REVISING THE REVISION: PROCEDURAL ALTERNATIVES TO THE ARBITRATION FAIRNESS ACT

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In the past decade, debate over the fairness of predispute arbitration agreements has intensified. Recently, some members of Congress have joined the chorus of opposition to these agreements and are attempting to outlaw them via the proposed Arbitration Fairness Act (AFA). Compounding the problem, both proponents and critics of the AFA are taking hard-line stances on the perceived ills or benefits of arbitration rather than trying to simultaneously address some of its flaws and preserve some of its benefits. The purpose of this Comment is thus twofold: first, it responds to the overbroad AFA proposal to outlaw predispute agreements; and second, it attempts to highlight some of the benefits of predispute agreements so as to ameliorate critics' concerns about their pitfalls. The Comment then proposes that businesses should shoulder the costs associated with arbitration and that an institutional middleman should be involved in arbitral proceedings. These recommendations will hopefully help balance the disproportionate influence of businesses in arbitration proceedings and eliminate the potential for arbitrator bias with which critics take issue.

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INTRODUCTION

Something is wrong with arbitration. I recently bought an iPhone and activated it on AT&T's cellular network. In order to access AT&T's voice and data services, however, I had to sign a contract including a provision agreeing in advance to arbitrate any and all disputes that may arise between AT&T and myself.[1] As I suspect the vast majority of AT&T's millions of customers have, I signed the contract without giving much thought to potential repercussions. Indeed, the remote possibility of litigation with AT&T makes binding arbitration seem a fairly small price to pay to assuage my iPhone envy. However, in binding myself to arbitration, I gave up my right to a jury trial in certain circumstances, exposed myself to potentially enormous arbitral filing fees,[2] and bound myself to a process that would give me a one in ten chance of winning and no right to appeal.[3] I could not have bought an iPhone without agreeing to these terms. Given the disadvantages to the consumer in mandatory arbitration contracts, it is no surprise that businesses are so fond of imposing predispute arbitration agreements on their customers and employees and that consumer advocates are working so determinedly to limit them.

What makes the situation even more troubling is that businesses rarely require predispute arbitration agreements when dealing with each other. Though AT&T bound me to arbitration, when it contracted with Apple to become the exclusive American carrier for the iPhone, neither company used arbitration clauses. Instead, their agreement leaves resolution of their potential disputes to litigation, an arrangement that is hardly unusual. According to a recent study, arbitration clauses exist in only 6.1 percent of business-to-business contracts, suggesting that, in settling disputes with each other, businesses prefer litigation to arbitration.[4] Meanwhile, predispute arbitration agreements are overwhelmingly prevalent in consumer and employment contracts. A recent study

1. AT&T, Answer Center, http://www.wireless.att.com/answer-center/solutionDisplay.jsp?solutionId=KB50041 (last visited Mar. 27, 2010).

2. *See infra* note 103.

3. *See infra* note 47 and accompanying text.

4. *See infra* note 47. *But see* Theodore Eisenberg et al., *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J.L. REFORM 871, 887 (2008) (suggesting that an explanation for businesses' preference for litigation over arbitration may be that a demand for arbitration in the business context could signal that one side anticipates breaching the contract terms).

showed that businesses require such agreements 92.9 percent and 76.9 percent of the time, respectively.[5] While proponents of arbitration have consistently heralded the benefits of arbitration over litigation in consumer and employment contexts,[6] the results of this study suggest that businesses prefer to arbitrate only when dealing with parties with unequal power. This should give consumers cause for concern.

Congress shares this concern because of the millions of consumers affected by predispute agreements and, as of 2007, the more than thirty million American employees covered by mandatory arbitration agreements.[7] In large part, the increasing use of such agreements can be attributed to a broad expansion of the scope of the Federal Arbitration Act (FAA), which first granted legal status to arbitration, and to subsequent Supreme Court jurisprudence that heavily favors arbitration.[8] Among legislators' chief concerns is that the FAA was only ever intended to apply to disputes between businesses and not to disputes between businesses and their consumers or employees.[9] Though several previous attempts to change the FAA have failed to get out of committee,[10] Congress has shown continued interest in revising the statute. In 2007 Senator Russ Feingold of Wisconsin introduced the Arbitration Fairness Act (AFA),[11] and in 2009 Representative Hank Johnson of Georgia introduced an identical bill in the House.[12] The bill includes sweeping measures, one of which would render predispute arbitration agreements completely unenforceable.[13] Congressional findings for the AFA assail current mandatory arbitration methods, and

5. Eisenberg et al., *supra* note 4, at 886.

6. *See infra* notes 47–51.

7. NAT'L EMPLOYMENT LAWYERS ASS'N, DATA POINTS: INCREASING PREVALENCE OF MANDATORY ARBITRATION SYSTEMS IMPOSED ON EMPLOYEES 1 (2007) ("[O]ut of a non-union workforce of 121 million employees . . . more than 30 million employees . . . are covered by such [arbitration] procedures.").

8. *See* Margaret L. Moses, *Statutory Misconstruction: How the Supreme Court Created a Federal Arbitration Law Never Enacted By Congress*, 34 FLA. ST. U. L. REV. 99 (2006) (citing the numerous ways the Supreme Court has expanded and continues to expand the original intent of the FAA).

9. *See id.* at 106.

10. *See* Joseph Matthews, A Proposal to Federalize Arbitration Law and Amend the FAA in Order to Save It: A Proposal to Amend the Federal Arbitration Act (Aug. 12, 2008), http://knol.google.com/k/joseph-matthews/a-proposal-to-federalize-arbitration/37ld2x0mzp8jd/3#.

11. S. 1782, 110th Cong. (2007).

12. H.R. 1020, 111th Cong. (2009). The substantive portions of the House and Senate bills are identical, and I will refer to the 2007 Senate bill throughout. As of the publication of this Comment, no action had been taken on either the House or the Senate side since March 2009 when the House bill was referred to the subcommittee on Commercial and Administrative Law. *See* GovTrack.us, S. 1782: Arbitration Fairness Act of 2007, http://www.govtrack.us/congress/bill.xpd?bill=s110-1782 (last visited Mar. 31, 2010); GovTrack.us, H.R. 1020: Arbitration Fairness Act of 2009, http://www.govtrack.us/congress/bill.xpd?bill=h111-1020 (last visited Mar. 31, 2010).

13. S. 1782 § 4(2)(b).

lament, among other perceived ills, the lack of choice given to consumers and employees, the lack of neutrality on the part of arbitrators, the lack of judicial review in arbitration, and the lack of transparency in the arbitral process.[14] The culprits, according to these findings, are contract provisions requiring predispute agreements to mandatory, binding arbitration, which force potential plaintiffs to forfeit their right to their day in court.[15]

This Comment suggests, however, that the picture is not quite so black and white, and that we should consider the many tangible benefits of predispute agreements, both for businesses and for their consumers and employees.[16] Let's return to my iPhone example. Even though I lost some of the potential benefits of litigation when I signed AT&T's service contract, I stand to gain other benefits through my access to arbitration. For example, a litigation-only option may exclude me from dispute resolution altogether since lawyers often refuse to take consumer claims because of their low potential damages.[17] Given the types of complaints I could have against AT&T and the relative cost of litigation, recourse to civil courts may be realistically no recourse at all.[18] I may also benefit financially from my predispute assent to arbitration, since AT&T may offer its cellular services at a lower rate because it can reasonably expect to shield itself from high litigation costs by requiring arbitration instead of litigation.[19] With an arbitration requirement in place, my monthly service charge does not have to include a cushion against unpredictable and arbitrary jury awards.

In seeking to make these kinds of agreements completely unenforceable in the courts, the AFA is in fact providing less of a benefit to consumers and employees than its proponents imagine. This disconnect between the AFA's goals and potential effects is evident in the disjunction between the congressional findings and the bill's actual provisions. A close examination of the

14. *Id.* § 2.

15. *Id.*

16. *See generally* Peter B. Rutledge, *Who Can Be Against Fairness? The Case Against the Arbitration Fairness Act*, 9 CARDOZO J. CONFLICT RESOL. 267 (2008) (arguing that there are too many benefits attached to arbitration to simply eliminate it altogether).

17. *See, e.g.*, Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate Over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RESOL. 559, 563 (2001) (describing many lawyers' disinterest in representing employee discrimination plaintiffs because of the perception that the claim is "small stakes").

18. *See* Lewis L. Maltby, *Out of the Frying Pan, Into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 WM. MITCHELL L. REV. 313, 314 (2003) (explaining that eliminating arbitration as an option may leave some consumers or employees without any access to justice, since many of these disputes do not involve a sufficient amount of damages to entice contingent fee representation).

19. *Id.*

findings shows that AFA proponents take issue with the propriety of arbitration agreements in general, yet the bill itself attempts to outlaw only predispute agreements. In other words, the problems the bill seeks to cure by making predispute agreements unenforceable are in fact germane to all arbitration agreements, whether pre- or postdispute.[20] With the passage of the AFA, these problems would remain in effect for postdispute agreements.[21]

This is not to suggest that the current system of arbitration is not in need of a makeover, especially given that current practice, as the AFA findings correctly note, is heavily tilted in favor of businesses. But while the sponsors of the bill are correct in pointing out the imperfections of predispute agreements, their solution throws out the baby with the bathwater: In going after a perceived systemic arbitral bias toward corporations, the bill consequently makes illegal some forms of affordable, accessible, and socially valuable dispute resolution.

My solution is not to eliminate arbitration altogether; rather, I suggest that Congress implement specific procedural rules to balance arbitral mechanisms between businesses and their consumers or employees. As currently written, the AFA takes too precipitous an approach to amending the FAA, especially when there are less disruptive, more economical, and more just ways for consumers and employees to settle their disputes with businesses. One possible alternative to the AFA is the subject of this Comment.

