *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. REV. 105, 108-11 (2003); Ernst & Young, *Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases* 15 (2004), http://www.arb-forum.com/rcontrol/documents/ResearchStudiesAndStatistics/2005ErnstAndYoung.pdf; California Dispute Resolution Institute, *Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure*, Figure 4 (2004); William Howard, *Arbitrating Claims of Employment Discrimination*, 50 Disp. Resol. J. 40, 44 (Oct.-Dec. 1995); William M. Howard, *Mandatory Arbitration of Employment Discrimination Disputes: Can Justice be Served*, 130-31 (May 1995) (unpublished Ph.D. dissertation, Arizona State University) (on file with author); GAO, Securities Arbitration: How Investors Fare, 7-8 (May 1992).

For studies using a comparative win rate methodology (that is, comparing how often a party recovers in arbitration as opposed to litigation), see Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate Over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. DISP. RES. 559, 564-65 (2001); Lewis Maltby, *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. REV. 105, 111-12 (2003); Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1569 (2005); William M. Howard, *Mandatory Arbitration of Employment Discrimination Disputes: Can Justice be Served*, p. 130-31 (May 1995) (unpublished Ph.D. dissertation, Arizona State University) (on file with author).

For studies using a comparative recovery methodology (that is, comparing the amount of recovery in arbitration as opposed to litigation), see Michael Delikat & Morris Kleiner, *Comparing Litigation And*

position achieves better, or at least comparable, outcomes in arbitration compared to litigation.[11]

A recent report by the organization Public Citizen presents a counterpoint to the general trend in the academic research.[12] The main claim of the report is that one particular arbitral institution, the National Arbitration Forum, systematically favors businesses in credit card disputes that come before it. I have read the report. At one level, Public Citizen should be commended for trying to move the debate beyond anecdote and to the level of aggregate empirical analysis. But at another level, I cannot agree with the organization that the data support the view that arbitration is fundamentally flawed. The data present a skewed sample set upon which to base any decision about arbitration. Specifically, the bulk of the arbitrations evaluated by Public Citizen appear to be default collection actions – that is, relatively straightforward arbitrations commenced by a bank when someone does not pay their credit card bill.

Arbitration Of Employment Disputes: Do Claimants Better Vindicate Their Rights In Litigation?, American Bar Association Litigation Section Conflict Management, Vol. 6, Issue 3, 10 & Table 3 (2003); William M. Howard, *Mandatory Arbitration of Employment Discrimination Disputes: Can Justice be Served*, p. 132 & Table 12 (May 1995) (unpublished Ph.D. dissertation, Arizona State University) (on file with author); William Howard, *Arbitrating Claims of Employment Discrimination*, 50 Disp. Resol. J. 40, 45 (Oct.-Dec. 1995); Elizabeth Hill, *Due Process At Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO STATE J. ON DISP. RES. 777, 791-92 (2003); Elizabeth Hill, *Due Process At Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO STATE J. ON DISP. RES. 777, 788-89 (2003).

For a good synthesis of the empirical record and a blueprint for future empirical research, see Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1567-68 (2005).

[11] There are two main exceptions to the dominant trend in the literature. First, the 1995 study by William Howard suggested that outcomes in arbitration were inferior to those in litigation, but subsequent scholarship has criticized the methodology that Howard employed. Second, more recent research by Hill and Eisenberg, cited above, suggested that arbitration may result in lower recoveries for employees earning less than $60,000. Yet as the authors themselves recognize, this study did not necessarily demonstrate that arbitration caused this outcome. Rather, given the well documented difficulties that this class of plaintiffs encounters in obtaining trial counsel, only very large meritorious suits ever actually reach court; by contrast, because arbitration is more cost-effective (or parties may elect to proceed pro se), a greater array of cases – both meritorious and non-meritorious – reach arbitration, creating the misimpression that arbitration is somehow responsible for these outcomes.

[12] Public Citizen, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers* (September 2007).

That is a poor metric upon which to base any conclusion about the fairness of arbitration generally. It is the equivalent of my trying to convince you that a baseball pitcher has a near-perfect ability to throw "no-hitters" – at least where no batter is standing at the plate.

