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**Professor Polinsky**

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**“Arbitration’s Summer Soldiers: An Empirical Study of Arbitration Clauses in  
Consumer and Nonconsumer Contracts”**

**by**

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**Note: It is expected that you will have reviewed the speaker’s paper before the Seminar.**

## **Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts**

Theodore Eisenberg, Geoffrey P. Miller, and Emily Sherwin\*

### Abstract

We provide the first study of varying use of arbitration clauses across contracts within the same firms. Using a sample of 26 consumer contracts and 164 nonconsumer contracts from large public corporations, we compared arbitration clause use in consumer contracts with their use in the same firms' nonconsumer contracts. Over three-quarters of the consumer agreements provided for mandatory arbitration but less than 10% of the firms' material nonconsumer, nonemployment contracts included arbitration clauses. The absence of arbitration provisions in nearly all material contracts suggests that, *ex ante*, many firms value, even prefer, litigation over arbitration to resolve disputes with peers. The frequent use of arbitration clauses in the same firms' consumer contracts appears to be an effort to preclude aggregate consumer action rather than, as often claimed, an effort to promote fair and efficient dispute resolution. Other common features of civil litigation reform discussion, avoidance of juries and loser-pays attorney fee rules, find little support in the pattern of contractual terms we observe.

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## I. Introduction

Arbitration clauses are common features of American consumer agreements. Popular products such as cellular phone service, credit cards, and discount brokerage typically come with fine-print contracts in which customers waive their right to litigate disputes in court. More or less consciously, the customer agrees to submit disputes to arbitration and, in most cases, agrees not to participate in class proceedings, either in court or before an arbitrator.

Mandatory arbitration clauses have been controversial among academic commentators and others, praised by some for their efficiency and condemned by others as one-sided, exploitative, and contrary to the ideals of public justice.<sup>1</sup> Arbitration clauses have also been a recurrent subject of litigation. Customers challenging company practices have filed class actions in court, and companies have invoked mandatory arbitration clauses in defense. Plaintiffs typically respond that standard-form contract provisions combining mandatory arbitration with class action waivers are unconscionable under state contract law. In the ensuing litigation, the parties have vigorously debated the justifiability of arbitration clauses, with major trade and

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<sup>1</sup>For a sample of the literature on the subject, see Mark E. Budnitz, *The High Cost of Mandatory Arbitration*, 67 *Law & Contemp. Probs.* 133 (2004); Mark E. Budnitz, *Arbitration of Disputes Between Consumers and Financial Institutions: A Serious Threat to Consumer Protection*, 10 *Ohio St. J. on Dispute Resolution* 267 (1995); Christopher R. Drahozal, "Unfair" Arbitration Clauses, 2001 *U. Ill. L. Rev.* 695 (2001); Myriam Gilles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 *Mich. L. Rev.* 373 (2005); Keith N. Hylton, *Agreements to Waive or Arbitrate Legal Claims: An Economic Analysis*, 8 *S. Ct. Econ. Rev.* 209 (2000); Eric J. Mogilnicki & Kirk D. Jensen, *Arbitration and Unconscionability*, 19 *Ga. St. U. L. Rev.* 761 (2003); David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 *Wis. L. Rev.* 33 (1997); Jean R. Sternlight & Elizabeth J. Jensen, *Using Arbitration to Eliminate Consumer Class Actions: Efficient Business Practice or Unconscionable Abuse?*, 67 *Law & Contemp. Probs.* 75, 103 (2004); Stephen J. Ware, *Contractual Arbitration, Mandatory Arbitration, and State Constitutional Jury-Trial Rights*, 38 *U.S.F. L. Rev.* 39 (2003) [hereinafter Ware, *Contractual Arbitration*]; Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 *J. Dispute Resolution* 89 (2001)[hereinafter Ware, *Paying the Price*]; Note, *The Court's Implicit Roadmap: Charting the Prudent Course at the Juncture of Mandatory Arbitration Agreements and Class Action Lawsuits*, 57 *Stan. L. Rev.* 1677 (2005); Note, *Beyond Unconscionability: Class Action Waivers and Mandatory Arbitration Agreements*, 59 *Vand. L. Rev.* 1735 (2006).

consumer organizations participating as *amici curiae* on the expected sides.<sup>2</sup> Decisions on the question of unconscionability have been mixed as a matter of both federal law<sup>3</sup> and state law.<sup>4</sup>

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<sup>2</sup>For example, in a recent case before the Supreme Court of Washington, *Scott v. Cingular Wireless*, 131 P.3d 1000 (Wash. 2007), Cingular's position was defended by the United States Chamber of Commerce, CTIA - The Wireless Association, Amazon.com, Intel, Microsoft and others. Among those supporting the plaintiffs were the Washington State Trial Lawyers Association, AARP, and the National Association of Consumer Advocates. See Brief of Amicus Curiae the Chamber of Commerce of the United States in Support of Respondent Cingular Wireless LLC; Brief of CTIA-The Wireless Association as Amicus Curiae in Support of Affirmance; Brief of Amazon.com, Inc., Intel Corp., Microsoft Corp., and Realnetwork, Inc. as Amici Curiae in Support of Affirmance; Brief of Amicus Curiae Washington State Trial Lawyers Association Foundation; Brief Amici Curiae of AARP and National Association of Consumer Advocates. Similarly, in *Discover Bank v. Superior Court*, 113 P.3d 1100 (Cal. 2005), Discover was supported by The U.S. Chamber of Commerce, the American Bankers' Association, the American Financial Services Association, the Consumer Bankers' Association, the Consumer Attorneys of California, and others. Plaintiffs were supported by AARP, the National Association of Consumer Advocates, and others. See Application of the Chamber of Commerce of the United States for Permission to File Amicus Curiae Brief and Amicus Curiae Brief in Support of the Defendant-Petitioner; Brief of Amici Curiae American Bankers' Ass'n., American Financial Services Ass'n., & Consumer Bankers' Ass'n. in Support of Petitioner Discover Bank at 7; Brief Amicus Curiae of AARP in Support of Christopher Boehr, Real Party in Interest; Amicus Curiae Brief of the National Association of Consumer Advocates in Support of Real Party in Interest; Brief of Consumer Attorneys of California in Support of Real Party in Interest.

<sup>3</sup>Compare *Kristian v. Comcast Corp.*, 446 F.3d 25 (1st Cir. 2006) (concluding that arbitration agreements barring antitrust treble damages, class actions, and attorney fees are invalid); *Edwards v. Blockbuster Inc.*, 400 F.Supp.2d 1305, 1309 (E.D.Okla.2005); *Luna v. Household Fin. Corp.* III, 236 F.Supp.2d 1166, 1178 (W.D.Wash.2002); *Lozada v. Dale Baker Oldsmobile, Inc.*, 91 F.Supp.2d 1087, 1105 (W.D.Mich.2000) with e.g., *Johnson v. West Suburban Bank*, 225 F.3d 366, 374 (3d Cir.2000) ("claims arising under the EFTA [Electronic Fund Transfer Act] may also be subject to arbitration notwithstanding the desire of a plaintiff who previously consented to arbitration to bring his or her claims as part of a class."); *Snowden v. CheckPoint Check Cashing*, 290 F.3d 631, 638 (4th Cir.2002) (rejecting "argument that the Arbitration Agreement is unenforceable as unconscionable because without the class action vehicle, she will be unable to maintain her legal representation given the small amount of her individual damages."); *Livingston v. Associates Fin., Inc.*, 339 F.3d 553, 559 (7th Cir.2003) (enforcing ban on class actions); *Randolph v. Green Tree Fin. Corp.-Alabama*, 244 F.3d 814, 819 (11th Cir.2001)(enforcing ban on class actions); .

