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A favorite technique of asking the parties folksy questions to gain confidence in the mediator might be ill advised, too. For instance, in speaking to the king, saying, "How is the war going in Prussia?" might not be a good opening. Similarly a discussion with the captain inquiring as to how his will was coming might not be a good idea, and similarly with the shipbuilder on his capital punishment views.

The rapid-fire chalkboard approach outlining issues and amounts, the hallmark of many mediators, would certainly fail if hardly anyone could read what was put on the chalkboard.


The only positive aspect of this type of mediation was, of course, that the king had the power to settle any dispute on the spot—and terminally. There would be no appeal.

Fault could be discussed against the king's admiral. But quite possibly, if the admiral knew he was going to die anyway, he might point the finger of fault at the king, creating such anger in the king that he might order everyone involved in the mediation to be executed. The same would follow logically to the shipbuilder and the designer.

This was not a matter of dividing money between parties, but rather of dividing heads from necks.

A prudent mediator in all the circum-

stances would have been most wise in order to remain in good health to simply adjourn the whole matter indefinitely for further evidence or investigation or whatever could conceivably be thought up, using best mediation skills, perhaps even deferring the matter to a "Royal Commission."

In fact, the investigator did exactly what a prudent mediator would have done: Nothing. Nothing was ever heard from him again and the issue of fault was never identified. Life went on with all parties intact. And in 1630 the king's army and navy invaded Germany without the Vasa. 

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## Non-Negotiable Mandatory Arbitration Clauses: From the Perspective of the Drafting Party

BY PAUL BENNETT MARROW

Courts—for example, *Hooters of America Inc. v. Philips*, 173 F.3d 933 (4th Cir. 1999)—and scholars—for example, Jean R. Sternlight, "Creeping Mandatory Arbitration: Is it Just?" 57 *Stan. L. Rev.* 1631 (2005); Paul D. Carrington, "Unconscionable Lawyers," 19 *Ga. St. U. L. Rev.* 361 (2003)—love to condemn mandatory arbitration clauses found in standard form contracts on the grounds that they are unconscionable.

Usually drafted by a business operator assumed to be opportunistic and predatory, these clauses are faulted for being one-sided—imposed without negotiation and fundamentally unfair because they cut the consumer off from access to the courts. Inherent is the argument that arbitrators

will unfairly prefer the cause of the business operator to that of the consumer.

While undoubtedly there are opportunistic and predatory business operators—for example, *Ting v. AT&T*, 319 F.3d 1126 (9th Cir. 2003)—most are not. To the contrary, the vast majority of busi-

### ADR THEORY

nesses seek to make a profit in a competitive environment that requires protection not only of their ability to make a profit, but also their reputation.

Most are repeat players who have invested heavily in their business and their reputation, players who recognize that they need their borrowers, clients, customers and consumers to exist and thrive. In addition, sparked by their drive to minimize lower operating costs, they crave stability and recognize that their interests are best served when they can build and maintain a relationship with a "good" borrower, customer, client or consumer. Empirical

evidence substantiates these conclusions. See Jason Scott Johnson, "The Return of Bargain: An Economic Theory of How Standard Form Contracts Enable Cooperative Negotiation Between Businesses and Consumers," 104 *Mich. L. Rev.* 857, 897-898 (2006).

Unfortunately, little is written about why reputable parties insist on clauses that are suspect as being unconscionable. There are many valid reasons. The law should accommodate such concerns. This article will discuss mandatory arbitration clauses within the context of credit card issuers, and the realities of the credit card industry.

Credit card disputes are uniquely suited to the arbitration process because they involve few potential fact issues. The card issuer (1) either did or didn't advance money at the user's instruction, (2) the user either does or doesn't have a Fair Credit Billing Act (15 U.S.C. §1601 et seq.; see also [www.ftc.gov/bcp/conline/pubs/credit/fcb.htm](http://www.ftc.gov/bcp/conline/pubs/credit/fcb.htm)) claim pending or (3) the user either did or didn't pay the money back.

That's pretty much it save for the extremely rare claim that the issuer engaged in a fraud. This factual simplicity makes the credit card dispute a perfect arbitration candidate.

Issuer drafted clauses are attacked as being procedurally unconscionable on the

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grounds that the cards are made too widely available to individuals who have less than sterling credit. It's the "Devil made me do it!" argument. But agreeing to advance money on behalf of someone with questionable credit doesn't entitle the beneficiary to a free ride. Being willing to assume such a risk doesn't mean that the issuer is to be precluded from using any and all lawful means to collect.

