Arbitration Clauses

Arbitration clauses can be very complex things. When they were first implemented they were highly supported by many in the legal community, especially by judges. Over time, the support for arbitration clauses has definitely dropped for several reasons. In recent years, there have been several cases dealing with arbitration clauses which have led to some restrictions placed on them but most of these cases have given arbitration clauses more power. While there are some benefits that can come from binding arbitration clauses and the binding arbitration process the negatives definitely outweigh most benefits.

Arbitration, a form of alternative dispute resolution, is an out-of-court proceeding in which a neutral third party listens to evidence about a case from both sides and then usually makes a binding decision on the case although sometimes the decision is nonbinding (Stim). The neutral third party who makes the decision is called the arbitrator. Arbitration is usually used to resolve a case without the use of a court. This frees up the courts and allows them to hear cases that could be seen as more important. Arbitration can only be used in civil cases and contract disputes make up by far the largest percent of civil cases at nearly 70% (Gent).

Arbitration started long before courts, governments, or even countries existed. Some historians believe that arbitration was used all the way back in ancient Rome, Greece, and Egypt. In these times, unlike today, the arbitrator was someone well known to both of the parties (A Brief History...). One of the first organized and well documented uses of arbitration arose in early England to settle trade disputes between merchants (Noussia). Because the first courts in England were mainly used to resolve land disputes and there were not many laws regulating trade or foreigners the merchants needed a way to ensure their trade agreements were followed. The traders therefore relied on tribunals to help solve trade disagreements. These tribunals acted like arbitrators and they placed a heavy emphasis on making the process speedy and using prior decisions as precedent for future decisions (Noussia). Since then
arbitration has grown and evolved greatly and it is now a very organized and heavily regulated process.

The United States recognized the importance and benefits of arbitration with the implementation of the Federal Arbitration Act, or FAA, of 1925. This allowed for the use of arbitration clauses in contracts and allows for courts to mandate and enforce arbitration. In section 2 of the act, it states that if there is a written agreement for arbitration is in a contract and a disagreement arises the agreement to arbitrate should be valid, irrevocable, and the outcome of the arbitration should be enforceable (Congress). The act laid the foundation for arbitration that is still followed today.

There are two basic types of arbitration, binding and nonbinding. A contract usually specifies what type of arbitration is going to be used. If the arbitration is binding it means that the parties must follow the decision that the arbitrator made and if the parties decide to go to court the court will enforce the arbitrators’ decision. If the arbitration is nonbinding the parties can choose to follow the arbitrators’ decision or they can take it to court. If the arbitration was nonbinding the court make a ruling in a different way than the arbitrator did (Stim). The most common form of arbitration is binding which makes sense because arbitration is usually a fairly long and expensive process and both parties would more than likely not want to have to continue on to court.

Arbitrators, in a way, take on a role very similar to a judge therefore they usually have to meet several requirements to become an arbitrator. Most states require arbitrators to have a law degree and experience as a practicing attorney (Arbitration: Who...). Typically, these individuals must become certified arbitrators which involves a special training course. Some states have arbitrator training programs run by the courts to teach arbitrators the required skills and some also require the arbitrator have an apprenticeship under a certified arbitrator for a specified length of time. However, there are a few states who do not require any sort of certification to become an arbitrator (Arbitration: Who...).

Arbitration is usually used when it comes to resolving disputes in contracts, using an arbitration clause (Stim). An arbitration clause is usually a provision in a contract that states that if a conflict between the parties should arise, the disagreement must be resolved using
arbitration and the parties cannot sue each other or take the case to court (USLegal).

Arbitration clauses can be relatively vague or extremely detailed. Some may just state that if a conflict arises it must be settled using arbitration while others may include several provisions. Some arbitration clauses state that if a conflict arises the contracting party gets to choose the arbitrator. Some arbitration clauses go even farther and list the arbitrator or arbitration firm who must be used if a conflict arises.