<sup>4</sup>Compare *Discover Bank v. Superior Court*, 36 Cal.4th 148, 161, 30 Cal. Rptr.3d 76, 113 P.3d 1100 (Cal.2005) (waiver of class arbitration in consumer class action can be unconscionable); *Skirchak v. Dynamics Research Corp.*, 2007 WL 4098823 (1st. Cir. 2007) (finding a mandatory arbitration clause in an employment clause unconscionable under Massachusetts Law); *Ting v. AT&T*, 319 F.3d 1126, 1130 (9th Cir. 2003) (finding ban on class claims unconscionable under California law); *Scott v. Cingular Wireless*, 160 Wash.2d 843, 161 P.3d 1000 (Wash. 2007) (class action waiver in arbitration clause violated public policy); *S.D.S. Autos, Inc. v. Chrzanowski*, 2007 WL 4145222 (Fla. Dist. Ct. App. Nov. 26, 2007) (refusing to enforce arbitration clause precluding class relief); *Powertel, Inc. v. Bexley*, 743 So.2d 570, 576 (Fla. Dist. Ct. App.1999) (same); *Muhammad v. County Bank Branch of Rehoboth Beach, Delaware*, 189 N.J.1, 912 A.2d 88, 100-01 (N.J. 2006) (unenforceable to deprive plaintiff of class-wide action); *State ex rel. Dunlap v. Berger*, 211 W.Va. 549, 567 S.E.2d 265, 278-79 (2002) (retailer's contract prohibiting class relief held unenforceable); *Leonard v. Terminix Int'l Co., L.P.*, 854 So.2d 529, 538 (Ala.2002); *Kinkel v. Cingular Wireless, L.L.C.*, 223 Ill.2d 1, 47, 857 N.E.2d 250, 306 Ill.Dec. 157 (2006); *Whitney v. Alltel Communications, Inc.*, 173 S.W.3d 300, 314 (Mo. Ct. App. 2005); *Schwartz v. Alltel Corp.*, 2006-Ohio-3353 ¶ 36, 2006 WL 2243649 (Ohio Ct. App.); *Vasquez-Lopez v. Beneficial Or., Inc.*, 210 Or.App. 553, 572, 152 P.3d 940 (2007); *Thibodeau v. Comcast Corp.*, 2006 PA Super. 346, ---, 912 A.2d 874, 886; *Wis. Auto Title Loans, Inc. v. Jones*, 2006 WI 53, ¶ 73, 290 Wis.2d 514, 714 N.W.2d 155 (questioning whether class action waiver in arbitration

Both in academic commentary and in litigation, arguments for and against mandatory arbitration and related limits on class action line up fairly predictably. Supporters of arbitration, and companies that require their customers to submit disputes to arbitration, argue that arbitration is cheaper, faster, and more effective as a means for dispute resolution than litigation. Professional arbitrators are neutral, outcomes are at least as favorable to consumers as the outcomes of litigation, and a majority of participants express satisfaction with the process. Class actions, meanwhile, are antithetical to arbitration because they undermine the speed, simplicity, and financial benefits of the arbitration process. More broadly, supporters argue that mandatory arbitration, coupled with class action waivers, benefits all consumers by reducing the price of consumer products. Companies save money, and in a competitive market, pass their savings on to customers.<sup>5</sup> Pre-dispute arbitration clauses, in short, are in the best interests of both companies and consumers.

Critics characterize mandatory arbitration as a limited and often unsatisfactory mode of dispute resolution imposed by economically powerful corporations on unsophisticated consumers without genuine consent. Consumers are deprived of jury trials; instead their claims are judged by private arbitrators who may seek to ingratiate themselves with companies that

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clause would be enforceable), with e.g., *Delta Funding Corp. v. Harris*, 189 N.J. 28,46-47, 912 A.2d 104,115 (N.J. 2006) (class arbitration waiver not unconscionable per se); *Spann v. American Express Travel Related Servs. Co., Inc.*, 224 S.W.3d 698, 714-15 (Tenn. Ct. App. 2006) (enforcing class arbitration waiver under Utah law); *Tillman v. Commercial Credit Loans, Inc.*, 177 N.C. App. 568, 629 S.E.2d 865, 875 (2006); *AutoNation USA Corp. v. Leroy*, 105 S.W.3d 190, 199-200 (Tex. App. 2003). See also the collection of cases cited in Tyler M. Paetkau, *Drafting Employment-Related Agreements*, PLI Order No. 11091, at 277-78 (Oct. 2007).

<sup>5</sup>See *Ware, Paying the Price*, supra note 1. *Ware* lists a variety of ways in which arbitration reduces the costs of dispute resolution for companies: high damages are less likely, defendant companies avoid adverse publicity, procedures are nationally uniform, discovery and appeals are limited, class actions may be avoided, and, more generally, claims may be deterred altogether. *Id.* at 90. Of course, deterring claims means that victims of corporate wrongdoing obtain no relief for violations of their legal rights; overall, however, consumers might be willing to forego legal remedies for minor wrongs in exchange for lower-priced goods and services. See *id.* at 94 (acknowledging that class action waivers save costs, and lower prices, in part by deterring valid claims).

frequently use their services. Studies showing favorable consumer win-rates involve relatively sophisticated consumers.<sup>6</sup> Damage awards may be lower in arbitration than in litigation,<sup>7</sup> though evidence supporting this claim is inconclusive.<sup>8</sup> Critics also maintain that mandatory arbitration is detrimental to the public interest in open resolution of legal disputes. Arbitration proceedings are typically private and do not result in published opinions; therefore decisions rendered by arbitrators contribute nothing to the body of law, have no deterrent effect on future wrongdoing, and fail to stimulate interest in legal reform.<sup>9</sup>

Opponents of mandatory arbitration are particularly critical of arbitration agreements in which consumers waive their ability to initiate or join in class actions, in or out of arbitration.<sup>10</sup> Class actions, they argue, are necessary to apprise consumers of corporate malfeasance, to make

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<sup>6</sup>See Budnitz, *Arbitration of Disputes*, supra note 1, at 320-21 (distinguishing securities purchasers from ordinary consumers); Sternlight, *Creeping Arbitration*, supra note 1, at 1659 (same).

<sup>7</sup>Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate Over Pre-dispute Employment Arbitration Agreements*, 16 *Ohio St. J. Disp. Resolution* 559, 565(2001) (tbl. 4) (showing lower median awards in arbitration of employment cases); Schwartz, supra note 1, at 64-65 (reviewing sketchy evidence and noting that limited empirical evidence raises a serious concern).

<sup>8</sup>For evidence that damage awards may not necessarily be lower in arbitration than in litigation, see Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 *Disp. Resolution J.* 44 (Nov. 2003-Jan. 2004) (no significant difference found between litigation and arbitration awards). Arbitrator-juror comparisons do not provide evidence of systematic differences. Researchers asked two groups, one made up of professional arbitrators, the other jury-eligible citizens, to determine the non-economic damages to be awarded for past pain and suffering and disfigurement in a medical negligence case. Neil Vidmar & Jeffrey J. Rice, *Assessments of Non-Economic Damage Awards in Medical Negligence: A Comparison of Juries with Legal Professionals*, 78 *Iowa L. Rev.* 883, 890-93 (1993) (statistical tests on arbitrator- mock juror samples yielded no statistically significant difference in the median or mean awards); Donald Wittman, *Lay Juries, Professional Arbitrators, and the Arbitrator Selection Hypothesis*, 5 *Am. L. & Econ. Rev.* 61 (2003) (little evidence of difference in juror and arbitrator outcomes in California automobile accident cases).

<sup>9</sup>See Richard M. Alderman, *Pre-Dispute Mandatory Arbitration in Consumer Contracts*, 38 *Hous. L. Rev.* 1237, 1262-64 (2001) (arguing that arbitration detracts from development of law); Richard C. Reuben, *Democracy and Dispute Resolution: The Problem of Arbitration*, 2004 *Law & Contemp. Probs.* 279, 298-303 (finding mandatory arbitration to be incompatible with “democratic values”); Sternlight, supra note 1, at 1661-65 (discussing transparency, public education, and the rule of law).

<sup>10</sup>See Sternlight & Jensen, supra note 1, at 103 (referring to the combination of mandatory arbitration and class action waiver as “do-it-yourself tort reform” by companies).

small claims economically viable, and to hold companies accountable for wrongdoing that results in small losses to many customers. Thus, class action waivers defeat both the rights of individual consumers and the public's interest in enlisting private litigants to enforce the law.<sup>11</sup> Avoiding class actions may save money for companies, but there is no guarantee that the savings will be passed on to consumers and in any event public interests in law enforcement trump private interests in lower prices for consumer products.

As reviewed below, empirical studies show a reasonably consistent pattern of arbitration clause use. In the securities industry, arbitration clauses have long been used for broker-customer disputes.<sup>12</sup> Arbitration clauses often are used in some other classes of consumer contracts, such as credit card agreements, often are used in executive employment contracts, but rarely are used in other contracts involving large corporations.<sup>13</sup> Contract-level studies, however, cannot reveal individual firms' preferences with respect to arbitration and related clauses. For example, if a corporation asserts before legislatures and courts that arbitration is an efficient, low-cost process that benefits both parties, one would expect the corporation to consistently include arbitration clauses in its contracts. A firm's true preferences about arbitration clauses can be meaningfully ascertained by studying, at the firm level, a firm's pattern

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<sup>11</sup>See e.g., Sternlight & Jensen, *supra* note 1, at 85-92.