Part I briefly discusses the congressional and jurisprudential history of arbitration before detailing the arguments of both the proponents and critics of predispute arbitration agreements. This Part concludes by showing that the proposed congressional intervention, which effectively eliminates arbitration altogether despite its many recognized benefits to both businesses and consumers, is incoherent. Part II then makes several normative assessments: It first discusses a law and economics justification for creating a pricing mechanism in which the external costs associated with predispute agreements are internalized by the businesses requiring them; and it then addresses case law on the issue of arbitrator neutrality and the so-called "repeat player" effect, before suggesting that an institutional middleman could alleviate many of the issues raised in the AFA findings. The Comment concludes with a real example of a "reformed arbitration" that shows that arbitration done differently

20. See *infra* notes 71–73 and accompanying text for further explanation of why it is illogical to eliminate only predispute agreements if the goal is to solve problems related to arbitration agreements more generally.

21. *See* Maltby, *supra* note 18, at 317–18 (criticizing the common retort that postdispute arbitration agreements are as effective and beneficial as predispute agreements).

can work well, eliminating some of the critics' concerns while preserving several benefits raised by proponents.

I. CONGRESS'S INCOHERENT RESPONSE: HISTORY AND DEBATE

Arbitration is a contract in which two or more parties agree to settle their disputes outside of court. The Federal Arbitration Act (FAA) makes arbitration agreements valid and enforceable as long as the agreements are fundamentally fair.[22] Other sections of the FAA allow courts to stay proceedings involving issues previously agreed by the parties to be arbitrated[23] and give courts jurisdiction to compel arbitration[24] and confirm arbitral awards.[25] This simple statute has been the subject of a contentious debate both in the courts and in Congress. The debate has centered on whether the FAA applies to individual consumers and employees or whether it only applies between commercial entities.

A. The FAA: From Inception to Current Application

Prior to the passage of the FAA, U.S. courts were hostile towards arbitration.[26] Courts refused to surrender their basic powers of adjudication to private individuals who lacked legal training.[27] The Supreme Court was forced to reconsider its stance in 1925 with the passage of the FAA, which validated arbitration and substantially limited grounds for judicial review of agreements to arbitrate. The statute "distinctly favor[s] the recourse to arbitration."[28] The principal backing for the FAA came from trade associations and commercial and mercantile groups.[29] Undoubtedly, the support of these commercial interests helped not only to ensure the FAA's passage but also to shape the statute itself.[30]

The history of the FAA suggests that it was intended to allow arbitration between parties with equal bargaining power, but not between businesses and their customers or employees. For example, the then-chair of the American Bar Association, W.H.H. Piatt, testified in the FAA hearings that he "would not favor any kind of legislation that would permit [ ] forcing a man to sign that

22. 9 U.S.C. § 2 (2006).
23. *Id.* § 3.
24. *Id.* § 4.
25. *Id.* § 9.
26. *See, e.g.*, THOMAS E. CARBONNEAU, THE LAW AND PRACTICE OF ARBITRATION 77 (2d ed. 2007) (discussing the Supreme Court's initial response to arbitration as a new dispute forum).
27. *Id.* at 78.
28. *Id.*
29. Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 409 n.2 (1967) (Black, J., dissenting).
30. Moses, *supra* note 8, at 102.

kindof [sic] contract," and that such agreements should be limited to those "between merchants . . . buying and selling goods."[31] Similarly, in explaining why courts had previously been unwilling to enforce arbitration agreements, Julius Cohen, one of the original promoters of arbitration, argued that ordinary consumers and workers

> were not able to take care of themselves in making contracts, and the stronger man would take advantage of the weaker, and the courts had to come in and protect them. And the courts said "If you let the people sign away their rights, the powerful people will come in and take away the rights of the weaker ones." And that still is true to a certain extent.[32]

The drafters of the FAA also intended that arbitration be a purely voluntary contract, not a contract of adhesion.[33] Representative George S. Graham noted in the House floor debate in 1924 that the bill "simply provides for one thing, and that is to give an opportunity to enforce an agreement in commercial contracts and admiralty contracts—an agreement to arbitrate, when voluntarily placed in the document by the parties to it."[34] The FAA passed with a unanimous vote.[35]

Someone looking at arbitration practices today (when contracts of adhesion between employers and employees and businesses and consumers are commonplace) would have a difficult time reconciling the current landscape with the legislative history of the FAA. Indeed, the Supreme Court has completely reversed its once hostile attitude towards arbitration to a jurisprudence that sanctions and even favors it. Indeed, despite the language in section 1 of the FAA, which excludes employment contracts, the Supreme Court ruled in the 1991 case *Gilmer v. Interstate/Johnson Lane Corp.*[36] that an arbitral clause arising out of a stockbroker's employment contract was valid.[37] Subsequently, the Court broadened this ruling in *Circuit City Stores, Inc. v. Adams*[38] and stated

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31. *Sales and Contracts to Sell in Interstate Commerce and Foreign Commerce, and Federal Commercial Arbitration: Hearing on S. 4213 and S. 4214 Before the Subcomm. of the S. Comm. on the Judiciary*, 67th Cong. 10 (1923).

32. *Arbitration of Interstate Commercial Disputes: Hearings on S. 1005 and H.R. 646 Before the Subcomm. of the J. Comm. on the Judiciary*, 68th Cong. 15 (1924) [hereinafter *Arbitration Hearings*].

33. Moses, *supra* note 8, at 107–08.

34. 65 CONG. REC. 1931 (1924).

35. *Arbitration Hearings*, *supra* note 32, at 13 ("Mr. Chairman, the question was asked: Who opposes this bill? There is no open opposition anywhere.") (statement of Julius Henry Cohen).

36. 500 U.S. 20 (1991).

37. *Id.* (finding that no overriding policy reasons precluded the enforcement of an employment agreement, particularly since the plaintiff was an experienced businessman and there was no indication that he was defrauded or coerced into agreeing to the arbitration clause).

38. 532 U.S. 105 (2001).

that employers could require employees to submit their disputes to arbitration.[39] Since *Gilmer* and *Circuit City*, businesses and corporations have begun to include mandatory binding arbitration in contracts with their employees or consumers. It is estimated that up to 20 percent of U.S. employers—employing over thirty million employees—have adopted mandatory binding arbitration in their employment contracts.[40] Similarly, consumers are today subject to adhesive contracts requiring binding arbitration with increasing frequency.[41] For example, almost every consumer credit card or cell phone contract requires the settlement of disputes through binding arbitration.[42]

B. Opponents and Proponents: Listening to Both Sides

In the last decade, several articles and reports have been published on predispute agreements, with opponents and proponents offering conflicting statistics to support their conclusions. Unfortunately, each side, in offering its criticisms or praise, displays a determinism that ignores the reality that arbitration offers both benefits and detriments.

The opponents of predispute arbitration agreements usually emphasize the involuntary denial of the constitutional right to a jury trial as a major drawback to these agreements while downplaying the potential benefits associated with a cheaper, more efficient means of dispute resolution. These critics often point to the particularly sensitive statutory rights at stake in employer-employee disputes, especially in discrimination claims brought by the employee, because predispute agreements can force employees to waive certain legal remedies, procedures, and benefits associated with a judicial forum in order to obtain a job.[43] They also point out that arbitration limits the availability of pretrial discovery and greatly curtails the opportunity to appeal the decisions made by arbitrators.[44] In addition, critics frequently refer to a phenomenon

39. *See id.* (reasoning that the exclusion from the FAA of "contracts of employment of seamen, railroad employees, or any other class of workers engaged in . . . interstate commerce" exempts only contracts of employment of transportation workers, and thus the FAA preempts state employment law restricting the ability of all non-transportation employees and employers to enter into arbitration agreements (quoting Federal Arbitration Act, 9 U.S.C. § 2 (2006))).

40. NAT'L EMPLOYMENT LAWYERS ASS'N, *supra* note 7, at 1.

41. *See generally* Richard M. Alderman, *Why We Really Need the Arbitration Fairness Act: It's All About Separation of Powers*, 12 J. CONSUMER & COM. LAW 151 (2009) (addressing the increase in contracts of adhesion in arbitration settings and the potential for even more).

42. *See, e.g.*, AT&T, *supra* note 1.

43. *See, e.g.*, Theodore J. St. Antoine, *Mandatory Arbitration: Why It's Better Than It Looks*, 41 U. MICH. J.L. REFORM 783, 787 (2008).

44. *See* 9 U.S.C. §§ 9–10 (2006); *see also* Jean R. Sternlight, *Creeping Mandatory Arbitration: Is It Just?*, 57 STAN. L. REV. 1631, 1648–53 (2005) (summarizing many of the arguments generally made against arbitration).

known as the "repeat player" effect, in which arbitrators ostensibly rule in favor of those to whom they are financially beholden, generally the private corporations that consistently hire arbitrators.[45] Critics further argue that because businesses are often responsible for drafting arbitration agreements, the arbitration process favors them both procedurally and substantively.[46] Statistics issued by the National Workrights Institute, a nonprofit consumer advocacy organization, support critics' claims: Arbitrators favor businesses over consumers over 90 percent of the time.[47]

Critics also argue that the detrimental effects of arbitration go further than just the unfair disposition of individual complaints; there is also a cost to society and to the development of the law as a whole, which must be taken into account.[48] Arbitrators are not required to write opinions explaining the legal bases for their decisions, which eliminates the creation of precedent, a foundation of the American legal system.[49] Moreover, since arbitration decisions are generally not published, and since the forum remains private, arbitration may hinder the deterrent effect that public lawsuits and judicial opinions often create.[50] For example, the private forum of arbitration allows discrimination in the workplace to go unnoticed by the general public, whereas the civil litigation system "generates specific and general deterrence, educates the public, creates precedent, develops uniform law, and forms public values."[51] Thus, critics argue, arbitration undermines what the public litigation system attempts to achieve: a "predictable, fair, and consistent interpretation of the society's laws."[52]

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45. *See* Lisa B. Bingham, *On Repeat Players, Adhesive Contracts, and the Use of Statistics in Judicial Review of Employment Arbitration Awards*, 29 MCGEORGE L. REV. 223, 239 (1998).

