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# THE ARBITRATION CLAUSE IN CONTEXT: HOW CONTRACT TERMS DO (AND DO NOT) DEFINE THE PROCESS

W. MARK C. WEIDEMAIER<sup>†</sup>

## INTRODUCTION

Consider the following arbitration clause, which might be found in a contract of employment or a standard-form consumer contract:

Any claim, controversy, or dispute of any kind between us will be resolved by binding arbitration, to be conducted in Philadelphia, PA under the then-applicable rules of American Arbitration Association or JAMS. The arbitrator may not award punitive or exemplary damages.

Arbitration clauses like these have engendered a significant amount of debate, much of which focuses on the proper response the law should make to “one-sided” clauses – *i.e.*, those that limit the procedures and remedies available to individuals in arbitration.<sup>1</sup> Because my example clause appears to prohibit awards of punitive damages and to require significant travel for individuals who live far from Philadelphia, it might fairly be termed “one-sided.”

But the clause may not be as one-sided as it seems. In fact, the drafter of this “one-sided” clause may have anticipated that it would yield, in at least some disputes, a more “even-handed” process in which punitive damages are available and arbitration hearings take place in a location convenient for the individual disputant. Conversely, drafters of apparently “even-handed” clauses may sometimes expect them to yield a “one-sided” disputing process.

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1. The debate over whether to enforce such clauses raises fundamental questions about the proper regulation of markets. *E.g.*, Omri Ben-Shahar, *Foreword: “Boilerplate”: Foundations of Market Contracts Symposium*, 104 MICH. L. REV. 821, 821 (2006). For a variety of views on the efficiency of consumer and employment arbitration contracts, see Matthew T. Bodie, *Questions About the Efficiency of Employment Arbitration Agreements*, 39 GA. L. REV. 1, 30-31 (2004); Keith N. Hylton, *Agreements to Waive or to Arbitrate Legal Claims: An Economic Analysis*, 8 SUP. CT. ECON. REV. 209, 250-54 (2000); Christopher R. Drahozal, *“Unfair” Arbitration Clauses*, 2001 U. ILL. L. REV. 695, 751-65; Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. DISP. RESOL. 89, 91-93; and Jean R. Sternlight & Elizabeth J. Jensen, *Using Arbitration to Eliminate Consumer Class Actions: Efficient Business Practice or Unconscionable Abuse?*, LAW & CONTEMP. PROBS., Winter/Spring 2004, at 75, 92-95.

This Essay explores these possibilities. It begins by asking an apparently simple, but foundational question: Why would the business produce a contract like this one? Part I explores the potentially complex interaction between the "one-sided" terms in my example clause – the punitive damages bar and the centralized hearing location – and the "due process" protocols adopted by many arbitration service providers. As I will explain, although my example clause appears straightforward, it may be complex in operation. In particular, the clause incorporates rules that may constrain the business's apparent preference to avoid punitive damages and to conduct hearings in a centralized location.

By and large, the business could structure the arbitration process however it wanted.<sup>2</sup> So what explains its decision to include these conflicting provisions in the clause? Part I briefly suggests a number of possibilities before identifying and exploring an alternative. I argue that the clause as written creates post-dispute strategic opportunities for both parties and that these opportunities may shape the arbitration in significant ways. Part I suggests that the business grants these opportunities to the individuals with whom it contracts as the "price" for the legitimacy conferred by the due process protocols. In some cases, the result may be an arbitration process that is less "one-sided" than the clause itself would suggest. The protocols, however, do not render "one-sided" terms meaningless or ineffective; the business sometimes may exploit such terms to its advantage. Indeed, we might view the one-sided terms as options that the business may or may not exercise in the context of a particular dispute.

If the selection of a particular provider or set of rules may sometimes render apparently one-sided arbitration clauses more even-handed than they seem, the opposite dynamic may also exist. Part II explains how explicit provider rules and evolved practices among arbitrators may, in effect, supply "one-sided" terms that cannot be detected from a review of the arbitration clause itself.

Together, Parts I and II yield two related and important insights. First, arbitration clauses may paint an incomplete or even misleading picture of actual arbitration procedures and remedies. Second, understanding arbitration as a legal, social, and contracting phenomenon may require sustained inquiry into the relationship between arbitration contracts and the rules and practices of arbitrators and arbitration providers.

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2. *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989).

## I. WHAT PRICE LEGITIMACY?

The following sections examine the potential dynamic created by the inclusion of apparently one-sided terms in a contract governed by arbitration due process rules. I do not purport to offer a systematic description of the actual operation of these rules on the ground. That is an empirical question, and we do not have enough information to offer meaningful answers. Instead, my goal is to generate hypotheses worthy of further exploration. Nevertheless, the following discussion draws in part on informal conversations with a variety of repeat players in the arbitration process, including lawyers, arbitrators, and arbitration provider employees and executives.

### A. AGREEMENTS THAT INCORPORATE, YET VIOLATE, THE DUE PROCESS PROTOCOLS

As an example of this potential dynamic, return to my example arbitration clause (reproduced below) and its one-sided terms: the limitation on remedies and the centralized hearing location. For simplicity, I will assume that this clause is contained in an employment contract and that at least some employees live a significant distance from Philadelphia:

Any claim, controversy, or dispute of any kind between us will be resolved by binding arbitration, to be conducted in Philadelphia, PA under the then-applicable rules of American Arbitration Association or JAMS. The arbitrator may not award punitive or exemplary damages.

Depending on one's beliefs about arbitration and the civil justice system, this clause might seem an objectionable attempt to self-deregulate – by channeling disputes into a forum that denies employees any meaningful remedy – or an attempt to rationalize a flawed process of resolving employment disputes.<sup>3</sup> But however we view it, the clause seems straightforward. It appears to reveal clear employer preferences for (i) arbitration (ii) in a centralized hearing location (iii) without the prospect of punitive damages. Beyond that, the employer may

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3. For a variety of perspectives, compare Paul D. Carrington, *Self-Deregulation, the "National Policy" of the Supreme Court*, 3 Nev. L.J. 259 (2002) (viewing arbitration as an opportunity for self-deregulation), with Jason Scott Johnston, *The Return of Bargain: An Economic Theory of How Standard-Form Contracts Enable Cooperative Negotiation Between Businesses and Consumers*, 104 MICH. L. REV. 857, 893-95 (2006) (arguing that courts can control opportunistic contracting behavior and that arbitration creates incentives for cooperative bargaining between firms and their customers and employees), and David Sherwyn, Samuel Estreicher & Michael Heise, *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1579-80 (2005) (arguing that many employers implement arbitration programs to avoid inefficiencies associated with disputes, and to increase morale and reduce employee turnover).

have no interest in specifying the minutiae of the arbitration process, so it incorporates off-the-rack procedures promulgated by its chosen arbitration providers.<sup>4</sup>

Yet the clause is actually quite puzzling. A number of arbitration providers, including AAA and JAMS, have adopted "due process" protocols designed to ensure minimally fair procedures in consumer and employment disputes.<sup>5</sup> As I will explain, the protocols purport to screen out contract terms that are incompatible with providers' views of basic adjudicatory fairness. Providers claim to refuse their services when the arbitration clause contains terms that conflict with the governing protocol.<sup>6</sup> In my example clause, the punitive damages bar and centralized hearing location appear to violate one or both sets of provider rules implementing these protocols.<sup>7</sup>

What might explain the decision to include both the one-sided terms and the (conflicting) provider rules? A party might agree to onerous terms in order to signal its commitment to a transaction.<sup>8</sup> Perhaps employees signal something of value to the employer

4. *E.g.*, Bodie, 39 GA. L. REV. at 30.

5. Margaret M. Harding, *The Limits of the Due Process Protocols*, 19 OHIO ST. J. ON DISP. RESOL. 369, 401-04 (2004); AM. ARBITRATION ASS'N, CONSUMER DUE PROCESS PROTOCOL (1998), available at <http://www.adr.org/sp.asp?id=22019> [hereinafter CONSUMER PROTOCOL]; AM. ARBITRATION ASS'N, EMPLOYMENT DUE PROCESS PROTOCOL (1995), available at <http://www.adr.org/sp.asp?id=28535> [hereinafter EMPLOYMENT PROTOCOL]; JAMS, JAMS POLICY ON CONSUMER ARBITRATIONS PURSUANT TO PRE-DISPUTE CLAUSES: MINIMUM STANDARDS OF PROCEDURAL FAIRNESS (2007), available at [http://www.jamsadr.com/rules/consumer\\_min\\_std.asp](http://www.jamsadr.com/rules/consumer_min_std.asp) [hereinafter JAMS CONSUMER POLICY]; JAMS, JAMS POLICY ON EMPLOYMENT ARBITRATION: MINIMUM STANDARDS OF PROCEDURAL FAIRNESS (2005), available at [http://www.jamsadr.com/rules/employment\\_Arbitration\\_min\\_stds.asp](http://www.jamsadr.com/rules/employment_Arbitration_min_stds.asp) [hereinafter JAMS EMPLOYMENT POLICY]. The NAF has similar rules, NAT'L ARBITRATION FORUM, CONSUMER AND EMPLOYEE ARBITRATION RIGHTS (2006), available at <http://www.arb-forum.com> (follow "Rules & Forms" hyperlink), although they differ in some respects and are viewed as inadequate by many consumer lawyers and advocates.