<sup>12</sup>*Wilko v. Swan*, 346 U.S. 427 (1953) (finding an arbitration clause in a brokerage agreement to be unenforceable). *Wilko* was limited by subsequent cases that reflected a different attitude towards arbitration. For example, in *Shearson/American Exp., Inc. v. McMahon*, 482 U.S. 220, 233 (1987), the Court stated: the mistrust of arbitration that formed the basis for the *Wilko* opinion in 1953 is difficult to square with the assessment of arbitration that has prevailed since that time. . . . Even if *Wilko*'s assumptions regarding arbitration were valid at the time *Wilko* was decided, most certainly they do not hold true today for arbitration procedures subject to the SEC's oversight authority.

<sup>13</sup>See Parts II, IV *infra*.

of arbitration clause use. Multiple contracts per firm, across a range of contractual situations, should be observed to reveal firm-level patterns.

This study adds to the empirical arbitration literature by studying whether particular firms vary use of arbitration clauses depending on the type of contract. Given a firm, will it uniformly include arbitration clauses or vary its practice based on the nature of the contract? The study is not designed to measure the frequency of arbitration clauses across a broad range of consumer agreements, which others have done.<sup>14</sup> Instead, our aim is to explore the common assertion by companies that employ mandatory arbitration clauses that arbitration is a preferable dispute resolution forum for all parties involved in light of those companies' own actual contractual practices.

The results are striking. Over three-quarters of the studied companies' consumer agreements provided for mandatory arbitration of disputes. Yet less than ten percent of their negotiated nonconsumer, non-employment contracts included arbitration clauses. The absence of arbitration provisions in the great majority of negotiated business contracts suggests that companies value, even prefer, litigation as the means for resolving disputes with peers. Systematic eschewing of arbitration clauses also casts doubt on the corporations' asserted beliefs in the superior fairness and efficiency of arbitration clauses. Large corporations' assertions that mandatory consumer arbitration is justified because it provides consumers with a superior form of dispute resolution thus appear to be disingenuous.

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<sup>14</sup>One study reports that one-third of typical consumer agreements contain arbitration clauses. Linda J. Demaine & Deborah R. Hensler, "Volunteering" to Arbitrate Through Predispute Arbitration Clauses, 2004 *Law & Contemp. Probs.* 55, 62 (2004) but also showed that rates of arbitration clause use varied by type of consumer contract. In the sectors we report on in this article, the rate of arbitration clauses is considerably higher than the one-third rate. See Part IV *infra*.

Rather, the empirical data support the view that the primary goal of mandatory consumer arbitration provisions is to preclude aggregate litigation against corporations. Sixty percent of the consumer contracts with mandatory arbitration clauses stated that the clauses were inoperable if class action arbitration were to be permitted. None of the nonconsumer contracts providing for arbitration voided the arbitration clauses in the event of class action arbitration. The pattern is clear: the large firms studied generally shun arbitration except against consumers and employees. The pattern of corporate contractual activity does not support the claim that firms believe arbitration is a uniformly superior dispute resolution mechanism.

The combination of results may not resolve the debate over enforcement of standard-form arbitration clauses, but it narrows the field of admissible arguments. Large corporations, and organizations representing them, cannot credibly claim that they regard arbitration as a uniformly superior dispute resolution mechanism because of its efficiency and fairness. They would not plausibly provide for arbitration in so few of their contracts if they truly believed their rhetoric. Large corporations prefer arbitration to litigation primarily for arbitration's ability to preclude aggregation of consumer claims. That may or may not be a desirable policy goal; but the debate about mandatory arbitration clauses should relate to the true issue, not to insincere arguments packaged as belief in fairness and efficiency.

Part II of this article discusses prior empirical research on arbitration clauses. Part III describes the data analyzed here and Part IV reports the results. Part V discusses the results and Part VI concludes.

## II. Prior Research and Hypotheses

*Prior Research.* Prior empirical research suggests that arbitration clauses appear more frequently in consumer agreements than in other contracts but also that substantial variation exists across types of contracts. Linda Demaine and Deborah Hensler report arbitration clauses in about 35 percent of consumer contracts with rates varying by the type of contract: for example, 69 percent of 26 consumer financial contracts, including credit card contracts, contained arbitration clauses compared to zero percent of 20 consumer food and entertainment contracts.<sup>15</sup> Florencia Marotta-Wurgler found that about six percent of 597 online end-user software license agreements contained arbitration clauses<sup>16</sup> although some of these would not necessarily be consumer contracts. Elizabeth Rolph, Erik Moller, and John Rolph found that nine percent of a sample of California physicians and hospitals used arbitration agreements<sup>17</sup> but it was reported at about the same time that the health care and health insurance industries had begun to require customers to agree to binding arbitration.<sup>18</sup> In a study of nonconsumer contracts, Eisenberg and Miller report arbitration clauses in about 11 percent of material contracts of large corporate firms.<sup>19</sup> As in the case of consumer agreements, the rate of arbitration clauses in material contracts varied substantially depending on contract type. For

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<sup>15</sup>Demaine & Hensler, *supra* note 14, at 63-64 (tbl. 2).

<sup>16</sup>Florencia Marotta-Wurgler, “Unfair” Dispute Resolution Clauses: Much Ado About Nothing?, in “Boilerplate”: Foundations of Market Contracts (Omri Ben-Shahar ed. 2007).

<sup>17</sup>Elizabeth Rolph, Erik Moller & John E. Rolph, Arbitration Agreements in Health Care: Myths and Reality, 60 *Law & Contemp. Probs.*, Winter 1997, at 171.

<sup>18</sup>Schwartz, *supra* note 1, at 52.

<sup>19</sup>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, 351 (2007). For other reports of rates of arbitration clauses, see *id.* at 346-48.

example, one-third of licensing agreements contained arbitration clauses whereas none of the trust agreements studied contained such clauses.<sup>20</sup> Employment contracts of senior executives have relatively high rates of arbitration clauses, with reports of clauses in 41.6 percent and 37 percent of executive contracts,<sup>21</sup> rates that exceed the approximately one-third rate reported by Demaine and Hensler for consumer contracts.

*Hypotheses.* Our core hypothesis is simple. The companies we studied, or organizations to which they belong, have publicly endorsed the virtues of arbitration, particularly in the context of challenges to pre-dispute arbitration clauses and related class action waivers in consumer agreements. Arbitration “takes less time and costs less than litigation;”<sup>22</sup> arbitration is “fair and effective;”<sup>23</sup> arbitration offers “a quick, cheap, and easy dispute resolution mechanism”<sup>24</sup> that is “more efficient”<sup>25</sup> than resolving disputes through litigation. Based on these assertions, we would expect that the same companies would consistently contract for dispute resolution through arbitration.

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<sup>20</sup>Eisenberg & Miller, *supra* note 19, at 351 (tbl. 2).

<sup>21</sup>Stewart J. Schwab & Randall S. Thomas, *An Empirical Analysis of CEO Employment Contracts: What Do Top Executives Bargain for?*, 63 Wash. & Lee L. Rev. 231, 234 (2006) (41.6%); Eisenberg & Miller, *supra* note 9, at 351 (tbl. 2) (37%).

<sup>22</sup>Brief of CTIA - The Wireless Association as *Amicus Curiae* in Support of Affirmance at 2, *Scott v. Cingular Wireless*, 131 P.3d 1000 (Wash. 2007). Similar citations of the benefits of arbitration appear in Cingular’s brief. Brief of Respondent Cingular Wireless LLC, *id.* at 39.

<sup>23</sup>Brief of CTIA, *supra* note 22, at 2.

<sup>24</sup>Discover Bank’s Answer to Amicus Curie [sic] Brief of Consumer Attorneys of California in Support of Real Party in Interest at 13-14, *Discover Bank v. Superior Court*, 113 P.3d 1100 (Cal. 2005).

<sup>25</sup>Brief of Amici Curiae American Bankers’ Ass’n., American Financial Services Ass’n., & Consumer Bankers’ Ass’n. in Support of Petitioner Discover Bank at 7, *Discover Bank v. Superior Court*, *supra* note 11.

