

Searle Civil Justice Institute

Statement of Christopher R. Drahozal
Chair, Consumer Arbitration Task Force
Searle Civil Justice Institute
John M. Rounds Professor of Law
University of Kansas School of Law

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I appreciate the opportunity to testify on “Consumer Arbitration Before the American Arbitration Association,” a report recently issued by the Consumer Arbitration Task Force of the Searle Civil Justice Institute (SCJI), Northwestern University School of Law. I am the John M. Rounds Professor of Law at the University of Kansas School of Law, and the Chair of the Task Force. I also am an Associate Reporter for the Restatement (Third) of the U.S. Law on International Commercial Arbitration, and have written extensively on the law and economics of arbitration.

Issues and Background

Empirical evidence has become a central focus of the policy debate over consumer and employment arbitration. Both supporters and opponents of the proposed Arbitration Fairness Act, which would make pre-dispute arbitration clauses unenforceable in consumer and employment (and franchise) agreements, have recognized that empirical evidence on the fairness and integrity of consumer and employment arbitration proceedings is essential to making an informed decision on the bill. Yet the empirical record, particularly on consumer arbitration, has critical gaps.

One set of issues on which further empirical research would be helpful is the costs, speed, and outcomes of consumer arbitrations. How much do consumers pay to bring claims in arbitration? How long do consumer arbitrations take to resolve? How do consumers fare in arbitration, particularly against businesses that are repeat users of arbitrators and arbitration providers? While a number of important studies on employment arbitration have been provided, the empirical record on these issues in consumer arbitrations is sparse.

A second set of issues of interest involves the enforcement of arbitration due process protocols -- privately created standards setting out minimum requirements of procedural fairness for consumer and employment arbitrations. Due process protocols commonly require independent and impartial arbitrators, reasonable costs, convenient hearing locations, and remedies comparable to those available in court. Leading arbitration providers have pledged not to administer arbitrations arising out of arbitration clauses that violate the protocols. But empirical evidence on the effectiveness of these private enforcement efforts is lacking.

Searle Civil Justice Institute Task Force on Consumer Arbitration

To shed light on these issues, the Searle Civil Justice Institute (SCJI) undertook a large-scale study of consumer arbitrations administered by the American Arbitration Association (AAA). Founded in early 2008 as a division of the Searle Center on Law, Regulation, and Economic Growth, the SCJI aims to become the preeminent national source of large scale, empirical studies on public policy issues related to our nation's civil justice system. An operating premise of the SCJI is that hard data is a powerful and necessary tool in public policy debates. Funding for this project came exclusively from the initial grant establishing the Searle Center from the late Daniel C. Searle, longtime philanthropist and Northwestern University trustee.

The AAA is a leading provider of arbitration services, including arbitrations between consumers and businesses. SCJI commissioned a Task Force to advise and lead this study of consumer arbitrations. Although the study will ultimately examine many aspects of AAA consumer arbitrations, the initial research inquiries were directed at two topics:

1. *Costs, Speed, and Outcomes of AAA Consumer Arbitrations.* This aspect of the Preliminary Report assesses key characteristics of the AAA consumer arbitration process, in particular questions concerning the costs, speed, and outcomes of AAA consumer arbitrations.
2. *AAA Enforcement of the Consumer Due Process Protocol.* This aspect of the Preliminary Report provides an empirical analysis of how effectively the AAA enforces compliance with the Consumer Due Process Protocol.

Data and Methodology

SCJI reviewed a sample of AAA case files involving consumer arbitrations. The primary dataset consists of 301 AAA consumer arbitrations that were closed by an award between April and December of 2007. (The focus on cases closed by an award during this particular timeframe is based on the availability of the original case files.) This sample of cases was then coded for approximately 200 variables describing various aspects of the arbitration process, including a review of the arbitration clause in the file. In addition, when possible a broader AAA dataset comprising all consumer cases closed between 2005 and 2007 was utilized. The AAA maintains this dataset in the ordinary course of its business, collecting data for internal purposes but not recording all variables of interest to SCJI. The data were analyzed using standard statistical methods in order to describe and evaluate consumer arbitrations as administered by the AAA. The report was subject to review by independent academic experts on arbitration and empirical studies of arbitration prior to release. It also was subject to review by the SCJI Board of Overseers, which consists of general counsel, plaintiffs' lawyers, defense lawyers, academics, and state and federal judges.

Key Findings – Costs, Speed, and Outcomes of AAA Consumer Arbitrations

The upfront cost of arbitration for consumer claimants in cases administered by the AAA appears to be quite low.

In cases with claims seeking less than \$10,000, consumer claimants paid an average of \$96 (\$1 administrative fees + \$95 arbitrator fees). This amount increases to \$219 (\$15 administrative fees + \$204 arbitrator fees) for claims between \$10,000 and \$75,000. These amounts fall below levels specified in the AAA fee schedule for low-cost arbitrations, and are a result of arbitrators reallocating consumer costs to businesses.

AAA consumer arbitration seems to be an expeditious way to resolve disputes.

The average time from filing to final award for the consumer arbitrations studied was 6.9 months. Cases with business claimants were resolved on average in 6.6 months and cases with consumer claimants were resolved on average in 7.0 months.