46. *See id.* at 1649–50 ("There are virtually an infinite number of ways in which a company, as the drafting party, can try to use an arbitration clause to gain the upper hand, including arbitrator selection, imposition of high costs, and limitation of remedies. While it would be wrong to suggest that most of these excesses are included in most arbitration clauses, some of them are quite common."). For an extreme case of a business taking procedural and substantive advantage of its employees, see the often cited *Hooters of America, Inc. v. Phillips*, 173 F.3d 933 (4th Cir. 1999) (ruling that an arbitration contract that procedurally benefited one side to the detriment of the other was unconscionable).

47. JOHN O'DONNELL, PUB. CITIZEN, THE ARBITRATION TRAP: HOW CREDIT CARD COMPANIES ENSNARE CONSUMERS 13 (2007), *available at* http://www.citizen.org/documents/Final_wcover.pdf. *But see* National Workrights Institute, Employment Arbitration: What Does the Data Show?, http://www.workrights.org/current/cd_arbitration.html (last visited Mar. 27, 2010) (finding no statistically significant difference with regard to employee win rates in arbitration as compared to litigation).

48. Sternlight, *supra* note 44, at 1661–63.

49. *Id.* at 1661–62.

50. Geraldine Szott Moohr, *Arbitration and the Goals of Employment Discrimination Law*, 56 WASH. & LEE L. REV. 395, 426–27 (1999).

51. *Id.* at 427.

52. Sternlight, *supra* note 44, at 1662.

Proponents of arbitration, on the other hand, offer a different story that often ignores the gross externalities of current arbitration practice. They emphasize that arbitration arose in response to a legal system that was too expensive and too slow to deal with increasingly numerous disputes.[53] For example, the average cost of litigating a typical employment case can range from $75,000 to more than $200,000, while the average cost of arbitrating an employment dispute is $20,000, including attorneys' fees.[54] Furthermore, a typical case that goes to trial lasts for months, and may even go on for years if appealed, while arbitrations can take as little as a few days.[55] Strong incentives exist on both the business side and the employee/consumer side to arbitrate disputes. For the latter, arbitration can place dispute resolution within financial reach. In fact, few claimants benefit under a litigation-based system, since both the costs and risks associated with trial and competent counsel are very high.[56] In addition, businesses are in a unique position that allows them to evaluate, in advance, the costs associated with arbitration versus the cost of litigation, enabling businesses to fix the cost of their goods at a predictable level.[57] In many cases, the private nature of the arbitral forum works to the advantage of both businesses and employees/consumers. For example, in employment discrimination disputes, businesses may benefit from the private nature of arbitration in their public relations, but potential plaintiffs may also appreciate the private nature of arbitration because it spares them potential public embarrassment over issues they might consider deeply personal.[58]

There are, however, difficulties in assessing these various arguments. Studies cited by proponents of arbitration often conflict with those cited by opponents. For instance, a study by the National Workrights Institute, a nonprofit organization whose goal is to improve the legal protection of human rights in the workplace, found that there is not a statistically significant

53. *See* Richard M. Alderman, *Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform*, 38 HOUS. L. REV. 1237, 1238 (2001).

54. Martha Halvordson, *Employment Arbitration: A Closer Look*, 64 J. MO. B. 174, 178 (2008). The lower cost is attributed to the simpler proceedings and the lack of appeal. *Id.*

55. *Id.* A statistic like this can be slightly misleading, as the author omits the time between filing an arbitration claim and the actual arbitration proceeding itself. Certainly the proceeding on the whole is shortened substantially, but it can often take weeks, for example, to find an appropriate venue and a convenient time for the arbitrator to hear the dispute. This problem can also be exacerbated by an increase in the number of arbitrators. *See* ROBERT M. SHEA, MORSE BARNES-BROWN PENDLETON PC, SHOULD EMPLOYERS REQUIRE THAT WORKPLACE DISPUTES BE ARBITRATED?, http://www.mbbp.com/resources/employment/arbitration.html (last visited Mar. 26, 2010).

56. *See* Estreicher, *supra* note 17, at 563 (likening the litigation system to that of a lottery system that is too expensive and too risky for most claimants to play).

57. Rutledge, *supra* note 16, at 273.

58. *Id.* at 276–77.

difference in employee win rates in arbitration as opposed to at trial, and further stated that damages awards for employees in litigation and arbitration are generally comparable.[59] Another study, comparing win rates, found that consumers are four times better off in arbitration than in court.[60] With regard to the "repeat player" effect, one study shows that it has no statistically significant effect.[61] Another indicates that businesses' greater success in arbitration is not due to repeat players but rather is the result of the advantage an employer gains from experience in prior cases.[62]

The debate over adhesion is equally unsettled. Proponents often respond to opponents' claims about the involuntary, adhesive nature of arbitration agreements by pointing out that adhesive contracts are not only very common but are also typically enforced by courts.[63] Proponents allege that critics of arbitration focus on the few egregiously unfair cases, such as *Hooters of America, Inc. v. Phillips*,[64] in which the arbitration agreement was so blatantly biased and one-sided as to be unconscionable.[65] Many proponents argue that, despite the general lack of judicial review, courts will still strike down unfair and unconscionable clauses, just like the court did in *Hooters*, thus protecting consumers and employees, to a certain degree.

C. Why Congress Is Getting It Wrong

In the most recent development of the debate, members of Congress, citing the typical criticisms of predispute arbitration agreements, joined the chorus of opposition, seeking to outlaw predispute agreements altogether. In the

59. National Workrights Institute, *supra* note 47.

60. Press Release, U.S. Chamber Inst. for Legal Reform, Arbitration Better Than Court for Consumer Debtors, Study Shows (July 15, 2008), *available at* http://www.instituteforlegalreform.com/media/pressreleases/20080715.cfm.

61. Lisa B. 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 NEW YORK UNIVERSITY'S 53RD ANNUAL CONFERENCE ON LABOR 303, 323 tbl.3, 324 (Samuel Estreicher & David Sherwyn eds., 2004).

62. David Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1571 (2005).

63. *See* Stephen J. Ware, *Consumer Arbitration as Exceptional Consumer Law (With a Contractualist Reply to Carrington & Haagen)*, 29 MCGEORGE L. REV. 195, 200–02 (1998). For a critical response to Ware's assessment that adhesive contracts for arbitration are not fundamentally different than other types of adhesive contracts, such as banking- and insurance-related contracts, see Sternlight, *supra* note 44, at 1653–54.

64. 173 F.3d 933 (4th Cir. 1999).

65. *Id.* at 935 (holding that the agreement was unconscionable).

findings sections of the AFA of 2007,[66] Feingold and his cosponsors responded quite vehemently to the Court's expansive interpretation[67] of the FAA:

> A series of United States Supreme Court decisions have changed the meaning of the Act so that it now extends to disputes between parties of greatly disparate economic power, such as consumer disputes and employment disputes. As a result, a large and rapidly growing number of corporations are requiring millions of consumers and employees to give up their right to have disputes resolved by a judge or jury, and instead submit their claims to binding arbitration.[68]

AFA proponents in Congress found that consumers and employees "have little or no meaningful option whether to submit their claims to arbitration."[69] The findings also echo common arguments against arbitration—namely the repeat player effect, the ways in which arbitration undermines the development of public law, unfair provisions that favor businesses, the lack of a written opinion, and the lack of appellate review.[70] These findings, however, are not consistent with specific provisions or likely consequences of the proposed language of the AFA. The AFA calls only for an end to predispute arbitration agreements in employment and consumer situations, yet its findings criticize arbitration in general without distinguishing between pre- and postdispute agreements.

For example, the AFA findings take issue with the ways in which arbitration undermines the development of public law (by failing to provide precedent), yet postdispute arbitration, which would not be outlawed by the AFA, also fails to provide a written opinion or create precedent. In addition, postdispute agreements to arbitrate are not likely to solve the problem of difference in bargaining power that arbitration critics deplore.[71] Employers in a postdispute environment will likely still only be willing to arbitrate when doing so gives them a competitive advantage over the employee,[72] so employees will remain vulnerable in particular instances:

> If the former employee cannot obtain counsel, it is not in the employer's interest to offer arbitration because the lower costs of arbitration will make more likely the pressing of a claim that otherwise simply would languish in the administrative agency. If, on the other hand, the former employees' economic losses are high enough to attract

66. *See* S. 1782, 110th Cong. § 2 (2007).
67. For a discussion of the Court's expansive approach, *see supra* notes 36–39.
68. S. 1782 § 2.
69. *Id.*
70. *Id.*
71. *See* Sternlight, *supra* note 44, at 1656–57.
72. Estreicher, *supra* note 17, at 567–68.

> competent counsel, that lawyer is exceedingly unlikely (absent unusual circumstances) to proffer arbitration even if the lawyer would prefer not to go to trial . . . for such a proffer reduces the settlement value of the case . . . .[73]

Thus, even though the provisions of the AFA only address predispute agreements, their adoption has the potential to preclude arbitration altogether, since allowing only postdispute agreements could have the effect of disincentivizing all agreements to arbitrate. Therefore, the AFA's focus on predispute agreements may ultimately address concerns with arbitration generally by indirectly eliminating it altogether.

Critics of the AFA have been vocal in their opposition. Lisa Rickard, president of the Institute for Legal Reform, issued a statement warning that the AFA would leave a large number of consumers and employees without access to a dispute forum.[74] She also claimed that the AFA serves the interests of the trial lawyers' lobby, which, she claims, could reap huge fees with arbitration out of the way.[75] Others argue that the AFA rewrites millions of contracts and would send too many disputes to the already overcrowded courts.[76] One critic goes so far as to argue that eliminating predispute agreements will have an adverse effect on the entire U.S. economy.[77] Critics further argue that similar contractual agreements, such as contracts including take-it-or-leave-it clauses, have not drawn congressional scrutiny even though these types of agreements similarly restrict choice.[78] Finally, a study conducted by the National Arbitration Forum suggested that congressional intervention vis-à-vis the AFA is unnecessary and ultimately harmful, not helpful. The study found that, in predispute arbitrations, 78 percent of trial attorneys find arbitration

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73. *Id.*

74. Press Release, U.S. Chamber Inst. for Legal Reform, Voters Strongly Back Arbitration, New Poll Shows (Apr. 2, 2008), *available at* http://www.instituteforlegalreform.com/component/ilr_media/30/pressrelease/2008/401.html.

