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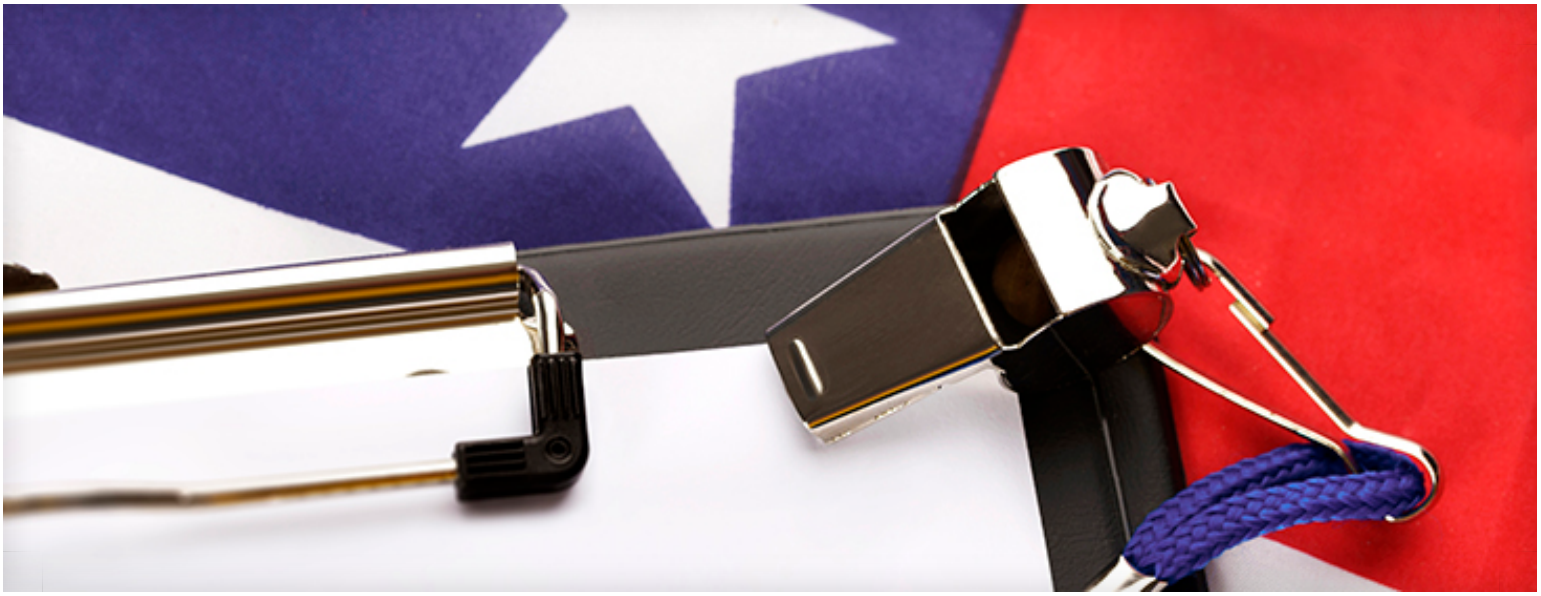

Arguments for arbitration

SHANA TING LIPTON 23 MARCH, 2016

In late 2015, the *New York Times* published a three-part series of articles on the increasing prevalence of arbitration clauses in consumer and employment contracts in the United States. *Shana Ting Lipton* gauges the reactions of commercial lawyers to the *Times'* campaign. Are the criticisms justified?

Arbitration, it seems, is out of favour in the United States. At least according to the *The New York Times*, (*NYT*) which in fall 2015, ran an exposé in which it alleged that US companies were abusing the process; drafting contracts which contained both class action waivers and arbitration clauses – purportedly forcing unwitting individual consumers or employees into opaque and costly proceedings overseen by flagrantly partial arbitrators.

This led *NYT* reporters to proclaim that "tens of millions of Americans have lost a fundamental right: their day in court". However, the articles, which some practitioners were surprised to see in a mainstream nationwide 'paper of record', troublingly, did not clearly differentiate domestic consumer arbitration and international commercial arbitration. Perhaps most saliently, the pieces – coupled with other recent developments in the US arbitration space – may signal a broader anti-arbitration zeitgeist.

MISINTERPRETATION AND POLEMIC

"Many in the international arbitration community are concerned about potential misinterpretation of the *NYT* articles," says **Daniel González**, global head of **Hogan Lovells**' international arbitration practice in Miami and chair-elect of the Miami International Arbitration Society.

"It is indicative that there is a sort of polemic around the use of arbitration," says **Julianne Hughes-Jennett**, a partner at Hogan Lovells in London, who authored a 2015 report on the *Rule of Law and Foreign Direct Investment*. She, like González, is quick to distinguish the mechanism as depicted in consumer and employment contexts in the journalistic investigation from arbitration between two consenting commercial parties.