Consumers won some relief in 53.3% of the cases they filed and recovered an average of \$19,255; business claimants won some relief in 83.6% of their cases and recovered an average of \$20,648.

The average award to a successful consumer claimant in the sample was 52.1% of the amount claimed and to a successful business claimant was 93.0% of the amount claimed. This result appears to be driven by differences in types of claims initiated by consumers and business. Business claims are almost exclusively for payment of goods and services while consumer claims are seeking recovery for non-delivery, breach of warranty, and consumer protection violations.

No statistically significant repeat-player effect was identified using a traditional definition of repeat-player business.

Consumer claimants won some relief in 51.8% of cases against repeat businesses under a traditional definition (i.e., businesses who appear more than once in the AAA dataset) and 55.3% against non-repeat businesses – a difference that is not statistically significant.

Utilizing an alternative definition of repeat player, some evidence of a repeat-player effect was identified; the data suggests this result may be due to better case screening by repeat players.

Consumer claimants won some relief in 43.4% of cases against repeat businesses and 56.1% against non-repeat businesses under an alternative definition (based on the AAA's categorization of businesses in enforcing the Consumer Due Process Protocol) – a difference that is statistically significant at the 10% level. However, 71.1% of consumer claims against repeat businesses so defined were resolved prior to an award, while only 54.6% of claims against non-repeat businesses were resolved prior to an award. This suggests that such effect is attributable to better case screening by repeat players (i.e., settling stronger consumer claims and arbitrating weaker claims).

Arbitrators awarded attorneys' fees to prevailing consumer claimants in 63.1% of cases in which the consumer sought such an award.

Consumer claimants sought to recover attorneys' fees in over 50% of the cases in which they were awarded damages and were awarded attorneys' fees in 63.1% of those cases. In those cases in which the award of attorneys' fees specified a dollar amount, the average attorneys' fee award was \$14,574.

Key Findings – AAA Enforcement of the Due Process Protocol

A substantial majority of consumer arbitration clauses in the sample (76.6%) fully complied with the Due Process Protocol when the case was filed.

Most arbitration clauses in consumer contracts that come before the AAA are consistent with the Consumer Due Process Protocol as applied by the AAA. The same is true for cases in which protocol compliance was a matter for the arbitrator to enforce.

AAA's review of arbitration clauses for protocol compliance was effective at identifying and responding to clauses with protocol violations.

In 98.2% of cases in the sample subject to AAA protocol compliance review, the arbitration clause either complied with the Due Process Protocol or the non-compliance was properly identified and responded to by the AAA.

The AAA refused to administer a significant number of consumer cases because of Protocol violations by businesses.

In 2007, the AAA refused to administer at least 85 consumer cases, and likely at least 129 consumer cases (9.4% of its consumer case load), because the business failed to comply with the Consumer Due Process Protocol. The most common reason for refusing to administer a case (55 of 129 cases, or 42.6%) was the business's failure to pay its share of the costs of arbitration rather than any problematic provision in the arbitration clause.

As a result of AAA's protocol compliance review, some businesses modify their arbitration clauses to make them consistent with the Consumer Due Process Protocol.

In response to AAA review, more than 150 businesses have either waived problematic provisions on an ongoing basis or revised arbitration clauses to remove provisions that violated the Consumer Due Process Protocol. This is in addition to the more than 1550 businesses identified by the AAA as having arbitration clauses that comply with the Protocol. By comparison, AAA has identified 647 businesses for which it will not administer arbitrations because of Protocol violations.

Policy Implications and Next Steps

The empirical findings in the SCJI Preliminary Report on AAA consumer arbitrations have important implications for those interested in discussing and formulating public policy regarding arbitration.

1. Not all consumer arbitrations, arbitration providers, or arbitration clauses are alike. Differing results from empirical studies of arbitration may reflect variations associated with case mix, type of claimant, or provider review processes. This suggests the need for a nuanced approach to public policy concerning arbitration.
2. Private regulation complements existing public regulation of the fairness of consumer arbitration clauses. Policy makers should not ignore the role that arbitration providers can play in promoting fairness on behalf of consumers.
3. Courts could usefully reinforce the AAA's enforcement of the Consumer Due Process Protocol by declining to enforce an arbitration clause when the AAA has refused to administer an arbitration arising out of the clause or by otherwise reinforcing the role of the Due Process Protocol.

While the empirical results presented in the SCJI Preliminary Report on Consumer Arbitration may usefully inform the policy debate on consumer arbitration, the Report nonetheless has limitations. First, its findings are limited to AAA consumer arbitrations. Empirical results from studying AAA consumer arbitration do not necessarily apply to other arbitration providers. Second, its findings on the costs, speed, and outcomes of AAA consumer arbitrations are difficult to interpret without a baseline for comparison, such as the procedures and practices in traditional court proceedings. A future phase of this research project by the Searle Civil Justice Institute's Task Force on Consumer Arbitration will undertake that comparison. It will seek to compare the procedures in AAA consumer arbitration with procedures available for consumers in court as well as comparing empirically key process characteristics of courts and arbitration.

At bottom, the Report also reinforces the importance of empirical work in the policy debate over consumer and employment arbitration. Sound policymaking should consider statistically valid empirical studies, not just anecdotal reports.