# Getting under the hood: A practical guide to drafting consumer and employee arbitration agreements

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Over the past two years, courts around the country, led by the Supreme Court's decision in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1745 (2011), have strongly supported the enforcement of agreements to arbitrate on an individual basis in lieu of class actions. These major developments in the law have made it far more attractive for businesses to adopt arbitration agreements with their customers and employees.

Much of our practice, especially since *Concepcion*, has involved advising companies on how to implement arbitration agreements that are practical, fair and enforceable. Because there are many different types of businesses — and because the nature of the relationships between those businesses and their customers and employees varies significantly — there is no "one-size-fits-all" arbitration clause. But we have identified some core principles that should help companies, and those advising them, tailor arbitration programs to fit their needs and those of their customers or employees.

## BACKGROUND

Arbitration often represents a win-win proposition for companies and their customers and employees. To begin with, both parties benefit from the cost savings of arbitration, as well as its simplicity, speed and less adversarial nature. Some studies show that consumers and employees, especially those with relatively small claims, often find the process more accessible than litigation.[1] And companies often benefit from a reduction in their dispute-resolution costs; basic economic theory teaches that those benefits are passed along to consumers and employees in the form of lower prices and higher wages.[2]

Federal law has long supported the use of arbitration agreements. In 1925, Congress enacted the Federal Arbitration Act, 9 U.S.C. § 1, to reverse the longstanding judicial hostility to arbitration agreements. The Supreme Court has repeatedly noted that the FAA embodies a strong federal policy favoring the enforcement of arbitration agreements.[3] The centerpiece of the FAA, Section 2, provides that written arbitration agreements are "valid, enforceable, and irrevocable, save upon such grounds as exist in law or in equity for the revocation of any contract."[4] In other words, the FAA puts arbitration agreements on "equal footing" with other kinds of contracts. Thus, courts must reject any asserted state-law defense to enforcement of an arbitration agreement unless the defense is applicable to contracts generally. These defenses include, for example, "fraud, duress, or unconscionability."[5]

Moreover, because "the FAA was designed to promote arbitration" and "to ensure the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings," states cannot condition the enforceability of arbitration agreements on compliance with "[r]ules aimed at destroying arbitration" or the availability of "procedures incompatible with arbitration."[6]

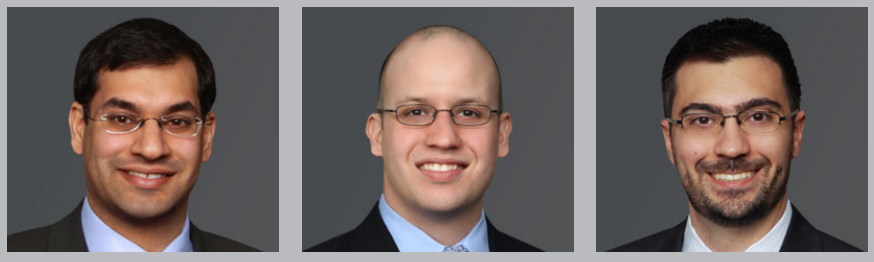
## IMPLEMENTING AN ARBITRATION PROGRAM

As many businesses have come to recognize, the foundation for a successful arbitration program is a well-crafted arbitration agreement. First, the dispute resolution process should function smoothly for both the company and its consumers or employees. In other words, the arbitration program should generally be more efficient and less costly than litigation. Second, because the arbitration agreement does not benefit anyone unless it can be enforced, it must be drafted with an eye on the courts in which it might be challenged and the arguments that might be asserted against its enforcement.

## HOW DOES THE ARBITRATION PROCESS FUNCTION?

Most fundamentally, an arbitration agreement should set up a dispute resolution process that works for all parties — the business as well as its customers or employees. As it tries to set up a well-functioning process, a company should consider several issues.

