

Lawsuit bound? There is another way: Arbitration

By Ed Winn III

If rental dealers cannot recover their money or their property through patient persistence, the choice finally is to sue the customer or take the loss (and maybe sue the customer, then take the loss, anyway). Likewise, when a customer has a beef with a rental company, the choice finally is to sue the company or get over it. There is another way: arbitration.

Arbitration is gaining favor among financial institutions and other retail industries as a cheaper and quicker means of resolving disputes with consumers than litigation. Rental dealers have considered alternative dispute resolution (ADR) mechanisms, mediation and arbitration, for resolving disputes with employees for some time. The notion of using ADR with consumers is fairly new, but it is gaining acceptance rapidly with businesses and consumers alike.

Last December, the U.S. Supreme Court handed down its first decision involving consumer financial services arbitration, *Green Tree Financial Corp. v. Randolph*. Some consumer advocates were hoping that the Supreme Court would limit the ability of companies to mandate arbitration in consumer transactions. But, rather than stifling consumer arbitration, the Supreme Court ruled that arbitration was appropriate in Truth-In-Lending cases. However, the Court did so with the caveat that some arbitration agreements might not be enforceable if the fees consumers have to pay in order to arbitrate were "prohibitive" and, further, that the consumer has the burden of proving the fees are excessive.

The Supreme Court could have stifled further development of the use of arbitration involving consumers, but instead, gave businesses a green light to move forward toward this mechanism for resolving disputes. The expectation is that arbitration will soon gain widespread acceptance in some industries in which consumer disputes frequently arise.

There is federal statute, the Federal Arbitration Act, which establishes a presumption in favor of arbitration as a lawful means of resolving disputes and which authorizes arbitration rulings to be enforced by the courts. A number of states have their own statutes authorizing arbitrations and establishing guidelines to insure that the process is fair and unbiased.

Over the years, both non-profit and for-profit organizations have arisen to offer arbitration services. The American Arbitration Association (AAA) is the largest and best known with written rules for different kinds of disputes and a nationwide pool of arbitrators with expertise in a variety of fields.

What is arbitration?

In a nutshell, it is a nonjudicial mechanism for resolving disputes. It is fundamentally a matter of contract. What the parties agree to may vary widely, depending upon the parties. Arbitration may be optional or mandatory. The parties may agree by contract in advance to arbitrate in the future if a dispute arises (mandatory) or they may agree to arbitrate after a dispute actually does arise (optional). Arbitration may be binding or nonbinding. The parties may agree to abide by whatever ruling the arbitrator gives or they may reserve the right to sue no matter how the arbitrator rules.

Arbitration provides a mechanism for the disputants to choose one or more independent, unbiased arbitrators who will act as judge and jury in the dispute and who will listen to both sides and make a decision about how the matter is to be resolved. The arbitration decision may be a sentence awarding money to one party or the other or it may contain a lengthy

explanation of the reasons for the decision, depending upon what the parties want and can agree to.

If the arbitration is binding, the ruling can be entered as a judgment in court and enforced with all of the powers available to the judiciary branch of the government. Discovery, when one party can examine the other side's evidence prior to the arbitration hearing, if there is one, is usually limited, and the rules of evidence and procedure are looser than they are in court. Some arbitrations are conducted entirely by telephone, others have face-to-face hearings with witnesses testifying under oath and subject to cross-examination.

Legal oversight of the process is limited. Without evidence of fraud or some fundamental unfairness in the process, e.g. a biased arbitrator, the courts will enforce arbitration decisions as rendered and there is no right of appeal.

Arbitration arose originally between merchants needing to resolve certain kinds of recurring commercial disputes without the time and expense of full-blown litigation. It has proven successful in the business world and, in recent years, has begun to enter consumer transactions, although the practice of arbitrating consumer disputes is not yet widespread.

Why Arbitrate?

Arbitration is an alternative to litigation. It is generally quicker and less expensive. For some kinds of arbitration, the disputants need not hire attorneys. Discovery is limited. Arbitration is private. Arbitration hearings are not open to the public, as are trials, nor are arbitration results generally publicized. While the rules vary from state to state, arbitrators may not be able to award punitive damages, nor can they hear cases involving more than one plaintiff at a time (no class-action arbitrations). Arbitrators are not as tightly bound to follow the letter of the law as are judges and juries. Instead, they are able to fashion relief based upon what they deem to be fair and just under the circumstances. Judicial review of arbitration decisions is very limited.

Initially skeptical, the judicial system today looks upon arbitration with approval. Arbitration has helped relieve case backlogs in courts. Repeat users have deemed the process fundamentally fair. The result is that arbitration continues to expand as an alternative to the courtroom.

Why some Consumer Advocates Don't Like Arbitration

Agreeing to arbitrate involves giving up some constitutional rights, namely the Seventh Amendment right to a trial by jury in all civil disputes when the amount in controversy is more than \$20. Consumer advocates do not like for consumers to waive any rights, certainly not constitutional rights. The standard for waiving such a right is that it must be done "knowingly, intelligently, and voluntarily." Consumer advocates complain that mandatory arbitration clauses are often buried in lengthy loan documents or, worse, sent in flyers from credit card companies along with the monthly statement. Consumer advocates suspect, but cannot prove, that consumers fare worse in arbitrations than they do in court.

