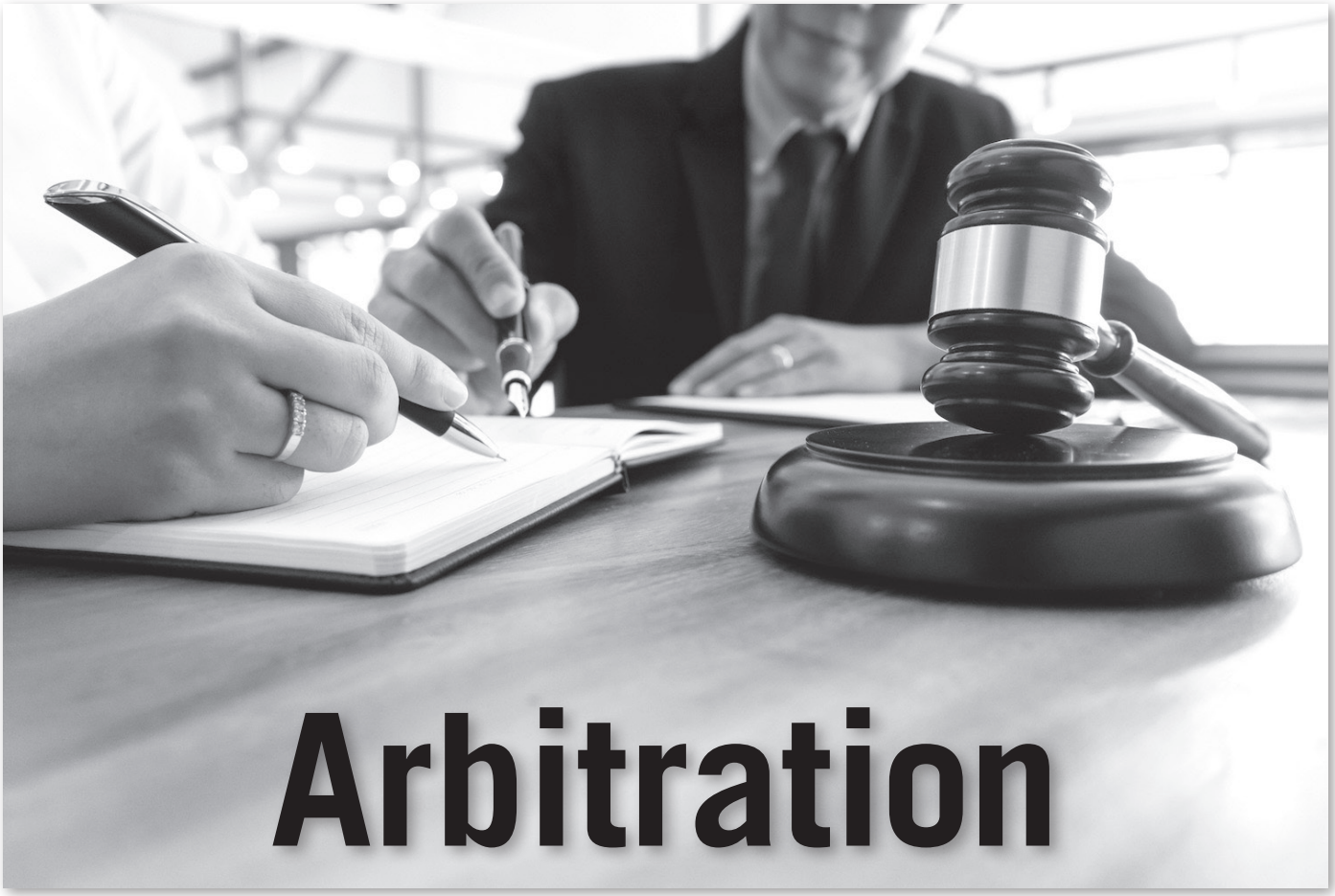

Arbitration

Time to Fix a Flawed Forum

By Gerald Sauer*

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Arbitration has become a hot-button issue. In September, the House of Representatives passed the *Forced Arbitration Injustice Repeal (FAIR) Act,*[1] intended to ban mandatory arbitration in the workplace, and California enacted AB 51,[2] the latest state effort to protect workers from forced arbitration. The Economic Policy Institute and the Center for Popular Democracy predict that, by 2024, almost 83% of the country's private, non-unionized employees will be subject to mandatory arbitration, an increase of 56% since 2017.[3]

In theory, arbitration is a good alternative to jury trials because it is supposed to offer a streamlined process (*e.g.*, limited discovery, motion practice and appellate review) that leads to quicker results than the judicial system. Employers benefit by having a retired judge or a veteran attorney serving as the trier of fact in workplace disputes because such individuals are less prone to identify with the plaintiff, less likely to be swayed by emotional factors, and more capable than a jury of rendering a reasonable monetary award.