I will return to these issues in detail later in the testimony. For now, I just offer them to illustrate the point that there remain critical gaps in the systematic understanding about arbitration. Until those gaps are filled, something that the academy is actively pursuing, I would urge Congress not to let the anecdotes drive the debate.

II. The Findings of H.R. 3010 and the Empirical Research

Section 2 of H.R. 3010 sets forth a series of findings that purport to justify the reforms contained in the rest of the bill. I compared the assumptions in those findings with the actual empirical record. In several cases, I identified instances where the empirical record either did not support or, in some cases, directly contradicted the bill's findings. Allow me to summarize some of my key determinations:

- Right to a Jury Trial: A frequently heard complaint about arbitration is that it surrenders the employee's or consumer's right to a jury trial. H.R. 3010 echoes this complaint. It is certainly true that arbitration does not involve a jury. But eliminating arbitration would not suddenly cause all of those disputes to be decided by a jury. Numerous studies have documented how most civil litigation is resolved far before a case ever reaches a jury – whether through voluntary dismissal, settlement or dispositive rulings by the judge.[13] Others have documented how difficult it is for a plaintiff such as an employee to find an attorney willing to take her case unless the

[13] Sherwyn *et al*., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1566 (2005) (Vast majority of cases dismissed or resolved without court action undermines claim that arbitration will stagnate development of the law); Lewis Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29, 47(1998) (Cases never reach jury – of 3419 employment discrimination cases filed in 1994 that led to definitive judgment, 60% were disposed of by pretrial motion, with employers prevailing in 98% of those); Michael Delikat & Morris Kleiner, *Comparing Litigation And Arbitration Of Employment Disputes: Do Claimants Better Vindicate Their Rights In Litigation?*, American Bar Association Litigation Section Conflict Management, Vol. 6, Issue 3, 8 (2003).

amount in controversy is sufficiently high and the merits sufficiently strong.[14] Indeed, a founder of the National Employment Lawyers' Association, an organization dedicated to employee representation in employment disputes, testified a few years ago that employment attorneys turned away at least 95% of employees who sought representation.[15] Thus, it is erroneous to suggest that arbitration somehow strips a claimant of her right to a jury trial; without arbitration, she likely would never obtain such a trial or, even worse, may not even be able to find an advocate to take her case.

- "Take it or Leave it": H.R. 3010 criticizes the use of arbitration clauses in employment and other contracts on the ground that it gives employees (and other claimants) no meaningful option. In other words, they are forced to accept arbitration on a "take it or leave it" basis as part of the underlying agreement. The main problem with this argument is that it proves too much. Individuals are presented with a variety of terms on a take it or leave it basis.[16] For example, my employer presents me with only a single health insurer and a single 401(k) plan. Similarly, as a consumer, I may be presented with a variety of "take it or leave it" terms ranging from the interest rate at my bank to the price of the car that I rented last week. Yet no one would deny there are valid economic reasons, some of which directly benefit me as an employee or a consumer, why my counterparty does not dicker over those terms. In my view, the same economic rationale that justifies these sorts of "take it or leave it" policies applies to arbitration.

- Repeat Player Effect: H.R. 3010 posits that providers of dispute resolution services are pressured to design systems favoring the "repeat player" in the arbitration (i.e., the company which can offer it return business). I acknowledge that this claim has a theoretical appeal and previously have noted that appeal in my own theoretical writings.[17] Notwithstanding the theoretical appeal of the repeat player claim, the empirical picture is far more complex. Some studies have found evidence of a repeat player phenomenon while others have found no demonstrable effect.[18] Furthermore,

---

[14] *See, e.g.*, David Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1574 & n.88 (2005); Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate Over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. DISP. RES. 559, 563 (2001); William M. Howard, *Arbitrating Claims of Employment Discrimination*, Dis. Resol. J., Oct.-Dec. 1995, at 40*;* William M. Howard, *Mandatory Arbitration of Employment Discrimination Disputes* (1995) (unpublished dissertation on file with author).