We also explore two related hypotheses. Arbitration clauses are one of a suite of possible dispute resolution clauses present in many contracts. Most closely related to arbitration clauses are contract terms relating to jury trials. Arbitration clauses forego litigation and therefore constitute a way of effectively avoiding jury trials. Contract terms expressly waiving jury trials preserve access to court but avoid jury trials.<sup>26</sup> Some tort reform proponents regard jury trials as a distinct source of problems with the U.S. legal system. This widely held corporate view regards juries as increasing the risks and costs of trials because they decide the questions put to them on the basis of legally irrelevant factors rather than according to the evidence and applicable law.<sup>27</sup> For example, in a series of studies funded by ExxonMobil, researchers claim that juries are poorly suited to address matters of punitive damages.<sup>28</sup> And large jury awards have been made in business vs. business litigation.<sup>29</sup>

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<sup>26</sup>Knowing and voluntary pre-dispute contractual waivers are enforced in federal courts, *Leasing Serv. Corp. v. Crane*, 804 F.2d 828, 832 (4th Cir.1986); *K.M.C. Co. v. Irving Trust Co.*, 757 F.2d 752, 755 (6th Cir.1985); *Rodenbur v. Kaufmann*, 320 F.2d 679, 683 (D.C. Cir.1963); *RDO Fin. Servs. Co. v. Powell*, 191 F.Supp.2d 811, 813 (N.D. Tex. 2002), and the majority of state courts agree. See Jay M. Zitter, *Contractual Jury Trial Waivers in State Civil Cases*, 42 A.L.R.5th 53, 71 (1996); *In re Prudential Ins. Co. of America*, 148 S.W.3d 124 (Tex. 2004); *Mall, Inc. v. Robbins*, 412 So.2d 1197, 1200 (Ala. 1982); *L & R Realty v. Connecticut Nat'l Bank*, 246 Conn. 1, 715 A.2d 748, 754-755 (1998); *Malan Realty Investors, Inc. v. Harris*, 953 S.W.2d 624, 626- 627 (Mo. 1997) (en banc) (per curiam); *Lowe Enters. Residential Partners, L.P. v. Eighth Judicial Dist. Court*, 118 Nev. 92, 40 P.3d 405 (2002); *Rhode Island Depositors Econ. Prot. Corp. v. Coffey and Martinelli, Ltd.*, 821 A.2d 222, 226 (R.I. 2003). California and Georgia reject at least some pre-dispute waivers. *Grafton Partners LLP v. Superior Court*, 36 Cal.4th 944, 116 P.3d 479, 32 Cal. Rptr. 3d 5 (2005); *Bank South, N.A. v. Howard*, 264 Ga. 339, 444 S.E.2d 799 (1994). See also Miss. Rule of Civ. Proc. 38(b) (“The court may, in its discretion, require that the action be tried by a jury notwithstanding the stipulation of waiver.”).

<sup>27</sup>E.g., John Lande, *Failing Faith in Litigation? A Survey of Business Lawyers’ and Executives’ Opinions*, 3 *Harv. Negot. L. Rev.* 1, 51-52 (1998). For a broader description of this view and the evidence for and against it, see Theodore Eisenbeg & Geoffrey P. Miller, *Do Juries Add Value?: Evidence from an Empirical Study of Jury Trial Waiver Clauses in Large Corporate Contracts*, 4 *J. Empirical Legal Stud.* 539, \_\_ (2007).

<sup>28</sup>E.g., Cass Sunstein et al., *Punitive Damages: How Juries Decide* (2002).

<sup>29</sup>See, e.g., *TXO Production Corp. v. Alliance Resources Corp.*, 509 U.S. 443, 464 (1993) (\$10 million jury award in business dispute); *Micro/Vest v. Computerland* (estimated \$400 million jury award), as reported in *Computerland*, *N.Y. Times*, June 4, 1985 and in Joni Hersch & W. Kip Viscusi, *Punitive Damages: How Juries Decide*, 33 *J. Legal Stud.* 1, 7-8 (2006); *50-Off Stores, Inc. v. Banques Paribas (Suisse), S.A.*, 180 F.3d 247 (5th Cir. 1999) (jury award in excess of \$150 million; punitive award struck on appeal); *City of Hope Nat. Medical Center v.*

By agreeing *ex ante* to avoid jury trials, businesses can avoid the perceived risk of a jury run amok granting possibly bankrupting awards, yet preserve access to judges. Based on the business community's expressed attitudes towards juries, one expects businesses to seek to avoid that risk. We therefore expect that, in addition to avoiding juries through the use of arbitration clauses, businesses would regularly contract to waive jury trials in contracts in which they do not agree to arbitrate or to require consumers to arbitrate.

Attorney fees, like juries, have been prominent in law reform discussions. Fee reform advocates target contingent fees<sup>30</sup> and some assert the benefits of a "loser pays" attorney fee rule over the American rule under which each side pays its own attorney fees.<sup>31</sup> Theoretical

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Genentech, Inc., 123 Cal. App. 4th 306 (2004), review granted, 20 Cal. Rptr. 3d 234, 238 (2005) (\$300,164,130 compensatory damages, \$200 million punitive damages); *Rubicon Petroleum Inc. v. Amoco Production Co.*, as reported in, *Amoco Loses Oilfield Suit*, N.Y. Times, Nov. 24, 1993 (\$417 million jury award); *Time Warner Entertainment Co. v. Six Flags Over Georgia, LLC*, 563 S.E.2d 178 (Ga. App. 2002) (\$257 million punitive award), cert. denied, 538 U.S. 977 (2003); *Pioneer Commercial Funding Corp. v. American Financial Mortg. Corp.*, 855 A.2d 818 (Pa. 2004) (striking large jury award); *COC Services, Ltd. v. CompUSA, Inc.*, 150 S.W.3d 654 (Tex. App. 2004), review denied, June 9, 2006) (striking large punitive damages award); *Amoco Chemical Co. v. Certain Underwriter's at Lloyd's of London*, 1996 WL 407855 (Cal. App.) (reversing large jury award); *IGEN Intern., Inc. v. Roche Diagnostics GmbH*, 335 F.3d 303 (4th Cir. 2003) (reducing award of about \$505 million by over 90%). In *MMAR Group, Inc. v. Dow Jones & Co.*, a jury awarded \$220,720,000 in compensatory and punitive damages. After a retrial was ordered, see Felicity Barringer, *Judge Says Record Libel Case Should Be Retried*, N.Y. Times, Apr. 9, 1999, it is reported that MMAR did not pursue the case. David McHam, *Law & the Media in Texas: Handbook for Journalists*, available at <http://www.texaspress.com/Lawpress/LawMedia/Libel/TexasLibelCases.htm>, accessed Aug. 9, 2006. Thomas Petzinger, Jr., *Oil and Honor: The Texaco-Pennzoil Wars* (1987) describes in detail a multi-billion dollar jury award in a corporate control battle.

<sup>30</sup>E.g., Lester Brickman, *Effective Hourly Rates of Contingency-Fee Lawyers: Competing Data and Non-Competitive Fees*, 81 Wash. U. L.Q. 653 (2003). But see Herbert M. Kritzer, *Advocacy and Rhetoric vs. Scholarship and Evidence in the Debate Over Contingency Fees: A Reply to Professor Brickman*, 82 Wash. U. L.Q. 477 (2004). For classic discussions of attorney fee mechanisms, see Kevin M. Clermont & John D. Currihan, *Improving on the Contingent Fee*, 63 Cornell L. Rev. 529 (1978); Murray L. Schwartz & Daniel J.B. Mitchell, *An Economic Analysis of the Contingent Fee in Personal-Injury Litigation*, 22 Stan. L. Rev. 1125 (1970).

<sup>31</sup>E.g., Joshua P. Davis, *Toward a Jurisprudence of Trial and Settlement: Allocating Attorneys' Fees by Amending Federal Rule of Civil Procedure 68*, 48 Ala. L. Rev. 65, 65-69 (1996) (requiring the loser to pay fees if he rejected a settlement offer would increase the likelihood of settlement).

predictions about the impact of adopting a loser-pays rule vary<sup>32</sup> and we therefore have no firm prediction about the use of attorney fee clauses in contracts. But observing how the contracts studied here address attorney fees should provide insight into how corporations contract with each other with respect to fees, and inferentially about what fee rule they regard as preferable.

### III. Data Description

We identified a number of companies with significant market shares or name recognition in the telecommunications, credit, and financial services industries. Most are in the top 100 of American companies listed in *Fortune* magazine's annual ranking;<sup>33</sup> others are close to the top 100 or are well-known within the relevant consumer sector. Next, we collected consumer agreements drafted by the companies. Some of these were available to anyone visiting the web site on which the company marketed its products. Others were available through a link or window that appeared during the process of placing an order. Others were available only by mail after ordering the company's product.<sup>34</sup> We searched for versions of these agreements current in July and August, 2007. In the industry sectors we studied, consumer agreements typically regulated an ongoing relationship between the company and the consumer, such as phone service, brokerage, or credit.

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<sup>32</sup>Herbert M. Kritzer, *Lawyer Fees and Lawyer Behavior in Litigation: What Does the Empirical Literature Really Say?*, 80 *Tex. L. Rev.* 1943, 1948 (2002) (discussing theoretical analyses of contingent fees).

<sup>33</sup>See [http://money.cnn.com/magazines/fortune/fortune500/2007/full\\_list/index.html](http://money.cnn.com/magazines/fortune/fortune500/2007/full_list/index.html).

