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Proposed Arbitration Ban Would Be Bad Law and Bad Policy

by

Daniel A. Lyons [*]

I. Introduction and Summary

On October 23, Senator Al Franken and FCC Commissioner Mignon Clyburn co-authored an op-ed that criticized arbitration agreements in consumer telecommunications contracts.[1] The article was part of a broader effort by Commissioner Clyburn to force the FCC to ban such agreements.[2] As Senator Franken and Commissioner Clyburn tell it, arbitration clauses originated with a "series of controversial Supreme Court decisions" that "effectively lock[] the courtroom door" on customers and allow companies to evade responsibility for misbehavior.[3] While the agency declined her call to ban these clauses as part of its recent ISP privacy order, it has committed to opening a rulemaking on the topic in February 2017.[4]

But while Commissioner Clyburn's dedication to consumers is unquestioned, she is wrong about both the law of arbitration agreements and their likely effects on customers. Arbitration originates not in recent Supreme Court cases but in the Federal Arbitration Act, a 1925 statute that established a strong federal policy favoring the practice. For nearly a century, this act has prevented government officials from banning arbitration provisions without permission from Congress in the form of a clear statutory directive – permission that the FCC does not have. And for good reason: while arbitration proceedings differ from traditional court cases, numerous studies show that consumers fare better in arbitration, especially when one considers arbitral rules and industry best practices that limit consumer exposure and provide incentives to pursue even small claims. Companies prefer arbitration not because they are more likely to win, but because they can resolve disputes more quickly and less expensively than through traditional litigation. And in the event that a claim proves difficult to arbitrate, Section 208 of the Communications Act assures that the Commission remains available as a backstop for consumer complaints.

The 2016 election will prompt a change in FCC leadership, which means it is less likely now that the agency will follow through on its commitment to propose new rules about arbitration agreements. But because the issue remains hotly contested, it is worthwhile to flesh out in greater detail why Commissioner Clyburn's proposed ban is both bad law and bad policy.

II. The Commission Lacks Authority to Prohibit Consumer Arbitration Agreements

As a threshold matter, the proposed ban runs afoul of the Federal Arbitration Act (FAA). The statute provides that any "written provision in any…contact evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction…shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[5] As the Supreme Court explained (in an opinion written by progressive luminary Justice William Brennan), the FAA "is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any [] substantive or procedural policies to the contrary."[6] Congress passed the statute "in response to widespread judicial hostility to arbitration agreements."[7] Federal policy favoring arbitration affords the parties "discretion in designing arbitration processes [] to allow for efficient, streamlined procedures tailored to the type of dispute."[8]

The Supreme Court recently rejected a ban similar to that proposed by Commissioner Clyburn – in the explicit context of a telecommunications contract. In *AT&T Mobility v. Concepcion* (2011), customers brought a putative class action alleging they were improperly charged sales taxes on "free" phones under their wireless service contracts.[9] AT&T moved to compel arbitration under the contract, which required arbitration of all disputes between the parties and prohibited classwide procedures.[10] The trial court denied the motion, holding that the ban on class arbitration was unconscionable under California law, which governed the agreement.[11] But the Supreme Court reversed, holding that California's prohibition on collective-arbitration waivers was preempted by the FAA.[12] The Court summarized its lengthy arbitration jurisprudence in no uncertain terms: "When state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA."[13]

Although *Concepcion* focused on state laws prohibiting arbitration, the same principles apply to agency rules that would prohibit the practice. After all, the Administrative Procedure Act requires courts to "hold unlawful and set aside agency action…found to be…in excess of statutory jurisdiction, authority, or limitations, or short of statutory right" or "otherwise not in accordance with law."[14] Agency rules must accord not only with the agency's own organic statute, but also "other Acts…where Congress has spoken…more specifically to the topic at hand."[15] This means that to override the FAA's strong endorsement of arbitration agreements generally, the Commission would need specific statutory authority to regulate such agreements in the telecommunications context.