Most significantly, businesses should make clear that class or representative arbitrations are not permitted. As the Supreme Court explained in *Concepcion*, class arbitration "sacrifices the principal advantage of arbitration — its informality — and makes the process slower, more costly, and more likely to generate procedural morass than final



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judgment."[7] Businesses are understandably reluctant to submit to class procedures because of the settlement pressures that result from aggregating a large number of claims; that problem is exacerbated in the arbitration context because businesses will face the risk of an effectively unreviewable class-wide award. Moreover, data show that few consumers and employees benefit from class actions, because most class claims are not certified, and the remaining ones are usually settled — often for pennies on the dollar, which makes it less likely that class members will submit claims and obtain recoveries.[8]

Despite the undesirability of class arbitrations, a number of courts have held that class arbitration may be available when an arbitration agreement fails to address the topic. To avoid this risk, businesses should include express language prohibiting the arbitration of class or representative claims rather than relying on silence.[9] For added security, drafters should include a provision that makes the "class waiver" language in an arbitration agreement non-severable to avoid the possibility of being forced into a class or representative arbitration if, notwithstanding *Concepcion*, a court were to invalidate the restriction on such proceedings.

Companies also should consider making a "pre-arbitration" dispute resolution mechanism an integral part of the arbitration procedure. For example, drafters of consumer and employee arbitration agreements could require the parties to notify one another of a dispute and to be given some time (say, 30 days or more) to try to settle the dispute before arbitration commences. Of course, even without a mandatory pre-arbitration dispute resolution process, the parties could settle disputes in advance of a formal arbitration. But when the arbitration agreement specifies a "cooling off" period that allows the company to try to settle a dispute informally, it is much more likely that claims can be resolved without the need for a customer or employee to initiate arbitration, saving time and money for all parties.

A company also should identify in its agreements an arbitration organization to administer the arbitrations. The two leading organizations are the American Arbitration Association and JAMS. Both organizations have developed arbitration rules and procedures that address the needs of consumers and employees. In our experience, these rules and procedures, although not perfect, are workable in practice and certainly make dispute resolution more streamlined than litigation.

**Most of the arguments against the enforcement of arbitration agreements fall into three categories:**

(1) How the arbitration agreement was formed.

(2) That a dispute falls outside the scope of the arbitration agreement.

(3) That the arbitration agreement is unfair.

Finally, the drafter should pore over the arbitration program for hidden landmines. While ideally all parties to arbitration agreements will make use of arbitration in good faith to pursue genuine disputes, the arbitration process can be, just like the court system, subject to abuse. Authors of arbitration clauses should attempt to anticipate such abuses and forestall them — without erecting obstacles to the pursuit of legitimate claims.

## IS THE ARBITRATION AGREEMENT FAIR AND ENFORCEABLE?

Of course, it is not enough to create a well-functioning arbitration process; the arbitration agreement must be enforceable in the first place. Because plaintiffs often seek to avoid their arbitration agreements, especially if they are seeking to bring a class action, companies will want to have certainty that courts will enforce their arbitration agreements, and that, in turn, means persuading courts that the agreements are fair to individual consumers or employees.

Plaintiffs have made a wide variety of arguments against the enforcement of arbitration agreements. Most of the arguments we have seen, however, tend to fall into three categories: (1) challenges to the manner in which an arbitration agreement was formed; (2) contentions that the dispute at issue is outside the scope of the arbitration agreement; and (3) assertions that the agreement is unconscionable or violates public policy (in short, that the agreement is unfair). Businesses should anticipate these arguments when creating an arbitration program, as most (if not all) of these objections to arbitration can be answered at the drafting stage.

### CONTRACT FORMATION

To begin with, a company should think carefully about how consumers or employees enter into their arbitration agreements. As a rule of thumb, a company should provide the consumer or employee with advance notice of the arbitration agreement if feasible (or an opportunity to cancel the contract if advance notice is not practical), and should ensure that the arbitration requirement is clearly disclosed in the contract. The company also should consider the possibility of giving consumers or employees a certain period of time after entering into the contract to opt out of the arbitration program.