<sup>34</sup>For example, Walmart (*Fortune*'s #1) provides credit card applicants with a "disclosure" statement at the time of application, then mails the full consumer agreement to the customer when the application is accepted. Telephone requests for an advance copy of the agreement, prior to submission of an application containing personal financial information, were declined on the ground that the company did not furnish its contracts to "just anyone." Telephone conversation with Walmart customer service June 15, 2007. The consumer contract that Walmart sends is in fact a contract with GE Money Bank.

We then searched for negotiated agreements entered into by the same companies. Our sources for these contracts were the companies' Form 8-K and Form 10-K filings during the period from January 1, 2006 to August 13, 2007. The SEC requires registered companies to file current and annual reports listing, among other things, contracts that materially affect the financial condition of the company.<sup>35</sup> Contracts filed by the companies we studied included stock purchase agreements; credit and security agreements; loan pooling and service agreements; employment agreements; and various agreements relating to benefits and incentives for key employees. Given the economic significance of these contracts—implied by their inclusion in Forms 8-K and 10-K—we assume that they were negotiated with care.

Our data include 26 consumer agreements drafted by 21 companies and 164 negotiated contracts entered into by the same companies. Fourteen of the negotiated contracts were employment agreements. Sorting by industry, seven of our companies (accounting for seven consumer contracts and 63 negotiated contracts) provide telecommunications services; five companies (accounting for seven consumer contracts and 38 negotiated contracts) provide “triple play” cable services (CATV, Internet, and phone); four companies provide securities services (accounting for four consumer agreements and 33 negotiated agreements); three companies are commercial banks (accounting for five consumer agreements and 14 negotiated contracts); two companies issue retail credit cards (accounting for two consumer contracts and eight negotiated contracts); and one company is a financial services company (accounting for one consumer contract and eight negotiated contracts). Table 1 reports the companies studied and the number of each kind of contract for each company.

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<sup>35</sup>See 15 U.S.C. §78l, 78m, 78o(d); 17 C.F.R. §§240.13a-1, 240.13a-11, 249.308, 249-310.

**Table 1. Companies and Contract types**

Company	Contract type			Total
	Consumer	Employment	Material contracts	
AT&T	1	0	17	18
Alltel	1	0	12	13
American Express	1	0	8	9
Ameriprise	1	0	7	8
Ameritrade	1	6	8	15
Bank of America	1	0	6	7
Cablevision	3	0	7	10
CellularOne	1	3	9	13
Charles Schwab	2	0	11	13
Charter Commun.	1	1	9	11
Chase	2	0	6	8
Citigroup	2	0	2	4
Comcast	1	0	10	11
Cox	1	0	1	2
E-Trade	1	0	1	2
GE/GE Money Bank <sup>a</sup>	1	0	8	9
Qwest	1	1	7	9
Sprint	1	3	3	7
Time Warner	1	0	10	11
U.S. Cellular	1	0	5	6
Verizon	1	0	3	4
Total	26	14	150	190

<sup>a</sup>GE Money Bank describes itself as “the consumer and small business financial services unit of General Electric.”<sup>36</sup> Sources. Authors’ collection of consumer contracts: EDGAR database Form 8-K and Form 10-K filings, Jan. 1, 2006 to Aug. 13, 2007.

We coded both consumer agreements and negotiated contracts for the presence of mandatory arbitration clauses,<sup>37</sup> class action waivers, jury trial waivers, choice of law provisions, forum selection clauses, and provisions for payment of costs, including attorney’s fees. If the contract required arbitration, we coded for waivers of class arbitration, rules governing arbitration, arbitration venue selection, and provisions on fees. We also noted and coded for a

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<sup>36</sup>[http://www.gemoney.com/about\\_us/index.html](http://www.gemoney.com/about_us/index.html), accessed Dec. 14, 2007.

<sup>37</sup>Some clauses provided for arbitration at the election of either party. Because the company can elect arbitration, we count these as mandatory.

fairly common non-severability provision stating that in the event that a class action waiver is found to be unenforceable, the entire agreement to arbitrate is nullified.

#### **IV. Empirical Results**

We report results for (1) arbitration clauses and the associated topic of class action waiver, (2) jury trial waiver clauses, and (3) attorney fee clauses.

##### **A. Arbitration Clauses, Class Action Waivers**

Table 2 reports, by major contract type, the rate of arbitration clauses. Over 75 percent of the consumer agreements we examined included mandatory arbitration clauses and 90 percent of the employment agreements included such clauses.<sup>38</sup> These rates are strikingly different from the rates in nonconsumer material contracts, those in the EDGAR database other than employment contracts. These material contracts included arbitration clauses only at about a six percent rate. The difference between the nonconsumer contract rate and the rate for consumer and employment contracts is highly statistically significant ( $p < 0.001$ ). Even including employment contracts, less than 10 percent of the negotiated contracts we examined contained arbitration clauses.<sup>39</sup> Although we cannot reconstruct the circumstances surrounding particular agreements, it seems probable that companies had more control over the terms of employment-related agreements than they had over other contracts included in the sample.

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<sup>38</sup>Three Executive Agreements relating to executive departures in the case of corporate takeovers provided for arbitration at the executive's option. We do not count those as contracts containing mandatory arbitration clauses.

<sup>39</sup>This is consistent with findings reported by Eisenberg and Miller. See Eisenberg & Miller, *supra* note 19.

At the individual firm level, only eight of 21 firms had any nonconsumer, nonemployment contract that provided for arbitration. None of these eight firms provided for arbitration in more than one material contract. In sum, the data establish that the large companies studied overwhelmingly selected arbitration as the ex ante method for resolving consumer disputes and litigation as the ex ante method for resolving business disputes.

**Table 2. Rate of Arbitration Clauses by Contract Type**

Contract type	Arbitration clause		
	No	Yes	Total
Consumer (N)	6	20	26
Percent	23.1	76.9	100.0
Employment (N)	1	13	14
Percent	7.1	92.9	100.0
Material contract (N)	138	9	147
Percent	93.9	6.1	100.0
Total (N)	145	42	187
Percent	76.3	23.7	100.0

Sources. Authors' collection of consumer contracts: EDGAR database Form 8-K and Form 10-K, Jan. 1, 2006 to Aug. 13, 2007.

As noted above, many of the consumer agreements we examined provided that if the class action waiver accompanying the arbitration clause were not honored, the arbitration clause would be ineffective. The pattern of these anti-arbitration clauses is also striking, as reported in Tables 3 through 5. Table 3 shows that every consumer contract with an arbitration clause included a waiver of class action arbitration. In contrast, only two of 20 nonconsumer contracts with arbitration clauses waived class arbitration. Table 4 shows that, in 60 percent of the consumer contracts that contained mandatory arbitration clauses, companies' standard form contracts deemed those clauses void if the arbitration process allows for class action activity. In none of the nonconsumer contracts that provide for arbitration did companies void arbitration

clauses in the event of class action activity. Since class actions exist in nonconsumer contexts,<sup>40</sup> one might expect disaffection with class action activity also to emerge in nonconsumer contexts. That such disaffection is not present isolates the relevant reasons for arbitration clauses. Table 5 shows that, independent of arbitration clauses, 80 percent of consumer contracts waived class action litigation rights. Only about 29 percent of nonconsumer contracts waived such rights. The differences in all three tables between consumer and nonconsumer contract are statistically significant at  $p < 0.001$ .

**Table 3. Pattern of Class Arbitration Waiver in Contracts with Arbitration Clauses**

Contract type	Class Arbitration Waiver		
	No	Yes	Total
Consumer (N)	0	20	20
Percent	40.0	60.0	100.0
Employment (N)	13	0	13
Percent	100.0	0.0	100.0
Material contract (N)	5	2	7
Percent	100.0	0.0	100.0
Total (N)	20	20	40
Percent	50.0	50.0	100.0

**Table 4. Pattern of Void Arbitration Clauses in the Event of Class Action Arbitration**

Contract type	Arbitration Clause Void if Class Arbitration Permitted		
	No	Yes	Total
Consumer (N)	8	12	20
Percent	40.0	60.0	100.0
Employment (N)	13	0	13
Percent	100.0	0.0	100.0
Material contract (N)	7	0	7
Percent	100.0	0.0	100.0
Total (N)	28	12	40
Percent	70.0	30.0	100.0

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<sup>40</sup>E.g., *In re Columbia Gas System Inc.*, 50 F.3d 233 (3d Cir. 1995) (describing settlement of class action by corporate purchasers against natural gas provider).