Consumer advocates have an instinctive aversion to all terms in "contracts of adhesion," which are contracts offered by a superior party to a weaker party on a "take-it-or-leave-it" basis. Most consumer contracts, including rental-purchase agreements, could be so categorized. If the arbitration process is a fundamentally fair one, no more so or less so than the judicial system, then consumer advocates should not care if consumer disputes are resolved by arbitrators instead of judges and juries. One might expect the same result,

more or less, in either forum. However, consumer advocates fear that repeat users of the arbitration process will learn the system better and achieve better results in it than one-time users. Of course, the same argument can be made of the judicial system. Some advocates fear that repeat users may even be able to bias the system in their favor by preferring one arbitration group or company over another with the very promise of more business in the future. Consumer advocates especially do not like consumers' inability to file class action claims or recover punitive damages in arbitration.

Finally, consumer advocates do not think that arbitration serves the ends of justice and social policy as decided by legislatures when the process resolves privately what are really public disputes. For example, the Truth-In-Lending Act was designed to curb certain lender abuses. The Federal Reserve Board was appointed to oversee and regulate the lending industry under this Act. One way for the FRB to measure lender conduct and compliance with the law is by reviewing the litigation that arises between lenders and borrowers.

If all TIL disputes were to be resolved by arbitration, the FRB, and for that matter, Congress and state legislatures, would be deprived of a valuable source of information about the nature of the debtor-creditor relationship. Consumer advocates argue that this lack of information because of arbitration risks making regulators less able to do their jobs.

The converse of all of the consumer advocate complaints, of course, is why businesses are motivated to arbitrate consumer disputes. If that is the case, one might fairly ask why the rental industry has not moved toward arbitration with the same zeal and speed as some other industries? It may be because customers do not often sue rental dealers, nor do dealers invoke the judicial system all that often to recover property. If dealers were unable to recover most property on their own without having to sue customers, the business would not work. At best, arbitration is only an alternative to litigation. If you don't litigate, you don't need to arbitrate.

Will Arbitration Work for Rental Dealers?

As with most things, there are pros and cons to arbitrating consumer disputes. First, the system is untried in the rental industry and no one knows how consumers and judges will react. Initially, mandatory arbitration clauses might hurt deliveries. Consumers confronted with having to waive the right to a trial by jury in order to rent a television in one store might choose a store down the street without an arbitration clause. In any case, the arbitration clause will have to be highlighted and explained in the store; objections will have to be overcome. This in addition to explaining the basics of the rental agreement.

If rental dealers want to arbitrate, they will have to be careful not to waive rights themselves that they need to run their businesses. Many arbitration agreements require the parties to arbitrate "all claims and controversies" that may arise between them. Rental dealers will not want to arbitrate before they attempt to pick up merchandise. Dealers will need to carve out self-help repossession and perhaps extraordinary judicial relief as well from arbitration if they resort to writs and other pre-trial judicial mechanisms for recovering property on a regular basis.

At the same time, dealers will have to be careful how they draft arbitration clauses, because the more one-sided the arbitration agreement, the greater the risk that a court will refuse to enforce it. Rental dealers would like to be able to require consumers to arbitrate their disputes while preserving the right of rental dealers to go to court. Dealers would like to require that the arbitrator be a rental dealer. Dealers might like all arbitrations to have to occur close to the home office. Dealers would like for consumers to have to pay for the

arbitration, at least if the consumer initiates the action. None of these clauses are likely to withstand judicial scrutiny, because arbitration statutes require that the arbitration process be fundamentally fair to both sides.

Courts are quite sensitive to economic and procedural barriers to arbitration. The Supreme Court just ruled that arbitration fees in consumer arbitrations can't be excessively high, without explaining how much is too much. Dealers might look at the fees for filing claims in small claims court as a guide and not require consumers to pay more than this amount to arbitrate a claim.

Because of the increasing use of arbitration in the consumer setting, a number of arbitration and consumer protection groups conferred together and issued a Consumer Due Process Protocol for arbitration. (For a copy, go to www.adv.org/education/education/consumer_protocol.html.) The protocol sets forth in some detail recommendations for achieving fundamental fairness in consumer arbitrations, how to provide adequate information to consumers about arbitration, how to choose neutral arbitrators, the relationship between arbitration and small claims court and other matters.

The decision to arbitrate with consumers will be made in the rental industry, as in other industries, company by company. Some will see the benefits of cost and time savings and limited liability as far exceeding any burdens to implementing the system into their rental programs. Other companies will remain content with the status quo.

Companies wishing to pursue the matter further must be attentive to the rules that exist, which vary considerably from state to state, and the developing case law. It is not the case that a simple arbitration paragraph borrowed from another industry or other source will necessarily work for a rental company and may even have the unintended result of impeding collection efforts and costing the company money. As companies begin to experiment with consumer arbitration, APRO will attempt to keep its membership informed about how arbitrating consumer disputes is working for dealers.