States, however, have seen significant inequities in arbitration that hurt individuals, and they have taken steps to protect workers by passing laws, such as AB 51, to ban forced workplace arbitration. Notwithstanding these efforts, mandatory arbitration remains the law of the land. In December, a federal judge in Sacramento stayed the California law, and on February 7, in *Chamber of Commerce of the United States v. Becerra,* the U.S. District Court for the Eastern District of California granted a request for a preliminary injunction.[4] Smart money says the law will never take effect. Federal courts have consistently ruled that the Federal Arbitration Act (FAA)[5] preempts state laws.[6]

The FAA was a simple, little-known law enacted in 1925 that was designed to support business contracts that called for alternative dispute resolution. It required courts to stay litigation, upon motion, when a dispute involved a contract with a written arbitration clause. The law clearly presupposed that parties to the contract would understand its terms, would be in a position to negotiate those terms, and would have willingly and knowingly agreed to those terms.

The existing system, however, is broken and efforts to outlaw forced arbitration at the state and federal levels prove that it is time to finally fix it.

Businesses have increasingly embraced arbitration because it helps them avoid the roulette-wheel outcomes of jury trials, but employees and consumers—bound by fine-print contract terms—do not provide informed consent. In the landmark 2018 Economic Policy Institute (EPI) report, "The Growing Use of Mandatory Arbitration," Cornell University professor Alexander J.S. Colvin polled employers rather than workers to determine the prevalence of employment arbitration.

> The study measured the extent of mandatory employment arbitration by surveying employers rather than by surveying employees because *research has found that employees are often unaware or fail to recall that they have signed arbitration agreements and may not understand the content and meaning of these documents* (emphasis added).[7]

Simply because they get a paycheck or want to purchase a product or service, millions of unsuspecting individuals find that they have signed away their constitutional right to trial by jury. Arbitrators' decisions, which often consist of a conclusory one-line statement, are shielded by secrecy, and the employee's or consumer's ability to reverse a bad decision is extremely limited. According to "The Arbitration Epidemic," a 2015 EPI report by Colvin and Katherine V.W. Stone, "On average, employees and consumers win less often and receive much lower damages in arbitration than they do in court."[8] Absent class actions—effectively killed by the Supreme Court's *Epic Systems* [9]decision—small claims can generally not be aggregated, so employers who shortchange workers a few dollars a month, or businesses that pad customers' bills, have little incentive to do the right thing.

Private judging is problematic. For-profit arbitrators, paid by employers and insurance carriers, are disinclined to bite the hand that feeds them. Businesses, which may utilize the same provider (e.g., the American Arbitration Association) for dozens or even hundreds of cases, provide a guaranteed revenue stream. The industry per diem ($15,000 or more for some neutrals) is still small potatoes when compared to unpredictable, sympathetic jury verdicts.[10]

The economics of arbitration mean that "neutrals," who may truly believe they can render impartial judgment, are subconsciously inclined to favor the party who pays them. A 2015 New York Times expose of private judging recounts tales of arbitrators lunching with defendants and conducting hearings in defendants' conference rooms.[11] Aside from the troubling optics, these stories speak to a fundamental conflict of interest.

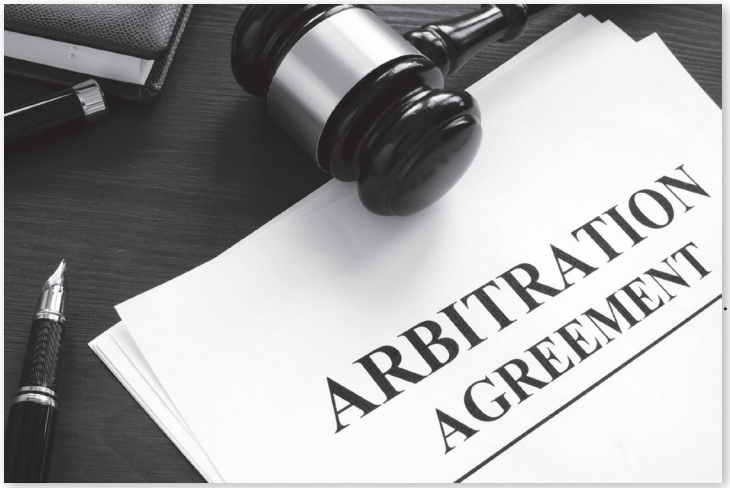
Most private arbitrators are retired judges who bring years of education and experience to the hearing and are eminently qualified to understand and evaluate evidence. These arbitrators should be capable of delivering reasoned legal decisions, but economics tend to skew outcomes. The FAA provides no recourse when an arbitrator's decision is based on a flawed legal analysis, and it allows judicial review if and only if a decision meets one of the following criteria:

