New Jersey Law Journal

VOL. 207 - NO 13 MONDAY, MARCH 26, 2012 ESTABLISHED 1878

Alternative Dispute Resolution

Consumer Arbitration: Friend or Foe?

A look at contracts where customers must agree to mandatory binding arbitration of potential disputes

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Alternative dispute resolution, long thought the answer to the woes of a clogged, over-burdened and possibly biased legal system, may have become the very beast it sought to conquer. Alternative dispute resolution methods and outcomes have themselves spawned massive amounts of case law, addressing everything from challenges to mandatory arbitration/mediation clauses in contracts to the arbitration decisions themselves, thus clogging the very system it was meant to relieve.

While alternative dispute resolution covers all kinds of disputes among countries, industries and individuals, this article focuses on mandatory arbitration clauses in consumer transactions.

Mandatory binding arbitration is one method parties use to resolve disputes outside the court system. Most contracts in consumer transactions actually require it. From credit cards to automobile purchases and leases, the consumer is required by the seller to sign agreements that contain mandatory binding arbitration provisions, precluding the consumer from pursuing most claims against the seller in court.

Whether these arbitration clauses are enforceable in the first place — the preliminary issue before even addressing an arbitration decision — has generated much litigation. Usually, the consumer is bound by the mandatory arbitration clause in a contract, and arbitration decisions are usually upheld on appeal.

The Federal Arbitration Act, enacted in 1925, requires courts to enforce privately negotiated agreements to arbitrate like they would any other contract. *Curtis v. Cellco Partnership*, 413 N.J. Super. 26, 33 (App. Div. 2010), discusses the enforceability of arbitration clauses, noting that New Jersey courts have adopted the federal policy favoring arbitration as a means of alternative dispute resolution and usually enforcing agreements to arbitrate. The court states that arbitration clauses will be presumed enforceable unless there is some interpretation that the provision does not cover the subject in dispute. And whether a particular issue is subject to the arbitration provision in a contract will be looked at on a case-by-case basis.

Consumer fraud claims are the usual issue of consumer litigation. The *Curtis* court found that these claims can be subject to arbitration even if the arbitration clause in the subject contract does not specify that such claims are covered by its provision. Indeed, arbitration of statutory claims is enforceable when the contract provisions merely contain language reflecting a general understanding of the type of claims included in the waiver; or provide that, by signing, the consumer agrees to arbitrate "all statutory claims arising out of the relationship"; or any claim or dispute based on a federal state statute. Thus, claims ranging from those under the Law Against Discrimination to those subject to the Consumer Fraud Act can be arbitrated even if not specified in the arbitration provision of the contract. There is later case law on this issue.

A common consumer challenge to the enforceability of a mandatory arbitration provision in a contract is that the contract itself is one of adhesion and therefore, its arbitration clause is unenforceable. An adhesion contract is an agreement in which one side (the seller/creditor) has all the bargaining power and uses it to write the contract primarily to his or her advantage.

An example of an adhesion contract is a standardized contract form that offers goods or services to consumers on essentially a "take it or leave it" basis without giving consumers realistic opportunities to negotiate terms that would benefit their interests. Such a contract is enforceable unless it is found to be unconscionable in that it is so unfair that a court will refuse to enforce it. This rare event may occur with a contract that has severe penalties for defaults and whose terms are not obvious due to the fact that they are in small

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print and hidden in the contract. Then a court will find there is no meeting of the minds.

Generally, when it is the seller/creditor seeking arbitration under a consumer contract, it is for debt collection purposes. And when it is the consumer who seeks arbitration, consumer fraud claims are involved. Consumer contracts with mandatory arbitration provisions may provide the consumer with a choice of forum to arbitrate a claim.

The largest and most common arbitration organizations used are the National Arbitration Forum (NAF) and the American Arbitration Association (AAA.) JAMS is also a commonly used private forum. Originally, "JAMS" was an acronym for Judicial Arbitration and Mediation Services, but now the official name of the organization is JAMS, The Resolution Experts, presumably because the neutrals are not all retired judges.

The NAF is the largest and most controversial of the arbitration organizations, coming under fire from consumer advocates for being the most biased against consumers. On July 14, 2009, the state of Minnesota filed a complaint against the NAF. The lawsuit alleged that the NAF, while holding itself out as impartial, actually worked behind the scenes — alongside creditors and against the interests of ordinary consumers — to convince credit card companies and other creditors to insert arbitration provisions in their customer agreements and then appointing the NAF to decide the disputes.

The lawsuit also alleged that the NAF paid commissions to executives whose job it was to convince creditors to put mandatory arbitration clauses in their customer agreements. The suit alleged that the NAF did this to generate arbitration filings with the NAF and hence, revenue for itself. This case was settled with the NAF agreeing not to arbitrate any more consumer debt-collection arbitration claims. The NAF website now states that the NAF is no longer accepting consumer arbitration claims. Another suit was filed against the NAF shortly after the Minnesota suit was commenced. Because these cases are recent, the NAF still appears as a choice of forum for arbitration proceedings in many contracts today. This may raise an enforceability issue if it is the only forum provided in the mandatory arbitration clause.

The AAA is the other commonly used arbitration organization. It is a not-for-profit organization. Not long after the NAF settlement with Minnesota, it too decided to end its debt-collection arbitration proceedings. However, it still offers consumer arbitration on other matters. For instance, consumers can still submit arbitration demands on their consumer fraud claims against sellers. The first step the AAA takes when it receives an arbitration demand is to determine whether the arbitration clause in the agreement is valid, and whether the issue in dispute is within the scope of the arbitration clause of the agreement.

Possibly in an effort to promote the AAA and address consumer concerns about arbitration in general, the AAA, on its website, has posted a video of a presentation discussing the latest study on the efficacy and fairness of arbitration. One point made was that while businesses win a higher percentage of the cases they initiate, it is because their cases are just debt collection proceedings, which are highly winnable for the creditor by nature. Apparently, arbitration proceedings initiated by the consumer also have a high rate of success on the consumer side.

JAMS, another commonly used forum, does not have a regional office in New Jersey but has one in New York. It is a for-profit arbitration company that has also been accused of collusion with an industry which sought to influence the outcome of arbitration decisions in its favor, and which arbitrations were mandatory pursuant to contracts with the company's customers. *Nitro Distributing v. Alticor* is a federal case in Missouri in which the plaintiffs amended their complaint to include allegations about the Amway company's influence on JAMS to obtain arbitration decisions in its favor. The allegations also discuss the difference between JAMS and the AAA, noting that AAA is not for profit. This lawsuit was not consumer-related but involved disputes between businesses in the tool industry.

The debate continues about whether arbitration is good for the consumer or not. While it is generally thought to be a quicker, more efficient and less costly means of resolving a dispute, consumer advocates claim that these benefits inure to the business or creditor rather than the consumer. The arbitration filing fees can be more costly than those in court, discouraging consumers from pursuing small claims. However, many arbitration organizations, and/or the arbitration clauses themselves, require the business to pay some or all of these fees. Otherwise, the contract may be deemed unconscionable.

Another common complaint about arbitration concerns the limited discovery process, which makes it difficult for consumers to fully and effectively pursue their claims. Furthermore, because arbitration proceedings are private, it is hard for consumer advocacy groups to gather data on cases and assess the true effectiveness and fairness of the system.

Facing an enforceable mandatory arbitration clause and given a choice of forum, the AAA seems to be the most unbiased forum for the consumer. If no choice is provided, the consumer may consider challenging the enforceability of the clause in court. ■