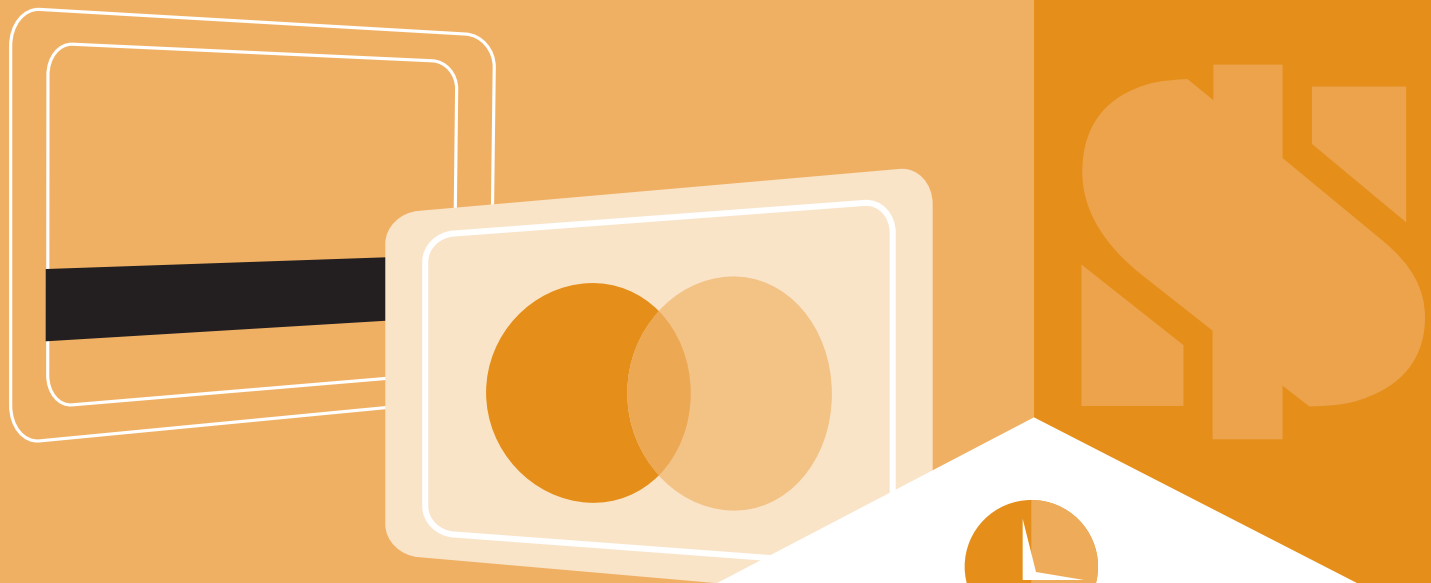


The Current State of Consumer Arbitration



By Sarah Rudolph Cole and Theodore H. Frank

In 2007, the advocacy group Public Citizen issued a scathing report attacking the consumer arbitration process.¹ This report, coinciding with more than a dozen pending antiarbitration bills in Congress,² as well as lawsuits against National Arbitration Forum and credit card companies,³ provided support to many antiarbitration advocates' claims that consumer arbitration is bad for the "little guy," a conclusion repeated with little scrutiny by stories in *Business Week* and on *Good Morning America*. Academics and arbitral organizations responded quickly, providing arguments and statistics that suggest significant difficulties with Public Citizen's analysis of the available empirical evidence.⁴ Although problems with consumer arbitration exist, our review of the available empirical evidence suggests that claims by Public Citizen and others that consumer arbitration is inherently unfair to consumers are overstated.

In writing this article, we reviewed the available empirical evidence about consumer arbitration. We did not consider empirical findings related to employment arbitration because the two processes are different in many ways. More important, perhaps, analysis of employment arbitration data is probably no longer necessary to provide insight about consumer arbitration. California's requirement that various arbitral organizations collect data about their California consumer arbitration cases provides a rich resource from which to draw conclusions about the benefits and drawbacks of consumer arbitration. Public Citizen utilized this rich resource of consumer arbitration data in preparing its report on consumer arbitration. Public Citizen's analysis of the California data, which appeared to reveal many potential concerns about consumer arbitration, is, however, only one of a number of analyses of that data.