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

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

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

[18] *Compare* Lisa Bingham, *Is there a Bias in Arbitration of Nonunion Employment Disputes? An Analysis of Actual Cases and Outcomes*, 6 INT'L J. ON CONFLICT MGMT. 369, 380 (1995) and Lisa Bingham & Shimon Sarraf, *Employment Arbitration Before and After the Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of Employment: Preliminary Evidence that Self-Regulation Makes a Difference* in ALTERNATIVE DISPUTE RESOLUTION IN THE EMPLOYMENT ARENA: PROCEEDINGS OF THE NYU 53RD ANNUAL CONFERENCE ON LABOR 303, 323 & Table 2 (Estreicher & Sherwyn eds. 2004), *with* Elizabeth Hill, *Due Process At Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO STATE J. ON DISP. RES. 777, 816 (2003).

even where the repeat player effect exists, the cause is not clear. Most research suggests that the repeat player effect – if it exists – is not due to the arbitrator's financial incentives but, instead, to the "learning effects" from the repeat player's experiences.[19] That is, the repeat player learns what sorts of cases can be won and, therefore, is more likely to settle those, leaving for arbitration those where the repeat player is relatively confident it can win outright (or at least where the costs of taking the case through arbitration are lower than the minimum amount that the claimant is prepared to accept in settlement).

- Development of Public Law: H.R. 3010 criticizes arbitration for hindering the development of public law. This is only partly true and certainly is not unique to arbitration. It is only partly true because there remain avenues for public law to develop even through arbitration – whether through publication of the awards or judicial decisions in actions to confirm the awards. In any event, it would be unfair to single arbitration out for this criticism. A variety of other mechanisms have a far greater impact on the development of public law. The most obvious one is settlement, which I would safely suspect occurs far more frequently than arbitration. Settled cases generally do not result in the creation of binding precedent. While some academics have criticized settlement on this ground, I am unaware of any real suggestion in Congress to ban settlements. Settlements certainly yield benefits – reduced stress on the judicial system, speedier relief for plaintiffs and lower legal fees for both sides. In my view, the same logic supporting settlements – notwithstanding their retarding effect on the development of public law – also supports arbitration.

- Transparency: H.R. 3010 criticizes arbitration for not being adequately transparent. According to the criticism, decisions take place in secret, denying both the litigants and the public adequate opportunity to scrutinize the arbitrator's decision-making process. This criticism is mistaken for three reasons. First, it misapprehends arbitration: there are at least two junctures where the merits of arbitration are publicly aired: the enforcement of the agreement and the enforcement of the award. Second, like several of the other criticisms noted here, it unfairly singles out arbitration: a variety of other mechanisms, judicial or otherwise, are not transparent. Settlement again is the most obvious – a claim of threatened litigation may settle with even less public disclosure than arbitration. Even when claims are litigated, the opportunities for transparency are limited. The judge may enter an order on the record without elaboration, or an appellate court may summarily affirm a lower court judgment on some issue without elaborating on its reasoning. Third and finally, the criticism over transparency has a flipside – namely confidentiality. Parties may well prefer arbitration precisely because, relative to

---

[19] Lisa Bingham & Shimon Sarraf, *Employment Arbitration Before and After the Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of Employment: Preliminary Evidence that Self-Regulation Makes a Difference* in ALTERNATIVE DISPUTE RESOLUTION IN THE EMPLOYMENT ARENA: PROCEEDINGS OF THE NYU 53RD ANNUAL CONFERENCE ON LABOR 303, 323 & Table 2 (Estreicher & Sherwyn eds. 2004). *See also* Sherwyn *et al., Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1570-71 (2005); Elizabeth Hill, *Due Process At Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO STATE J. ON DISP. RES. 777, 816 (2003).

civil litigation, the proceedings take place in a less public setting and, thereby, avoid the more open hostility that can be engendered when the parties stake out their position in public. Indeed, one of the great benefits of arbitration is a psychological one – it enables parties to sort out their differences before their dispute spills out into the court of public opinion and causes parties to dig into their positions.

III. Existing Mechanisms To Address Problems

My testimony should not be understood as an uncritical acceptance of the *status quo*. Surely there are instances of indefensible arbitration agreements.[20] But the question is not whether arbitration is perfect; like any system, it is not. Rather, the question is whether Congress should jettison the entire enterprise of predispute arbitration agreements in order to combat these difficulties. I would submit that it should not do so, and part of the reason is my trust in the existing mechanisms that have evolved to address this problem.