And this is where the FCC differs from other agencies that Senator Franken and Commissioner Clyburn cite to support their proposed ban. The op-ed notes that other agencies, such as the Department of Defense and the Consumer Financial Protection Bureau (CFPB), have adopted or are considering bans on arbitration agreements by entities subject to their regulatory purview. With respect to the Defense Department, this prohibition arises not from agency regulation but from statute, specifically the Defense Appropriations Act of 2010, which bars large defense contractors from requiring employees to arbitrate civil rights or sexual harassment claims.[16] The statute stemmed from Halliburton's (unsuccessful) attempt to arbitrate claims arising from an employee who alleged she was raped by co-workers in Iraq. This harm is a far cry from a hypothetical "mysterious 99-cent fee…appearing on your broadband bill" about which Senator Franken and Commissioner Clyburn express concern – far enough for Congress to have created a statutory exception to the FAA to cover such claims. Similarly, the CFPB is considering rules limiting arbitration in consumer financial services agreements because the Dodd-Frank Act explicitly directed the Bureau to study and, if necessary, restrict such agreements in this specific context.[17]

The FCC lacks a similar statutory mandate to consider the role of arbitration agreements in telecommunications contracts, and therefore is subject to the FAA's general policy in favor of arbitration agreements. For any agency concerned with respecting the boundaries of its statutory authority – or with avoiding another embarrassing reversal in federal court – this legal reality should be the end of the matter.

III. A Ban on Arbitration Agreements Would Be Bad Policy

Aside from these legal obstacles, a ban on consumer arbitration agreements is also likely to be bad policy. Admittedly, Senator Franken and Commissioner Clyburn raise a concern that is reflected among many academics, namely, the potential that arbitration panels may be systemically biased in favor of corporations and against consumers. But, of course, these claims are empirical in nature and can be tested. After years of criticism based largely upon anecdotal evidence and supposition, scholars are beginning to study arbitration more thoroughly, finding results that are at odds with this perceived wisdom. Surveying these recent studies, Professor Peter Rutledge of the University of Georgia Law School concluded that "most of the methodologically sound empirical research does not validate the criticisms of arbitration."[18] For example, he explains that contrary to popular critique, in employment cases "arbitration generally results in higher win rates and higher awards for employees than litigation."[19] Rutledge states that "most measures – raw win rates, comparative win rates, comparative recoveries and comparative recoveries relative to amounts claimed – do not support the claim that consumers and employees achieve inferior results in arbitration compared to litigation."[20]

Professor Rutledge's results are mirrored by a 2010 study by Northwestern Law School's Searle Civil Justice Institute, which looked at the results of over 300 consumer arbitrations by the American Arbitration Association, one of the leading arbitral forums. The study found that consumers won some relief 53% of the time, and 63% of successful consumers who requested attorney's fees received them.[21] The study also found no statistically significant difference between the success rate of repeat players and non-repeat players.[22] Of course, both this study and Professor Rutledge's article correctly note that more analysis is needed. But these studies provide no support for, and therefore call into question, the policy claims driving the call for an arbitral ban.

Senator Franken and Commissioner Clyburn seem particularly troubled by clauses prohibiting class arbitration. In addition to the "mysterious 99-cent charge" hypothetical noted above, they imagine a scenario in which a customer pays for an upgrade to faster Internet service but the service keeps cutting out, and another one in which a customer seeking to terminate service is charged a $200 early termination fee that he or she does not remember agreeing to. They argue that, absent the ability to aggregate multiple smaller claims into a larger payday, no consumer-friendly lawyer has an incentive to take the case, and any consumer who pursues such litigation will pay more in court costs than he or she can expect to recover. Therefore, they argue, the claimant effectively lacks a forum to seek relief.

While on the surface these anecdotes seem compelling and help flesh out the general arguments in favor of class actions, a closer examination reveals three difficulties with this logic. First, as Commissioner Michael O'Rielly noted when dissenting from the Broadband Privacy Order, the "fact-specific nature of many of the disputes that end up in arbitration – such as an incorrect bill – do not lend themselves to class certification."[23] Federal Rule of Civil Procedure 23(b)(3), which governs class actions for damages, allows certification only if questions of law or fact common to class members predominate over any questions affecting individual members. In each of the three scenarios above, liability could turn upon individual facts unique to each claimant. For example, both the "mysterious 99-cent charge" and the early termination fee turn upon specific facts about what the claimant was told about the purpose of the charge and whether the claimant agreed – facts that differ from claimant to claimant and therefore make class certification inappropriate.[24] Similarly, poor service quality could stem from environmental factors unique to each customer's property, which makes class certification impossible.