Our analysis of the Public Citizen report and evidence collected in California and elsewhere reveals different, and more positive, conclusions about the state of consumer arbitration.

The Public Citizen Report (2007)

Public Citizen articulates two major concerns about arbitration. First, it argues that businesses prevail at a "stunning" rate in arbitration. Second, it claims that the use of a small cadre of arbitrators results in biased decisions against consumers. A closer examination of Public Citizen's findings, however, raises significant concerns with its selective use and interpretation of data.

Public Citizen's study started with a data set of 33,948 consumer arbitration cases filed with the National Arbitration Forum (NAF) between January 1, 2003, and March 31, 2007. All but 15 of these cases were designated "collections" cases. Collections cases are unlike other consumer cases. In a collections case, the consumer is the defendant. Typically, there is no question that the consumer owes the debt to the credit card issuer. In mediation, the consumer admits the debt and then typically works out a payment plan with the issuer. In arbitration,

though, the debtor will lose, because he owes the debt. In such situations, all an arbitrator can do is enter an award against the debtor. Thus, the win-loss record for consumers in these cases is not cause for concern. Moreover, it mirrors consumer success, or, more aptly, lack thereof, in court collection cases.⁵

Another concern the Public Citizen report raised is the use of a small number of arbitrators to decide a large number of cases in a short period of time. Though Public Citizen had a data set of 33,948 cases, it reviewed only the 19,294 of the consumer cases that proceeded far enough to actually have an arbitrator assigned⁶ to hear the case.⁷ According to Public Citizen, NAF used 148 arbitrators to resolve these cases, 28 of whom handled 89.5 percent of cases (17,265 cases). These arbitrators ruled in favor of business almost 95 percent of the time. The remaining 120 arbitrators handled the other 10 percent of the cases in which an arbitrator was assigned, ruling for business 86 percent of the time and for consumers 10 percent of the time,⁸ with the remainder settling. By themselves, these results should not be surprising because collections cases are very easy to resolve in favor of the credit issuer, and because more than 16,000 of the 19,294 cases Public Citizen analyzed involved default judgments. A far larger proportion of consumer civil litigation results in default judgments.⁹

Navigant Analysis (2008)

So what does the available data actually reveal? A July 2008 study that Navigant Consulting performed at the behest of the Institute for Legal Reform analyzed the same data set that Public Citizen considered, but found major discrepancies between the underlying data and Public Citizen's statistical analysis of it.¹⁰ According to Navigant's report, Public Citizen's numbers are quite misleading.

Navigant reported that Public Citizen slanted its numbers by omitting from its analysis more than 8,000 cases that were dismissed without an award before an arbitrator was selected because the creditor decided not to pursue charges for lack of evidence or otherwise. When the dismissed cases are included in the data set where the prevailing party is identified, the analysis reveals that consumers prevailed in initiated arbitration cases 32.1 percent of the time. According to Public Citizen's own



Sarah Rudolph Cole is the Squire, Sanders & Dempsey Designated Professor of Law at Moritz College of Law, Ohio State University. She can be reached at cole.228@osu.edu. Professor Cole would like to thank research assistants Catharine Adkins and Tim Nittle for their assistance in putting this article together. **Theodore H. Frank** is a resident fellow at the American Enterprise Institute for Public Policy Research. He can be reached at tfrank@aei.org.

spreadsheet, consumers prevailed in nearly every case that Public Citizen omitted from its percentages.

Moreover, even in the cases where Public Citizen identifies the business as the prevailing party, the consumer was frequently successful in reducing the amount the business sought. Consumers won reductions in 37.4 percent of the cases that went to hearing, with a median reduction of \$824. More impressive, in 3,632 of the 16,054 cases where there was no hearing because the respondent defaulted, the arbitrator refused to award the entire amount the business requested. The median reduction for consumers was \$599. This may be because “[i]n cases administered under the NAF Code of Procedure, the arbitrator considers all evidence, whether or not there is a response to the claim.” This added layer of protection is unavailable to consumers in civil litigation, where default judgments are entered on sums certain without consideration of the underlying evidence. The average consumer thus comes out ahead in arbitration, compared to court.