There are several essential elements that all arbitration clauses should contain. These elements are an agreement to arbitrate, what types of disputes are to be arbitrated, the rules that will govern the arbitration, the firm that will conduct the arbitration, the location that the arbitration will be conducted, the applicable and procedural law that allows an arbitration agreement, the number of arbitrators and the process for choosing them, and finally an agreement that judgment may be entered on the award (Townsend). Because of the lengthy list of elements required for an arbitration clause one or more of them are commonly forgotten. If one of the elements is forgotten the whole arbitration clause could be put in jeopardy. Therefore, it is critical that all of the listed elements are fulfilled when writing the arbitration clause.

Arbitration clauses are most commonly found in contracts between a business and a consumer or between an employer and employee. Some common contracts that include arbitration agreements are contracts with banks, home builders, insurance companies, and product manufacturers among others (Arbitration Agreements). These contracts usually include arbitration clauses to help prevent the business from having to go to court. The arbitration clauses in these contracts have been proven to be legal and valid by several courts in various jurisdictions.

A 2011 Supreme Court case involving AT&T furthered the prevalence of arbitration clauses in contracts (Corkery). In the case, there were state laws that banned contracts from prohibiting class action arbitration or lawsuits in contracts that had arbitration clauses. Class action lawsuits occur when multiple parties join a lawsuit against a party and they usually claim the same thing. The Supreme Court of California had previously ruled, in Discover Bank v. Superior Court, that even if there is an arbitration clause in a contract a class action lawsuit or
arbitration suit could still be brought against the contracting party and the plaintiffs do not have to partake in individual arbitration (Discover Bank). AT&T claimed that, because they had an arbitration clause in the contract that their customers signed, their customers could not bring a class action lawsuit or class action arbitration but instead needed to bring up individual arbitration cases. The Supreme Court looked at the question of whether the FAA preempts states from conditioning the enforcement of an arbitration agreement on the availability of class-wide arbitration procedures (AT&T Mobility). The court ruled that the FAA did preempt “state-law rules that stand as an obstacle to the accomplishment of the FAA’s objectives.” This ruling helps companies prevent class-action lawsuits and gives them and incentive to add arbitration clauses to their contracts (Corkery).

Arbitration clauses as a whole should be held as legal but binding arbitration clauses, where the individuals cannot appeal the decision to a court, should not be held as legal. While several courts have ruled that all types of arbitration clauses, even binding, are perfectly legal under the constitution, they prevent people and corporations from taking their issues up in court. Some would argue that by signing the contract, the parties are willingly giving up their constitutional rights, but in many cases, they have no clue what they are signing. There are a plethora of disadvantages that come along with arbitration clauses and only a few, not well supported, advantages. It appears that, after much research, the main reason that arbitration clauses are still held as being legal is because they make less work for the courts. Support for binding arbitration clauses are also helped by the fact that many organizations see them as being a safer alternative to litigation. Arbitration clauses and the arbitration process appear to blatantly infringe on individuals’ constitutional rights. Below are most of the advantages and disadvantages that people would claim come from having an arbitration clause and going through the arbitration process.

There are several claimed advantages to having an arbitration clause and partaking in arbitration rather than litigation. Since the FAA was passed back in 1925 arbitration has had two main pillars that it could claim give it an advantage and those are that it is faster and cheaper than litigation. Many would argue that those two pillars are still valid today and would add to them other advantages. In addition to being faster and cheaper, supporters of
arbitration clauses and arbitration would also claim that they free up the courts, provide a binding opinion, are more flexible and simple, and allow the case to be kept private.

Since arbitration began in America supporters have claimed that it is faster than traditional litigation. This is still a very commonly claimed advantage of arbitration. Because arbitration does not require going through the steps and long waiting times of litigation many times it is faster. There are usually several steps in a lawsuit that take several weeks and months. A civil case starts when a plaintiff submits a complaint to which the defendant usually has several weeks to respond. When the defendant responds the litigation, they have to admit to whatever claims are true and contest the claims and provide defenses for them (What to Expect). They can also enter a counter-claim to which the plaintiff usually has several weeks to respond to. Once the claims have all been made the parties must partake in the discovery process which can take anywhere from a few weeks to several months. After the discovery phase the case can go to court and the judge will provide a ruling which can take several weeks. If either party does not agree with the judges’ ruling they can appeal the case to a higher court (What to Expect). The appeals process can take several months to over a year in some cases. With arbitration, the case can be heard quicker than litigation and the ruling can be provided almost immediately.