6. Harding, 19 OHIO ST. J. ON DISP. RESOL. at 403-04, 407. I do not mean to suggest that this "claim" is false. To the contrary, I suspect that many providers diligently seek to enforce their due process rules. But we presently have little more than providers' assurances as to the actual operation of the protocols.

7. With respect to punitive damages, see CONSUMER PROTOCOL, *supra* note 5, Principle 14; EMPLOYMENT PROTOCOL, *supra* note 5, ¶ 5; AM. ARBITRATION ASS'N, RESOLVING EMPLOYMENT DISPUTES: A PRACTICAL GUIDE 14 (2006), available at <http://www.adr.org/si.asp?id=4426>; JAMS CONSUMER POLICY, *supra* note 5, ¶ 3; JAMS EMPLOYMENT POLICY, *supra* note 5, Standard No. 1. See also Affidavit of Neil B. Currie on Behalf of the American Arbitration Association in Response and Objection to a Subpoena for Documents Issued by Plaintiff, *Ragan v. AT&T Corp.*, No. 02-L-168 (Ill. Cir. Ct., 3d Dist., July 15, 2002) (on file with author). With respect to hearing location, see JAMS EMPLOYMENT POLICY, *supra* note 5, Standard No. 6.

8. For example, a party might agree to pay substantial liquidated damages to signal its low probability of breach. *E.g.*, RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 129 (4th ed. 1992); Thomas M. Palay, *Comparative Institutional Economics: The Governance of Rail Freight Contracting*, 13 J. LEGAL STUD. 265, 276 (1984); Charles J. Goetz & Robert E. Scott, *Liquidated Damages, Penalties and the Just Compensation*

(nonlitigiousness?) by signing my example contract. But this seems implausible; it may be that few employees are even aware of the clause. Of course, the signaling might run in the other direction. The inclusion of one-sided terms might be a communication from the business to plaintiffs' lawyers, signaling that disputes under the agreement will be expensive to litigate or will yield a lower payout.<sup>9</sup> But then why weaken that signal by selecting a provider with conflicting rules?

Another possibility is that the company knows that JAMS and AAA often do not enforce their rules. This cannot be ruled out, in part because providers are reluctant to provide the data needed to evaluate this possibility. There have been allegations that actual practices sometimes conflict with providers' public stances.<sup>10</sup> Providers, however, are under no small amount of scrutiny, and I am not aware of supported allegations of under- or non-enforcement of these providers' due process rules.<sup>11</sup>

Perhaps the employer intends to waive the one-sided terms if challenged and includes them primarily for their potential *in terrorem* effect: the clause may deter employees from bringing claims.<sup>12</sup> This is indeed a possible explanation, but it seems at least incomplete. Even after a dispute arises, many employees will be unaware of the terms, and it seems implausible to suggest that many of those who know about the terms will refrain from filing a claim, or contacting a lawyer, because of them.<sup>13</sup> Whether the terms would deter many lawyers is an open question.

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*Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554, 578-80 (1977).

9. Whether the dispute indeed would be more expensive to litigate depends in part on how effectively the due process rules induce businesses to waive these terms in arbitration. See *infra* pp. 666-71.

10. E.g., Paul Bland, CL&P Blog, AAA Breaks its Promise Not to Hear Pre-Dispute Arbitrations in Health Care Cases (Feb. 22, 2007), [http://pubcit.typepad.com/clpblog/2007/02/aaa\\_breaks\\_its\\_.html](http://pubcit.typepad.com/clpblog/2007/02/aaa_breaks_its_.html).

11. Cf. Richard C. Reuben, *Mandatory Arbitration Clauses Under Fire*, A.B.A. J., Aug. 1996, at 58, 58-60 (noting link between a threatened boycott of ADR providers by the National Employment Lawyers Association and the adoption of the due process protocols).

12. E.g., William T. Vukowich, *Lawyers and the Standard Form Contract System: A Model Rule That Should Have Been*, 6 GEO. J. LEGAL ETHICS 799, 828 (1993); Bailey Kuklin, *On the Knowing Inclusion of Unenforceable Contract and Lease Terms*, 56 U. CIN. L. REV. 845, 862 (1988); see also Warren Mueller, *Residential Tenants and Their Leases: An Empirical Study*, 69 MICH. L. REV. 247, 272 (1970) (reporting results of survey of residential tenants, many of whom took for granted the validity of unenforceable lease terms).

13. It may be that few parties contact a lawyer in the first place, although not much is known about the frequency with which aggrieved parties make claims against perceived wrongdoers, contact attorneys, or file lawsuits. For some exceptions, see Herbert M. Kritzer, W.A. Bogart & Neil Vidmar, *The Aftermath of Injury: Cultural Factors*

Inadvertence might also explain the inclusion of these conflicting terms. The lawyers for the business may not have known about the AAA and JAMS rules. My example arbitration agreement, however, likely governs many employees, and a lawyer drafting such an agreement would surely become familiar with the designated providers' rules. A related possibility is that arbitration contracts are "sticky." An employer is unlikely to change its contracting practices unless it perceives a flaw, and even then there are costs involved in changing contract terms.<sup>14</sup> Maybe there have been no disputes under the agreement, so the employer has not identified the conflict with provider rules, or perhaps it has identified the conflict but does not wish to incur the cost of making a change. I suspect, however, that this explanation will not apply to all such contracts. Large employers in particular may have significant experience with arbitration, and both AAA and JAMS publicize their due process rules fairly heavily.<sup>15</sup>

To varying degrees, some or all of these explanations may be valid in different contracting contexts. But there is another explanation, one that highlights the complex interplay between arbitration providers and arbitration clauses. As I will explain, the choice of provider is a deliberate and consequential one, with potentially significant, though hard to observe, implications for the meaning and function of the arbitration clause. To understand this interplay, we should first consider the diverse "products" offered by arbitration service providers.

#### B. THE LEGITIMACY FUNCTION OF THE DUE PROCESS PROTOCOLS

My example arbitration clause is not atypical. Many and perhaps most consumer and employment arbitrations are conducted under the

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*in Compensation Seeking in Canada and the United States*, 25 LAW & SOC'Y REV. 499 (1991); David M. Trubek et al., *The Costs of Ordinary Litigation*, 31 UCLA L. REV. 72, 85-87 (1983); Richard E. Miller & Austin Sarat, *Grievances, Claims, and Disputes: Assessing the Adversary Culture*, 15 LAW & SOC'Y REV. 525, 537 & Table 2 (1980). I know of no evidence suggesting that onerous contract terms deter those who would otherwise contact an attorney from doing so, although there is some evidence to suggest that consumers and others may take for granted the legality of unenforceable terms. *E.g.*, Mueller, 69 MICH. L. REV. at 272.

14. Pierre Azoulay & Shane Scott, *Entrepreneurs, Contracts, and the Failure of Young Firms*, 47 MGMT. SCI. 337, 340 (2001).

15. On the likelihood of the employer having experience with arbitration, see Sherwyn et al., 57 STAN. L. REV. at 1586-87, and Mei L. Bickner et al., *Developments in Employment Arbitration: Analysis of a New Survey of Employment Arbitration Programs*, DISP. RESOL. J., Jan. 1997, at 8, 81-82. For examples of the public nature of provider rules, see AM. ARBITRATION ASS'N, AAA REVIEW OF CONSUMER CLAUSES, available at <http://www.adr.org/sp.asp?id=29149>; AM. ARBITRATION ASS'N, ARBITRATING UNDER THE EMPLOYMENT ARBITRATION RULES AND MEDIATION PROCEDURES (RULES), AS AMENDED AND EFFECTIVE JULY 1, 2006, available at <http://www.adr.org/sp.asp?id=29174>; JAMS EMPLOYMENT POLICY, *supra* note 5.

auspices of arbitration service providers like the AAA, JAMS, or the NAF.<sup>16</sup> And it is not unheard of (and may even be common) for an arbitration clause to incorporate provider rules that appear to conflict with other contract terms.<sup>17</sup> What explains the choice of provider in a contract? Without purporting to explain the full sweep of contracting behavior, I suggest that providers offer a variety of arbitration-related goods and services and bundle these in different ways. Thus, the choice of provider is driven, at least in part, by the particular arbitration "product" the business wants to buy.