Robert de By, partner in **Connon Wood**'s London and Los Angeles offices, and chair of the firm's international arbitration practice group, says that the legal community was disquieted by the arbitration abuse chronicled in the articles, which detailed parties "doing everything that we have been eradicating [internationally] for many years and using arbitration as a weapon against consumers, such that arbitration is getting a bad name".

Dana Welch, a Bay Area arbitrator and co-chair of the arbitration committee of the American Bar Association's dispute resolution section, concurs that the *NYT* investigation conflates to some degree commercial and consumer arbitration issues. However, she says, "I think these kinds of concerns flare up every few years," adding, "it is a good thing that they flare up. I do think that the Supreme Court decisions have been troubling for a number of reasons".

The decisions to which she refers are *AT&T Mobility v Concepcion* (2011) and *American Express v Italian Colors Restaurant* (2013). In the former case, the Supreme Court ruled that the Federal Arbitration Act (FAA) pre-empts state laws (in this case California's) which prohibit class arbitration waivers, based on unconscionability doctrines.

In the latter case, it ruled that – under the FAA – courts were not permitted to invalidate a contractual waiver of class arbitration on the grounds that the plaintiff's costs of individually arbitrating a federal statutory claim exceed potential recovery. The game-changing Supreme Court decisions applied the tenets of commercial arbitration (in cases involving consumers and a small business) and reinforced the FAA's support of arbitration law and policy.

THE PROBLEM WITH APPEALS

Prior to these rulings, the US class action climate had been notoriously excessive, with one report published in the *Los Angeles Daily Journal* stating that 30% of US companies had had a class action filed against them in 2009, and 39% of companies in California alone faced impending class action litigation. Coupled with this environment, the landmark Supreme Court decisions have arguably paved the path for the practices so ardently critiqued in the *NYT* investigation.

"After 27 years of practice in jury, bench trials and arbitration hearings, I have seen arbitration panels that are just as sophisticated and impartial as some of the great judges I have also had the pleasure to appear before," says González.

He underscores that "no system is perfect and all dispute resolution alternatives have their good and bad that you can find, but no one example should be determinative of the overall system".

Cedric Chao, partner and co-head of the international arbitration practice at **DLA Piper** in San Francisco notes: "One of the unique features of arbitration is that there is no automatic right of appeal from errors of law contained in the arbitrator's award."

Instead, there are more limited grounds to set aside (or 'vacate') an arbitrator's award. This is one of arbitration's big draws for commercial parties – although generally not for consumers or employees. "People want to have the dispute decided by skilled people and they don't want a second round or even a third round," says de By.

These narrow review provisions, however, form part of the pro-arbitration argument that the mechanism is time – and cost-saving. González challenges the *NYT's* charges that limitations on appeal favour companies, suggesting that it cuts both ways. Arbitrations, although not always shorter than court proceedings, "can be more efficient in the long run when you consider the limitation on appellate rights and likely enforcement after an initial award", he says.

When they are shorter, this represents a positive side-effect of the limited grounds for appeal. In comparison, in court, González adds, "you can go through 10 years of proceedings if you have gone through appeals and then remands for another trial, and go back to appeal it again".

WHO GUARDS THE GUARDIANS?

The difficulty in having a decision reviewed underscores the paramount importance of effective arbitrator selection – a process heavily criticised by the *NYT*. California, where the previously mentioned lion's share of class action litigations had been brought prior to *AT&T* and *Italian Colors* – has addressed concerns of partiality by requiring what Welch describes as "fairly extensive" disclosure from arbitrators.

The California ethics standards adopted by the California Judicial Council require a neutral to disclose whether a party or a lawyer (or law firm) has appeared in front of that arbitrator during the prior five years, and whether they would be willing to accept a future appointment from any of the parties involved, while the case is pending.

"The rap on California for a long time has been, [particularly internationally], that there is too much disclosure," says Welch, adding that she believes transparency to be a good thing.

"You have great powers as an arbitrator, you are supposed to be neutral, and it is an honour to serve as an arbitrator. So it is not unreasonable to require arbitrators to be scrupulously complete in their disclosures," says Chao, adding that arbitrators can mitigate the risk of subsequent

frivolous assertions of bias by complete disclosures.

He notes that despite some arbitrations exiting California, as a result of such onerous disclosure, it is a hotbed of economic activity with many arbitrations taking place there, and many neutrals residing there, and so poised to be a major arbitration destination.

PROPOSALS FOR REFORM

Other developments arising out of this wave of increased scrutiny of arbitration fall under the *NYT* model of domestic consumer and employment arbitrations. In April 2015, Democratic senator Al Franken and representative Henry 'Hank' Johnson, Jr. introduced their proposed bill, the Arbitration Fairness Act of 2015, which is intended to amend the FAA and effectively invalidate pre-dispute arbitration agreements covering employment, consumer, antitrust or civil rights disputes.

In November 2015, senators Franken and Patrick Leahy publicly urged president Obama to take action against so-called 'forced arbitration'. Amid an election year, the issue is expected to get highly political and could potentially be challenging for corporations wishing to enforce such agreements.