Because the arbitration process is usually shorter than litigation the costs that are associated with arbitration can be much less than with litigation (Hoffman). Therefore, a mandatory arbitration clause in a contract would mean that both parties would be saving money should a conflict arise. Both parties usually hire attorneys for both arbitration and litigation and these lawyers usually charge based on the time they spend on the case. Obviously if they are having to spend more time on a litigation case the fees will be more than that of a litigation case. In recent years, however, this savings has lessened. There has been a dramatic increase in arbitrator fees that have closed the gap between the arbitration and litigation costs. There is now some data that supports the claim that arbitration and litigation cost the same on average. But most organizations that include arbitration clauses in their contracts will still claim that arbitration is significantly cheaper than litigation.
Another advantage of arbitration that is not realized by either party, but is felt by the courts, is that it frees up the courts case load. When a contracting party includes a mandatory and binding arbitration clause in their contract they are almost guaranteeing that they will never have to or be able to take the case to court (Hoffman). Many judges have a very favorable opinion of arbitration because it makes their job easier by not requiring them to hear every little dispute between the parties. An alternate advantage of arbitration clauses and arbitration are that they provide a binding opinion meaning that when the arbitration ends it will not be brought up again. Only the supreme court can provide opinions that are as final as an arbitrator and getting a case up to the supreme court is undoubtedly a multi-year process that includes several appeals.

The arbitration process is also usually much more flexible and simple than that of litigation. There are set court calendars that the parties must adhere to and the meetings almost always take place during normal work hours. It can be challenging for both parties to make it to these meetings and can cause them to miss their work. With arbitration, the meetings can take place at any time. If both parties are busy during the normal work week the arbitration can cater to their schedules and take place at night or on the weekends (Repa). In addition to the flexibility that arbitration provides it is also usually simpler than litigation. With litigation, there is usually a set procedure and rules that must be followed. But arbitration can be more flexible and relaxed. The arbitration process is made even easier because of the fact that there is usually no discovery process (Repa). The discovery process involves several steps and can become confusing and with arbitration the parties do not have worry about any of it.

The final advantage of arbitration is that it allows all of the parties’ information and the information about the arbitration to remain private (Repa). In both litigation and arbitration, a large amount of private information about the parties can be brought up but that information can only become part of the public record through litigation. With arbitration, every detail and step can be kept private (Repa). Many individuals and organizations may see a large benefit to keeping their information private. With an arbitration clause, the parties can ensure that all of their information never becomes part of the public record.
When arbitration first started in America it was viewed favorably as an alternative to litigation. It used to be perceived as having several advantages over litigation but those advantages have lessened over time. Many people are not satisfied with arbitration or arbitration clauses and have tried to change them. Arbitration definitely has some positive attributes but there are some negative parts of it that many people would view as disadvantages compared to litigation. They include the fact that arbitration is, in many cases, more expensive than litigation, the fact that the average consumer does not know what arbitration or an arbitration clause is, the suspected collusion between an arbitrator and the contracting party, the idea that arbitration is the privatization of the courts, and the fact that the parties are being deprived of basic rights afforded to them in the constitution.

Arbitration was originally thought to be much cheaper for all of the parties involved. The parties would not have to pay court fees and usually arbitration would be shorter than traditional litigation and therefore their lawyer fees would be less with arbitration. But recently the idea of arbitration being cheaper has started to change. A watchdog group has recently found that the cost to initiate an arbitration is significantly more expensive than the cost of filing a lawsuit (Stim). The cost to initiate a claim worth $80,000 in state court would be a $250 court fee while the cost to initiate the same claim to arbitration would be $9,000. There is also the fee to hire the arbitrators which is usually split between the parties, the details of that split should be included in the arbitration clause, and those fees can be $10,000 or more. If that case were to go to court the parties do not have to pay the judge or jury to listen to the case (Stim).

In another case study comparing the average costs associated with an arbitration case versus a litigation case there was a very interesting outcome. The study found that the average arbitration case ended up costing an organization roughly $79,000 while the average litigation case ended up costing that same organization an average of $63,000 (Dabdoub). In both litigation and arbitration each party usually hires an attorney and there are additional fees associated with that.