The Public Citizen report also criticizes the “loser pays” rule employed in mandatory binding arbitration, and claims that arbitration often results in consumer costs that are higher than those incurred in court. Public Citizen’s own data set contradicts this contention. In 99.3 percent of cases, the consumer paid no fee; in the remaining 246 cases where a consumer paid a fee, the median fee was \$75.

Overall, out of 26,665 cases in the Public Citizen data for which a prevailing party was identified, businesses received all of what they requested in 13,731 of them—meaning consumers had at least partial success in 48.5 percent of the cases in Public Citizen’s data set, a far cry from the 95 percent business success rate portrayed in Public Citizen’s report.

As we went to press, Public Citizen had not responded to the Navigant report. It did, however, respond to ILR’s earlier response to the Public Citizen report.¹¹

Other Consumer Arbitration Studies

Several other independent studies on consumer arbitration reveal additional discrepancies between what the data establish and Public Citizen’s characterization of them.

California Dispute Resolution Institute, Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure (2004)

The California Dispute Resolution Institute (CDRI), a California organization focused on dispute resolution policy, issued a study focused on data from six providers (ADR Services, AAA, Arbitration Works, ARC Consumer Arbitration, JAMS, and Judicate West) spanning January 1, 2003, through December 31, 2003. CDRI collected and analyzed 2,175 cases, though it noted repeatedly in the report that inconsistencies and ambiguities made analysis of the data difficult. CDRI’s report presents a dramatically different picture of consumer arbitration than the one Public Citizen advanced.

The CDRI study revealed a prevailing party for 302

cases. The consumer was listed as the prevailing party for 71 percent (215) of those cases, with business prevailing 29 percent of the time. This consumer success rate is much higher than those reported in either the Navigant or Public Citizen analyses. The CDRI study also analyzed all 2,175 cases in order to calculate the average amount of claim, amount of award, and arbitrator fees. It did not differentiate between cases in which either business or consumer prevailed for the purposes of calculating these averages. Nevertheless, the report’s average and median arbitration fees are relatively small—\$2,256 and \$870, respectively. Although CDRI’s report does not provide great detail, its findings offer further support for the notion that consumers do find success in arbitration and that, regardless of the outcome, do not pay exorbitant fees.

Ernst & Young, Outcomes of Arbitration: An Empirical Study of Consumer Lending Cases (2004)

In 2004, Ernst & Young published a study about consumer arbitration. The results of this report suggest that consumers fare extremely well in consumer-initiated arbitration, prevailing in 55 percent of cases that reach decision. In close to 80 percent of the cases reviewed, consumers obtained “favorable results,” defined as cases where the parties reached a settlement satisfactory to the consumer or cases dismissed at the consumer’s request. In addition, the report contained the results of a telephone survey of 26 of the participants. The telephone survey found that 69 percent of the respondents indicated that they were satisfied or very satisfied with the process. Public Citizen criticized Ernst & Young’s report, primarily because of its small sample size (226 respondents) and the representativeness of the sample studied (limited to consumer-claimants).

The American Arbitration Association (AAA) conducted a similar small study that offers further support of results other than those contained in the Public Citizen report. In this study of 310 AAA consumer cases decided between January and August 2007, AAA found that consumers prevailed in 48 percent of cases in which they were the claimant, whereas businesses prevailed in 74 percent of cases in which they were the claimant.¹²