First, there has been a good deal of self-regulation in this area. In the securities industry, for example, the major arbitration services promulgate and revise their rules under the auspices of the Securities and Exchange Commission. On the commercial side, several of the major arbitration organizations have signed on to "Due Process Protocols". For example, the employment protocol sets forth a variety of rights including:

- the employee's right to be represented by a person of her own choosing;
- the employer is encouraged to pay at least a share of the employee's fees;
- employees should have access to all information reasonably relevant to their claims;
- before selecting an arbitrator, parties should have sufficient information to contact parties who previously have appeared before her;
- arbitrators should have sufficient skill and knowledge;

[20] *See, e.g., Hooters of America, Inc. v. Phillips*, 173 F.3d 933 (4th Cir. 1999) (refusing to enforce agreement with one-sided procedural rules).

- arbitrators should be drawn form a diverse background;
- arbitrators should be free of any relationships that would create an actual or apparent conflict of interest;
- the employee's entitlement to the same array of remedies in arbitration as she would be entitled to in a judicial proceeding

Subsequent protocols governing consumer disputes and health care disputes differ in some of the specifics but contain the same basic protections. Many of the major arbitration associations have committed to administering arbitrations in the consumer and employment areas only if the parties agreed to be bound by the protocols.[21]

To be clear, not all arbitral institutions have signed onto the protocols. But even where they do not bind the organizations, that does not mean they are wholly irrelevant. As I have explained elsewhere, some courts, including several justices on the Supreme Court, have looked to the protocols as a benchmark by which to assess the procedural fairness of a particular arbitral scheme. [22] In other words, while the protocols technically do not have the binding force of a legal rule, they nonetheless have exerted a persuasive influence on how some courts have interpreted existing doctrine governing the enforceability of arbitral agreements and awards.

Even where the protocols or the judicial reliance on them is inadequate, the FAA provides several mechanisms for regulating arbitration. Section 2 of the FAA, as

---

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

[22] *See* Peter B. Rutledge, *Is Arbitration State Action? Does It Matter?* (unpublished manuscript on file with author).

interpreted by the Supreme Court, authorizes courts to deny enforcement of arbitration agreements when, for example, the agreement is deemed to be substantively or procedurally unconscionable. Several courts have relied on these doctrines to invalidate agreements that, for example, cede too many of the claimant's procedural rights or impose too heavy a financial burden on arbitration.[23] Additionally, Section 10 of the FAA sets forth several grounds upon which courts can vacate awards, and the federal courts have articulated several other grounds, such as the manifest disregard of the law doctrine.

Finally, in certain contexts, administrative agencies perform an important role to check imperfections in the system. Agencies such as the Equal Employment Opportunity Commission have responsibility for the enforcement of federal laws such as the employment laws. Only recently, the Supreme Court made clear that these agencies retain the right to commence litigation against an alleged violator even where the claim is on behalf of individual or a group who, due to an arbitration clause, may be unable to pursue litigation themselves.[24]

IV. The Net Harm Wrought By Eliminating Pre-Dispute Arbitration

Let us assume that Congress enacts H.R. 3010. What would happen? In my view, it likely would increase the costs of dispute resolution, and a portion of these costs

---

[23] *See, e.g., Walker v. Ryan's Family Steak Houses, Inc.*, 400 F.3d 370 (6th Cir. 2005) (refusing to enforce arbitration agreement where arbitral forum was nonneutral); *McMullen v. Meijer, Inc.*, 355 F.3d 485 (6th Cir. 2004) (refusing to enforce arbitration agreement which granted exclusive control over arbitrator selection to employer); *Murray v. United Food and Commercial Workers Intern. Union*, 289 F.3d 297 (4th Cir. 2002) (refusing to enforce arbitration agreement after finding agreement unconscionable). *Hooters of America, Inc. v. Phillips*, 173 F.3d 933 (4th Cir. 1999) (refusing to enforce agreement with one-sided procedural rules). *See generally* Born & Rutledge, *International Civil Litigation in the United States* 1106-08 (4th ed. 2006).

[24] *See EEOC v. Waffle House, Inc.*, 534 U.S. 279 (2002).

would be passed onto employees (in the form of lower wages), consumers (in the form of higher prices) and investors (in the form of lower share prices). Ironically, then, eliminating predispute arbitration agreements may end up hurting some of the very groups that Congress is trying to protect. The only group who would come out ahead in this scenario is the lawyers, who would reap higher fees engaging in more protracted litigation.