Arbitration providers sell a diverse range of goods and services, including administration, "lawmaking," risk management, and legitimacy. Administrative services include identifying and training arbitrators, handling case logistics, and managing arbitration facilities.<sup>18</sup> Providers also sell private "lawmaking," for example by generating default disputing procedures and by providing an institutional context in which private legal norms can develop.<sup>19</sup> And providers sell risk management, such as insulation from some of the risk of class actions.<sup>20</sup>

Most important for my purposes, providers may also sell legitimacy. Arbitration clauses are often challenged by parties who would prefer to litigate their disputes in court,<sup>21</sup> and the designation of a recognized provider may help immunize the arbitration agreement from challenge.<sup>22</sup>

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16. Carrie Menkel-Meadow, *Ethics Issues in Arbitration and Related Dispute Resolution Processes: What's Happening and What's Not*, 56 U. MIAMI L. REV. 949, 965 (2002).

17. For similar agreements in the consumer and employment context, see Sprint Communications Co., L.P. Customer Agreement dated May 2002, (quoted in *In re Universal Serv. Fund Tel. Billing Practices Litig.*, 300 F. Supp. 2d 1107, 1122-23 (D. Kan. 2003)), and *Booker v. Robert Half Int'l, Inc.*, 315 F. Supp. 2d 94, 96 (D.D.C. 2004), *aff'd*, 413 F.3d 77 (D.C. Cir. 2005). The actual agreement in *Booker* called for arbitration pursuant to the AAA's commercial arbitration rules. *Id.* But the AAA applies its employment rules anyway, at least when the arbitration is conducted pursuant to an employer-promulgated plan. AM. ARBITRATION ASS'N, COMMERCIAL ARBITRATION RULES AND MEDIATION PROCEDURES, Rule 1 (2005), available at <http://www.adr.org/sp.asp?id=22440>.

18. See Edward Brunet, *Replacing Folklore Arbitration with a Contract Model of Arbitration*, 74 TUL. L. REV. 39, 52-53 (1999).

19. *Id.*; Stephen J. Ware, *Default Rules from Mandatory Rules: Privatizing Law Through Arbitration*, 83 MINN. L. REV. 703, 747 (1999).

20. On the risk management function of arbitration generally, see Scott Baker, *A Risk-Based Approach to Mandatory Arbitration*, 83 OR. L. REV. 861, 874-81 (2004).

21. *E.g.*, *McMullen v. Meijer, Inc.*, 337 F.3d 697, 704-06 (6th Cir. 2003), *amended* by 355 F.3d 485 (6th Cir. 2005); *Burch v. Second Judicial Dist. Court*, 49 P.3d 647, 650-51 (Nev. 2002); *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669 (Cal. 2000).

22. See, *e.g.*, *Izzi v. Mesquite Country Club*, 186 Cal. App. 3d 1309, 1318 (Cal. Ct. App. 1986) ("The rules of the American Arbitration Association . . . are generally regarded to be neutral and fair."); *Veliz v. Cintas Corp.*, No. C 03-1180 SBA, 2004 WL 2452851, at \*15 (N.D. Cal. Apr. 5, 2004) (rejecting challenge to confidentiality requirement under AAA rules: "The AAA is a reputable arbitration body and the reasons for

One way a provider can confer legitimacy is to publicly adopt and enforce due process or “fairness” rules.<sup>23</sup> As I have mentioned, the due process protocols purport to screen out terms that providers view as incompatible with a fair disputing process. These are not default rules to fill gaps in incomplete contracts;<sup>24</sup> they are mandatory. When a demand for arbitration is filed, the stated policy of both AAA and JAMS is to review the applicable clause for compliance with the governing rules and to bring clauses with non-compliant terms to the parties’ attention.<sup>25</sup> The business may waive any non-compliant term, and if it does not, the claimant may waive any objection to the term.<sup>26</sup> In either case, the arbitration will go forward. Otherwise, the provider should decline the case.<sup>27</sup>

The provider’s decision to decline the case does not necessarily mean the dispute will be litigated in court. The business may ask a court to compel arbitration, possibly before a provider who will enforce its chosen terms.<sup>28</sup> In reply, the claimant will likely ask the court to invalidate the arbitration clause altogether. As I explain below, in the resulting dispute over the enforceability of the arbitration clause, the provider’s refusal to accept the case may increase the probability that

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confidentiality are designed to protect all parties in a dispute”); *Hooters of Am., Inc. v. Phillips*, 173 F.3d 933, 939 (4th Cir. 1999) (noting testimony that “reputable” providers like AAA and JAMS would refuse to enforce the agreement challenged in that case); see also *Harding*, 19 OHIO ST. J. ON DISP. RESOL. at 409-12 (noting guidance provided to courts by due process protocols); *Drahozal*, 2001 U. ILL. L. REV. at 752 (discussing value of providers’ reputational capital).

23. *E.g.*, *Harding*, 19 OHIO ST. J. ON DISP. RESOL. at 426.

24. *E.g.*, Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 87 (1989).

25. AM. ARBITRATION ASS’N, *FAIR PLAY: PERSPECTIVES FROM AMERICAN ARBITRATION ASSOCIATION ON CONSUMER AND EMPLOYMENT ARBITRATION* at 33-34 (2003), available at <http://www.adr.org/si.asp?id=3652> [hereinafter *FAIR PLAY*]; JAMS CONSUMER POLICY, *supra* note 5.

26. I understand that JAMS policy is to accept the dispute if the employee waives objection to the offending term. I do not know whether AAA has a similar policy, although I imagine that it does. It is not clear why a provider would prevent an employee from agreeing, post-dispute, to arbitrate without the possibility of recovering punitive damages.

27. See *FAIR PLAY*, *supra* note 25, at 34; JAMS EMPLOYMENT POLICY, *supra* note 5.

28. *E.g.*, *Great W. Mortgage Corp. v. Peacock*, 110 F.3d 222, 232 n.42 (3d Cir. 1997). For example, the business might argue as a matter of contract law that the contract should be enforced insofar as possible – i.e., by compelling arbitration before a provider who *will* enforce the punitive damages restriction and hearing locale. As for objections to the punitive damages waiver itself, the business might argue that the Federal Arbitration Act requires courts to enforce arbitration agreements “according to their terms” and preempts state law to the contrary. *E.g.*, *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444, 455-60 (2003) (Rehnquist, C.J., dissenting). A similar argument could be made about the choice of location. *E.g.*, *Boynton v. ESC Med. Sys., Inc.*, 566 S.E.2d 730, 734 (N.C. Ct. App. 2002). But see David S. Schwartz, *Understanding Remedy-Stripping Arbitration Clauses: Validity, Arbitrability, and Preclusion Principles*, 38 U.S.F. L. REV. 49, 84-86 (2003) (arguing against this broad FAA preemption standard).

the dispute will wind up in court.<sup>29</sup> For now, it is enough to say that governing “law” – in the sense of norms and rules articulated by public actors like courts and legislatures – does not clearly establish the validity or non-validity of the one-sided terms, but that a conflict with a provider’s due process rules may increase the likelihood that the parties’ entire dispute will wind up in court.

Note that a provider’s decision to market the legitimacy component of its product may constrain it in other ways. For example, a provider who emphasizes risk management may need to depart from the due process protocols – say, by agreeing to enforce the one-sided terms in my example contract – and doing so may reduce its ability to confer legitimacy.<sup>30</sup> (If these departures are difficult to detect, however, the constraint may be minimal. I return to this possibility at the end of this Essay.)<sup>31</sup> Because arbitration may serve different functions for different users,<sup>32</sup> providers inhabit a segmented market, tailoring their offerings to accommodate different customer groups. Thus, the choice of provider is a deliberate one, and the designated provider is often an integral part of the arbitration clause.

### C. THE POST-DISPUTE STRATEGIC VALUE OF CONTRACT TERMS AND DUE PROCESS RULES

The preceding discussion suggests another explanation why the employer in my example contract would incorporate rules that seem to conflict with other terms in the contract. The employer clearly prefers arbitration to litigation. Ideally, it wants to arbitrate before one of the providers designated in the clause.<sup>33</sup> As I have explained, different providers offer different arbitration products, and both AAA and JAMS arguably confer more legitimacy than other providers.<sup>34</sup> It seems safe to assume that my hypothetical employer deliberately sought this legitimacy; after all, it could have designated a provider

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29. See *infra* notes 48-58 and accompanying text.