75. *Id.* Rickard argues that "eliminating arbitration is a top priority of the trial lawyers' lobby," purportedly for opportunities to collect more fees through litigation, and package claims against companies into class action suits. *Id.* The assumption appears to be that lawyers make less representing clients in arbitration than in litigation or that, for those lawyers working on a contingent basis, arbitration awards are lower, so the lawyer receives a lower fee. Of course, lawyers working on a contingent basis might also be recovering less if the opposition is correct in its assertion that arbitration really does favor businesses. However, this latter suggestion would need to be corroborated by relevant statistics.

76. Edna Sussman, *The Unintended Consequences of the Proposed Arbitration Fairness Act*, FED. LAW., May 2009, at 48; Letter From the Am. Bankers Ass'n et al., to the Honorable Patrick Leahy and the Honorable Arlen Specter (Feb. 7, 2008), *available at* http://www.sifma.org/regulatory/comment_letters/62757902.pdf.

77. Sussman, *supra* note 76, at 48.

78. Rutledge, *supra* note 16, at 273.

faster than lawsuits, 86 percent find the costs associated with arbitration equal to or less than those of lawsuits, 78 percent find that arbitration offers faster recovery than lawsuits, and 83 percent find arbitration to be at least as fair as lawsuits.[79] This study further found that monetary relief is slightly higher for individuals in arbitration, that arbitration is 36 percent faster than a lawsuit,[80] that 93 percent of consumers using arbitration find it to be fair, and that consumers prevail 20 percent more often in arbitration than in courts.[81] Statistics like these are certainly not the final word on the soundness or fairness of current arbitration procedures, but they at least call into question the proposed congressional overhaul of arbitration.

The problem with the debate over arbitration is that critics often ignore the benefits of arbitration while proponents often overstate its virtues and ignore its externalities. The debate is only muddled by Congress's proposal to *categorically* outlaw predispute agreements. As this Part has demonstrated, both critics and opponents wholeheartedly attack or defend arbitration without taking a more balanced approach that could address some of the criticisms while preserving some of arbitration's benefits. The next Part is an attempt to do just that.

II. THE UNBALANCED MARKET OF CURRENT ARBITRATION PRACTICE

Given the debate over arbitration and the abundance of potentially irreconcilable and conflicting information, it is difficult to truly estimate the value of predispute arbitration agreements. Yet, Senator Feingold and Representative Johnson have decided that predispute arbitration agreements are social and legal ills that need to be eradicated. This decision may constitute a misreading of their constituents' actual feelings on the matter. According to a U.S. Chamber of Commerce Institute of Legal Reform poll, 71 percent of voters oppose congressional efforts to remove arbitration agreements from consumer contracts, and 82 percent prefer arbitration to litigation in settling a dispute with a company.[82] The poll only adds to the conflicting literature, raising more

79. NAT'L ARBITRATION FORUM, THE CASE FOR PRE-DISPUTE ARBITRATION AGREEMENTS 2 (2004), *available at* http://www.adrforum.com/rcontrol/documents/ResearchStudiesAndStatistics/2004EmpiricalStudies.pdf.

80. *Id.* at 1.

81. *Id.* at 1–7.

82. Press Release, U.S. Chamber Inst. for Legal Reform, *supra* note 74. The seemingly persuasive value of these polls should be tempered by the fact that a business group, the Chamber of Commerce (an organization that probably favors arbitration agreements), conducted them. Of course, those polled are likely not well informed about the benefits or risks associated with arbitration and may lack the

questions about why members of Congress fail to recognize arbitration's value and its potential for positive results if done differently.[83] The remainder of this Comment focuses on ways to conceive of predispute arbitration differently, so that instead of throwing the baby out with the bathwater, Congress might think of ways to enhance arbitration's value while minimizing its current flaws.

This Comment proposes two procedural changes that could make arbitration more balanced and effectively eliminate several of the issues cited in the AFA findings. I deal specifically with critics' concerns while largely ignoring the potential benefits recognized by proponents (except in an effort to maintain these benefits in calling for the proposed changes). First, I suggest the creation of a pricing mechanism whereby those who impose predispute arbitration are forced to pay for it. A pricing mechanism that forces businesses to pay for the costs associated with arbitration would compel businesses to "price in" some of the externalities that businesses currently impose by forcing consumers and employees to agree to arbitrate ex ante. Second, I propose a requirement whereby an institutional middleman can combat some of the potential bias and repeat-player effects with which the AFA findings take issue. The middleman would act as a go-between for businesses and arbitrators in an effort to eliminate some of the bias and conflict of interest challenges that Congress and critics bemoan. While these two proposals are not exhaustive of the changes necessary to make predispute arbitration work, they do offer a starting point upon which further scholarship could build.

A. A Pricing Mechanism: Making Businesses Pay

The current practice of arbitration creates substantial externalities for consumers and employees while providing no incentive for businesses to consider these costs because businesses mostly stand to benefit from arbitration. The creation of a pricing mechanism that requires businesses to "price in" the benefits they receive would force them to do a cost-benefit analysis, and could be accomplished through the creation of a liability rule where businesses pay for the costs associated with the arbitration they have imposed. Requiring

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proper legal knowledge to make a fully informed decision. *See generally* Christine M. Reilly, *Achieving Knowing and Voluntary Consent in Pre-Dispute Mandatory Arbitration Agreements at the Contracting Stage of Employment*, 90 CAL. L. REV. 1203, 1206 (2002) (arguing that the general public "probably lack[s] the proper legal knowledge and cognitive capabilities to truly understand and evaluate [arbitration agreements]").

83. For more on how arbitration done differently can produce positive outcomes, see Stephen Choi & Theodore Eisenberg, *Punitive Damages in Securities Arbitration: An Empirical Study*, (NYU Ctr. for Law, Econ. & Org., Working Paper No. 09-01, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1322482.

businesses to pay would force them to consider the externalities they impose on consumers and employees.

1. Current Practices and Resulting Externalities

Arbitration often begins with a business providing a contract to a consumer as the terms of a purchase or to an employee as the terms of employment. Agreements to arbitrate employment disputes, for example, are often simple and take the following form: "I agree that I will settle any and all previously unasserted claims, disputes or controversies arising out of or relating to my application or candidacy for employment, employment and/or cessation of employment with [business], exclusively by final and binding arbitration before a neutral Arbitrator."[84] Often, when a dispute arises, businesses submit their claims to an agency, such as the American Arbitration Association (AAA) or National Arbitration Forum (NAF), to handle the arbitration procedures. However, businesses may alternatively forego using an agency to save time and costs and instead create their own procedures for the arbitral process. Either way, with businesses controlling the arbitral process almost exclusively, the arbitral mechanisms between parties are unbalanced, creating significant potential for unfairness. When businesses create their own procedures, they are usually given exclusive control over the process, including choosing the arbitrator. Businesses can take advantage of this kind of system, thus creating substantial procedural inequities for the consumer or employee.[85] In the first scenario, when a business uses a recognized third-party organization, such as the Judicial Arbitration and Mediation Services (JAMS) or the AAA to resolve its disputes, these outside organizations hold a financial interest in and stand to benefit financially from disputes submitted to them, and consequently each "has a direct interest in the volume of business done, and thus has a stake in maintaining satisfied institutional clients that constitute a repeat volume business."[86] These organizations and their employees come to depend on the referral of disputes to their organizations for their continued vitality.[87] Further, these organizations may have information about the decisional patterns

84. Circuit City Stores, Inc. v. Adams, 532 U.S. 105, 109–10 (2001) (quoting respondent's employment application).

85. For the most obvious example of a business imposing terrible procedural inequities on an employee, see *Hooters of America, Inc. v. Phillips*, 173 F.3d 933, 938–39 (4th Cir. 1999).

86. Matthew David Disco, *The Impression of Possible Bias: What a Neutral Arbitrator Must Disclose in California*, 45 HASTINGS L.J. 113, 139 (1993). Disco maintains further that there is no significant difference between JAMS and AAA simply because one is a private institution and the other is a public one. *See id.*

87. *See id.*

of their arbitrators. This may enable them to select arbitrators likely to favor the position of businesses in an effort to get businesses to use them repeatedly for arbitrations in the future.[88]

The incentives for businesses and arbitral institutions to offer a fair forum are strained by the fact that *both* parties' financial positions are tied to arbitration outcomes. Further, arbitrators and arbitral institutions enjoy broad immunity in the court system from civil liability for their actions. This immunity may be so pervasive as to allow blatant abuse of an arbitral institution's asymmetrical knowledge (for example, where the arbitral institution only employs arbitrators they know are likely to favor the business in a particular circumstance) to continue unabated.[89]

Despite the difficulty in assessing the conflicting arguments on both sides of the arbitration debate, it is clear that arbitration favors businesses (at least procedurally) and that the externalities it imposes on individuals are staggering. Some commentators have drawn attention to the drawbacks of arbitration for individual claimants, including lower awards than litigation might produce,[90] insufficient deterrent effects, shorter statutes of limitations, and the loss of rights.[91] Individuals forced into arbitration give up their right to a jury trial, which often substantially benefits the business defendants since juries tend to be less sympathetic to corporate defendants, particularly in consumer and

88. *See* Lisa B. Bingham, *Employment Arbitration: The Repeat Player Effect*, 1 EMP. RTS. & EMP. POL'Y J. 189, 204 (1997) (showing that institutional bias may play a role in the repeat player effect). See *infra* Part II.B for a discussion of the so-called "repeat player" effect.