What about substantive unconscionability? Given the plethora of federal and state consumer laws that govern credit cards it's hard to imagine a viable substantive claim. Nevertheless, attempts directed at mandatory arbitration are made because this is one feature that isn't regulated. But these attempts should fail because issuers have good reason to want mandatory arbitration.

Mandatory arbitration isn't about overreaching to the detriment of the user. It's about being sure that the issuer gets back the money that indisputably it has advanced on the user's behalf. And that's as good as good reasons can get!

### DRAFTING THE CLAUSE: FORGET ABOUT NEGOTIATION

As a practical matter, negotiation with each new user isn't practical or even possible. So the issuer takes it upon itself to structure the card use terms and offers it on a take it or leave it basis. That's not as onerous as it may initially sound. There are lots of issuers, and there is nothing to stop the user from shopping for favorable terms.

Still, today most credit cards are issued on the understanding that usage is an acceptance of all the credit card agreement terms and conditions, which are sent along with the card when first issued. And embedded in most of these agreements is a mandatory arbitration provision.

Not only is arbitration imposed on the user without negotiation, the issuer gets to specify all the arbitration terms. So the issuer gets to select the forum for any proceedings, to exclude the right to a jury trial, to select applicable state and federal law, and to dictate the terms of the arbitrator's authority.

But there's more! Some clauses shorten statutes of limitation, seek discovery, prevent class actions and bar counterclaims for injunctive relief, punitive damages and

attorneys fees. And if all the above isn't enough, the arbitration process assumes a final award, and usually denies the user the right to appeal the outcomes, except that users have limited statutory vacatur rights.

And there's yet more! Some issuers reserve the right to unilaterally modify the mandatory arbitration clause at anytime, even after the card is first issued and used.

The only choice the user has is to either not use the card at all, or use it subject to all the terms the draftsman has deemed appropriate. Admittedly, this is a harsh reality. But just because it's harsh doesn't mean it is unconscionable. Let's try to understand why the need for the harshness.

### WHAT'S ON THE CARD ISSUER'S MIND?

So why do credit card issuers insist on mandatory arbitration? To start, consider the risks involved. The nature of the relationship between an issuer and user is quite similar to that of lender and borrower: card use obligates the issuer to advance cash—a loan on behalf of the user, who is the equivalent of a borrower. Until the advance is repaid, the issuer bears the entire risk. At the same time, while the debt remains unsatisfied, the user has complete control over the existence of the risk.

Is it any wonder, therefore, that the issuer would want to create an environment that encourages the user to remove the risk?

Of course, the issuer is in the business, and is compensated for taking risk by extremely high-interest assessments. But that doesn't mean that the issuer will not take any and all risk reduction measures. Why? Because the magnitude of the risk can accelerate without warning if the issuer is exposed to the vagaries of bankruptcy proceedings initiated by the user.

When issuers look at the market, this is some of what they see:

1. The environment is competitive. There are many issuers. Users aren't loyal and can easily establish and terminate relationships with multiple issuers.
2. While they see a large population of potential users, issuers can't accurately determine who is and who isn't a good potential user. The information they have about a given potential user is imperfect.

3. Even if issuers obtain good information about any given user, the information is always in the past tense. Things can and do change.
4. Issuers know that many users either are opportunistic or have the potential to become opportunistic if necessity so requires.
5. Issuers require a mechanism with which they can signal their intentions to counter opportunism in a forceful, expeditious and prompt manner.
6. Issuers know that the judicial system isn't user friendly and subject to delays because, in the courthouse summary judgment rarely is available.
7. Because of competition and the goal of building a continuing relationship, and the need to preserve their reputation, issuers must appear to be reasonable when confronted by requests for a waiver of any "right" that is "granted" by the issuer and contained in the credit card agreement.

Let's now look in some detail at these concerns.

### INCOMPLETE INFORMATION

All issuers know that there are good users and opportunistic users. The challenge is screening out the bad guys.

Even the most diligent issuer has available only partial information about credit worthiness. Services such as Equifax ([www.Equifax.com](http://www.Equifax.com)), Experian ([www.Experian.com](http://www.Experian.com)) and Transunion ([www.Transunion.com](http://www.Transunion.com)) are a start, but they also are far from perfect. Information can lag about a card's issuance or usage. Things often do change: The user loses a job or incurs an unexpected debt for something like medical bills not covered by insurance, etc. So over time, even the "good" user can degrade and become opportunistic—with the issuers having no forewarning whatsoever.