30. To a degree, the provider may free ride on (and ultimately weaken) the efforts of other providers to build legitimacy. *E.g.*, Harding, 19 OHIO ST. J. ON DISP. RESOL. at 425-26. But its failure to convince lawyers, advocates, and courts of the fairness of its procedures may also attract scrutiny. *E.g.*, *Mercuro v. Superior Court*, 116 Cal. Rptr. 2d 671, 684 (Cal. Ct. App. 2002).

31. See *infra* notes 94-96 and accompanying text.

32. *E.g.*, Sherwyn et al., 57 STAN. L. REV. at 1581 (arguing that many employers implement arbitration programs to “avoid inefficiencies created by disputes, increase morale, and reduce turnover”; possibly, these concerns might affect the choice of provider, as well as choice of which procedures and remedies to make available in arbitration).

33. *E.g.*, *In re Salomon Inc. S’holders’ Derivative Litig.* 91 Civ. 5500, 68 F.3d 554, 557-61 (2d Cir. 1995) (recognizing that choice of arbitral forum may be integral to the arbitration agreement).

34. See *supra* notes 5, 15, & 22.

that would enforce its chosen terms, including the one-sided terms.<sup>35</sup> Yet it did not do so.

Why then did the employer include the one-sided terms in its agreement? The answer is that these terms still serve an important function. In effect, the contract bestows on the employer an option to insist on enforcing the one-sided terms in particular disputes. The price of exercising this option is a modest but non-trivial increase in the likelihood that a court will invalidate the entire arbitration clause and allow the dispute to be litigated in court. Significantly, the employer decides whether to exercise the option post-dispute, after it has investigated the merits of the employee's claim.

The following discussion examines the post-dispute dynamic created by the filing of an arbitration demand. For simplicity, I focus on the interaction between the due process rules and the punitive damages bar, leaving to one side the term requiring all hearings to occur in a centralized location. As I will explain, this dynamic may shape the arbitration process, sometimes in ways that appear to conflict with the arbitration clause itself.

### *1. Disputes posing low risk of punitive damages*

Consider a hypothetical dispute in which an employee bound by my example agreement, represented by an attorney, files a demand for arbitration with JAMS. If the process works as stated, JAMS will identify the conflict between the punitive damages bar and its minimum standards and will ask the employer to waive the non-compliant term.<sup>36</sup> Before responding, the employer's lawyers will presumably investigate the claim to assess whether the dispute poses a material risk of a punitive damages award. For now, assume that the employer assesses this risk as low.

Under these circumstances, it seems plausible to assume that the dispute will proceed to arbitration. Either the employer will waive the punitive damages bar, or the employee's lawyer will waive any objection. Indeed, given the presumed benefits of arbitration, the employer may routinely waive the term in cases where it perceives little or no risk of punitive damages. Of course, if the employer is wrong in its assessment of this risk, its waiver – induced by the due process rules – benefits the employee.

Alternatively, the employer might refuse to waive the punitive damages bar, perhaps to avoid setting an informal "precedent" that

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35. *E.g.*, Harding, 19 OHIO ST. J. ON DISP. RESOL. at 421-22; Carrington, 3 NEV. L.J. at 284-85.

36. JAMS Employment Policy, *supra* note 5, Standard No. 1; Reuben, A.B.A. J., Aug. 1996, at 59.

might create pressure to waive the term in future cases. If the employee's lawyer wants to seek punitive damages, or has other reasons for wanting to challenge the arbitration agreement, the lawyer may object to the term and JAMS should reject the case.<sup>37</sup> Although the consequences of that rejection are not clear, the employer's refusal to waive the offending term may increase the probability of a successful challenge to the arbitration agreement.<sup>38</sup> That is another potential benefit to claimants of the due process protocols.

Of course, the employee's lawyer also may waive any objection to the punitive damages bar, and the dispute will proceed to arbitration. This decision might reflect the lawyer's assessment that the benefits of arbitration outweigh any incremental strategic advantage gained by asserting a claim for punitive damages or simply an assessment that the cost of challenging the arbitration clause outweighs the potential benefits of a jury trial. Either way, it is worth noting that this decision – unlike the employee's initial commitment to arbitrate – occurs post-dispute and on the advice of the employee's lawyer. Objections premised on the employer's superior knowledge and bargaining power may have less force in this context.<sup>39</sup>

Two points should be clear from this discussion. First, in my example contract, the due process protocols may produce "waivers," by one side or the other, in a significant number of cases.<sup>40</sup> This will be

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37. JAMS EMPLOYMENT POLICY, *supra* note 5. Other reasons for challenging the arbitration agreement might include situations where the lawyer represents a number of employees bound by this (or similar) agreements and stands to benefit from a court ruling invalidating the clause. Of course, the lawyer might institute such a challenge without first filing an arbitration demand, but the provider's rejection of the dispute may strengthen the challenge. See *infra* notes 48-58 and accompanying text.

38. See *infra* notes 48-58 and accompanying text.

39. Cf. Sarah Rudolph Cole, *A Funny Thing Happened on the Way to the (Alternative) Forum: Reexamining Alexander v. Gardner-Denver in the Wake of Gilmer v. Interstate/Johnson Lane Corp.*, 1997 BYU L. REV. 591, 620 (noting potential benefits of superior knowledge of arbitration process to employer, both in contracting and in arbitration itself). Whether "repeat-players" fare better in arbitration is a matter of some dispute (see, for example, Sherwyn et al., 57 STAN. L. REV. at 1571-72), and I do not know of any evidence comparing the magnitude of any such effect to that found before courts. It is possible that plaintiffs' lawyers can moderate any repeat-player effect. *E.g.*, Samuel Estreicher, *Predispute Agreements to Arbitrate Statutory Employment Claims*, 72 N.Y.U. L. REV. 1344, 1355 (1997). Some providers have taken steps to increase arbitration transparency and expand access to information about arbitration awards, and these efforts may also moderate any repeat-player effect. For example, the AAA has begun making its arbitration awards available to the public and on its website. AM. ARBITRATION ASS'N, EMPLOYMENT ARBITRATION RULES AND MEDIATION PROCEDURES, Rule 39(b) (2006), available at <http://www.adr.org/sp.asp?id=28481#39> [hereinafter EM-EMPLOYMENT RULES]; AM. ARBITRATION ASS'N, EMPLOYMENT DISPUTE AWARDS ONLINE, available at <http://www.adr.org/sp.asp?id=29632>.

40. I use "waiver" to refer to the intentional relinquishment of a right, whether the employer's right to insist on enforcement of a term that conflicts with the due process protocols or the claimant's right to object to the term. *E.g.*, Kenneth S. Broun & Daniel

true especially where the business perceives a low risk of punitive damages. Indeed, I have had a number of informal discussions in which arbitration provider employees and executives have asserted that waivers – by both sides – are quite common. Second, frequent waivers may reflect nothing more than the rarity of disputes in which the underlying conduct would support (or an arbitrator would award) punitive damages.<sup>41</sup> In cases where the employer correctly perceives a low risk of punitive damages, we can further conclude that the punitive damages bar and the choice of provider rules will rarely have a significant impact on the parties' substantive rights or strategic options.

But this will not always be true. In at least some cases, the employer may incorrectly assess its risk and waive the punitive damages bar. When this happens, the due process protocols produce a benefit to the employee. In the process, they also produce an arbitration in which remedies apparently forbidden by the contract are in fact available. Moreover, as I discuss below, waivers (by both sides) may occur even when the employer perceives a legitimate risk of punitive damages.

## 2. *Disputes posing a risk of punitive damages*

Now consider a hypothetical dispute, again involving an employee bound by my example contract and represented by an attorney, in which the employer's investigation uncovers conduct that might support an award of punitive damages. How might the punitive damages bar and the due process protocols interact in disputes like these? There are a number of possibilities.

First, waiver may be relatively common even when punitive damages are at stake. The protocols may force the employer to choose between the certainty of arbitration before an arbitrator empowered to award punitive damages and the (unknown) probability of litigation before a similarly-empowered jury. In some cases, the employer may choose arbitration. By hypothesis, however, the employer will also have superior information about the likelihood of punitive damages,

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J. Capra, *Getting Control of Waiver of Privilege in the Federal Courts: A Proposal for a Federal Rule of Evidence 502*, 58 S.C. L. REV. 211, 213 n.3 (2006).