89. *See* Emmanuela Truli, *Liability v. Quasi-Judicial Immunity of the Arbitrator: The Case Against Absolute Arbitral Immunity*, 17 AM. REV. INT'L ARB. 383, 388–91 (2006).

90. Damages awards in arbitration are often as much as 50 percent lower than damages in court cases. *See* Theodore Eisenberg & Elizabeth Hill, *Employment Arbitration and Litigation: An Empirical Comparison* 18 tbl.2 (NYU Sch. of Law, Public Law and Legal Theory Research Paper Series, Research Paper No. 65, 2003), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=389780. In disputes not involving civil rights claims, the median award for the higher-paid employees was $94,984, the mean was $211,720, and the standard deviation was $313,624. The lower-paid employees, those making less than $60,000 a year, by contrast had a median award of $13,450, a mean of $30,732, and a standard deviation of $38,723. The median, mean, and standard deviation in state court cases not involving civil rights claims were $68,737, $462,307, and $1,291,020 (N=79), respectively. In state and federal court cases involving discrimination claims, the medians were $206,976 (N=68) and $150,500 (N=408), respectively. The means were $478,488 and $336,291. The standard deviation for the state cases was $761,297. There were only eight AAA civil rights arbitrations in this sample: two involving higher-paid employees and six initiated by lower-paid employees. The higher-paid employees had a median and mean award of $32,500. For the lower-paid employees, the median was $56,096 and the mean was $259,795. *Id.*

91. Kathryn A. Sabbeth & David C. Vladeck, *Contracting (Out) Rights*, 36 FORDHAM URB. L.J. 803, 831–32 (2009).

employment claims.[92] It is hardly novel to say that arbitration (or any other mechanism of dispute resolution) creates externalities, but it is worth noting that the externalities arbitration creates are almost all imposed on the individual, rather than more evenly distributed across all parties.[93]

2. The Necessity of a Cost-Benefit Analysis

Ronald Coase's seminal article *The Problem of Social Cost*[94] began with a now famous illustration of a cost-benefit analysis. His example of straying cattle that destroy crops growing on neighboring land helps illustrate what is wrong with current arbitration practice. In Coase's example, a farmer and a cattle rancher are operating on neighboring properties without a fence.[95] Because the cattle raiser's cattle tend to stray, an increase in the number of cattle increases the total damage to the neighbor's crops.[96] If liability is imposed on the cattle raiser, he or she "will not increase the size of the herd unless the value of the additional meat produced . . . is greater than the additional costs that this will entail, including the cost of additional crops destroyed."[97] The cattle raiser will be compelled to build a fence if the cost of the fence is cheaper than paying for the damaged crops.[98] This example simply illustrates that when liability is placed on a party, that party will be forced to consider the economic consequences of its actions, which might result in a decision to pay for resulting externalities. This will compel the liable party to reduce the externalities of its actions by creating alternatives or choosing not to act at all.[99]

Coase assumes a liability rule and fails to mention that if there were no liability, the cattle raiser would likely produce so many cattle that the neighboring farmer's crop would be destroyed entirely.[100] Current arbitration practice works the same way. Because businesses are not systematically held

92. *See id.*; *see also* Jean R. Sternlight, *The Rise and Spread of Mandatory Arbitration as a Substitute for the Jury Trial*, 38 U.S.F. L. REV. 17, 35–38 (2003) (arguing that corporate defendants often benefit from arbitration in employment cases, since juries are often more sympathetic to individual plaintiffs).

93. Litigation, for example, imposes externalities on both plaintiffs and defendants. Both parties, for instance, must pay for the costs associated with the court system.

94. R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960). Note that Coase's example assumes zero transaction costs.

95. *Id.* at 2–3.

96. *Id.* at 3.

97. *Id.*

98. *See id.*

99. *See generally* Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972) (discussing generally the consequences of liability rules).

100. This phenomenon is often referred to as "the tragedy of the commons." *See* Garrett Hardin, *The Tragedy of the Commons*, 162 SCIENCE 1243 (1968).

liable for the procedural externalities imposed by the predispute contracts they require, they do not need to consider alternatives. Businesses may decide ex ante that predispute agreements are the cheapest and best alternative for them, without considering the consumer or employee. No fence is necessary when one may freely destroy crops without consequences. In the arbitration context, one can analogize the fence to the alternatives to current predispute contracts. These alternatives include offering a different contract with better arbitration procedures or eliminating arbitration altogether and resorting to litigation. The point is that businesses will not consider (and in fact have no incentive to consider) these alternatives unless they are forced to internalize some of the costs that are presently externalized by the predispute method.

In order to determine whether the benefits associated with arbitration are worth the costs it imposes on individuals and society, the party producing the activity should bear the costs associated with the activity, so that it has an incentive to assess whether the costs are worth the benefits.[101] A liability rule that creates a pricing mechanism by which businesses that require predispute agreements are forced to internalize costs that are presently externalized will achieve this result. Implementation of the pricing mechanism would simply require codification of what a few courts have already done: demand that businesses shoulder the costs of arbitration.

For example, filing a civil case in California Superior Court costs a single plaintiff as little as $180 and no more than $320.[102] But because arbitration is a private proceeding, filing fees for arbitration can cost as much as thousands of dollars, depending on the case and the arbitration firm; fees for hearing rooms and the arbitrator's time can run tens of thousands of dollars more, all of which can discourage individuals from pursuing a case.[103] At present, only a few courts have required businesses to absorb these costs.

In *Armendariz v. Foundation Health Psychcare Services, Inc.*,[104] the plaintiffs, former employees of Foundation Health, filed a complaint alleging sexual harassment and discrimination.[105] Both employees had signed employment

101. *See* Calabresi & Melamed, *supra* note 99, at 1096 ("[I]n the absence of certainty as to whether a benefit is worth its costs to society . . . the cost should be put on the party or activity best located to make such a cost-benefit analysis. . . .").

102. Superior Court of California, Statewide Civil Fee Schedule 1 (Dec. 20, 2005), http://www.courtinfo.ca.gov/courts/trial/tehama/feesched.pdf.

103. *See* Christopher R. Drahozal, *Arbitration Costs and Forum Accessibility: Empirical Evidence*, 41 U. MICH. J.L. REFORM 813, 817 & tbl.1 (2008); *see also* Henry S. Noyes, *If You (Re)Build It, They Will Come: Contracts to Remake the Rules of Litigation in Arbitration's Image*, 30 HARV. J.L. & PUB. POL'Y 579, 586 (2007) (calling into question the assumption that arbitration is cheaper than litigation given the cost of arbitrators).

104. 6 P.3d 669 (Cal. 2000).

105. *Id.* at 674–75.

contracts that included an agreement to arbitrate wrongful termination claims.[106] The arbitration agreement was governed by the California Code of Civil Procedure, which provides that each party in arbitration shall pay for his or her share of the fees associated with arbitration.[107] The plaintiffs claimed that "requiring them to share the often substantial costs of arbitrators and arbitration effectively prevent[ed] them from vindicating their [statutory] rights."[108] The California Supreme Court found that requiring an employee to pay for the services of an arbitrator would prevent many employees from gaining access to an arbitral forum after having already been denied access to the courts.[109] Employees, the court reasoned, "would never be required to pay for a judge in court," and added that requiring an employee to pay arbitrators' fees ranging from $500 to $1000 per day or more would hinder an employee's ability to pursue his or her statutory claims.[110] The court concluded that "when an employer imposes mandatory arbitration as a condition of employment, the arbitration agreement or arbitration process cannot generally require the employee to bear any type of expense that the employee would not be required to bear if he or she were free to bring the action in court."[111] This result is fair, explained the court, since unlike the employee, the employer is in a position to determine whether arbitration is economical after doing a cost-benefit analysis.[112]

The U.S. Supreme Court in *Gilmer v. Interstate/Johnson Lane Corp.*[113] endorsed a system of arbitration whereby an employer is required to pay the expenses associated with arbitration.[114] At least two circuit courts have adopted this endorsement,[115] ruling that agreements requiring employees to pay even one-half of the fees are unenforceable under the FAA.[116]

106. *Id.* at 675.
107. *Id.* at 685.
108. *Id.*
109. *Id.* at 686 (quoting Cole v. Burns Int'l Sec. Servs., 105 F.3d 1465, 1484–85 (D.C. Cir. 1997)).
110. *Id.* at 685–86.
111. *Id.* at 687.
112. *Id.* at 688.
113. 500 U.S. 20 (1991).
114. *See id.* at 28 (noting that "so long as the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function"). Note that the Court did not specifically address arbitration fees, but the interpretation is that these fees may not allow the perspective litigant to effectively vindicate his or her claim.
115. *See* Shankle v. B-G Maint. Mgmt. of Colo., Inc., 163 F.3d 1230, 1234 & n.3 (10th Cir. 1999) (ruling that causing the plaintiff to pay even half of the fees associated with arbitration does not provide an accessible forum alternative to litigation); Paladino v. Avnet Computer Tech., Inc., 134 F.3d 1054, 1062 (11th Cir. 1998) (ruling that causing the plaintiff to pay for the fees associated with arbitration constitutes fee-shifting and is grounds for nonenforcement of the arbitration provision).
116. *Paladino*, 134 F.3d at 1062.

Though all of these courts assessed the arbitration of statutory claims, the reasoning they used applies to all predispute clauses regardless of what type of claim is brought, since arbitration is ostensibly a substitute for a judicial forum. Potential plaintiffs bringing any type of claim in an arbitral forum should not be denied vindication of their claims on the basis of cost. This protection is particularly important since employers and corporations will continue to determine whether mandatory arbitration or litigation is more economically advantageous in a given employment or consumer interaction.