Fellows’ Analysis of Consumer Arbitration Data

In 2006, Mark Fellows wrote an article in which, among other things, he analyzed the California consumer arbitration data.¹³ Fellows’ analysis of the data revealed that consumers prevailed in 65.5 percent of consumer-initiated arbitration cases that reached decision. By contrast, consumer plaintiffs litigating contract claims in the 75 largest American counties prevailed only 61.5 percent of the time overall and 60.9 percent of the time in bench trials. Businesses prevailed in 77.7 percent of business-initiated arbitration cases that reached decision. In comparison, business plaintiffs litigating contract claims in the 75 largest American counties prevailed 76.8 percent of the time overall, and 78.9 percent of the time in cases by bench trial. Although not directly inconsistent with Public

Citizen's conclusions, this analysis suggests that consumers fare better in arbitration than Public Citizen's report alleges.¹⁴

Fellows further states that case duration in arbitration is shorter than in litigation. Consumer claims against businesses typically last 4.35 months in arbitration and 19.4 months in litigation. For business-initiated claims, the figures are 5.60 and 15 months, respectively. In addition, for claims brought by consumers against businesses, businesses paid an average arbitration fee of \$149.50; for claims initiated by businesses, consumers paid an average arbitration fee of \$46.63. This is consistent with findings that consumers typically do not pay large arbitration fees. It does not address Public Citizen's concern that mandatory binding arbitration may discourage the filing of valid consumer claims, though Public Citizen presented no empirical evidence that consumers are less likely to file valid consumer claims in the mandatory arbitration regime than in the civil litigation regime. In theory, the loser pays rule in mandatory arbitration regimes should actually encourage the filing of small, valid claims relative to civil litigation and the American Rule.¹⁵

Consumer Surveys

Three studies in the last few years polled arbitration participants and consumers.

Harris Interactive surveyed 609 adults who participated in binding arbitration in 2005.¹⁶ Because all survey respondents participated in arbitration reaching a decision, and only 19 percent of the respondents indicated that they participated in arbitration because it was contractually required, the applicability of the study to the question at hand is limited. In addition, only 48 percent of those surveyed were involved in disputes between an individual and a business. Generally, however, this study suggests greater satisfaction with arbitration than the Public Citizen study reported. Sixty percent of respondents stated that rules for the arbitration were given in advance and largely followed, in contrast to Public Citizen's suggestion that arbitration rules are not often followed. Only 13 percent indicated that the arbitrator did not follow the arbitration rules, provided in advance to both parties. In addition, 74 percent of respondents found arbitration faster than litigation (63 percent found arbitration simpler, and 51 percent found it cheaper). The majority of respondents were either moderately or very satisfied with both the arbitrator's performance and the fairness of the procedure and outcome.

Public Citizen's use of collections cases to demonstrate inherent bias within the arbitration system undermines its conclusions.

Competing studies done on behalf of the Chamber of Commerce's Institute for Legal Reform (ILR) and the American Association for Justice (AAJ) had contradictory results. The AAJ study, conducted by Peter D. Hart Research Associates, Inc., polled 833 adults by telephone nationwide. The study found that consumers disapproved of arbitration by a 51 percent to 32 percent margin. When questions were phrased to emphasize purported drawbacks of arbitration while downplaying arbitration's benefits, the margins increased. For example, respondents were told that the "consumer may never take legal action against the company over the dispute," which falsely implies that arbitration is not "legal action."

In contrast, the ILR study, conducted by Public Opinion Strategies and Benenson Strategy Group, which polled 800 likely voters in December 2007, reached the opposite result. Voters in that poll said they preferred arbitration to litigation by 82 percent to 15 percent. Another question asked:

Arbitration is a non-court procedure for resolving disputes using one or more neutral third parties—called the arbitrator or arbitration panel. Arbitration uses rules of evidence and procedure that are less formal than those followed in trial courts. Now, there are lots of products and services you buy where you are required to sign a contract with the company providing the good or service. In some of these contracts there is an arbitration agreement, so when you sign the contract you agree to resolve any disputes with the company through the process of arbitration. Now, some officials in Congress would like to remove these arbitration

agreements from the contracts consumers sign with companies providing goods and services. How about you, do you think Congress should or should not remove arbitration agreements from contracts consumers sign with companies providing goods and services?