41. In what may be a familiar refrain, I note here that there is little evidence of actual arbitrator practices in awarding punitive damages. For some limited exceptions, see Lewis L. Maltby, *Out of the Frying Pan, Into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 WM. MITCHELL L. REV. 313, 317 n.11 (2003) (referring to unpublished empirical evidence finding little difference between arbitrators and juries in awarding punitive damages); Kenneth R. Davis, *Due Process Right to Judicial Review of Arbitral Punitive Damages Awards*, 32 AM. BUS. L.J. 583, 586 n.22 (1995) (referring to limited evidence of punitive damage awards in securities arbitration).

and in some cases it may exploit this advantage to procure a waiver by the employee's lawyer.

Second, the employer's refusal to waive the punitive damages bar may increase the probability of a successful challenge to the entire arbitration clause.<sup>42</sup> (This makes relying on a waiver by the employee's lawyer a risky strategy for the employer.) But the employee might trade the right to make such a challenge, and potentially to seek punitive damages before a jury, for other concessions in the arbitration. In this sense, the due process protocols may provoke a secondary negotiation over the terms of the arbitration. And unlike the "negotiation" that produced the arbitration agreement, this negotiation would be conducted post-dispute, often by lawyers, and in the shadow of legal doctrine that, from the employee's perspective, is relatively favorable.<sup>43</sup>

a. Reasons for waiver by the business

In my hypothetical dispute, the employer might agree to waive the punitive damages bar even though it perceives a risk of punitive damages. Without attempting to model this decision, let me suggest that in some cases the employer will still expect the dispute to cost it less in arbitration, even if the arbitrator has the certain authority to award punitive damages. I assume here that arbitrators tend to issue lower awards than juries, and that this holds true for punitive damages awards as well.<sup>44</sup> And I make the standard assumption that direct costs of disputing – lawyer fees, discovery costs, and the like – are lower in arbitration.<sup>45</sup>

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42. See *infra* notes 48-58 and accompanying text.

43. I do not claim that the law guarantees the employee success; far from it. Most of modern arbitration law aims to ensure that arbitration agreements are "enforced according to their terms." *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 478 (1989). My point is only that the employer's refusal to waive the punitive damages bar and the provider's subsequent rejection of the dispute strengthen the employee's hand in a dispute over the enforceability of the contract. See *infra* notes 48-58 and accompanying text.

44. For evidence that awards may be lower in arbitration than in litigation, see, for example, Lisa B. Bingham, *Focus on Arbitration After Gilmer: Employment Arbitration: The Repeat Player Effect*, 1 EMP. RTS. & EMP. POL'Y J. 189, 199-200 (1997); Sherwyn et al., 57 STAN. L. REV. at 1576.

45. E.g., Sherwyn et al., 57 STAN. L. REV. at 1572-73 (noting lower disposition time of arbitration); Richard A. Bales, *Normative Consideration of Employment Arbitration at Gilmer's Quinceanera*, 81 TUL. L. REV. 331, 346-47 (2006) (summarizing mixed evidence on employer cost savings). Professor Bales rightly notes that an employer's implementation of an arbitration program might actually increase costs – especially given start-up costs associated with the creation of the program and the potential for increased claiming rates. I make here only the relatively uncontroversial assumption that, once a dispute has arisen, direct costs of dispute resolution will tend to be lower in arbitration.

By contrast, if the business refuses to waive the punitive damages bar, it faces not only the potential cost of defending against a challenge to the arbitration clause, but, if it loses that fight, the additional cost of litigation before a jury. Here, I define the cost of litigation broadly to include, say, the cost of a precedential ruling affecting the employer's relationships with all of its employees.<sup>46</sup> Depending on its beliefs about the vagaries of the jury system, the employer might prefer the certain prospect of an arbitration in which punitive damages are available to the unknown probability of a jury trial that might result in a much higher award.<sup>47</sup>

If the employer refuses to waive the term, the employee too has an option: waive objection to the punitive damages bar or assert the objection and cause the provider to reject the case. In the latter case, the employee is not necessarily free to litigate the dispute in court. The employee could, however, file a lawsuit and, if the employer seeks to compel arbitration, challenge the enforceability of the arbitration clause. And here, the provider's rejection of the dispute may strengthen the employee's hand.

One possibility is that the rejection may influence the court to invalidate the punitive damages bar and perhaps the arbitration clause itself. To determine the validity of the punitive damages bar, the court will look to relevant federal or state law, often state-law unconscionability doctrine.<sup>48</sup> In theory, the provider's refusal to accept the case should be irrelevant to this inquiry; providers may disapprove of legally enforceable terms if they choose.<sup>49</sup> In practice, however, the provider's rejection of the dispute, and its determination that the clause violates the due process protocol, might heighten the court's suspi-

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46. For example, a decision invalidating the arbitration clause or declaring a particular employment practice unlawful would of course impose substantial costs. For a similar point in the context of consumer transactions, see Johnston, 104 MICH. L. REV. at 895. In my view, there is reason to believe that, in at least some contexts, consumer and employment arbitration can create "precedent" in a similar manner. W. Mark C. Weidemaier, *Arbitration and the Individuation Critique*, 49 ARIZ. L. REV. 69, 103-06 (2007).

47. Rightly or wrongly, the employer might expect the magnitude (if not the likelihood) of a punitive damages award to be much greater before a jury. *E.g.*, Theodore Eisenberg, Jeffrey J. Rachlinsky & Martin T. Wells, *Reconciling Experimental Incoherence with Real-World Coherence in Punitive Damages*, 54 STAN. L. REV. 1239, 1245 (2002) (noting deeply ingrained public assumptions about "outrageous" punitive damages); Steven Garber, *Product Liability, Punitive Damages, Business Decisions and Economic Outcomes*, 1998 WIS. L. REV. 237, 283 (suggesting that, at least in automobile product liability cases, "company decisionmakers are likely to substantially overestimate the frequency and magnitudes of punitive damages awards").

48. *E.g.*, Jeffrey W. Stempel, *Arbitration, Unconscionability, and Equilibrium: The Return of Unconscionability Analysis as a Counterweight to Arbitration Formalism*, 19 OHIO ST. J. ON DISP. RESOL. 757, 765-66 (2004).

49. *E.g.*, FAIR PLAY, *supra* note 25, at 34.

cion.<sup>50</sup> If the court holds the punitive damages bar invalid, it will have to decide whether to sever the term and compel arbitration or to invalidate the entire arbitration agreement, thus allowing the dispute to proceed in court.<sup>51</sup> Typically, when the challenge to the arbitration agreement occurs *before* the dispute reaches the arbitration provider, severance might be the likelier result.<sup>52</sup> But here, the court may be less inclined towards severance. After all, the employer has already declined precisely this result by refusing to waive the punitive damages bar when asked by the provider.

What if governing law permits the punitive damages bar?<sup>53</sup> Presumably, the court cannot compel arbitration before the providers specified in the contract. If we are to take provider rules and public statements seriously, neither should accept the case.<sup>54</sup> To be sure, the court might resolve this dilemma by compelling arbitration before an arbitrator who will enforce the contract as written.<sup>55</sup> But it might also refuse to compel arbitration, interpreting the contract to designate the AAA and JAMS as the exclusive arbitration providers and concluding that, because they will not accept the dispute, "there is no further promise to arbitrate in another forum."<sup>56</sup> I do not necessarily advocate this result. I make only the descriptive claim that courts sometimes interpret as integral to the contract language selecting a particular provider or set of arbitration rules.<sup>57</sup> If I am correct that the choice of provider is a significant contracting decision, reflecting the specific arbitration "product" desired by the business, these decisions are easily understood. The provider's refusal to take the case thus offers an addi-

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50. Cf. *Harding*, 19 OHIO ST. J. ON DISP. RESOL. at 409-12 (noting that protocols may influence judicial decisions about the enforceability of arbitration agreements).

51. E.g., *Lacey v. Healthcare & Ret. Corp. of Am.*, 918 So. 2d 333 (Fla. Dist. Ct. App. 2005) (invalidating agreement).

52. *Ex parte Celtic Life Ins. Co.*, 834 So. 2d 766 (Ala. 2002); *Gannon v. Circuit City Stores, Inc.*, 262 F.3d 677 (8th Cir. 2001).

53. For cases enforcing punitive damages waivers, or at least suggesting that such terms alone will not render the agreement unenforceable, see *New S. Fed. Sav. Bank v. Anding*, 414 F. Supp. 2d 636, 650 (S.D. Miss. 2005); *Gatton v. T-Mobile USA, Inc.*, No. SACV 03-130 DOC., 2003 WL 21530185 (C.D. Cal. Apr. 18, 2003); *Kinnebrew v. Gulf Ins. Co.*, CA No. 3:94-CV-1517-R, 1994 WL 803508, at \*1-2 (N.D. Tex. Nov. 28, 1994); and *Morgan v. Smith Barney, Harris Upham & Co.*, 729 F.2d 1163, 1168 n.7 (8th Cir. 1984).