**Table 5. Pattern of Class Action Waiver in Contracts with Arbitration Clauses**

Contract type	Class Action Waiver		
	No	Yes	Total
Consumer (N)	4	16	20
Percent	20.0	80.0	100.0
Employment (N)	13	0	13
Percent	100.0	0.0	100.0
Material contract (N)	5	2	7
Percent	71.4	28.6	100.0
Total (N)	22	18	40
Percent	55.0	45.0	100.0

Sources for Tables 3, 4, and 5. Authors' collection of consumer contracts: EDGAR database Form 8-K and Form 10-K filings, Jan. 1, 2006 to Aug. 13, 2007.

The pattern of clauses is revealing. Arbitration clauses in consumer contracts are strongly associated with efforts to preclude aggregate consumer activity against corporations. Indeed, the clauses appear to exist predominantly for this purpose. The provisions also reflect a preference on the part of companies for judicial application of standards for class certification and for the opportunity to appeal judgments rendered in favor of a plaintiff class.<sup>41</sup>

We attribute the frequency of arbitration clauses in our sample to the nature of the agreements: in each case, the company and the customer entered into a relationship in which disputes might arise over small sums of money such as monthly service charges or interest. For reasons we propose in the Part V, this is precisely the setting in which arbitration clauses are most useful to companies.

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<sup>41</sup>See *Long John Silver's Restaurants, Inc. v. Cole*, 409 F. Supp. 2d 682 (2006) (applying a deferential standard of review to an arbitrator's lenient class certification); Alan S. Kaplinsky, *The Use of Pre-Dispute Arbitration Agreements by Consumer Financial Services Providers* 12 (2007) (unpublished outline on file with the authors) (advising company lawyers to avoid class arbitration); Mark J. Levin, *Drafting a "Bulletproof" Arbitration Agreement and Related Practice Issues* 6 (unpublished outline on file with the authors) (suggesting that consumer agreement should include a non-severability provision).

## **B. Jury Trial Waiver**

As noted above, jury trial waivers are closely related to mandatory arbitration clauses. Table 6 shows that our large-corporation sample did not systematically flee juries in its material contracts but could be viewed as doing so in consumer and employment contracts. The table's first two columns limit the sample to contracts not containing mandatory arbitration clauses to isolate jury trial clauses in contracts in which jury trial clauses are unaffected by arbitration clauses. Column (1) and (2)'s "Material contract" rows show that only about 25 percent of 138 material contracts contained express jury trial waivers. This is consistent with prior work on jury trials, which shows low rates of jury trial waiver, about 20 percent, for large corporations.<sup>42</sup> Columns (3) and (4) account for the fact that arbitration clauses implicitly waive jury trials. They show that consumer and employment contracts effectively avoid juries largely through the use of arbitration clauses. When arbitration clauses were not in consumer and employment contracts, jury trial was not waived. But even treating arbitration clauses as jury trial waivers, columns (3) and (4) show that large corporations do not systematically opt out of jury trials. Treating arbitration clauses as jury trial waivers results in only about 30 percent of material contracts precluding jury trials.<sup>43</sup>

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<sup>42</sup>Eisenbeg & Miller, *supra* note 27.

<sup>43</sup>Since arbitration clauses opt out of all litigation, arbitration clauses may reflect a dislike of judges as well as juries as decisionmakers. Eisenberg & Miller, *supra* note 27, at 552-53.

**Table 6. Summary of Jury Trial Waiver Clauses by Contract Type**

Contract type	Sample limited to contracts without arbitration clauses		Arbitration clauses treated as jury trial waivers	
	(1)	(2)	(3)	(4)
	No jury trial waiver	Jury trial waiver	No jury trial waiver	Jury trial waiver
Consumer (N)	6	0	6	20
Percent	100.0	0	23.1	76.9
Employment (N)	1	0	1	13
Percent	100.0	0	7.1	92.9
Material contract (N)	103	35	103	44
Percent	74.6	25.4	70.1	29.9
Total (N)	110	35	110	77
Percent	75.9	24.1	58.8	41.2

Sources. Authors' collection of consumer contracts: EDGAR database Form 8-K and Form 10-K filings, Jan. 1, 2006 to Aug. 13, 2007. Columns (3) and (4) treat arbitration clauses as jury trial waivers.

### C. Attorney Fee Clauses

As noted above, some proposals call for departures from the American rule of each party paying its own fees. Sophisticated litigants who believe a loser pays rule is superior presumably will bargain for such a rule. Yet we find little enthusiasm for a loser pays rule in either consumer or other contracts. Indeed, we find that few contracts even address the topic of attorney fees, much less provide for a loser pays system.

Table 7 shows that attorney fees were mentioned in only 11 percent of contracts. They were most prominent in employment contracts and least prominent in non-employment material contracts. Only a total of nine contracts (five employment, four material) provided for a loser pays system. These constitute less than five percent of the contracts in the database. Large corporations thus appear to be sufficiently content with the American rule covering attorney fees to not bother to regularly contract around the rule. This result is subject to the limitation that our sample of firms was limited to those with consumer contracts.

**Table 7. Rate at Which Contracts Mention Attorney Fees**

Contract type	Contract Mentions Fees		
	No	Yes	Total
Consumer (N)	21	5	26
Percent	80.8	19.2	100.0
Employment (N)	9	5	14
Percent	64.3	35.7	100.0
Material contract (N)	139	11	150
Percent	92.7	7.3	100.0
Total (N)	169	21	190
Percent	88.9	11.1	100.0

Sources. Authors' collection of consumer contracts: EDGAR database Form 8-K and Form 10-K filings, Jan. 1, 2006 to Aug. 13, 2007.

## **V. Discussion**

This Part discusses the implications of our results with respect to four issues: (1) the use of arbitration clauses to preclude class actions, (2) the nascent softening of arbitration clause terms to insulate the arbitration clause-class action strategy from attack, (3) the sincerity of industry fairness arguments in defending arbitration clauses, and (4) the relation between our findings and prior empirical consumer arbitration findings.

### **A. Arbitration As A Tool to Limit Class Actions**

The companies we studied consistently chose arbitration as the method for resolving disputes with consumers, but seldom opted for arbitration in material contracts negotiated with other parties. While it is possible that companies encountered difficulties in persuading their counterparts to agree to arbitrate business disputes,<sup>44</sup> the absence of arbitration provisions in negotiated contracts suggests that litigation, with jury trials, and a rights of appeal, is the companies' preferred method of resolving business disputes.

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<sup>44</sup>See Eisenberg & Miller, *supra* note 19 (suggesting possibility that parties could not agree to arbitrate).

This raises the question of why companies choose arbitration for consumer disputes. From the perspective of rational corporate self-interest, the reasons why companies might insert arbitration clauses in standard-form consumer contracts are fairly easy to reconstruct. The evidence from the pattern of contract clauses relating to arbitration and class actions indicates, as others have suggested, that companies' primary motive for requiring arbitration is to avoid class actions by consumers.<sup>45</sup>

Companies may wish to suppress consumer class actions for several reasons. The explanation most favorable to companies is that class actions, with their potential for large judgments in favor of consumers, put significant pressure on risk-averse corporations to settle claims even when the claims are weak.<sup>46</sup> More cynically, companies may hope that if class actions are not available, consumers will not find it worthwhile to assert even meritorious claims on an individual basis.<sup>47</sup> Disputes arising under the types of consumer agreements we examined are likely to involve small losses to each consumer, making individual legal action impractical. Whatever slant one puts on corporate motivation, the consistent opposition consumer products companies have voiced to expansive interpretation of class action rules leaves little doubt that minimizing exposure to class actions is a substantial influence on their contractual patterns.

If companies are primarily interested in avoiding class actions by consumers, the question arises as to why they do not simply prohibit class actions, without also requiring

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<sup>45</sup>See, e.g., Gilles, *supra* note 1, at 391-412; Sternlight & Jensen, *supra* note 1.

<sup>46</sup>See Richard A. Nagareda, *Aggregation and Its Discontents: Class Settlement Pressure, Class-Wide Arbitration, and CAFA*, 106 *Colum. L. Rev.* 1872, 1879-95 (2006) (discussing legitimate and illegitimate settlement pressures).

<sup>47</sup>See Samuel Issacharoff & Erin F. Delaney, *Credit Card Accountability*, 73 *U. Chi. L. Rev.* 157, 170-77 (2006) (noting that consumers cannot afford to arbitrate small claims on an individual basis); Sternlight & Jensen, *supra* note 1, at 86-87 (same).

arbitration of individual claims? In fact, we found no stand-alone class action waivers. In all cases, class action waivers were embedded in mandatory arbitration clauses.

