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With Mandatory Arbitration, Corporate America Opts Out of the Legal System

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Pop quiz: Does leasing a car, opening a credit card or entering into a cell phone contract require you to sacrifice your constitutional rights? If you live in the United States in 2016, then chances are the answer is yes.

Over the last several years, an increasing number of companies have incorporated mandatory arbitration provisions into their customer contracts, requiring that consumer disputes be resolved by "neutral" third-party arbitrators rather than in a court of law.

This might not sound like a big deal, but as a recent three-part investigative series by Jessica Silver-Greenberg and Robert Gebeloff in the New York Times reported, arbitrations are highly problematic forums for individuals with few rules of evidence or discovery and almost no right to appeal the arbitrators' binding decisions.

Arbitrators are often far from neutral, with an inherent bias in favor of the companies they rely on for repeat business. Additionally, mandatory arbitration provisions typically include bans on class actions, one of the few (if only) means for individuals to combat unfair business practices.

By preventing people from joining together to sue as a group, consumers are forced to litigate their claims individually. In cases where individual damages are relatively low, high litigation costs make it unlikely that an attorney will represent a single plaintiff against a deep-pocketed corporation.

Indeed, as a class action attorney, the first question I ask any client with a potential case is, "Is there a mandatory arbitration provision?" If the answer is yes, then it's a simple business decision to pass on the case.

As the New York Times reported, mandatory arbitration provisions have been stunningly effective in ending consumer litigation against corporations. From 2010 to 2014, Verizon, which has more than 125 million subscribers, faced just 65 consumer arbitrations. Time Warner Cable, with 15 million subscribers, faced seven.

As Judge Richard Posner of the U.S. Court of Appeals for the Seventh Circuit noted in Carnegie v. Household International, "The realistic alternative to a class action is not 17 million individual suits but zero individual suits."

Corporate Adoption

The right to a trial by jury is guaranteed by the Seventh Amendment, but like any constitutional right it can be waived by the parties. Arbitration has been around for centuries and in theory can be an effective method for settling disputes if both parties have agreed to arbitrate.

In 1925, Congress passed the Federal Arbitration Act, a law which provided the legislative framework for the enforcement of arbitration agreements. Though the FAA was originally intended to apply to arbitrations between two companies of generally comparable bargaining power, beginning in the mid-1980s, courts expanded the scope of the law to include disputes between companies and their employees or customers.

With their weak (if not non-existent) bargaining power, consumers and employees had little choice but to accept the terms of these adhesion contracts, which now included mandatory arbitration clauses.

In the landmark class action case AT&T v. Concepcion, the Supreme Court in a 5-4 decision explicitly upheld the use of mandatory arbitration clauses which banned class actions. And so with the explicit approval of the nation's highest court, companies in virtually every sector of the economy have adopted these provisions.

A small sampling of these businesses includes each of the five largest mobile phone carriers; most cable and satellite companies (including Comcast, Time Warner Cable and DIRECTV); consumer banking and credit card companies (American Express, Wells Fargo, Chase and Discover, among many others); online retailers (Amazon, Netflix, Ebay, et al.); consumer electronics (Dell, Sony, Electronic Arts, etc.); homebuilders (including D.R. Horton, Lennar, and Pulte, the three largest home builders in the country); and investment advisers and brokers (Fidelity, Vanguard, T. Rowe Price and many others).

Car dealerships, doctors, nursing homes, cemeteries—the list goes on and on. Thus, consumers are faced with a stark choice. Either give up your right to sue a company in court or give up your cell phone/cable service/ability to shop online, etc.

Opt Out

What's the problem with arbitration as a forum for deciding disputes? For starters, the companies, not the individual plaintiffs, are often allowed to choose the arbitrator, and companies regularly steer cases to friendly arbitrators who are likely to rule in their favor.

Private arbitrators, who can charge several hundred to over $1,000 per hour, are thus incentivized to rule in favor of repeat players or risk losing business by ruling against them.

Arbitrations can be expensive for individuals as the fees of the arbitrator typically must be split, plaintiffs may be unable to recover their attorney fees if they win and plaintiffs may be required to pay the other side's fees if they lose.

Standard rules of evidence and rules of discovery, which have evolved through centuries of jurisprudence, do not apply and are left to the discretion of the arbitrator. Arbitration proceedings are also confidential, and arbitrators' opinions are rarely appealable.

Finally, with the loss of public hearings and published opinions comes the loss of public scrutiny of corporate wrongdoing. Indeed, one of the many benefits to class actions is the policy changes companies have been forced to adopt when their abusive practices have been brought to light. Without class actions, citizens can't obtain injunctive relief to halt corporate wrongdoing, and abusive practices continue.

So what can be done to counteract this troubling trend? Unfortunately, after the Supreme Court's Concepcion decision, challenging mandatory arbitration provisions through the courts is not a viable option.

In April 2015, U.S. Sen. Al Franken, D-Minnesota, and Rep. Hank Johnson, D-Georgia, reintroduced the Arbitration Fairness Act, which would amend the FAA and eliminate mandatory arbitration clauses in employment, consumer, civil rights and antitrust cases.

Passing such common-sense legislation in the current Congress would appear to be a nearly impossible task, but if you care about the issue, contact your congressman. And vote. If the trend of forced arbitration continues, corporate America will effectively opt itself out of the civil justice system.

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