54. E.g., *FAIR PLAY*, *supra* note 25, at 34 ("There may be circumstances where AAA will not provide administration even if a provision may be legally enforceable, as the standard followed by AAA may be higher than the law allows.").

55. *Great W. Mortgage Corp. v. Peacock*, 110 F.3d 222, 232 n.42 (3d Cir. 1997).

56. *In re Salomon Inc. S'holders' Derivative Litig.* 91 Civ. 5500, 68 F.3d 554, 557 (2d Cir. 1995); see also *Martinez v. Master Prot. Corp.*, 12 Cal. Rptr. 3d 663, 674-75 (Cal. Ct. App. 2004).

57. See *supra* note 56.

tional argument to claimants who wish to pursue their claims in court.<sup>58</sup>

As I have mentioned, I have heard anecdotally from provider employees that businesses and employers often waive terms that conflict with the due process protocols. I know of no other evidence to support this assertion, and of course the waivers might be confined to cases where the offending term serves no function, such as disputes in which the employer correctly perceives no risk of punitive damages. But if the foregoing analysis is correct, at least some "meaningful" waivers will also occur. If so, these are cases in which the due process rules yield a clear benefit to individual claimants. They are also cases where the contract paints a misleading picture of actual arbitration remedies and procedures.<sup>59</sup>

Indeed, I do not discount the possibility that, over time, the due process rules may lead some businesses to remove noncompliant terms from their agreements altogether. Some providers overtly seek that goal, at least in their public statements about the protocols.<sup>60</sup> Whether or not this occurs with any frequency, the due process rules merit further inquiry for their potential impact on individual disputes.

b. Reasons for waiver by the employee

To this point, I have suggested some reasons why the employer in my hypothetical dispute might waive its right to seek enforcement of the punitive damages bar even when it perceives a risk that punitive

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58. *E.g.*, *Martinez*, 12 Cal. Rptr. 3d at 674-75; *see also* *Smith Barney, Inc. v. Critical Health Sys.*, 212 F.3d 858, 861-62 (4th Cir. 2000) (noting the rule in different context); *Brown v. ITT Consumer Fin. Corp.*, 211 F.3d 1217, 1222 (11th Cir. 2000) (stating that arbitration should be compelled unless choice of provider was an integral part of the agreement to arbitrate).

59. This assumes, of course, that arbitrators actually do award punitive damages in appropriate cases. They may not, which might resolve the apparent conflict between the terms in my example contract. This is yet another unanswered empirical question about arbitration. Providers rely on the protocols to give public assurances of fair procedure. *E.g.*, *Harding*, 19 OHIO ST. J. ON DISP. RESOL. at 371 (noting that adoption of protocols may have helped ward off more direct regulation of arbitration providers); AM. ARBITRATION ASS'N, AAA REVIEW OF CONSUMER CLAUSES, available at <http://www.adr.org/si.asp?id=4453> [hereinafter REVIEW OF CONSUMER CLAUSES] ("If you have a dispute with a business . . . [t]he American Arbitration Association will only administer your dispute if the arbitration clause meets certain fairness standards that are contained in the AAA's Consumer Due Process Protocol."); JAMS EMPLOYMENT POLICY, *supra* note 5 (stating that JAMS will administer an arbitration only if the agreement complies with its minimum standards). Without empirical study, it is hard to evaluate these assurances.

60. *E.g.*, REVIEW OF CONSUMER CLAUSES, *supra* note 59 ("If you do not revise your arbitration agreement to comply with the Consumer Due Process Protocol, we will return the filing information to the consumer with instructions to pursue other remedies and we will refuse to administer any other cases until your arbitration agreement is in compliance.").

damages might be awarded.<sup>61</sup> But the punitive damages bar does serve a function. By including it, the employer will probably avoid punitive damages in some cases. The protocols cannot prevent this, but on occasion they might enable claimants to bargain for other concessions in the arbitration.

One reason the protocols will not ensure that punitive damages are available in all arbitrations is because the employer can force a judicial decision on the term's validity by refusing to waive the term. Previously, I argued that the employer's refusal may lessen its chances of success,<sup>62</sup> but it remains possible that a court will compel arbitration before an arbitrator who will enforce the contract as written.<sup>63</sup> More significantly, some or all providers may allow the employee to waive any objection to the punitive damages bar. Thus, the employer may insist on the punitive damages bar and gamble that the employee will waive objection.

Anecdotally, I understand that such waivers are relatively common. This should not be surprising. For one thing, the employee's lawyer may view the additional cost of challenging the punitive damages bar as prohibitive. In reasonably high-stakes disputes, the additional cost of litigating the term's validity (a mostly legal issue) might not be substantial.<sup>64</sup> But in relatively small-stakes disputes, this explanation might have some force.<sup>65</sup>

Perhaps a more likely explanation is that the employer will sometimes have superior information about the risk of punitive damages. For example, it will know whether similar claims have been made against it in arbitration, or whether it has a track record of ignoring complaints similar to that made by the employee. Because the provider's review of the arbitration agreement occurs at the beginning of the case, the employee's lawyer may lack the information needed to accurately assess the likelihood of punitive damages.<sup>66</sup> Thus, in some

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61. The same analysis would apply to the term requiring significant travel to attend the hearing. JAMS EMPLOYMENT POLICY, *supra* note 5, Standard No. 6.

62. See *supra* notes 48-58.

63. *E.g.*, *Great W. Mortgage Corp. v. Peacock*, 110 F.3d 222, 232 n.42 (3d Cir. 1997).

64. In some cases, as when the plaintiff's lawyer has or expects to bring additional cases against that employer, the benefits of a successful challenge may be significant.

65. Small-stakes disputes, of course, may not attract lawyers in the first place. *E.g.*, William M. Howard, *Arbitrating Claims of Employment Discrimination: What Really Does Happen? What Really Should Happen?*, DISP. RESOL. J., Oct.-Dec. 1995, at 40, 44 (reporting, based on survey of employment lawyers, that before accepting a case lawyers required, on average, minimum provable damages of \$60,000 to \$65,000 and a retainer of \$3,000 to \$3,600).

66. *E.g.*, REVIEW OF CONSUMER CLAUSES, *supra* note 59; FAIR PLAY, *supra* note 25, at 33-34. Of course, even if the review occurred later, the arbitrator might not permit sufficient discovery to uncover the employer's history.

cases the punitive damages bar may allow the employer to exploit its informational advantage to procure relatively uninformed waivers.<sup>67</sup> In this sense, frequent waivers by claimants might be a sign of the ineffectiveness of the protocols.

Yet not all such waivers will be uninformed. Returning to my example contract, the employee's lawyer may know enough about the employer, and learn enough from the employee, to make a reasonably informed decision. And the stakes will be high enough in some disputes to justify a challenge to the arbitration clause.<sup>68</sup> Given our limited knowledge of arbitration, it is impossible to say whether individual claimants frequently waive objection to contracts that conflict with the protocols and, if so, why. No doubt there are uninformed waivers as well as cases where the claimant's lawyer correctly perceives a low probability of punitive damages or prefers arbitration to litigation for other reasons.

A final point is worth making. I have explained that when the provider rejects a dispute, the claimant may have a stronger case for invalidating the arbitration agreement.<sup>69</sup> Thus, in my example, the employer's refusal to waive the punitive damages bar may expose it to an increased risk of a jury trial and possibly even punitive damages. On occasion, an employee may barter away the right to make such a challenge for some other concession in the arbitration – say, the employer's agreement to provide certain discovery, or its agreement to

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67. This is not the only function served by the punitive damages bar in my example contract. For example, the business or employer may not know whether the due process rules will apply to every case. *E.g.*, JAMS EMPLOYMENT POLICY, *supra* note 5 (noting standards do not apply to individually-negotiated contracts of employment). Or it may be aware of the prospect of class arbitration and wish to preserve the argument that the protocols do not apply in such cases.