In October 2015, the congressionally established Consumer Financial Protection Bureau (CFPB) proposed new rules which would ban consumers from applying pre-dispute arbitration agreements to class litigation related to some consumer financial products.

While a bitter pill for corporates such a provision would potentially be an elixir to plaintiffs' lawyers. **Joshua Bressler**, principal at **Bressler Law** in New York, points out, "what arbitrations do most profoundly is eat into the spoils of the plaintiffs' Bar" – citing the "wild card" of large-scale attorneys' fees which he refers to as "the price of admission".

Should the pro-arbitration climate continue to strengthen, he predicts, "their business model is going to be restricted". The CFPB's 700-page study on arbitration agreements in consumer contracts for financial service providers, published in March 2015, perhaps unsurprisingly confirmed that class actions are significantly more lucrative for plaintiffs and their attorneys than arbitrations and individual lawsuits.

The CFPB's proposed rules followed on the heels of the report. One provision of concern would require that records of all arbitral disputes and awards be submitted for review and potential publication on its website.

Chao says: "That would turn arbitration on its head" – confidentiality being a corporate-friendly hallmark of arbitration, and one which the *NYT* had critiqued as prompting difficulty in ascertaining the fairness of the proceedings.

"Confidentiality is for the protection of both parties; it benefits all of the parties in an arbitration," says González who believes this point is overstated by the journalists. "It doesn't stop any party

[from going] outside and reporting what happened unless there's a further confidentiality agreement between the parties or in the arbitration process itself".

One recent bright spot for the pro-arbitration camp has come out of a case in the 2nd US Circuit Court of Appeals in New York. In November, it ruled that **American Express, Citigroup** and **Discover Financial Services** did not violate the Sherman Antitrust Act and collude to require that disputes be settled in arbitration, rather than through class action suits.

However, de By warns that the story is likely not over. "It was a technical decision," he says, citing an article featuring reactions from baffled appellate judges who claimed they would not have ruled in favour of the financial services companies.

"What is to stop the plaintiffs' bar from going to court in California, Texas, or Illinois with cases like this?" he says, speculating that should these make their way up to the Supreme Court and succeed, such a ruling "would be disastrous in the international commercial arena. The rulings apply to all arbitrations".

It is not surprising that such worst case scenario projections for arbitration are in the ether. Apart from *the NYT* investigation and recent calls for regulatory and statutory arbitration reform, a more broad-reaching spectre looms over such discussions.

THE SHADOW OF TTIP

"This may be symptomatic of the broader debate about the use of investor state arbitration in TTIP," says Hughes-Jennett referring to the European Parliament's rejection of investor-state dispute settlement to resolve disputes under the proposed Transatlantic Trade and Investment Partnership between the EU and US.

She adds that this "has probably provoked a lot of navel gazing which in turn has resulted in journalists pursuing the arbitration question more broadly – in particular in the consumer and employment contexts".

She notes that criticisms of arbitration are not novel, particularly in the investor-state realm, where they were addressed in part by initiatives such as when UNCITRAL adopted new transparency rules in 2014.

Equally, internationally, there are endeavours like *Arbitrator Intelligence* (AI) are promoting fairness and transparency. Jump-started by a pilot project in early 2015, AI aims to cull together as many arbitration awards as possible to facilitate a more transparent flow of information on arbitrators.

"There definitely is a move within the arbitration community to address issues of diversity among the arbitrator pool, to address the transparency of the process and so on," says Hughes-Jennett, adding that such scrutiny and calls for reform represent "a very healthy thing – very reflective of

the mood today in the world".

González agrees that generally, transparency is beneficial to the institution of arbitration but notes that there has been talk of the International Chamber of Commerce and other organisations will spend increasing amounts of time on requests for arbitrator disqualification.

"The more transparent, the more credible, the better it is for arbitration because the less challenges there will be of particular awards, and the more credibility arbitration will gain in the longer term," says de By.

There is some agreement among ADR practitioners that such transparency along with fair terms for consumers is also good for companies; both by keeping negative press and regulatory scrutiny at bay and for supporting a smart long-term disputes strategy.

"Companies want these arbitration processes and as a result they're going to want them to be regarded as fair and impartial and not one-sided," says González. "For a company to win a case or two and in the long run have this reversed and lose the ability to handle these cases in arbitration doesn't serve a long-term purpose."

ROOM FOR IMPROVEMENT

Domestic consumer arbitration is in its infancy; practitioners warn that ruling it out so early on may be unfairly throwing 'the baby out with the bathwater', before the area has had a chance to be fully tested and develop.

"Many of these abuses have been dealt with in the international commercial arbitration world," says de By of the *NYT*'s chronicles. Perhaps one of the most important things to come out of the journalistic investigation is that it is vital to distinguish domestic arbitration from international commercial arbitration, albeit one clearly affects each other. De By concludes: "Maybe the domestic arbitration world should learn something from the international commercial arbitration world."

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