Second, while it may not be cost-efficient to *litigate* small claims in a traditional courtroom, it may nonetheless be worthwhile to *arbitrate* such claims. Many corporations, including telecommunications companies, adopt consumer-friendly arbitration practices that help make smaller claims viable. For example, the court in *Concepcion* noted that AT&T's arbitration agreement included the following provisions:

- Customers could file a complaint with a simple one-page web form;
- AT&T must pay all costs for nonfrivolous claims;
- The arbitration must occur in the county where the customer is billed;
- For claims less than $10,000, the customer could proceed in person, by telephone, or on written submissions alone;
- Either party could elect to proceed in small claims court rather than arbitration;
- AT&T could not seek reimbursement for attorney's fees; and

- If the customer received an arbitration award greater than AT&T's last settlement offer, the company would pay a minimum $7500 recovery plus twice the claimant's attorney's fees.[25]

The trial court found that the informal resolution process was likely to "prompt full or even…excess payment to the customer without the need to arbitrate."[26] More importantly, the $7500 premium provided a "substantial inducement for the customer to pursue the claim in arbitration" even if it was for a small amount. In fact, the trial court found that consumers who pursued individual arbitration were *better off* than participants in a class action, which "could take months, if not years, and which might yield an opportunity to submit a claim for recovery of a small percentage of a few dollars."[27] Nor is AT&T an outlier in this regard: in a recent FCC filing Verizon explained that its customers similarly receive their choice of in-person, telephonic, or written proceedings, that the company covers all arbitration fees, and that the customer is guaranteed $5000 plus attorney's fees if he or she receives an award greater than the company's final settlement offer.[28] In the CFPB proceeding, the U.S. Chamber of Commerce highlighted similar provisions in arbitration agreements by many different companies, including Amazon, Dell, Microsoft, American Express, and Sprint.[29] Where companies do not assume all costs voluntarily, national arbitration organizations typically cap consumer arbitration costs by rule, mandating the remaining costs be paid by the company.[30] For example, under AAA rules the consumer pays a $200 filing fee but the company pays all other costs, including arbitrator compensation, expenses, hearing fees, and room rental fees.[31]

Finally, even if Commissioner Clyburn were correct that individual arbitration was not cost-effective, there remains a forum available for the consumer to file a complaint and seek redress: the Federal Communications Commission. Section 208 of the Communications Act allows consumers to file complaints directly with the agency for any violation of its common carriage duties.[32] Those duties include the obligation to assure that "all charges, practices, classifications, and regulations for and in connection with such communications service, shall be just and reasonable"[33] and that it avoid "unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services."[34] And Section 209 authorizes the Commission to order telecommunications carriers to pay damage awards to consumers based on their filed complaints.[35] Most companies acknowledge, as they must, that arbitration agreements do not displace a consumer's right to bring issues before federal, state, or local authorities such as the FCC.[36] So the idea that class waivers mean that corporations "evade accountability" for misconduct and become "impossible to stop," as Senator Franken and Commissioner Clyburn claim,[37] is simply false. The Commission itself remains a backstop for consumer complaints that somehow escape arbitration.

IV. Conclusion

In recent years the Commission has displayed an unfortunate tendency to pursue controversial policy objectives even in the face of serious questions about its authority to do so. For example, in its rush to support municipal broadband, the agency was willfully blind to Supreme Court precedent that clearly foreclosed it from preempting state laws governing municipal actions.

When challenged, the agency suffered an embarrassing and entirely foreseeable defeat in the Sixth Circuit.[38] Commissioner Clyburn's proposed arbitration ban suffers from a similarly glaring legal deficiency, and if enacted would likely suffer a similar fate in court.

It would be doubly foolish for the agency to risk another such loss in pursuit of such a poor policy. The crusade against arbitration agreements is built upon a caricature of both the arbitration process and the companies that rely upon them. In reality, consumers fare well in arbitration proceedings, particularly when arbitral organizations and companies adopt procedures that minimize the burden of arbitration on consumers and provide adequate incentives to pursue even small claims. The concern about loss of class status is exaggerated, as many telecommunications issues are not suitable for class treatment and even if they were, individual arbitration has numerous structural advantages over traditional class litigation.

Ultimately, the Commission itself remains an adjudicator of last resort for such claims, meaning that a consumer can always choose not to pursue arbitration, but instead to vest his or her concerns in the agency Congress designated as the country's expert on telecommunications issues. An arbitration ban would be a boon to trial lawyers, but it's difficult to see how foregoing the benefits of arbitration would be beneficial to American consumers.

* Daniel A. Lyons, an Associate Professor of Law at Boston College Law School, is a Member of the Free State Foundation's Board of Academic Advisors. The Free State Foundation is an independent**,** nonpartisan free market-oriented think tank located in Rockville, Maryland.