A further justification for requiring employers and corporations to shoulder the cost of arbitration is that they are the only party with sufficient information to minimize their own costs. Requiring employers or corporations to bear the cost of arbitration will compel them to justify predispute agreements to arbitrate by minimizing costs in their cost-benefit analyses. Guido Calabresi, in his seminal article on strict liability in tort law, argued that the cost of an accident should be factored into the cost of the product.[117] He gave the now common example of the smoke-emitting factory:

> The argument runs that if the cost of a factory-smoke nuisance, for instance, is put on the homeowner rather than on the factory, and the cheapest way to avoid this cost is not for the homeowner to move or wear a gasmask but is for the factory to install a smoke-clearing device or cut down production, the homeowner will pay the factory to do this. On the other hand, if the cost is originally put on the factory, and the best way to minimize the loss is to get the homeowners to move, the factory will find it cheaper to pay for such a move rather than to cut down production. Either way, it is argued, the market will find the cheapest way to deter or minimize the loss.
>
> . . . .
>
> . . . In such a case placing the loss on the factory initially would, in fact, minimize losses whereas placing it on the homeowners would not.[118]

Placing the initial cost on the smoke-producing factory compels the factory to consider its activities: Should it keep polluting and pay the homeowners to move, or should it alter its activity and save costs? According to Calabresi, the cheapest cost avoider pays. If, however, the homeowners were faced with the initial burden of assessing the costs, they may be placed in a position where they simply cannot afford to pay either to move or to install a smoke-clearing device in the factory. In short, Calabresi argues that the "original cost" should

117. Guido Calabresi, *The Decision for Accidents: An Approach to Nonfault Allocation of Costs*, 78 HARV. L. REV. 713 (1965).

118. *Id.* at 729–31.

be placed "on the party to the bargain whose actuarial class can best evaluate the risk of such costs in the future."[119]

Calabresi's theory of the cheapest cost avoider can similarly be applied to arbitration. If potential plaintiffs must assume the costs associated with arbitration, there will likely be several plaintiffs who cannot bear these costs and lose their ability to file a claim. If, however, the initial cost of arbitrating is placed on the corporation or employer, it will compel the corporation or employer to consider the cost of its activity. According to the reasoning of the *Armendariz* court, employers are in a unique position that allows them to assess in advance the costs of arbitration versus litigation. Under Calabresi's market deterrence principle, the corporation or employer is in a position to choose the cheaper method, so the corporation is the cheapest cost avoider. If absorbing the initial costs of arbitration due to the imposition of my proposed pricing mechanism proved to be too much of a financial burden, especially given the potential increase in frivolous or meritless arbitration claims, businesses would consider alternatives, most likely settlement or litigation.

As Calabresi points out, there is, of course, an arguable downside to placing the initial costs of arbitration on companies: the price of products or activities will eventually reflect the costs associated with them.[120] Requiring companies to pay the costs of arbitration will cause them to spread that cost in various forms, either by reducing employee wages or increasing the price of products or services. The market will eventually weed out what consumers no longer demand; or, if something is truly desirable, the market will support the extra costs associated with it.[121] In the case of arbitration, if an employer or corporation is required to pay for the costs of arbitration, it will respond by pricing its goods or paying its employees at a predictable and profitable level. While this could be interpreted as a potential downside of shifting the cost to the company, consumer or employee demand would determine how necessary or desirable the good or employment is. If consumers or employees demand an alternative to arbitration agreements because of the resulting inflation in price or decrease in wages, the market would eliminate agreements to arbitrate altogether. In short, the market would determine the desirability of arbitration, and Congress should not deprive the market the opportunity to make the decision.

119. *Id.* at 729.
120. *See id.* at 722.
121. *See id.*

B. The "Repeat Player" Effect and the Meaning of Neutrality

One of the most compelling arguments made against arbitration (and one which resonates with the AFA findings) is the inherent conflict of interest when arbitrators are employed by the very business for which they are ruling. This conflict may provide an incentive for arbitrators to rule in favor of the corporation that pays them in order to obtain their business again in the future.[122] As noted, this "repeat player" effect is one of the seven findings the AFA offered as justification for outlawing predispute agreements to arbitrate.[123]

The issue of arbitrator neutrality has come to greatly define the arbitration debate, and perhaps rightfully so.[124] Current statistics on arbitration suggest that arbitrators do in fact come down heavily in favor of businesses. A report issued recently by the nonprofit consumer advocacy group Public Citizen issued a damning finding about arbitration,[125] claiming that 99.6 percent of all cases brought to binding arbitration were brought by the corporation, not the consumer, and 94 percent of arbitration decisions sided with the business or corporation.[126] This issue, however, runs deeper than whether the arbitrator is potentially biased in favor of the business or corporation, since the repeat player effect exists in multiple forms.

There are at least two distinct ways in which the repeat player effect can come into play in arbitral decisional practices. First, an arbitrator may be directly biased in favor of *his* employer, usually the business.[127] In this instance, the arbitrator takes advantage of his or her repeat status. And second, the

122. *See* RICHARD EDWARDS, RIGHTS AT WORK: EMPLOYMENT RELATIONS IN THE POST-UNION ERA 221 (1993); Tia Schneider Denenberg & R.V. Denenberg, *The Future of the Workplace Dispute Resolver*, 49 DISP. RESOL. J. 48, 50 (1994).

123. Arbitration Fairness Act of 2007, S. 1782, 110th Cong. § 2(4) (2007) ("Private arbitration companies are sometimes under great pressure to devise systems that favor the corporate repeat players who decide whether those companies will receive their lucrative business."). *But see* Bingham & Sarraf, *supra* note 61, at 323 tbl.3, 324 (suggesting that some studies have found there is no statistically significant repeat arbitrator effect and that employers rehiring an arbitrator in a second case did not have a higher probability of success).

124. *See* David Sherwyn et al., *supra* note 62, at 1571 (discussing the major debates centered on the issue of arbitrator neutrality).

125. O'DONNELL, *supra* note 47. For a rebuttal to this report, see PETER B. RUTLEDGE, U.S. CHAMBER INST. FOR LEGAL REFORM, ARBITRATION—A GOOD DEAL FOR CONSUMERS: A RESPONSE TO PUBLIC CITIZEN (2008), http://www.instituteforlegalreform.com/get_ilr_doc.php?id=1091.

126. O'DONNELL, *supra* note 47, at 1–2, 4. Another report, prepared on behalf of the Institute for Legal Reform, countered the claim that arbitrators necessarily favor business, arguing that consumers are four times more likely to prevail in arbitration than in court. *See* Press Release, U.S. Chamber Inst. for Legal Reform, Arbitration Better Than Court for Consumer Debtors, Study Shows (July 15, 2008), http://www.instituteforlegalreform.com/media/pressreleases/20080715.cfm.

127. *See* Bingham, *supra* note 88 (surveying a list of potential explanations for the repeat player effect in the employment setting, including the possibility of institutional bias).

business paying for the arbitration may choose an arbitrator based on the ruling record of that particular arbitrator.[128] For example, if a business or arbitral institution knows that a particular arbitrator has ruled in favor of an employer in employment discrimination claims based on gender 80 percent of the time, then that business or institution may employ that "neutral" arbitrator in gender discrimination disputes to try to ensure success. In this scenario, the arbitrator may unwittingly be involved in the repeat player effect. For example, in *Cole v. Burns International Security Services, Inc.*,[129] the court recognized such a possibility, noting that organizations are "advantage[d] in having superior knowledge with respect to selection of an arbitrator."[130]

Some literature downplays the repeat player effect.[131] Even the *Cole* court, while acknowledging the possibility of the effect, dismissed the phenomenon:

> [T]here are several protections against the possibility of arbitrators systematically favoring employers because employers are the source of future business. For one thing, it is unlikely that such corruption would escape the scrutiny of plaintiffs' lawyers or appointing agencies like AAA. Corrupt arbitrators will not survive long in the business. In addition, wise employers and their representatives should see no benefit in currying the favor of corrupt arbitrators, because this will simply invite increased judicial review of arbitral judgments. Finally, if the arbitrators who are assigned to hear and decide statutory claims adhere to the professional and ethical standards set by arbitrators in the context of collective bargaining, there is little reason for concern.[132]

Though the court was confident that the repeat player effect posed little threat, its analysis remains flawed. First, while the court recognized that employers sometimes use their superior knowledge with respect to arbitrator selection to gain an advantage over the employee, the court failed to extend that analysis beyond the employer-employee relationship. Further, the court missed the possibility that arbitral institutions can sometimes be involved in this corruption. This corruption is likely to go unnoticed by plaintiffs' lawyers since they will not have access to the same kind of information that businesses or arbitral institutions may have. Arbitrator awards are almost never published, so

128. *Id.* (showing that institutional bias may play a role in the repeat player effect).

129. 105 F.3d 1465 (D.C. Cir. 1997) (finding that nonunion employees could be at a disadvantage since they lack the ability to collectively bargain in the market for arbitrators in the same way that unions and corporations can).

130. *Id.* at 1476.

131. *See, e.g.*, Bingham & Sarraf, *supra* note 61, at 323 tbl.3, 324 (finding no statistically significant repeat player effect); Sherwyn et al., *supra* note 62, at 1571 (arguing that the repeat player effect is due in part to employer experience rather than bias on the part of the arbitrator).

132. *Cole*, 105 F.3d at 1485. The California Supreme Court agreed with the *Cole* court in *Armendariz v. Foundation Health Psychcare Services, Inc.*, 6 P.3d 669, 687–88 (Cal. 2000).

it would be difficult to determine whether any particular arbitrator systematically favored an employer.[133] Moreover, arbitrators are not required to write opinions and almost never do, and thus provide the uninformed observer with little information on which to make an assessment.[134]

Second, the *Cole* court failed to acknowledge that arbitral awards are subject to judicial review only in extremely limited circumstances.[135] The right to appeal, which could screen out egregious cases of arbitrator bias, generally does not exist in arbitration. Although corruption is one of the narrow instances where the FAA allows for judicial review, the absence of a written award or opinion means that arbitrator reasoning is rarely assessed by reviewing courts.