68. For limited evidence about claim sizes in consumer and employment arbitration, see CAL. DISPUTE RESOLUTION INST., CONSUMER AND EMPLOYMENT ARBITRATION IN CALIFORNIA: A REVIEW OF WEBSITE DATA POSTED PURSUANT TO SECTION 1281.96 OF THE CODE OF CIVIL PROCEDURE (2004), available at [http://www.mediate.com/cdri/cdri\\_print\\_Aug\\_6.pdf](http://www.mediate.com/cdri/cdri_print_Aug_6.pdf). The report reviews consumer and employment arbitration data disclosed pursuant to California law. Mean and median claim amounts, in the minority of cases where this was reported, were \$90,341 and \$19,800, respectively. *Id.* at 20. (Presumably claim amounts are higher than realistic expected recoveries.) The mean is skewed by some particularly high claims – e.g., one for \$6.5 million. Mean and median awards, again reported in only a minority of cases, were \$33,112 and \$7,615, with at least one outlier again distorting the mean. *Id.* These numbers are drawn from a vast range of disputes involving consumers, employees, personal injury claimants, investors, and others. *Id.* at 22. In employment cases, 61 of the 76 cases that reported the employee's yearly wages listed wages as under \$100,000. *Id.* at 23. As the report notes, poor data reporting quality limits the conclusions that can be drawn from published provider data. *Id.* at 26-32.

69. See *supra* notes 48-58 and accompanying text.

pay an award without requiring the employee's lawyer to seek a court order confirming the award.<sup>70</sup>

In this sense, then, the due process protocols may provoke a secondary negotiation over the terms of the arbitration. Of course, the parties are always free to engage in such negotiations, and their leverage will be a function, in part, of background legal rules. For example, with or without the protocols, the employee can trade the right to challenge the agreement on unconscionability grounds for a more favorable arbitration process. The protocols, however, may both alter the background legal rules and effectively force a negotiation in cases where noncompliant contract terms prevent the arbitration from going forward. Once again, if such negotiations occur, the resulting arbitration may offer remedies and procedures that appear unavailable from a review of the contract itself.

### 3. *Summary*

The preceding discussion has explored the apparent conflict between the one-sided terms of my example contract – the punitive damages bar and the centralized hearing location – and the designated providers' rules. Although for simplicity I have focused on the punitive damages waiver, both terms could be analyzed in similar fashion.<sup>71</sup> One explanation for the employer's decision to include both one-sided terms and conflicting provider rules may be that it wants, insofar as possible, to limit its disputing risk without foregoing the legitimacy conferred by reputable arbitration providers. These preferences are in tension, and the due process rules may require the employer to accept some limits on its ability to structure the arbitration process as it pleases.<sup>72</sup>

But it would be a mistake to conclude that the one-sided terms serve no function – that they are nullified by the due process rules. The price of legitimacy is not so high. In effect, one-sided terms bestow an option that the employer may choose to exercise, or not, after gathering information about the employee's claim. If implemented consistently, the due process protocols force the employer to make this choice and also increase the cost of insisting on enforcing the one-sided terms. This dynamic sometimes may yield arbitration remedies and procedures that differ from those apparently specified by the contract.

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70. See 9 U.S.C. § 9 (2000).

71. The JAMS minimum standards for employment disputes provide that "[a]n employee's access to arbitration must not be precluded by the employee's inability to pay any costs or by the location of the arbitration." JAMS EMPLOYMENT POLICY, *supra* note 5, Standard No. 6.

72. See *supra* notes 23-30 and accompanying text.

## II. THE SUPPLY OF IMPLICIT "ONE-SIDED" TERMS

The interaction between contract terms and provider rules and practices may not always produce benefits for individual disputants. As I have mentioned, in the context of my hypothetical dispute information asymmetries may allow the employer to procure relatively uninformed waivers of the employee's right to challenge the punitive damages bar in court.<sup>73</sup> The due process rules do not enable this result, but they do not prevent it either. In some contexts, moreover, provider rules and practices may benefit their business customers more directly. In effect, providers may supply "one-sided" terms that cannot be detected from a review of the arbitration clause itself.

### A. ARBITRATION PROVIDERS AS SUPPLIERS OF RISK MANAGEMENT

To see how this might be, return to the notion that there is a highly segmented market for arbitration services.<sup>74</sup> Providers differentiate themselves in part by supplying varying degrees and kinds of risk management.<sup>75</sup> As an example, consider the following data, which I compiled from reports of arbitrations conducted in California by both the NAF and JAMS.<sup>76</sup> The data show markedly different worlds of arbitration.<sup>77</sup>

#### 2003-2006 CALIFORNIA ARBITRATIONS<sup>78</sup>

Provider	Cases	Consumer as Claimant	Consumer as Respondent
JAMS	1241	98.7%	1.3%
NAF	27309	0.4%	99.6%

The NAF data reveal a provider whose business, at least in California, consists almost exclusively of collections cases brought against consumers by businesses in the consumer finance industry. This will come as no surprise to many familiar with current arbitration de-

73. See *supra* notes 66-67 and accompanying text.

74. See *supra* page 663.

75. See *supra* note 20 and accompanying text.

76. California law requires that arbitration providers file public reports containing certain information about "consumer" arbitrations (defined broadly to include a variety of dispute types, including employment disputes). See CAL. CIV. PROC. CODE § 1281.96 (West Supp. 2007).

77. The reports are lengthy, in .pdf format, and omit a good deal of information. Because I needed only rough counts, I compiled this data by running various searches, rather than by hand-counting nearly 30,000 case entries. The data are sufficiently accurate for my purposes, although I cannot guarantee that my counts are precise.

78. At the time this Essay went to press, the NAF had not published data for fourth quarter 2006.

bates.<sup>79</sup> The JAMS data, by contrast, include few if any collections cases; virtually all disputes involve consumer or employee claimants.<sup>80</sup> Moreover, the JAMS data reveal a much more diverse range of business customers and dispute types.<sup>81</sup>

The prevalence of consumer finance industry collections cases before the NAF might be explained by the NAF's relatively unique arbitration product. Arguably, the NAF distinguishes itself by offering a form of risk-management especially valued by the consumer finance industry: class action protection.<sup>82</sup> Unlike JAMS and the AAA, the NAF has not promulgated rules for class arbitration.<sup>83</sup> Indeed, it appears to market its rules as incompatible with class actions.<sup>84</sup> This offers several benefits for businesses that wish to avoid class actions in general and class arbitration in particular. First, when the clause does not expressly forbid classwide proceedings, NAF arbitrators may interpret it to require individual arbitration.<sup>85</sup> That decision will be virtually immune from judicial review.<sup>86</sup> Second, if the clause does forbid classwide proceedings, and a court invalidates the clause, the

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79. Trial Lawyers for Public Justice, for example, has posted on its website discovery material obtained from litigation involving First USA reporting that the bank had been a party to over 51,000 NAF arbitrations, four of which had been filed by cardholders. See Plaintiffs' Memorandum of Law in Opposition to Defendants' Motion to Compel Arbitration and Stay Proceedings, *McQuillan v. Check 'n Go of N.C., Inc.*, No. 04-CVS-2858 (N.C. Super. Ct. Aug. 8, 2005), available at [http://www.tlpj.org/briefs\\_documents.htm](http://www.tlpj.org/briefs_documents.htm).

80. In the few arbitration demands filed with JAMS by businesses against individual consumers and employees, the individual often appears to be the real claimant. For example, in several cases the consumer "respondent" is represented by the Beasley Allen law firm as part of a broader litigation in which Beasley Allen represents the plaintiffs.

81. For example: 39.5% of the reported cases are categorized as "professional liability/malpractice," many involving the Kaiser Permanente arbitration program administered by JAMS. Another 22.4% are categorized as "business/commercial" disputes, and disputes involving the consumer finance industry (as respondent) are a subset of this category. Another 28.2% are categorized as employment disputes, and the remainder are scattered among insurance, health care (non-malpractice), personal injury, real estate, and construction disputes. By contrast, most of the NAF cases appear to involve businesses in the consumer finance industry.

82. E.g., Alan S. Kaplinsky & Mark J. Levin, *Drafting and Implementing of a Consumer Loan Arbitration Clause*, 51 CONSUMER FIN. L.Q. REP. 295, 295 (1997) (noting the possibility that arbitration will prevent class actions in the consumer financial services industry); Letter from Curtis V. Brown, V.P. and General Counsel, National Arbitration Forum, to prospective client (Jan. 14, 1999) (on file with author) (noting that arbitration may eliminate class actions).

83. See JAMS, JAMS CLASS ACTION PROCEDURES (2005), available at [http://www.jamsadr.com/rules/class\\_action.asp](http://www.jamsadr.com/rules/class_action.asp); AM. ARBITRATION ASS'N, SUPPLEMENTARY RULES FOR CLASS ARBITRATIONS (2003), available at <http://www.adr.org/sp.asp?id=21936>.

84. See Letter from Curtis V. Brown to prospective client, *supra* note 81 (noting that an arbitration clause may eliminate class actions).

85. Where there is doubt about the availability of class arbitration, *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444 (2003), allocates this decision to the arbitrator.