One likely answer is that using arbitration as a tool to preclude class actions provides a layer of doctrinal insulation not available through clauses directly waiving class actions without relying on mandatory arbitration clauses. By using arbitration clauses to effectively preclude class actions, corporations impose a substantial legal hurdle that must be overcome before courts can even address the substantive merits of precluding class actions. A straight class action waiver clause can be directly tested for its validity. Limiting class actions through arbitration first requires an attack on arbitration itself. That attack must succeed before the anti-class action strategy becomes vulnerable.

Corporations did not randomly choose arbitration as the vehicle through which to implement their attack on class actions. The link between class action waivers and mandatory arbitration can be traced to the Federal Arbitration Act (FAA) and the U.S. Supreme Court's interpretations of that act.<sup>48</sup> The FAA validates pre-dispute arbitration agreements and requires state courts to enforce arbitration agreements on the same conditions as they enforce other contracts.<sup>49</sup> In a series of decisions toward the end of the twentieth century, the Supreme Court concluded that the FAA established a "federal policy favoring arbitration."<sup>50</sup> In the wake of

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<sup>48</sup>For a lively description of the history of judicial decisions under the FAA and legal strategies developed in response, see Gilles, *supra* note 1, at 393-99 (describing, among other things, a class action against credit card issuers alleging that banks and their lawyers had conspired to suppress class actions).

<sup>49</sup>U.S.C. §§ 1-14 (2000). At the same time, the FAA preserves the power of state courts to set aside particular arbitration contracts based on generally applicable state law. *Id.* § 2.

<sup>50</sup>*Moses H. Cone Memorial Hosp. v. Mercury Construction Corp.*, 460 U.S. 1, 24 (1983); see *Mitsubishi Motors v. Soler Chrysler-Plymouth Corp.*, 490 U.S. 614, 626 (1985); *Greentree Financial Corp. v. Bazzle*, 529 U.S. 444, 452 (2003); Gilles, *supra* note 1, at 393-95; Judith Resnik, *Procedure as Contract*, 80 *Notre Dame L. Rev.* 593, 619-20 (2005).

these decisions, and coincident with an increase in corporate anxiety over the prospect of large consumer class actions,<sup>51</sup> companies in consumer industries began to incorporate arbitration clauses, together with class action waivers, in consumer agreements.<sup>52</sup>

## **B. Softening Arbitration Terms to Preserve the Anti-Class Action Strategy**

Federal and state courts typically have enforced arbitration clauses in standard-form consumer agreements unless they contain specific provisions found to violate state contract law. Recently, however, some state courts, including California's, have found class action waivers in consumer arbitration agreements to be unconscionable and therefore contrary to generally applicable state law, at least when the consumers' claims were too small to support individual actions.<sup>53</sup> Company lawyers responded to these adverse decisions by softening other terms pertaining to arbitration, while retaining the class action waiver. For example, companies may subsidize the costs of arbitration, use larger print for arbitration clauses, or may permit customers to opt out of arbitration (within a short time after purchasing the product).<sup>54</sup> The apparent purpose of these kinder and gentler arbitration clauses is to avoid the appearance of one-

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<sup>51</sup>See Gilles, *supra* note 1, at 382-85 (describing wave of class action certifications in the 1980s and 1990s).

<sup>52</sup>See *id.* at 395-98.

<sup>53</sup>E.g., *Discover Bank v. Superior Court*, 113 P.3d 1100 (Cal. 2005); *Muhammad v. County Bank of Rehobeth Beach*, 912 A.2d 88 (N.J. 2006); *Scott v. Cingular Wireless*, No. 77406-4 (Wash. 2007). Several courts have reached the opposite conclusion. See the more comprehensive summary of authority cited in note 4 *supra*.

<sup>54</sup>E.g., *Scott v. Cingular Wireless*, 161 P.3d at 1007 ("Cingular contends that it has cured any concerns about access to a remedy by promising to pay all AAA filing, administrative, and arbitrator fees unless the arbitrator finds the claim frivolous, and by promising to pay the attorneys fees under certain circumstances.").

sidedness, and thus to protect both the basic choice of arbitration over litigation and the connected waiver of class proceedings from challenges based on unconscionability.<sup>55</sup>

This sequence of judicial decisions and contractual responses further suggests that company lawyers have turned to arbitration as a source of protective cover for class action waivers. The prevalence of non-severability clauses in arbitration agreements reinforces this inference. If a class action waiver contained in an arbitration clause is found to be unconscionable, companies prefer to litigate, probably because litigation preserves their right to appeal both the initial certification and a final judgment in favor of consumers and because defendants or defense lawyers have substantial experience in litigating class actions.

Moreover, apart from the role of arbitration clauses in shoring up the validity of class action waivers, it is not clear why consumer arbitration would appeal to companies. Particularly when the company has agreed to subsidize a portion of the consumers's costs, fair arbitration provides little clear advantage for companies. Arbitration may be cheaper, but a cheaper forum invites more claims. Compensatory claims arising under the types of consumer agreements we studied are inherently limited, therefore civil juries are unlikely to assess large damage awards. Companies may worry about punitive damages in court, but arbitrators are capable of awarding

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<sup>55</sup>See Levin, *supra* note 41, at 3, 7-8 (“Ironically, the best way to ensure that [an] arbitration clause will be enforced is to give the consumer or employee the right to reject it”).

One recent case, *Berensen v. National Financial Services, LLC*, 485 F.3d 35 (1st Cir. 2007), might be taken as evidence that companies prefer to arbitrate, rather than litigate, consumer claims, even when class action is not an issue. In *Berenson*, brokerage customers sued Fidelity for failure to pay interest on funds debited from their account for electronic bill payments but held for several days before bills were paid. After the district court refused to certify the plaintiffs as a class but also refused to grant summary judgment on some of the plaintiffs' individual claims, Fidelity went on to argue strenuously (but unsuccessfully) for arbitration of the remaining individual claims. However, Fidelity knew that this point that the district court viewed the interest claims as potentially viable; therefore its continued stance in favor of arbitration does necessarily support a general preference for arbitration as a method of dispute resolution.

punitive damages, and contractual provisions barring punitive damages in arbitration increase the chance that the arbitration clause will be stricken as unconscionable.<sup>56</sup>

Companies might also worry about the res judicata effects of judicial decisions in favor of consumers. Yet, the Restatement of Judgments accords the same effect to adverse outcomes in arbitration as it does to adverse outcomes in court.<sup>57</sup> In any case collateral estoppel may not be available if courts (or arbitrators) have reached varied conclusions in prior cases.<sup>58</sup>

Finally, it is possible that companies, as repeat players in arbitration and the source of much business for arbitrators and the organizations to which they belong, anticipate favoritism from arbitrators. Yet studies do not show that biased outcomes have emerged. Thus, from the perspective of corporate self-interest, concern over class actions remains the most likely explanation for the prevalence of arbitration clauses in consumer agreements.

### **C. Exposing Disingenuous Fairness Arguments**

Whatever the companies' private motives may be in requiring arbitration of consumer disputes, our data cast considerable doubt on the public justifications companies have offered for judicial enforcement of standard-form arbitration clauses. The argument companies have most often relied on in defense of mandatory arbitration clauses is that, from the point of view of all parties, arbitration is the most effective procedure for just resolution of disputes. Yet, if companies in fact believed that arbitration is not only cheaper and faster than litigation but also

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<sup>56</sup>Levin, *supra* note 41, at 8 (“A company might be tempted to put in the clause that the arbitrator cannot award punitive or exemplary damages. But that is asking for trouble...”)

<sup>57</sup>E.g., *E.W. Audet & Sons, Inc. v. Fireman’s Fund Ins. Co.*, 635 A.2d 1181, 1186-87 (R.I. 1994) (parties to arbitration proceeding bound by res judicata), citing 1 Restatement (Second) of Judgments § 34(1).

<sup>58</sup>See, e.g., *Hardy v. Johns-Manville Sales Corp.*, 681 F.2d 334, 346-47 (5th Cir. 1982) (refusing to recognize collateral estoppel).

equally consistent and fair, they presumably would negotiate for arbitration with business partners as well as customers. According to our data, they do not, as at least one court has noted.<sup>59</sup>

Of course, business disputes are distinguishable from consumer disputes in a number of ways. Class actions are unlikely in connection with business contracts. Both parties may have reputational interests in avoiding legal action. When claims are brought, larger sums may be at stake and factfinders may be called on to resolve complicated issues of interpretation and performance. For the most part, however, these distinctions are pertinent to the companies' interests rather than the overall desirability of arbitration as a means of resolving contractual disputes.