Good users are valuable to the issuer. It is in the issuer's best interests to take reasonable steps to accommodate the good user, whenever possible, so long as its doing so doesn't undermine its ability to recover any amounts advanced on the user's behalf.

The standard-form credit card agree-

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ment contains a number of rights favoring the issuer precisely because of the shortfalls of information and the changing nature of each risk situation. These may include the right to charge late fees, to withhold benefits such as frequent flyer miles, and mandatory arbitration. These rights are designed to signal the possibility of cooperation, as well as to signal the issuer that opportunism will not be tolerated and, when necessary, secure the issuer's position.

The good user most likely is aware of the need to preserve good user status. In other words, the good user knows the value of a good credit rating. The good user, like the issuer, is a repeat player who is concerned about his or her credit reputation. But good users can, and do, encounter circumstances that put their credit worthiness in jeopardy. When this happens, the good user may want the issuer's assistance.

The good consumer need not be penalized just because of a change in circumstances. More often than not the option exists to call the 800 number shown on all cards and to ask for help. Employees responding to these calls are often given a certain amount of discretion to say yes or no. Discretion is a win-win, with the issuer winning favor for being reasonable and the user being able to get help when needed. The value of the benefits accorded by discretion have even been quantified and reduced to a mathematical equation! See Lucian A. Bebchuk and Richard A. Posner, "One-Sided Contracts in Competitive Consumer Contracts," 104 *Mich. L. Rev.* 827, 831-833 (2006).

This discretion is limited, however, to issues involving the user's performance. It is commonplace for a user to ask for a waiver of late fees where the payment arrived one or two days late. The issuer's employee has discretion to grant the request based on the user's track record. In contrast, requests concerning terms aimed at the consequences of a "breakdown," i.e., a termination of the relationship are never waived. See Jason Scott Johnson, "The Return of Bargain: An Economic Theory of How Standard-Form Contracts Enable Cooperative Negotiation Between Businesses and Consumers," *supra* at 858-59; Lisa Bernstein, "Private Commercial Law in the Cotton Industry: Creating Coopera-

tion Through Rules, Norms, and Institutions," 99 *Mich. L. Rev.* 1724 (2001)). This is because to do so would jeopardize the issuer's ability to recover the amounts that it has advanced on the user's behalf. Mandatory arbitration is a breakdown default term.

## THE TOOL OF CHOICE

There are users who simply are opportunists. No question about it. This reality is known to every issuer. Opportunistic users have little regard for their reputation. They are prepared to run up large outstanding balances with little intention of paying them off. They are even disposed to frustrating collection in the hopes that the issuer will compromise a claim. The problem is that the issuer may not be able to identify this type of user until it is too late.

As noted at the outset, the user holds all the cards until it's time to pay the outstanding balance. From that day forward, the issuer must move quickly to ensure that the damage is held to a minimum. How does mandatory arbitration serve this need?

In the courthouse, the denial of any pleaded fact requires a trial, unless the denial can be shown to be without any possible merit whatsoever. This is often quite difficult. The need for a trial means that the issuer is subject to the unpredictability of the court system, as well as delay and expense.

Summary judgment is almost never available to the issuer, in particular because it has the burden of proving to the factfinder that it advanced money on the user's behalf, and that it did so at the user's specific instruction.

This is an odd result given the relationship between the issuer and the user. After all, what fact issues can exist in a relationship that involves only three fact questions: Did the user call upon the issuer to advance money? And if so, did the issuer comply? And is there an unresolved Fair Credit Billing Act claim? Nevertheless, forget about summary judgment.

The issuer's position can be further undermined by protracted discovery, and an inability to secure scheduling preferences. And there always is the possibility of an appeal, and even a remand for a new trial.

Given these hurdles, it isn't surprising that an opportunistic user wouldn't find the prospect of a suit in the court system very threatening.

So faced with the prospect of delay, the issuer sooner or later will consider the possibilities for compromise. A bird-in-hand is worth far more than one in the bush, and is just what the opportunistic user counts on.

While mandatory arbitration is no panacea, at the very least it gives the issuer greater control over timeliness of resolution and removal or reduction of risk. The rules of the CPR Institute—which co-publishes this newsletter—the American Arbitration Association, and Irvine, Calif.-based provider JAMS all provide for either fast track, expedited proceedings, or streamlined proceedings. Minneapolis-based National Arbitration Forum permits a document hearing on claims of less than \$75,000.

Even if the regular rules apply, speediness is encouraged by these service providers as well as the arbitrator handling the case. Thus, discovery is tolerated although not available as of right, and then only under the arbitrator's careful watch. In the end, soup to nuts, an arbitration can produce an award in far less time than a comparable courthouse proceeding.