86. E.g., *Sun Ship, Inc. v. Matson Navigation Co.*, 785 F.2d 59, 62 (3d Cir. 1986).

NAF's refusal to administer class arbitrations likely means that the dispute will proceed as a class action in court.<sup>87</sup> Alternatively, instead of determining the validity of the class action waiver itself, a court might refer that issue to an NAF arbitrator.<sup>88</sup> NAF arbitrators may be likely to uphold such terms, and these decisions should once again be subject to limited judicial review.<sup>89</sup> These are valuable benefits even in collections cases. Indeed, lenders who engage in collections activity in arbitration, especially before the NAF, may lower their risk of encountering statutory defenses to the debt or class actions filed as counterclaims.<sup>90</sup>

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87. For examples of decisions invalidating arbitration agreements containing class action waivers, see *Discover Bank v. Superior Court*, 113 P.3d 1100, 1110 (Cal. 2005); *Muhammad v. County Bank*, 912 A.2d 88 (N.J. 2006); *State ex rel. Dunlap v. Berger*, 567 S.E.2d 265, 278-80 (W. Va. 2002); and *Luna v. Household Fin. Corp. III*, 236 F. Supp. 2d 1166, 1178-79 (W.D. Wash. 2002).

88. Arguably, the arbitrator should decide whether the class action waiver is enforceable. *E.g.*, *Hawkins v. Aid Ass'n for Lutherans*, 338 F.3d 801, 807 (7th Cir. 2003).

89. 9 U.S.C. § 10 (Supp. IV 2004); Stephen J. Ware, *Default Rules from Mandatory Rules: Privatizing Law Through Arbitration*, 83 MINN. L. REV. 703, 711 (1999) (describing an arbitration agreement as "in effect, an agreement to comply with the arbitrator's decision whether or not the arbitrator applies the law").

90. It is not clear whether arbitration is cheaper for collections cases, for the lender still must go to court to obtain an order confirming the award. *E.g.*, 9 U.S.C. § 9 (2000). Although these judicial proceedings can be perfunctory, they should require at least formal service of process, *e.g.*, REVISED UNIF. ARBITRATION ACT § 5, 7 U.L.A. 1, and possibly a hearing before a judge. (Unlike collections cases brought in court for a sum certain, this may be true even when the defendant fails to appear. *See* FED. R. CIV. P. 55(b) (clerk may enter default judgment for sum certain; "all other cases" left to the judge). Local practice may vary, but I would view an order confirming an arbitration award as akin to a declaratory judgment, and thus not suitable for a clerk-entered default judgment.) That, plus the cost of arbitration, might make collections activity more expensive in arbitration, at least in cases that involve no significant legal issues or discovery, and also in cases where the lender anticipates a default judgment. But this assumes that cases are processed individually, and arbitration may allow for bulk processing. For example, on July 3, 2006, five NAF arbitrators issued awards in thirty-four collections cases, apparently brought by four lenders. *See* <http://www.arb-forum.com/rcontrol/documents/FocusAreas/CAConsumerArbitrations2006Q3.pdf>.

Other advantages of arbitration might be a higher rate of favorable awards and (a related point) fewer statutory defenses raised by borrowers. The California data suggest that almost half (45%) of the NAF collections cases were resolved without an appearance by the borrower. Technically, the NAF rules do not provide for a default, *e.g.*, NAT'L ARBITRATION FORUM, CODE OF PROCEDURE Rule 36 (2006), available at <http://www.arb-forum.com> (follow "Rules & Forms" hyperlink), but merits hearings are likely to be perfunctory when the respondent is absent, and decisions may be made on paper submissions. *Id.* Rule 25. Of course, default rates are likely to be high in collections cases generally. *E.g.*, Stephen J. Ware, *Paying the Price of Progress: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. DISP. RESOL. 89, 97-98. Finally, the existence of collections cases in arbitration might be attributable, at least in part, to the mutuality requirement sometimes imposed by courts. *E.g.*, *Showmethemoney Check Cashers, Inc. v. Williams*, 27 S.W.3d 361, 366-67 (Ark. 2000). *But see* *Oblix, Inc. v. Winiecki*, 374 F.3d 488, 490-91 (7th Cir. 2004).

As for the danger of encountering class action counterclaims in collections cases, *see* *Sears Roebuck & Co. v. Avery*, 593 S.E.2d 424 (N.C. Ct. App. 2004).

## B. PROVIDERS AS SUPPLIERS OF IMPLICIT "ONE-SIDED" TERMS

Although the NAF is something of a *bête noire* for consumer advocates,<sup>91</sup> my point is not that its procedures are "unfair" for individuals. That may or may not be true. Instead, the NAF usefully illustrates two broader points. First, some providers emphasize the risk management component of their arbitration product. Second, users may obtain some of these risk management benefits without including "one-sided" terms in the contract itself. Thus, by selecting the NAF, a business may purchase some degree of insulation from class action risk whether or not it expressly addresses the topic of class actions in the arbitration clause.<sup>92</sup> Of course, the business could attempt to obtain more protection by expressly forbidding class actions, but doing so might risk attracting increased judicial scrutiny.<sup>93</sup>

Indeed, any arbitration provider could implicitly supply one-sided contract "terms" by fostering strong risk management practices among its arbitrators. For example, a provider could facilitate the development of implicit norms concerning, say, the propriety of arbitral awards of punitive damages. Acting in accordance with such norms, arbitrators might refuse to award punitive damages even in cases of severe misconduct, or might award punitive damages in amounts too small to serve any meaningful deterrent purpose. Such a practice would amount to an implicit punitive damages waiver that cannot be detected by reading the contract. As a result, apparently "even-handed" arbitration clauses may, by virtue of their designation of a particular arbitrator or provider, yield a "one-sided" process.

The historically private nature of arbitration may facilitate the development of such practices by shielding them from public view.<sup>94</sup> Furthermore, to an extent, less scrupulous providers may free-ride on other providers' efforts to enhance the public image of arbitration as "fair."<sup>95</sup> Thus, it should not surprise us if some providers differentiate themselves by offering procedures that are subtly and not-so-subtly biased in favor of their business customers.

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91. *E.g.*, Letter brief of Trial Lawyers for Public Justice, *Mercuro v. Superior Court*, No. S105424 (Cal. Apr. 25, 2002), available at [http://www.tlpj.org/briefs\\_documents.htm](http://www.tlpj.org/briefs_documents.htm).

92. *See supra* notes 85-90 and accompanying text.

93. *E.g.*, *Discover Bank*, 113 P.3d at 1110; *Muhammad*, 912 A.2d 88; *Dunlap*, 567 S.E.2d at 278-80; *Luna*, 236 F. Supp. 2d at 1178-79. Depending on the jurisdiction, it might even be preferable in some cases for the business to designate the NAF as provider, yet leave the agreement silent on the topic of class actions. If the arbitrator interpreted the agreement to require only individual arbitration, that decision should receive substantial deference by a reviewing court. *See supra* notes 86 & 89.

94. *E.g.*, *Bales*, 81 TUL. L. REV. at 365 (noting traditionally private nature of arbitration).

95. *E.g.*, *Harding*, 19 OHIO ST. J. ON DISP. RESOL. at 372.

Without further evidence, we cannot evaluate the extent to which providers or individual arbitrators offer implicit one-sided “terms” to the businesses that use their services. Recent efforts by some providers to increase the transparency of the arbitration process may shed light on this question.<sup>96</sup> More likely, providers who adopt more transparent practices do so, in part, to enhance the legitimacy value of their offerings and to further differentiate themselves in an already segmented market for arbitration services. This suggests that courts should view lack of transparency as a signal prompting further inquiry into the actual provider practices. Such an inquiry would follow from the recognition that limits on arbitration remedies and procedures need not be specified in the clause itself. Just as the due process rules may sometimes produce an even-handed process from an apparently one-sided clause, an apparently even-handed clause may sometimes obscure a one-sided disputing process.

## CONCLUSION

This Essay has suggested that there may be an important and poorly-understood interaction between arbitration clauses and the rules and practices of arbitration providers and arbitrators. If true, this realization has significant consequences for those interested in arbitration clauses as contracts. Put simply, the clauses may paint an incomplete or even misleading picture of actual arbitration procedures and remedies.

For those interested in arbitration as a legal and social phenomenon, the interaction I have described may be equally important. Arbitration clauses are implemented in a relatively unique institutional context, one in which third parties – arbitration providers and arbitrators – may both constrain and abet efforts to impose a one-sided arbitration process. It may be that we cannot understand arbitration without exploring the relationship between these third parties and the arbitration contracts that designate them.

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96. *See supra* note 39.