Why exactly would that occur? Well begin by considering why parties agree to arbitrate. They do so in one of two circumstances. First, they will naturally agree to another form of dispute resolution when, for each party's preference ordering, that form provides the greatest marginal benefit over all other possible forms of dispute resolution (that is the expected payoff of a particular form of dispute resolution less the cost of that form). Second, parties will agree to an alternative form of dispute resolution where it is the preferred form for at least one party, and that party can make the economic equivalent of a side payment to the other party. In either case, eliminating arbitration reduces the marginal benefits – in the first case, it reduces the marginal benefits for both parties; in the second case, it eliminates marginal benefits for one party and the side payment to the other.

If that is the theory, how much evidence is there that arbitration actually functions this way? Let me stress here that this is probably the point in the debate where the empirical record is the thinnest. Nonetheless, there is some anecdotal evidence that arbitration improves welfare for both parties, including the sorts of parties whom H.R. 3010 seeks to protect. One early indication of the relationship between dispute resolution and individual wealth came in report of the Dunlop Commission, created by President

Clinton.[25] As part of its work, the Commission considered the impact of employment litigation and dispute resolution. It concluded:

> For every dollar paid to employees through litigation, at least another dollar is paid to attorneys involved in handling both meritorious and non-meritorious claims. Moreover, aside from the direct costs of litigation, employers often dedicate significant sums to designing defensive personnel practices (with the help of lawyers) to minimize their litigation exposure. *These costs tend to affect compensation. As the firm's employment law expenses grow, less resources are available to provide wage [sic] and benefits to workers.*[26]

This "dollar for dollar" statistic derives from a report of factual findings issued by the Secretaries of Labor and Commerce.[27] Those findings trace to a 1988 study of wrongful termination litigation in California conducted by the Rand Corporation's Institute for Civil Justice.[28] In that study, researchers reviewed a sample of jury trials over an eight-year period in California. The authors surveyed counsel in each case to gather information about litigation costs. Based on their analysis of counsel's answers and the final recovery by prevailing claimants, they determined that a claimant's legal fees were more than one-third of her final payment and that the sum of the claimants' legal fees and the defendant's legal fees represented over 75% of the final payment

---

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

[26] *Id.* at 50.

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

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

received by the claimant.[29] Thus, the Commission's findings provide some support of an inverse relationship between litigation costs and employee compensation.

More recent research confirms that the cost savings generated through arbitration result in benefits passed on to employees. One survey of thirty-six employers who had alternative dispute resolution programs found that several employers provided certain benefits such as the right to participate in a corporate profit sharing plan in return for the employees' willingness to participate in an ADR program that included arbitration. [30]

Finally, one case suggests that the distributive benefits of cost savings might extend to the credit industry as well.[31] In one case, a finance company varied the interest rate on its credit facility with a consumer's willingness to agree to arbitration.[32] If the borrower did not agree to arbitration, the APR was 18.96%; if the borrower agreed to arbitration, the interest rate dropped to 16.96%. In other words, arbitration generated some unspecified quantity of cost savings for the lender, a portion of which was passed on to the customer in the form of a 2-point drop in the interest rate.

Recognizing the limited explanatory value of such anecdotes, in my own research, I have endeavored to take the empirical record one step further. Employing a comparative cost recovery framework, I analyzed the data on arbitration caseloads, the costs of dispute resolution and the frequency with which alternatives to arbitration are used. Here, I wish to be very cautious because the data sets are incomplete, the analysis

---

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

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

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

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

rests on several assumptions and the figures require further testing. But based on the data that I have been able to generate, I believe that eliminating the employment arbitration docket of just one of the nation's leading arbitration associations – the American Arbitration Association -- would increase aggregate dispute resolution costs approximately fourfold or approximately $88 million.

Let me be clear, this figure does not reflect any changes in recovery. I assume that recoveries remain constant. Rather, this estimate reflects simply the increase in how much it will cost society to resolve these disputes. This is why I say that the only people who come out ahead from the abolition of arbitration are the lawyers. Individuals will find it more difficult to obtain a lawyer, at least for smaller claims. Companies will have higher litigation costs, which they must pass on to individuals in the form of lower wages, higher prices or reduced share value.