Developing the contract-formation process, however, is only part of the story. When it becomes necessary to compel arbitration, a company will need to prove that its customers or employees have agreed to arbitrate. To do so, a business should maintain records that allow it either to identify particular contracts or to demonstrate its routine practices for entering into customer or employee agreements. To be sure, it is rare that plaintiffs are able to raise a genuine issue of disputed material fact over whether an arbitration agreement has been formed. But if that does happen — and sometimes it does — the FAA provides for a jury trial on such issues. Certainly no company wants to face a jury trial — even on such a narrow issue — when one of the key reasons it agreed to arbitrate was to avoid jury trials in the first place.

### SCOPE OF ARBITRATION AGREEMENT

Plaintiffs frequently argue that their claims fall outside the scope of the issues that the parties agreed to arbitrate. This problem often is simple to fix, because the drafter of an arbitration provision can (and should) define precisely how broadly or narrowly construed the arbitration agreement is intended to be. Many courts have held that agreements to arbitrate disputes "arising out of or relating to" the contract or its breach are "broad" and require arbitration of "all issues that 'touch matters' within" the underlying contract. But there are outlier decisions that adopt a far more constricted reading of that standard

language, and so a company that wishes to avoid fights over the scope of the arbitration agreement may prefer to adopt a more all-encompassing arbitration agreement, such as an agreement to arbitrate "all disputes" between the parties.

Some companies may prefer to exempt certain categories of claims from arbitration. There are many situations in which doing so makes perfect business sense, but a company should be watchful for attacks on any such exceptions. For example, if the company intends to create only a narrow exception to arbitration, that exception should be defined in precise terms to prevent other kinds of claims, especially claims that could in theory be brought on a class basis, from being shoehorned into the exception (and out of arbitration). Although the Supreme Court has held that the federal policy favoring arbitration requires that "[a]ny doubts concerning the scope of arbitrable issues ... be resolved in favor of arbitration,"[10] parties seeking to exploit an ambiguity in an exception to an arbitration agreement can be expected to argue that the controlling principle is instead that contracts should be interpreted against the drafter.

Finally, the company should consider whether it wants courts or arbitrators to decide whether a particular dispute is arbitrable. The Supreme Court has explained that "[c]ourts should not assume that the parties agreed to arbitrate arbitrability unless there is clear and unmistakable evidence that they did so."[11] But prudence dictates that the drafter of an arbitration agreement address this topic expressly to avoid a surprise in either direction. Many businesses prefer to have courts decide these issues to guarantee appellate review. Such businesses should specify in the agreement that courts will decide questions of arbitrability. Conversely, if the company prefers to have arbitrators resolve challenges to the enforcement of an arbitration agreement, something the Supreme Court has confirmed is permissible, the drafters should say so directly.[12]

## UNCONSCIONABILITY AND PUBLIC POLICY

In recent years, the plaintiffs' bar has regularly contended that arbitration agreements are unconscionable and/or violate state or federal public policy. *Concepcion* makes clear that states may not declare (either as a matter of unconscionability or public policy) that arbitration agreements are unenforceable on the ground that they preclude class treatment of claims. And the Supreme Court has recently rejected a similar argument under federal law in *American Express Co. v. Italian Colors Restaurant*.[13]

That said, doctrines like unconscionability will still have a role to play in challenges to the enforcement of arbitration agreements, as long as the principles being invoked are generally applicable. As the Supreme Court has recently recognized, arbitration agreements may be "unenforceable under state common law principles that are not specific to arbitration and preempted by the FAA."[14]

Some unconscionability challenges attack features of the arbitration agreement that arguably tilt the process in favor of the company, such as requirements that consumers or employees pay arbitration costs that are excessive in the context of small claims, waive substantive rights available to remedy an individual's claims under applicable law or travel to distant places to arbitrate. Many of these features are common in business-to-business agreements. To forestall unconscionability challenges, companies should consider removing these artifacts of older business agreements from their consumer or employee arbitration agreements. In addition, drafters may consider adding some or all of the following hallmarks of pro-consumer arbitration provisions (see box).