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[1] Al Franken & Mignon Clyburn, How Your Internet Provider Restricts Your Rights, Time Magazine, Oct. 23, 2016, available at http://time.com/4541176/al-franken-arbitration-clauses/?iid=sr-link2.
[2] See, e.g., Keynote Remarks of Commissioner Mignon L. Clyburn, #Solutions2020 Policy Forum, Georgetown University Law Center, Oct. 19, 2016, available at http://transition.fcc.gov/Daily_Releases/Daily_Business/2016/db1020/DOC-341824A1.pdfc.
[3] Franken & Clyburn, *supra* note 1.
[4] In re Protecting the Privacy of Customers of Broadband and Other Telecommunications Services, Final Order, WC Docket No. 16-106, Nov. 2. 2016, ¶ 14, 305, available at http://transition.fcc.gov/Daily_Releases/Daily_Business/2016/db1103/FCC-16-148A1.pdf.
[5] 9 U.S.C. § 2.
[6] *Moses H. Cone Mem. Hosp. v. Mercury Const. Corp*., 460 U.S. 1, 24 (1983).
[7] *AT&T Mobility v. Concepcion*, 563 U.S. 333, 339 (2011); *see also id*. at 360 (Breyer, J, dissenting) (discussing legislative history about "costliness and delays of litigation").
[8] *Id.* at 344.
[9] *Id.* at 337.
[10] *Id.*
[11] *Id.* at 338.
[12] *Id.* at 344.
[13] *Id.* at 341 (citing *Preston v. Ferrer*, 552 U.S. 346, 353 (2008)).
[14] 5 U.S.C. § 706.
[15] *FDA v. Brown & Williamson Tobacco Corp*., 529 U.S. 120, 133 (2000).
[16] Pub. L. 111-118 (Dec. 19, 2009).
[17] Public Law 111-203, 124 Stat. 1376 (2010), section 1028(a). Senator Franken and Commissioner Clyburn also reference recently adopted or proposed arbitration bans by the Department of Education and the Center for Medicare

and Medicaid Services. While neither of these appears to have an explicit statutory hook, they also have not yet been tested in court and I would expect them to be invalidated for the same reasons discussed above.

[18] Peter B. Rutledge, *Whither Arbitration?* 6 Georgetown J. of Law & Pub. Pol'y 549, 551 (2008).

[19] *Id.*; see also David Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 Stan. L. Rev. 1557 (2005).

[20] Rutledge, *supra* note 18, at 560.

[21] Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Arbitrations*, 26 Ohio State J. on Disp. Res. 843, 897-898 (2010).

[22] *Id.* at 846.

[23] Dissenting Statement of Commissioner Michael O'Rielly, In re Protecting the Privacy of Customers of Broadband and Other Telecommunications Services, Final Order, WC Docket No. 16-106, Nov. 2. 2016, available at http://transition.fcc.gov/Daily_Releases/Daily_Business/2016/db1103/FCC-16-148A1.pdf.

[24] See, e.g., *Geier v. M-Qube, Inc*., 314 F.R.D. 692 (W.D. Wash. 2016).

[25] *Concepcion*, 563 U.S. at 337.

[26] *Id.* at 338.

[27] *Id.* at 352.

[28] See Verizon Comments, In re Protecting the Privacy of Customers of Broadband and Other Telecommunications Services, Final Order, WC Docket No. 16-106; see also Verizon Wireless Customer Agreement, https://www.verizonwireless.com/legal/notices/customer-agreement/.

[29] Letter from David Hirschmann & Lisa A. Rickard, U.S. Chamber of Commerce, to Monica Jackson, Consumer Financial Protection Bureau, at 30-38 (Dec. 11, 2013), available at http://www.instituteforlegalreform.com/uploads/sites/1/2013_12.11_CFPB_-_arbitration_cover_letter.pdf.

[30] Drazohal & Zynotz, supra note 21, at 863; *Green Tree Fin. Corp.-Alabama v. Randolph*, 531 U.S. 79, 95 (2000) (Ginsburg, J., concurring in part and dissenting in part).

[31] AAA Consumer Arbitration Rules (2016), available at https://www.adr.org/aaa/ShowProperty?nodeId=/UCM/ADRSTAGE2021425&revision=latestreleased.

[32] 47 U.S.C. § 208.

[33] *Id.* § 201(b).

[34] *Id.* § 202(a).

[35] 47 U.S.C. § 209.

[36] See, e.g., Verizon Wireless Customer Agreement, supra note 28 ("You can also bring any issues you may have to the attention of federal, state, or local government agencies, and if the law allows, they can seek relief against us for you."); AT&T Wireless Customer Agreement, available at https://m.att.com/shopmobile/legal/terms.wirelessCustomerAgreement.html ("Notwithstanding the foregoing, either party may bring an individual action in small claims court. This arbitration agreement does not preclude you from bringing issues to the attention of federal, state, or local agencies, including, for example, the Federal Communications Commission. Such agencies can, if the law allows, seek relief against us on your behalf.").

[37] Franken and Clyburn, supra note 1.

[38] *Tennessee v. FCC*, 832 F.3d 597 (2016).