As an academic, I am frankly reluctant to share this tentative conclusion in the public record. It is something that I am testing further and about which I am currently conferring with my colleagues at other universities. Yet, in the face of possible congressional action, I felt compelled to share this very tentative conclusion with the subcommittee both to give you a sense of the potential stakes and to emphasize the need for additional research and study in this area so Congress has a more complete and accurate picture of the economic impact.

Finally, for the lucky few who actually find a lawyer willing to take their case in a world without arbitration, justice will not come quickly. The comparative speed of recovery with respect arbitration and litigation is one area where we have especially good

data and where the import of the data is clear. Virtually every study considering the issue has concluded that results in arbitration are far swifter than those in litigation.[33]

V. Postdispute Arbitration Is Not a Viable Alternative.

Let me close by hopefully debunking one of the seductive arguments of those who would do away with predispute arbitration. Individuals opposing predispute arbitration often argue that they do not oppose arbitration, only agreements that bind a party to arbitration before a dispute has arisen; parties remain free to agree voluntarily to arbitrate after the dispute has arisen. The explanation for this proposal is deceptively simple: if defenders of arbitration are correct that arbitration offers so many advantages, then those advantages are equally likely to apply after a dispute has arisen; consequently, eliminating predispute arbitration agreements should not have much impact.

Postdispute arbitration has several problems, but let me focus on the central one: the parties' incentives in the postdispute context differ in the predispute context.[34] This enables them to make more strategic calculations about which form of dispute resolution better advances their interests (or more effectively hinders the individual's interests). If a company knows that an individual's claim is below a certain amount, it may calculate

---

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

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

that the individual could have difficulty obtaining a counsel willing to represent her. In those cases, a company may be *less* likely to agree to arbitration precisely because it knows that, effectively, its holdout will prevent the individual from pursuing her claim.[35]

Now contrast this state of affairs with those in the predispute context. In this setting, neither the company nor the individual knows in advance the terms or nature of a dispute.[36] Yet each has an incentive to enter into arbitration – from the individual's perspective, arbitration provides an affordable forum with superior chances for obtaining a favorable result; from the company's perspective, arbitration can lower the company's litigation costs. To be sure, both sides are engaging in some tradeoffs- the individual may be trading greater forum accessibility off against higher recoveries in litigation (assuming, of course, she can find a lawyer willing to take her case); the company is trading lower litigation costs off against a reduced likelihood of prevailing in the dispute. But that is the nature of any contractual bargain. The comparative advantage of arbitration is that it enables both parties to enter into an arrangement to manage some of the *ex ante* uncertainties about disputes before they arise, a possibility that is lost once the dispute arises and its terms are better known.[37]

Samuel Estreicher has used a very memorable metaphor to describe this essential bargain in predispute arbitration. According to Estreicher, "in a world without employment arbitration as an available option, we would essentially have a Cadillac

---

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

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

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

system for the few and a rickshaw system for the many."[38] Cadillacs represent the high-level recoveries for those few individuals with high-value, meritorious claims who find representation; the rickshaws represent the majority of individuals who struggle to find counsel willing to take their lower-stakes or more questionable claim. In a world with predispute arbitration, people substitute their Cadillacs and rickshaws for Saturns. In other words, individuals as a whole achieve the greater access to justice afforded by arbitration, even if a few individuals with high-stakes claims experience a marginal reduction in recoveries.[39]

CONCLUSION

In sum, Madam Chair, thank you for the opportunity to offer these views on H.R. 3010. At bottom, it is my view that Congress should not prohibit predispute arbitration agreements in employment, consumer and franchise contracts. Rather, it should both encourage and await additional empirical research. That research may well show that minor additions to the existing regulatory repertoire are necessary. But eliminating predispute arbitration agreements would have a net negative effect on the economy, making worse off the very people whom Congress is seeking to protect.

---

[38] Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate Over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RES. 559, 563 (2001) (internal quotations omitted) (noting that employers are willing to agree to predispute arbitration because they "are willing to create a risk of liability in many cases they could have otherwise ignored in order to decrease the risk of a ruinous punitive damages award.")

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