Before *Concepcion*, plaintiffs often sought to challenge arbitration agreements on the ground that they required individual rather than classwide arbitration. And at least in some states, most notably California, those arguments had met with success. But as noted above, in *Concepcion*, the Supreme Court held that the FAA preempts such state-law rules because "[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA."[15] To condition the enforcement of arbitration agreements on the availability of class procedures therefore impermissibly creates an "obstacle to the accomplishment of the FAA's objectives" of "ensur[ing] that private arbitration agreements are enforced according to their terms."[16]

The majority opinion in *Concepcion* also rejected an argument made in the dissent that "class proceedings are necessary to prosecute small-dollar claims that might otherwise slip through the legal system." The majority first explained that, "States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons." The majority then added that the consumer false-advertising claim at issue "was most unlikely to go unresolved,"

### Hallmarks of pro-consumer arbitration provisions

- Low-cost or cost-free arbitration: Make arbitration affordable for customers and employees. Consider offering to pay the full costs of arbitration for modest-size claims.
- Mutuality: To the greatest extent possible, both parties should be obligated to arbitrate claims, and any exceptions to arbitration should be fully mutual.
- Do not impose limits on legal remedies: Courts remain skeptical of efforts to bar statutory or punitive damages and recovery of statutory attorneys' fees or to shorten statutes of limitations.
- Offer a convenient location for the non-business party: Courts are reluctant to enforce arbitration agreements that require a consumer or employee to cross the country to arbitrate.
- Confidentiality: Although confidentiality is often thought of as a benefit of arbitration, some courts have expressed concerns with arbitration agreements that require a consumer or employee to keep the results of arbitration secret.
- Neutral arbitrator-selection process: When specifying an organization as the forum for arbitration of disputes, make sure that the organization and its process for selecting arbitrators are reputable and unbiased.

because under the AT&T arbitration provision at issue, "AT&T will pay claimants a minimum of $7,500 and twice their attorney's fees if they obtain an arbitration award greater than AT&T's last settlement offer." The majority noted that lower courts had "found this scheme sufficient to provide incentive for the individual prosecution of meritorious claims that are not immediately settled" and that "aggrieved customers who filed claims would be 'essentially guarantee[d]' to be made whole."[17]

A company that wishes to avoid fights over the scope of the arbitration agreement may prefer to adopt a more all-encompassing agreement to arbitrate "all disputes" between the parties.

Some plaintiffs, taking their cue from *Concepcion*'s praise for AT&T's exceptionally consumer-friendly arbitration provision, have argued that the reach of *Concepcion* is limited to arbitration provisions that contain the same (or very similar) pro-consumer features as AT&T's clause in *Concepcion* did. But most courts have rejected that attempt to narrow *Concepcion*; explaining that *Concepcion*'s holding is both "broad and clear" and prohibits states from relying on the absence of class procedures as a ground for refusing to enforce arbitration provisions.[18]

And in *American Express*, the Supreme Court ruled that an arbitration provision that did not contain all of the exceptionally pro-consumer feature of AT&T's provision in *Concepcion* is enforceable as a matter of federal law, explaining that "our decision in [*Concepcion*] all but resolves this case."[19] That said, given the Supreme Court's ruling in *Concepcion*, companies that adopt arbitration provisions similar to AT&T's clause will likely benefit from what one judge has described as a "safe harbor."