Because arbitration clauses are becoming a part of more contracts arbitrators know that their services are in high demand and they can charge more for them than they previously did. The field that arbitration clauses are becoming very commonplace is in employment contracts.
where at least one fifth of all employees are now subject to mandatory arbitration (Malveaux). These rising fees are the main driver in arbitration becoming more expensive than litigation. With all of that additional money being spent for arbitration one has to question if arbitration is actually cheaper than litigation. There is no doubt that in some cases arbitration is cheaper than litigation but that might not be the case for the vast majority of cases now that costs have increased.

Arbitration clauses are put in a lot of contracts that people sign on a regular basis. For example, almost every mobile phone carrier has an arbitration agreement in the contract that every customer must sign before being allowed to use their service. These contracts are usually lengthy and contain legal jargon that the typical consumer would not understand. The average consumer would also more than likely not read the entire agreement before they sign it. Even if the consumer were to read the entire contract, the average person would not know what arbitration is nor would they know what the process entails. These companies know this and will use it to their advantage.

Some people believe that there might be collusion between the arbitrator and the contracting party because contracting party typically chooses which arbitrator is going to be used in the arbitration. In some cases, the arbitrator only arbitrates cases for that party. In a way, the arbitrator can be viewed as an employee of the contracting party because they exclusively deal with that company and do not deal with any other arbitrations. This can bring to question the objectivity of arbitrator or the arbitration firm.

Others believe that this relationship creates an incentive for the arbitrator to side with the contracting party. They believe that the arbitrator might be worried about losing the contracting parties business. If the arbitrator works exclusively with that contracting party there is definitely a possibility that they will favor them more than the opposing party. Even though the arbitrator is supposed to be unbiased and look at each case objectively one could argue that if they only work with one contracting party there is a definite possibility of the two colluding against the other parties. However, it could be fairly hard to prove this collusion and would just be an added expense to the opposing party. Because the parties are forced to accept the decision that the arbitrator makes and are usually not able to take the case to court the
arbitrator must remain objective in order for the parties to have a fair outcome. While some arbitration agreements do not specify who will conduct the arbitration there is a large amount who do. People would feel much better about the objectivity of the arbitrator if both parties agreed to them after the contract was signed and before the arbitration occurs. This would help prevent any question of collusion between the arbitrator and one of the parties.

Another argument against arbitration clauses and arbitration is the fact that it can be viewed as the privatization of the court systems. In arbitration, the arbitrators’ ruling is binding meaning that even if an individual attempts to appeal the ruling to a court the court will almost always uphold the arbitrators’ decision. The arbitrator in essence could be viewed as a judge and jury or even more powerful because the decision the arbitrator makes is usually changed by courts if the case is brought up (Corkery).

The final and most substantial argument against forced arbitration such as arbitration clauses are that they deprive people of their constitutional rights. Americans are guaranteed the right to a fair and speedy trial by jury, in a public forum, with a written record, using binding legal precedents, and the right to have an appeal (Malveaux). By signing a contract with an arbitration clause people are giving up their right to each of these things.

The right to a fair and speedy trial is one that is well known but when partaking in arbitration neither of those are ensured. While many would claim that an arbitration case would be quicker than litigation there is no guarantee that it will be. In some cases, arbitrations take much longer than litigation. In a case study comparing 19 different arbitration and litigation lengths of a corporation the study found that the average litigation lasted 19 months and the average arbitration case lasted 21 months (Dabdoub). Arbitrations are also not part of the public forum. Unlike court cases, the vast majority of the time the process, discovery, and outcome of arbitration is kept confidential and will never be released to the public.