- It was procured by fraud,
- The arbitrator was biased,
- The arbitrator refused to hear relevant evidence, or
- The arbitrator exceeded his or her power as set forth in the arbitration agreement.[12]

According to California's Ethics Standards for Neutral Arbitrators in Contractual Arbitration, "For arbitration to be effective there must be broad public confidence in the integrity and fairness of the process."[13] Standard 5, General Duty, reads as follows: "An arbitrator must act in a manner that upholds the integrity and fairness of the arbitration process. He or she must maintain impartiality toward all participants in the arbitration at all times."[14] Standard 6 says that "a proposed arbitrator must decline appointment if he or she is not able to be impartial."[15]

An arbitrator who receives substantial repeat business from one party to a dispute is really between a rock and a hard place. Unlike trial judges, who are paid by taxpayers and have no horse in the race, arbitrators have reason to hitch themselves to the horse who provides their livelihood.

Arbitration costs and awards are a relative bargain for most companies, but they could become untenable if every injured worker and consumer pursued individual arbitration. Uber and Lyft drivers are now testing this proposition; imagine if thousands of mistreated workers at other companies and millions of consumers with legitimate grievances followed suit. Companies may find a reason to embrace changes to the current system.



Legislation at the state and federal levels could also help improve arbitration outcomes while leaving mandatory arbitration in place. Such laws might require that every arbitral decision include a reasoned, published opinion; that the legal basis for the decision be subject to outside review and judicial appeal if erroneous; and that awards be commensurate with prevailing court awards for similar cases. Such laws would remove the unchecked discretion that now plagues the system and help level the playing field for all parties.

Arbitration is not bad. It is actually a good vehicle for reducing court dockets and ensuring timely resolution of disputes. The existing system, however, is broken, and efforts to outlaw forced arbitration at the state and federal levels prove that it is time to finally fix it.

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1 H.R. 1423, 116th Cong. (2019).
2 Cal. Gov. Code § 12953; Cal. Lab. Code § 432.6.
3 https://populardemocracy.org/news-and-publications/epi-report-forced-arbitration-cover-80-private-sector-workers-2024
4 *Chamber of Commerce of the U.S.A. v. Becerra*, No. 2:19-cv-02456-KJM-DB, 2020 WL 605877 (E.D. Cal. Feb. 7, 2020)
5 9 U.S.C. § 1, et seq.
6 *See, e.g., Latif v. Morgan Stanley & Co., LLC,* No. 18-cv-11528, 2019 WL 2610985 (S.D.N.Y. June 26, 2019); *Logan v. Lithia Motors, et al.*, No. 18-2-19068-1 SEA (Wa. Sup. Ct. 2019); https://www.lexology.com/library/detail.aspx?g=f5c8f23c-101c-4fab-a4fc-7d88fdff1896.
7 Alexander J.S. Colvin, *The growing use of mandatory arbitration,* Econ. Policy Inst. (Sept. 27, 2017), https://www.epi.org/publication/the-growing-use-of-mandatory-arbitration/.
8 Katherine V.W. Stone & Alexander J.S. Colvin, *The arbitration epidemic: Mandatory arbitration deprives workers and consumers of their rights,* Econ. Policy Inst. (Dec. 7, 2015), https://www.epi.org/publication/the-arbitration-epidemic/.
9 *Epic Systems Corp. v. Lewis,* 138 S. Ct. 1612 (2018).
10 Deborah Rothman, *Trends in Arbitration Compensation*, Dispute Resolution Magazine (Spring 2017) at 8, https://www.americanbar.org/content/dam/aba/publications/dispute_resolution_magazine/spring2017/3_rothman_trends_in_arbitrator.authcheckdam.pdf.
11 Jessica Silver-Greenberg & Michael Corkery, *In Arbitration, a "Privatization of the Justice System,"* N.Y. Times (Nov. 1, 2015), https://www.nytimes.com/2015/11/02/business/dealbook/in-arbitration-a-privatization-of-the-justice-system.html.
12 9 U.S.C. § 10(a).
13 Cal. R. Ct., Ethical Standards for Neutral Arbitrators in Contractual Arbitration, std. 1(a).
14 *Id.* std. 5.
15 *Id.* std. 6.