Alternatively, plaintiffs have sought to oppose arbitration by arguing that their arbitration agreements prevent them from "effectively vindicating" their federal statutory rights because the agreements waive class actions. In *American Express*, the Supreme Court held that the so-called "effective vindication" doctrine cannot be used to challenge a requirement that arbitration proceed on an individual rather than class-wide basis.[20] But the Congress suggested that, when it comes to federal claims, the doctrine might be used to challenge the enforcement of arbitration agreements that "forbid[] the assertion of certain statutory rights," or (possibly) to attack arbitration provisions that require the claimant to pay "filing and administrative fees attached to the arbitration that are so high as to make access to the forum impractical."[21]

## CONCLUSION

In light of *Concepcion, American Express* and subsequent developments in the law, consumer and employment arbitration agreements are now more attractive to businesses than ever. But it remains critical that businesses make informed choices about the types of arbitration provisions that they adopt. We are the first to recognize that there is no such thing as an optimal arbitration agreement for every company. But all businesses that wish to make use of arbitration — and their lawyers — should benefit from the guidelines we've discussed: Make the arbitration process function well for all parties and ensure that it is fair and enforceable. WJ

## NOTES

[1] *See, e.g.* Lewis L. Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29, 48 tbl. 1 (1998) (comparing results in employment arbitration with results in federal court during the same period of time and finding that employees won 63 percent of cases in arbitration compared to 15 percent in federal court); Searle Center on Law, Regulation, and Economic Growth, Consumer Arbitration Before the American Arbitration Association Preliminary Report (finding that consumers win relief in 53 percent of the cases they file in arbitrations before the American Arbitration Association); Sarah Rudolph Cole & Theodore H. Frank, *The Current State of Consumer Arbitration,* DISP. RESOL. MAG. (Fall 2008), at 34 (reporting results of studies of consumer arbitrations).

[2] Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements,* J. DISP. RESOL. 89, 92 (2001).

[3] *See, e.g., AT&T Mobility LLC v. Concepcion,* 131 S. Ct. 1740, 1745 (2011); *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.,* 460 U.S. 1, 24 (1983).

[4] 9 U.S.C. § 2.

[5] *Doctor's Assocs. Inc. v. Casarotto,* 517 U.S. 681, 687 (1996).

[6] *Concepcion*, 131 S. Ct. at 1748-49 (internal quotation marks omitted).

[7] *Id.* at 1748.

[8] *See, e.g.,* Thomas Willging & Shannon Wheatman, *Attorney Choice of Forum in Class Action Litigation: What Difference Does It Make?*, 81 NOTRE DAME L. REV. 591, 635-36, 638 (2006); James Tharin & Brian Blockovich, *Coupons and the Class Action Fairness Act,* 18 GEO. J. LEGAL ETHICS 1443, 1445-46 (2005); Jill Fisch, *Class Action Reform, Qui Tam, and the Role of the Plaintiff,* 60 L. & CONTEMP. PROBS. 167, 168 (1997).

[9] Although the majority view is that an arbitrator may not preside over a class or representative arbitration unless the arbitration agreement expressly authorizes such a proceeding, there is continuing disagreement about how to construe "silent" arbitration agreements. In *Oxford Health Plans LLC v. Sutter,* 133 S. Ct. 2064 (2013), the Supreme Court declined to overturn an arbitral award interpreting an arbitration agreement that does not expressly address class arbitration nonetheless to authorize that procedure.

[10] *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.,* 473 U.S. 614, 626 (1983) (internal quotation marks omitted).

[11] *First Options of Chicago Inc. v. Kaplan,* 514 U.S. 938, 944 (1995) (internal quotation marks and alternations omitted).

[12] *See Rent-A-Center West Inc. v. Jackson*, 130 S. Ct. 2772 (2010).

[13] *Am. Express Co. v. Italian Colors Rest.,* 133 S. Ct. 2304 (2013).

[14] *Marmet Health Care Ctr. Inc. v. Brown,* 132 S. Ct. 1201, 1204 (2012).

[15] *Concepcion,* 131 S. Ct. at 1748.

[16] *Id.* at 1748, 1753.

[17] *Id.* (citation omitted).

[18] *Litman v. Cellco P'ship,* 655 F.3d 225, 231 (3d Cir. 2011).

[19] *Am. Express*, 133 S. Ct. at 2309-12.

[20] *Id.* at 2310-12.

[21] *Id.* at 2310.