Our data indicate that companies do not view consumer arbitration as offering a superior combination of cost savings, expeditious decision-making, consistency, and justice. Rather, they view consumer arbitration as a way to save money, perhaps by discouraging legitimate suits. If this is correct, the range of possible principled justifications for mandatory arbitration clauses in standard form consumer agreements is reduced to just one: by saving money for companies, arbitration allows companies to lower the prices they charge for consumer goods and services. Consumers who are harmed by unlawful company practices lose the opportunity to litigate, so that all consumers can benefit from a decrease in the cost of consumer products.

Our data do not rule out this possibility: the effect of arbitration clauses on the price of consumer products depends on market conditions that are outside the scope of our study. Yet, if

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<sup>59</sup>*Sutton Steel & Supply, Inc. v. BellSouth Mobility, Inc.*, No. 2007-146, 2007 WL 4326705, at \*9 (La. App. 3rd Cir. 12/12/07) (arbitration clause contained in defendants' standard form consumer contract was not subject to negotiation with individual consumers but defendant was willing "to dispense with arbitration provisions in its dealings with non-consumers").

we are correct that lowering consumer prices is the only credible public defense for arbitration, then to the extent the legal system tolerates mandatory consumer arbitration, it is tolerating a certain level of lawlessness in consumer industries in exchange for cheaper goods.

#### **D. Reconciling Consumer Arbitration Clause Studies' Findings**

The 76.9 percent rate of arbitration clauses in our sample of consumer contracts contrasts with the 35.4 rate reported by Demaine and Hensler, a difference that is highly statistically significant ( $p < 0.001$ ).<sup>60</sup> The explanation for the difference appears to be the industries studied. Our study is limited to a fairly narrow range of industries. As described above, only six major industry groups appear in our sample. Demaine and Hensler reported on a wider range of consumer contracts. But isolating some of their contract categories yields an interesting pattern of results. Demaine and Hensler report on five categories of insurance contracts (homeowners', renters', auto, health, and life insurance). Seventeen of 21 insurance contracts (80.9 percent) in their sample provided for arbitration, with life insurance not containing arbitration clauses in the three life insurance contracts in their sample. Outside the insurance industry, real estate contracts (two of two contracts), online retail contracts (three of five contracts), gas credit card contracts (four of five contracts), tour operator contracts (three of five contracts), contracts with attorneys (two of three contracts), and financial contracts (18 of 26 contracts) included arbitration clauses in more than half the contracts studied. A small minority of contracts in 21 other consumer contract categories had arbitration clauses. In those 21 categories, only eight of 97 contracts (8.2 percent) had arbitration clauses.

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<sup>60</sup> The rate of arbitration clauses in Demaine & Hensler is 35.4% (57 of 161 contracts). Demaine & Hensler, *supra* note 14, at 64.

There thus appear to be two classes of consumer contract categories, those with a substantial portion containing arbitration clauses and those with a small minority containing arbitration clauses. Some of the pattern may be explained by industrial concentration and corresponding corporate ability to behave in a monopolistic manner. Our high rate of arbitration clauses appears in financial services and telecommunications contracts. Demaine and Hensler similarly report a 69.2 percent rate of arbitration clauses in financial contracts.<sup>61</sup> Five credit card issuers dominate their industry,<sup>62</sup> three of whom, JP Morgan Chase, Citigroup, and Bank of America, appear in our consumer contracts data. Similarly, the telecommunications industry has a high level of industrial concentration.<sup>63</sup> For the typical consumer today, a mobile phone contract is realistically available from only a handful of companies, including AT&T, Alltel, Qwest, Sprint Nextel, and Verizon, all of which appear in our consumer contracts data.

But the variance Demaine and Hensler establish in the cross-industry use of arbitration clauses and the concentrated nature of industries with high rates of arbitration clauses suggests at least part of the explanation for the pattern of use of consumer contract arbitration clauses. Marotta-Wurgler reports an association between industrial concentration in the software industry, as measured by market share, and pro-seller contract conflict resolution terms, including arbitration clauses.<sup>64</sup>

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<sup>61</sup>Demaine & Hensler, *supra* note 14, at 64. Only the “Accountant/Tax Consultant” subcategory showing less than half the contracts with arbitration clauses. *Id.*

<sup>62</sup>Douglas Akers, Jay Golter, Brian Lamm & Martha Solt, Overview of Recent Developments in the Credit Card Industry, *FDIC Banking Rev.* (tbl. 2), last updated Nov. 17, 2005, available at <http://www.fdic.gov/bank/analytical/banking/2005nov/article2.html>

<sup>63</sup>E.g., William D. Ram, *Watching Over the Web: A Substantive Equality Regime for Broadband Applications*, 24 *Yale J. Reg.* 1, 13 (2007) (noting high concentration of telecommunications and cable companies).

<sup>64</sup>Florencia Marotta-Wurgler, *Competition and the Quality of Standard Form Contracts: The Case of Software License Agreements*, *J. Empirical Legal Stud.* (forthcoming).

A further likely contributing factor would be the substantial economic threat posed to such companies due to their millions of customers. Intentional or intentional acts that deprive millions of customers of small amounts threaten financial and telecommunications firms only if customers can aggregate their claims.

Industries for which Demaine and Hensler find low arbitration clause rates, including apartment rentals, grocery stores, cultural/sports events, and restaurants lack firms with millions of so similarly situated customers affected by central company policy, and also lack the extreme industrial concentration present in the credit card and telecommunications industries. The pattern is not perfect but, we believe, suggests an explanation for the pattern of consumer contract mandatory arbitration clauses.

## **VI. Conclusion**

Corporations regularly defend their use of mandatory consumer arbitration clauses by asserting their belief in arbitration's asserted superior fairness and efficiency over traditional litigation. This article does not purport to address whether arbitration is fairer or more efficient than litigation. It does, however, address corporate, attorney, and interest group claims that firms mandate consumer arbitration because firms believe arbitration is in the interest of their customers. Corporations' selective use of arbitration clauses against consumers, but not against each other, suggests that corporate use of mandatory arbitration clauses is based more on the strategic advantage it provides in avoiding aggregate litigation than on an actual belief that corporations are serving their customers. That consumer contracts consistently eschew

aggregate arbitration and that they do not regularly waive jury trials further suggest that mandatory arbitration in consumer contracts targets aggregate litigation and little else.

Properly understood, the growth of mandatory consumer arbitration clauses is part of a broader initiative by large corporate defendants to preclude or limit aggregate litigation. Industry-supported statutory initiatives, the Private Securities Litigation Reform Act (“PSLRA”)<sup>65</sup> and the Class Action Fairness Act of 2005 (“CAFA”),<sup>66</sup> limited or modified class action practice. But these statutory initiatives merely raised the bar for successfully aggregating small claims. Notwithstanding the enactment of PSLRA and CAFA, many class actions proceed in both state and federal court notwithstanding these statutes.<sup>67</sup> In comparison to these statutes, mandatory consumer arbitration clauses are more draconian attacks on aggregate consumer litigation. The clauses do not merely elevate pleading standards, reform attorney fees, or promote use of a federal over a state forum, as do the PSLRA and CAFA. Arbitration clauses seek to completely preclude aggregation of small plaintiff claims into economically viable actions. Policy debate about and judicial assessment of consumer arbitration clauses should proceed on the basis of the dominant reason for consumer arbitration clauses and not on

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<sup>65</sup>Pub. L. No. 104–67, 109 Stat. 737 (1995).

<sup>66</sup>Pub. L. No. 109–2, 119 Stat. 4 (codified in scattered sections of 28 U.S.C.). See generally Georgene M. Vairo, *Class Action Fairness Act of 2005* (2005); 7A Charles Alan Wright, Arthur R. Miller & Mary Kay Kane, *Federal Practice and Procedure* § 1756.2 (3d ed. 2005).

<sup>67</sup>E.g., Kevin M. Clermont & Theodore Eisenberg, *CAFA Judicata: A Tale of Waste and Politics*, *U. Pa. L. Rev.* (forthcoming) (reporting on CAFA cases in federal court); Marilyn F. Johnson, Karen K. Nelson & A.C. Pritchard, *Do the Merits Matter More? The Impact of the Private Securities Litigation Reform Act*, 23 *J. Law, Econ. & Org.* 627, 628 (2007) (stating that securities fraud class actions returned to and exceeded pre-PSLRA levels). For evidence of the effect of the PSLRA, see, e.g., Stephen J. Choi, *Do the Merits Matter Less After the Private Securities Litigation Reform Act?*, 23 *J. Law, Econ. & Org.* 598 (2007), and for evidence of the effect of CAFA, see Thomas E. Willging & Emery G. Lee III, *The Impact of the Class Action Fairness Act of 2005 on the Federal Courts: Third Interim Report to the Judicial Conference Advisory Committee on Civil Rules* (Federal Judicial Center Apr. 2007).

questionably sincere expressions of belief in fairness or on ex post justifications offered at the time of litigation.