Third, the court assumes that arbitrators' ethical principles will prevail over economic incentives to rule in favor of corporations. The court, however, appears to forget that arbitrators enjoy broad immunity in civil actions against them, even for charges of potential bias—as the Supreme Court has noted, arbitrators' independence, necessary to perform "without harassment or intimidation,"[136] must remain intact. Finally, the court misses the point that even if arbitrators are completely neutral, arbitration may still be tilted against the consumer or employee as a result of asymmetrical knowledge distribution benefiting the business or arbitral institution. The *Cole* court's analysis focused on and dismissed potential arbitrator corruption, but failed to address the more subtle conflict of interest issues at play in the institutional setting. The potential for unfair advantage results from the conflict of interest that exists when businesses (or institutions that businesses pay) not only are more knowledgeable about the arbitrators themselves but also select and pay the very arbitrators that are to decide their cases.

The repeat player effect could be easily solved,[137] yet the AFA does not seem to provide such a simple solution. Senator Feingold and Representative Johnson seem perhaps too willing to blame predispute agreements for this downside, leaving only two alternatives: litigate or agree to arbitrate postdispute. Unfortunately, conflicts of interest and asymmetrical knowledge remain in a postdispute setting. The selection of an arbitrator always occurs postdispute,

133. Bingham, *supra* note 88, at 194.

134. For an extended discussion of the problems associated with the lack of a written award requirement, see *infra* Part II.B.1.

135. *See* 9 U.S.C. § 10 (2006).

136. Butz v. Economou, 438 U.S. 478, 512 (1978).

137. There is potentially a less aggressive approach to combating arbitrator bias, at least within the realm of the "repeat player" effect. Congress could implement a rule requiring that arbitrators who have arbitrated a case between two parties could not be involved in a separate arbitration between either party for a requisite amount of time. This could potentially decrease the incentives for an arbitrator to rule in favor of either party for any reason.

so finding, as Congress does, that predispute agreements should be unenforceable at least partially on the grounds of arbitrator bias or the so-called repeat player effect fails to fully address the problem. If courts, commentators, and Congress agree that there is a potential conflict of interest when a business hires its own arbitrator, then, instead of (what amounts to) outlawing arbitration altogether, they should focus on eliminating the potential conflict of interest associated with arbitration. Any effective congressional act must tackle both the conflict of interest and the problem of asymmetrical knowledge. The first of these problems could be solved by adding an institutional middleman to eliminate conflicts of interest, while the problems with asymmetrical knowledge could be alleviated by requiring more transparent arbitration forums.

1. Adding an Institutional Middleman Between Businesses and Arbitrators

The *Cole* court went amiss when it neglected the potential abuse of arbitrator immunity, but allowing causes of action for arbitrator bias could potentially deter arbitrators from participating in the market altogether. As such, any procedural alternative to the AFA will have to take into account the realities of the market for arbitrators.

Congress's task should be to save predispute agreements without either ridding arbitration of its inherent benefits or deterring possible arbitrators from entering the market. In order to do this, Congress needs to ensure that the conflicts of interest inherent in having businesses both selecting and paying arbitrators and also having asymmetrical access to knowledge of the decisional patterns of arbitrators are effectively eliminated, while still keeping arbitration relatively inexpensive and efficient. Adding an institutional middleman may help to eliminate potential conflicts of interest and safeguard consumers and employees from both bias and asymmetrical knowledge. Two examples will illustrate how each problem—the potential for conflicts of interest and knowledge asymmetry—may be combated through such an addition.

a. Conflicts of Interest and the Federal Election Commission Example

Adding a middleman has proven effective in eliminating conflicts of interest in various other contexts. One notable example relates to public campaign finance laws. Throughout American history, money has played a pervasive role in election campaigns, often leading to bribery and the "buying

of influence."[138] The high cost of campaigns forces candidates to depend on the financial contributions of others, which could make these candidates beholden to these contributors, thereby creating a conflict of interest if the candidate is elected.[139] To combat this conflict of interest, Congress created the Federal Election Commission (FEC) to "disclose campaign finance information, to enforce the provisions of the law such as the limits and prohibitions on contributions, and to oversee the public funding of Presidential elections."[140] In effect, Congress added a middleman between contributors and candidates in an attempt to effectively eliminate the conflict of interest. Further, if presidential candidates opt to use public financing, their resources still come from the electorate but come indirectly via a taxpayer contribution to the government, making these candidates beholden to no one except the FEC.

Adding a mandatory middleman to the arbitral process could serve a function similar to the role the FEC plays in election campaigns. An arbitral middleman could serve as a processor for financial transactions and offer oversight of the arbitration process. While the government is the repository and redistributor of campaign contributions in public financing of presidential elections, the government does not need to play the middleman in arbitration. There are several arbitration organizations already well-established in the U.S., such as the American Arbitration Association (AAA), the National Arbitration Forum (NAF), or the Judicial Arbitration and Mediation Services (JAMS), that could act as the middleman in the arbitral process.

Most arbitration proceedings already take place through one of these administering arbitral institutions. There are three chief ways in which these institutions, if Congress mandated that they be involved in every arbitration, could help remove conflicts of interest. First, and perhaps most importantly, these institutions would be responsible for choosing arbitrators for disputes between businesses and their employees or consumers. Such a scheme would eliminate unilateral arbitrator selection by businesses.[141] Currently these institutions are not required to provide a list of neutral arbitrators unless the

138. Jason B. Frasco, Note, *Full Public Funding: An Effective and Legally Viable Model for Campaign Finance Reform in the States*, 92 CORNELL L. REV. 733, 736 (2007).

139. *Id.*

140. Federal Election Commission, About the FEC, http://www.fec.gov/about.shtml (last visited Mar. 27, 2010).

141. Some businesses offer a list of arbitrators from which the consumer or employee can choose, but the business still makes the initial selection of acceptable arbitrators. The Fourth Circuit, one of the most pro-arbitration circuits in the country, invalidated an agreement like this, ruling that it was "so one-sided that [the agreement's] only possible purpose is to undermine the neutrality of the proceeding." Hooters of Am., Inc. v. Phillips, 173 F.3d 933, 938–39 (4th Cir. 1999).

parties request it.[142] But requiring these institutions to either select the arbitrator or provide a list of preapproved arbitrators to both parties would eliminate the conflict created when businesses party to a dispute directly hire arbitrators to settle their dispute. Furthermore, these steps would ensure that the measures these institutions already take to provide and maintain neutral arbitrators are not skirted easily by the institutions themselves, since multiple parties would be involved in the arbitrator selection process.[143]

Second, these institutions would be responsible for accepting payments from third-party businesses. Just as with public financing of campaigns in which candidates receive contributions indirectly from taxpayers, these institutions would ensure that arbitrators would never be directly financially beholden to the businesses whose disputes they hear.

However, the question remains whether the arbitral institutions would somehow encourage or even coerce their arbitrators to rule in favor of those businesses which generate the most cases (and revenue) for the arbitral institutions. This is a particularly relevant question since arbitral institutions also benefit from vicarious immunity from civil liability and would not be accountable for such potential coercion.[144] Since businesses would be paying these institutions, some kind of limiting principle would be necessary to ensure that these institutions would not coerce or hire only pro-business arbitrators. This could be accomplished in a number of ways, including, but not limited to, a governmental or private organization vested with the necessary oversight powers or some kind of other deterrent scheme whereby institutions could be held liable for coercion. A more aggressive approach might simply be to force these institutions to publish their arbitrator databases, so that attorneys general could investigate and bring suits against the institutions if necessary.

Third and finally, these institutions can provide the necessary procedures to safeguard the arbitral process from conflicts of interest. The AAA and the NAF already have in place codes of conduct and ethical standards for their arbitrators.[145] Bias claims brought by either party alleging a violation of these codes and standards could then be brought before the arbitral institution rather than a judicial court. This could be handled on an administrative level

142. *See* CARBONNEAU, *supra* note 26, at 5.

143. Arbitrators at the AAA, for example, must have at least ten years of professional experience, must be "held in the highest regard by peers for integrity, fairness and good judgment," and must be dedicated to upholding the AAA Code of Ethics. American Arbitration Association, Qualification Criteria for Admittance to the AAA National Roster of Arbitrators, http://www.adr.org/si.asp?id=4223 (last visited Apr. 1, 2010).

144. Truli, *supra* note 89, at 388–89.

145. *See, e.g.*, American Arbitration Association, The Code of Ethics for Arbitrators in Commercial Disputes (Mar. 1, 2004), http://www.adr.org/si.asp?id=4582.

by the same institution that handled the original arbitration, so long as the institution has no incentive to rule unfairly. Since the institution would be paid in any event, no such incentive seems apparent in this context. These institutions could then either sanction an arbitrator or terminate his or her employment if they find arbitrator bias, which would then further deter other arbitrators from exercising potential bias. These institutions could also run conflict checks on the parties and arbitrators similar to those performed by law firms.[146]

b. Balancing the Playing Field: The Example of the ICSID

Adding a middleman has also proven to be effective in balancing the interests of the parties involved and eliminating asymmetry not only in access to knowledge but also in participation in structuring the process. One example exists in the field of international arbitration of foreign investment disputes between developed and developing countries. Historically, foreign investment has flowed from developed to developing countries.[147] Investors from developed countries seek to protect their investments in politically or economically unstable countries; however, international law at present remains too weak to provide sufficient safeguards that would ensure that investments seized or repudiated by the developing country will be legally protected.[148]

The shortcomings of the existing legal framework prompted several disagreements between developed and developing countries in the latter half of the twentieth century. For example, many developed countries argued that customary international law demanded certain minimum protections of investments from developing countries.[149] Meanwhile, developing countries had grown wary of investment agreements, believing that the current legal regime "perpetuated the economic dominance of developed over developing countries, and infringed on their sovereignty by circumscribing their ability to control economic activities within their borders."[150] In response to these failures, developed countries began negotiating bilateral treaties with developing countries in an effort to more adequately govern international investment,

146. The AAA already requires arbitrators to disclose any financial or other interests they may have related to the parties in its Code of Ethics for Arbitrators in Commercial Disputes. *Id.*

147. Jarrod Wong, *Umbrella Clauses in Bilateral Investment Treaties: Of Breaches of Contract, Treaty Violations, and the Divide Between Developing and Developed Countries in Foreign Investment Disputes*, 14 GEO. MASON L. REV. 135, 138 (2006).