Voters answered in the negative, 71 to 24 percent, with 56 percent strongly opposing.

These last two surveys reveal little, other than that consumers' opinions about arbitration vary depending on the characterization of the questions: Consumers appear to like the idea of "a judge or jury" but strongly dislike "litigation" and "filing a lawsuit and going to court."

Is Arbitration a "Good Deal" for Consumers?

Contrary to the claims in the Public Citizen report, the available data—including Public Citizen's own data—suggest that compared to litigation, arbitration is a relatively inexpensive and fair mechanism that produces positive

outcomes for consumers. Public Citizen's use of collections cases to demonstrate inherent bias within the arbitration system undermines its conclusions. The win rate in those cases will always be low for consumers. Worse, Public Citizen omits thousands of cases where businesses voluntarily dismissed arbitrations against consumers and thousands more cases where consumers won reductions in debt, making its statistics unreliable. As other studies show, consumers as plaintiffs actually are quite successful in arbitration and, when they participate in arbitration, do not pay exorbitant fees. Public Citizen's study fails to compare apples to apples or to account for the benefits to consumers through lower prices from mandatory binding arbitration clauses. Although additional analysis of the California data may eventually show other trends, the news so far seems good.

Nevertheless, Public Citizen has succeeded in creating a false perception among legislators, some advocacy groups, and some academic commentators. Professor Nancy Welsh, while finding some fault with the Public Citizen report, concluded that, "[i]f the numbers reported by Public Citizen are accurate . . . I fear that arbitral firms and arbitrators involved in the mass processing of cases will find it increasingly difficult to argue that people's concerns about the *appearance* of bias are just not plausible."¹⁷ Certainly some of the one-sided media coverage of the Public Citizen report did not help the case for consumer arbitration. One hopes that the Navigant refutation of Public Citizen's misleading numbers will garner the same publicity.

At the same time, perceptions are important. One concern that NAF could easily address is the repeated use of the same arbitrators in hundreds of cases. NAF and other organizations have already pushed to diversify their ranks¹⁸ and could add the numerous qualified neutrals available to their rolls so that consumers will be more convinced that they are receiving a fair hearing. If consumers incorrectly perceive that the arbitration process is unfair, it behooves the arbitral organizations and companies utilizing arbitration to continue efforts to address any appearance of unfairness. ♦

Endnotes

1. "The Arbitration Trap," www.citizen.org/publications/release.cfm?ID=7545 (Sept. 2007).

2. See, e.g., "Party at Ralph's," *WALL ST. J.*, Nov. 7, 2007, at A22 (documenting Public Citizen's work with the trial lawyer lobby in promoting antiarbitration legislation). The Public Citizen webpage on its report announces its support for the Arbitration Fairness Act of 2007.

3. See Koppel, "San Francisco Sues Provider of Arbitrators," *WALL ST. J.*, Apr. 7, 2008, at A3; *Ross v. Bank of America*, No. 06-04755 (2d Cir. Apr. 25 2008) (holding plaintiffs have antitrust standing to allege conspiracy). At least three of the defendants alleged to be part of the conspiracy to agree to include mandatory arbitration clauses do not actually have mandatory arbitration clauses.

4. PETER B. RUTLEDGE, *ARBITRATION: A GOOD DEAL FOR CONSUMERS* (United States Chamber Institute for Legal Reform, April 2008); NAF REPORT; EDWARD L. YINGLING, *ABA STATEMENT ON PUBLIC CITIZEN'S ARBITRATION REPORT* (Sept. 27, 2007) (American Bankers Association); INSTITUTE FOR LEGAL REFORM, *BOGUS ATTACK ON ARBITRATION REALLY*

ABOUT PLAINTIFFS' LAWYERS' RIGHT TO SUE (Sept. 27, 2007); Walter Olson, post to Overlawyered blog, *Behind Those "Unfair" Arbitration Numbers*, www.overlawyered.com/2007/10/behind-those-unfair-arbitration-numbers.html, Oct. 18, 2007. In July 2008, Public Citizen responded to Rutledge's study. See "The Arbitration Debate Trap," at www.citizen.org/publications/release.cfm?ID=7589&secID=1052&catID=126.