To be sure, mandatory arbitration provides other benefits for the issuer, although none is as important as the speediness of the process. Mark Fellows, "The Same Result as in Court, More Efficiently: Comparing Arbitration and Court Litigation Outcomes," *Metropolitan Corporate Counsel* 32 (July 2006).

Most cited is the benefit of confidentiality. Arbitration awards are normally not made public whereas jury awards are. This benefit is supposedly prized by an issuer not because of inclinations to conceal the amount of an award, but because of the veil of secrecy thrown over the reasoning offered by the arbitrator as support for the award.

But is this a real benefit in cases involving credit cards? Probably not. The factual issues in these cases are mostly simple and of little interest as precedent. Either the user received the advance and the goods or services associated with the transaction, or he or she didn't. So the chances that an arbitrator will issue a reasoned opinion that deals with anything other than the specific case facts before him or her is remote.

Arguably there might be some sensitiv-

ity to the possibility of statistical studies involving arbitrator awards, especially if these studies show that issuers will tend to prevail. But in reality, those studies already exist in the general literature. See, e.g., Michael T. Burr, "The Truth About ADR: Do Arbitration and Mediation Really Work?" *Corporate Legal Times* (February 2004). The studies are not only widely available through the Internet, but they also are posted on the Web pages of some of the service providers. For example, NAF makes available on its Web page a study by Ernst & Young LLP titled "Outcomes of Arbitration—An Empirical Study of Consumer Lending Cases" (2004) (available at [www.adrforum.com](http://www.adrforum.com)).

Other benefits, some of which are favorable for the user as well, are reduced costs, and hearings that don't necessarily require an attorney because of institutional informalities and finality. And some feel that arbitration is useful if the terms prohibit user-initiated class actions.

Rarely discussed is the benefit of deterrence. Deterrence comes in more than one form. Many see arbitration as a *fait accompli*. And given the limited factual issues that are likely to arise, there probably is something to that argument. This reality serves to discourage many who might otherwise be tempted to frustrate collection. See Paul Bennett Marrow, "Eliminating Unconscionability in Assessing Mandatory Clauses by Deploying the 'Vantage Point of Public Policy,'" 24 *Alternatives* 51 (2006). Mandatory arbitration under circumstances that appear to favor one or the other parties does deter.

## DOES UNCONSCIONABILITY EXIST?

All this is not to say that mandatory arbitration clauses can never be unconscionable. The draftsman has to be mindful of that reality.

As a simple rule of thumb, if the clause serves no purpose other than to put the user at a disadvantage, it's a good bet that a court will throw it out. So don't attempt to impose excessive costs by requiring that the situs for the proceedings be at someplace far off or attempt to impose an arbitrator who may be biased, or appears to be biased.

Some also argue that there is a so-called "repeat provider problem." See, Carrie

Menkel-Meadow, "Do the 'Haves' Come Out Ahead in Alternative Judicial Systems?: Repeat Players in ADR," 15 *Ohio St. J. on Disp. Resol.* 19, 35-37 (1999).


This is an argument that should be of great interest to *Alternatives* readers because it involves the credibility of all arbitration service providers.

Prof. Sternlight notes that providers of arbitration services such as AAA, NAF, JAMS and CPR must compete for clients, and therefore must be sure that the customer is satisfied with the outcomes. In addition, the providers are thought to have a financial interest in keeping clients happy. "If the disputant company is displeased with the results secured through a particular provider, it may well switch providers. Needless to say, providers and arbitrators vehemently deny the charge that they are biased. Providers urge that they have no direct influence over their arbitrators." Sternlight, *supra* at 1650.

The bottom line is that care must be taken when drafting any mandatory arbitration clause. It must never be assumed that such a clause is beyond attack merely because the drafter can provide a reason for its terms. And to assuage critics such as Prof. Sternlight, issuers are probably well advised to insist that providers and arbitrators disclose the track record of any arbitrator who serves on more than one case involving a given issuer.

What counts is that the preferences of the drafting party appear reasonable from the perspective of courts that are often biased against boilerplate.

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The drafting party must keep in mind that mandatory arbitration clauses always will be vulnerable because there is no regulatory oversight. The default is to the courts to determine the reasonableness of a clause on a case-by-case basis. The drafting party ultimately must establish the reasonableness of mandatory arbitration. In doing so the drafter must be able to prove the motivation is for a constructive purpose, and not an attempt to overreach or frustrate the process, or to cut the nondrafting party off from access to the courts to gain an upper hand. 

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