148. *Id.* at 140.

149. Jeswald W. Salacuse & Nicholas P. Sullivan, *Do BITs Really Work?: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain*, 46 HARV. INT'L L.J. 67, 69 (2005).

150. Wong, *supra* note 147, at 140.

including disputes between the contracting parties.[151] Nevertheless, disputes continued to arise under these bilateral treaties, and often involved cases in which developing countries lacked confidence in the neutrality of arbitration procedures mandated in such agreements.[152]

To settle this problem, the World Bank, recognizing the benefits that foreign investment affords both developed and developing countries, created the International Centre for Settlement of Investment Disputes (ICSID) to assist in the conciliation and arbitration of international investment disputes.[153] The ICSID Convention, to which 155 States are now party, sought to balance the interests of both developed and developing countries, and called for the creation of the Administrative Council, which is responsible for the adoption of procedures and rules in arbitration proceedings, and is composed of representatives from both developed and developing states.[154] In effect, the Convention gives developing countries equal representation and thus an equal voice with other states, allowing them to ensure that arbitration procedures are not stacked against them. As a result, these countries have likely gained confidence in the arbitral dispute process.[155] Furthermore, the Convention's arbitration procedures have been quite effective at balancing win rates, as both investors and developing countries have shown up on the winning side of arbitral awards.[156]

Adding a middleman partly modeled on the ICSID's position between developing and developed countries could help balance the amount of knowledge available to each side when entering the arbitral process. Since businesses would no longer be choosing arbitrators, the problems associated with asymmetrical knowledge between a business and its consumer or employee would be mooted. There would still, however, need to be a transparency mechanism in place to prevent the arbitral institutions from using their own knowledge about arbitrator decisional patterns to favor one party over another and, as with the ICSID, to instill confidence in the fairness of the arbitral process to unequally situated parties. One possible transparency mechanism might be

151. *See id* at 140–41.

152. *See* Malcolm D. Rowat, *Multilateral Approaches to Improving the Investment Climate of Developing Countries: The Cases of ICSID and MIGA*, 33 HARV. INT'L L.J. 103, 107 (1992).

153. International Center for Settlement of Investment Disputes, About ICSID, http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ShowHome&pageName=AboutICSID_Home (last visited Mar. 27, 2010).

154. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States arts. 4, 6, *opened for signature* Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159, *available at* http://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/partA-chap01.htm.

155. *See* Rowat, *supra* note 152, at 135.

156. *Id.* at 118.

a public national registry of arbitrator decisions. However, this would likely not only be too expensive to maintain but also might compromise confidentiality, a desirable hallmark of arbitration.[157] A less expensive and simpler solution might be to require the arbitral institution to give each party all available information on the chosen arbitrator's decisional patterns. This could be done without sacrificing confidentiality and would simply give a record of the way in which a particular arbitrator or set of arbitrators has ruled (in a business vs. customer/employee sense). If the parties are given this information, the parties' lawyers could evaluate and challenge particular arbitrators.[158] Undoubtedly, to ensure strict compliance with reporting, the shield against institutional vicarious liability would have to be lowered in instances where the institution withholds available decisional patterns from one or both of the parties.

C. Some Reponses to Potential Counterarguments

In response to these mechanisms, commentators will surely note that a system such as the one proposed would raise prices of consumer goods and even potentially decrease wages for employees. The price of predispute arbitration would increase since businesses would be required to use a third party institution. Those businesses that utilize arbitration agreements would have to pass on these costs in the form of increased prices or decreased wages. This may be a necessary evil attached to attaining fairness. The costs to individuals, however, might be slightly mitigated by increased competition amongst the arbitral institutions, which could drive down the cost of arbitration. Furthermore, if prices rise, fewer consumers may be attracted to a particular product, and if wages are driven down, fewer people may be attracted to that particular employer, resulting in businesses' evaluation of whether predispute arbitration agreements are truly worth the costs.

Another counterargument to these new procedures is the potentially high transaction costs involved in adding institutional middlemen and enforcement mechanisms necessary to secure neutrality among arbitral institutions. This counterargument however is easily addressed by Coase.[159] In the arbitration

157. Christina Knahr & August Reinisch, *Transparency Versus Confidentiality in International Investment Arbitration—The* Biwater Gauff *Compromise*, 6 LAW & PRAC. INT'L CTS. & TRIBUNALS 97, 109 (2007).

158. Of course, some other kind of system would have to be in place to make sure that an infinite number of challenges cannot be had by one party or another. Perhaps it could be like the jury system, where each party is given a certain number of peremptory challenges.

159. Since transactions costs should be as close to zero as possible, as the Coase Theorem states, the right will go to the most highly valued user in the absence of transactions costs. *See* Coase, *supra* note 94, at 15.

setting, businesses and consumers/employees would theoretically dispute the right to have a predispute agreement to arbitrate; however, when the players have unequal bargaining power, there are inherent difficulties in the bargaining process. The importance of a liability rule is that it balances transaction costs between the parties to obtain not a costless alternative but an optimal one.[160] Shifting the financial burdens of arbitration onto the party that implements predispute arbitration agreements in consumer or employment settings will not impose a new transaction cost; instead, it will simply shift a cost from the party unable to bargain out of the particular contract onto the party who requires it, creating a greater incentive for informed decisions about the value of predispute agreements.

CONCLUSION

In 1998, the National Association of Securities Dealers (NASD) reformed their securities arbitrations by implementing greater party involvement in the selection of arbitrators.[161] The NASD created a selection system that selects arbitrators from a list at random before allowing parties to choose.[162] The system makes every attempt to select neutral arbitrators, so that regardless of who the parties ultimately agree upon, the selected arbitrator will not necessarily favor one side or the other.[163] Unlike traditional arbitration, which has typically yielded outcomes in favor of businesses, this alternative system has yielded "outcomes decreasingly favorable to contestants."[164] The NASD alternative system should be taken as a suggestion that arbitration done differently can work well. It further indicates that Congress may be taking too precipitous an approach in simply outlawing certain forms of arbitration instead of thinking about ways to improve it.

This Comment has attempted to show that the mechanisms of arbitration heavily favor businesses and how proposed changes might remedy the downsides of current arbitration practice. These proposed procedural requirements are one attempt to level the playing field between businesses and their consumers or employees. The difficulty in any suggested arbitration reform is

160. *See* Guido Calabresi, *Transaction Costs, Resource Allocation and Liability Rules—A Comment*, 11 J.L. & ECON. 67, 67, 69 (1968) (pointing out in a direct response to the Coase Theorem that transactions do cost money in the real world and that there is still an optimal result that is not necessarily costless).

161. *See* Choi & Eisenberg, *supra* note 83.

162. *See* Douglas J. Schultz, *The New NASD Arbitrator Selection Process—NLSS*, SEC. ARB. COMMENTATOR, http://www.sacarbitration.com/nasd.htm (last visited Mar. 26, 2010).

163. *Id.*

164. Choi & Eisenberg, *supra* note 83, at 9.

offering some of the substantive procedures of the court system without losing the less expensive, more efficient forum that arbitration offers.[165] The procedural proposals discussed herein thus attempt to amend existing arbitration law without sacrificing those benefits.

It is important to note that these procedural alternatives are neither exclusive nor exhaustive.[166] Certainly, the AFA findings address many unresolved issues, such as the lack of appeal after arbitration decisions, but the bill still goes too far in its attempt to effectively eliminate arbitration altogether.[167]

This is not to say that Congress's task should be to save arbitration either. One study found that mandatory predispute arbitration clauses between businesses are extremely rare,[168] which suggests that businesses value and prefer litigation (over arbitration) with their peers.[169] With consumers and employees, however, businesses overwhelmingly prefer arbitration, suggesting that businesses see a tactical and strategic advantage of using arbitration for those with less sophistication and little negotiation power.[170]

If Congress enacts procedural requirements that level the playing field between businesses and individuals, businesses may overwhelmingly opt out of settling their claims through arbitration. On the other hand, businesses may still prefer arbitration against the backdrop of a leveled playing field.[171] In any event, Congress should consider less drastic alternatives than outlawing predispute agreements altogether.

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165. *See* William W. Park, *Amending the Federal Arbitration Act*, 13 AM. REV. INT'L ARB. 75, 106 (2002) (intimating that too many rigid procedural requirements may make arbitration simply a precursor to litigation).

166. *See, e.g.*, Eisenberg et al., *supra* note 4, at 888 ("Companies prefer individual over aggregate dispute resolution because aggregate treatment creates overwhelming settlement pressure and because few consumers will seek redress on an individual basis due to lack of information or the small amounts in dispute.").

167. *See supra* Part I.

168. *See* Eisenberg et al., *supra* note 4, at 886 (finding that only 6.1 percent of nonemployment, nonconsumer contracts had arbitration clauses).

169. *Id.* at 876.

170. *See id.* at 886. For a discussion of some of those tactical and strategic advantages, see Theodore Eisenberg & Geoffrey P. Miller, *The Flight From Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in the Contracts of Publicly Held Companies*, 56 DEPAUL L. REV. 335, 336–41 (2007).

171. The Eisenberg and Miller study found that there was an inverse relationship between the speed of trials in particular states and the choice to include arbitration clauses in contracts within that state. Eisenberg & Miller, *supra* note 170, at 372. The authors of the study interpret this as evidence that substantive legal rules have a greater impact on decisions to include arbitration clauses than considerations of the efficiency of litigation. *Id.* This suggests that balancing the playing field with certain procedural requirements may have little impact on whether businesses choose to include arbitration clauses in their contracts with consumers or employees.