5. Hillard M. Sterling & Philip G. Schrag, *Default Judgments Against Consumers: Has the System Failed?*, 67 *DENV. U. L. REV.* 357 (1990) (finding consumers prevailed in Small Claims and Conciliation Branch of the Superior Court of the District of Columbia only 4% of the time, with the vast majority of cases being default judgments); Matthew C. McDonald & Kirkland E. Reid, *Arbitration Opponents Barking Up Wrong Branch*, 62 *ALA. LAW.* 56, 60 (2001) ("[V]irtually all of these cases were collection cases filed by the bank against customers more than six months behind on their credit cards bills. Unquestionably, the result in collections court would have been the same.").

6. Under Rule 21A of the NAF Code of Procedure, parties select an arbitrator on "mutually agreeable terms" or by each party selecting an arbitrator and those two arbitrators selecting a third arbitrator for a panel. NAF selects an arbitrator only if a party has failed to participate under Rule 21A.

7. More than half of NAF's California consisted of MBNA claims. NAF provided the name of the arbitrator for 10,573 of those cases. In cases where NAF provided the arbitrator's name and indicated that there was a recorded decision, MBNA won 96% of the time, with awards totaling \$145.8 million. Eighty-four percent of MBNA cases were decided by 27 arbitrators. One hundred sixteen arbitrators handled the remaining 16%. The group of 27 arbitrators ruled for business 94% of the time and for consumers 2.8% of the time. The 116 arbitrators ruled for MBNA 87.9% of the time and for consumers 8%.

8. These numbers come from Public Citizen's report. The report does not explain what happened with the remaining 4 percent of cases, which are presumably among the 7,283 cases that settled without identifying a prevailing party.

9. Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 *J. DISP. RESOL.* 89, 99; Teresa McUSIC, *Unpaid credit-card bills giving rise to lawsuits*, *FORT WORTH STAR-TELEGRAM*, Aug. 31, 2007 (80% of consumers fail to contest civil litigation brought by credit-card companies).

10. www.instituteforlegalreform.com/issues/docload.cfm?docId=1212.

11. Public Citizen responded to the United States Chamber of Commerce's study, attempting to refute some of the Chamber's findings. See "The Arbitration Debate Trap," at www.citizen.org/publications/release.cfm?ID=7589&secID=1052&catID=126.

12. AAA, *ANALYSIS OF THE AMERICAN ARBITRATION ASSOCIATION'S CONSUMER ARBITRATION CASELOAD*, www.adr.org.

13. Mark Fellows, *The Same Result as in Court, More Efficiently: Comparing Arbitration and Court Litigation Outcomes*, *METROPOLITAN CORPORATE COUNSEL*, July 2006, at 32.

14. It is impossible, however, to calculate the overall win rates for businesses and consumers without knowing the ratio of consumer-initiated to business-initiated filings. The studies summarized above suggest that the vast majority of filings are initiated by businesses. Thus, it is possible that the overall consumer win rate, assuming that 95% of cases that reach decision are business-initiated, may be as low as 25%.

15. E.g., Lucian Arye Bebchuk, *A New Theory Concerning The Credibility and Success of Threats to Sue*, 25 *J. LEG. STUD.* 1 (1996); Steven Shavell, *Suit, Settlement, and Trial: A Theoretical Analysis Under Alternative Methods for the Allocation of Legal Costs*, 11 *J. LEG. STUD.* 55 (1982).

16. HARRIS INTERACTIVE, *ARBITRATION: SIMPLER, CHEAPER, AND FASTER THAN LITIGATION* (2005). The sampling error is +/- 4 at the 95% confidence level.

17. Nancy Welsh, *When Is the Temptation Too Much?*, www.indisputably.org (Oct. 10, 2007).

18. See William K. Slate II, *Diversity at the American Arbitration Association*, *DISP. RESOL. J.*, Feb.-Apr. 2008, at 2.