If a judge or jury makes a ruling usually the ruling can be appealed to a higher court and there is a chance for the ruling to be changed but in arbitration that is not usually the case. By forcing someone into arbitration through an arbitration clause they are effectively putting all of their faith into the arbitrator who has almost completely free reign to decide whatever they would like.
This free reign for arbitrators is another downside of arbitration clauses and arbitration. The arbitrator usually does not have a background of being a judge but they are given more power than most judges. Because the ruling from an arbitrator is binding and usually not reviewable they have more power than a judge. There have been several cases where plaintiffs in arbitration cases are unhappy with the outcome of arbitration and have appealed their case to courts and asked them to intervene. When the courts look at the rulings from arbitrators most have claimed that they have no power to overturn the arbitrators’ decisions (Corkery). Because arbitrators are not judges they also do not have to follow legal precedents. In a lawsuit, the courts legally have to look at prior cases with similar facts to the one at hand and give a ruling comparable to the prior cases. In arbitration, the arbitrator does not have to look at any prior cases when ruling over the current arbitration case. This can make it difficult to predict the outcome of a case and means that even with the same exact facts of a case an arbitrator can rule differently each time.

Arbitrators also do not have a legal requirement to prevent injustices between the parties. Because there is a freedom of contract in the US the courts will generally allow most contracts even if they benefit one party significantly more than the other. The courts believe that it is up to the parties to ensure that they only enter contracts that are beneficial for themselves (Corkery). But there are some circumstances where courts can step in and invalidate a contract or part of it when the contract if they believe it is something extremely wrong with it. There are several claims a plaintiff can make in court, such as unconscionability, duress, and misrepresentation among others that could invalidate a contract (Farnsworth, March 16, 2017). When one of these claims is made in court the court must look at the facts and see if there was actually some sort of unfairness in the case and they make a ruling accordingly. In an arbitration, the arbitrator could hear claims like these but they do not have to follow the legal precedents that the courts do. Therefore, they do not have to protect against injustices like the courts do. When plaintiffs have brought claims to the courts claiming that the arbitrator did not follow legal precedents or prevent an injustice the courts have said point blank that they could not overturn arbitrators’ decisions even if they caused a substantial injustice (Corkery).
There have been a few significant court cases that have upheld or limited arbitration clauses. The case that provided the biggest change in arbitration was the 1985 case involving Mitsubishi motors v. Chrysler. There became a disagreement between the two parties with respect to anti-trust violations. The supreme court ruled that the parties must settle their dispute using arbitration because they had agreed to it in the contract both signed (Malveaux). The Supreme Court ruled in a 2011 case involving AT&T that class action lawsuits and arbitrations are not allowed if there was an arbitration agreement in place.

There are several consequences for employees who have signed a contract that included an arbitration clause and some can be irreversible. Because of the rulings of court cases in recent years, arbitration clauses have become more prevalent. By delimiting regulations on when arbitration clauses can be used there have been several negative effects on employees. The courts have agreed to allow employers to require disputes over serious issues such as discrimination, unsafe work conditions, harassment, wrongdoing and several other very important issues to be resolved without any input by the courts (Stone). The courts can make any law or set any precedent and an arbitrator does not have to follow either of those. The employer now basically has the freedom to commit some serious transgressions without any negative consequences from the courts.

There are negative effects felt by consumers who sign contracts with arbitration clauses in them too. If a consumer has a serious injustice committed against them by a merchant and they signed an arbitration clause the consumer could very easily be given a very bad deal by the arbitrator. The consumer has to rely on and hope that the arbitrator will be fair and listen to their complaints. If the arbitrator comes back with an unfair deal there is literally nothing the consumer can do. The courts have held that they will not get involved in an arbitration even if a serious injustice has occurred.

The implications for someone who has agreed to arbitration in the form of a contract with an arbitration clause in it can be severe and extremely detrimental to a parties’ chance of receiving a fair shot of resolving their conflict. While not every arbitration case is resolved in an unfair manner, there are definitely some cases where a party is taken advantage of. If a party is not able to appeal an arbitrators’ decision they must live with the ruling even if it involves a
serious injustice. The right for these individuals to have their case heard in court is a constitutional right that should never be able to be signed away. All of the benefits of binding arbitration can be seen with non-binding arbitration with the exception of providing a binding opinion. The binding opinion is the most controversial part of the binding arbitration which is completely eliminated when switching to nonbinding arbitration. While there are several claimed advantages and disadvantages to arbitration clauses, the disadvantages definitely outweigh the advantages when it comes to the most common form of arbitration, binding, and therefore binding arbitration clauses should be upheld as illegal while non-binding arbitration clauses should remain legal.

Works Cited


