## REPORT OF THE COMMITTEE STUDYING THE NEED FOR CHANGES IN VIRGINIA'S ARBITRATION LAWS

During its 2008 meeting, the Conference considered whether to recommend that the Virginia Uniform Arbitration Act, first promulgated by the National Conference of Commissioners on Uniform State Laws in 1955, should be amended to conform to the revision of that Act promulgated in 2000. After considering some of the major differences between the 1955 Act and the 2000 revision, the members of the Boyd Graves Conference reached consensus that in the absence of significant complaints from either the bar or the public concerning Virginia's existing arbitration laws, there was no apparent reason to change those laws. The Conference also concluded, however, that the Committee studying Virginia's arbitration laws should be continued for an additional year and that it should be charged with the responsibility of determining whether there are, in fact, problems with the application of the present law and, if so, whether the Code should be amended to address such problems.

In pursuing its charge, the Committee addressed an e-mail to each member of the Conference asking for information concerning problems experienced in conducting proceedings under Virginia's arbitration laws. In addition, a request for such information was published in the *Virginia Lawyer's Weekly*. These efforts produced less than twenty responses, the overwhelming majority of which indicated no problems with the current Virginia law and included no suggestions for changes. Several of those responding felt that the process of arbitration itself has become cumbersome, slow, and excessively expensive, and there were one or two complaints about the limited ability to obtain appellate review of a final arbitration award. In general, however, the Committee can report that it has been able to identify no widespread discontent with the present Virginia arbitration laws, and no obvious demand for major changes.

Despite the apparent absence of any widespread support for making major changes in the present law, during the course of its deliberations the Committee identified, considered, and is prepared to make specific recommendations with respect to several independent issues related to Virginia's present arbitration laws.

### 1. The Presence of Mandatory Arbitration Clauses in Consumer Contracts

It is clear that the use of mandatory arbitration clauses has become pervasive, and that such clauses are commonly included in most contemporary consumer contracts, including cellular phone service, credit cards, automobile rentals, and even discount brokerage agreements. In an article entitled *A Study of Arbitration Clauses in Consumer and Non-consumer Contracts* published in the November-December 2008 edition of *Judicature*, the authors observed:

> *Most significantly, we found that more than 75 percent of consumer contracts in our sample included mandatory arbitration clauses, while fewer than 10 percent of non-consumer agreements provided for arbitration. Excluding employment contracts, which required arbitration at a very high rate (90 percent), the comparison is more dramatic: fewer*

*than 6 percent of non-employment, non-consumer contracts provided for arbitration.*

Consumer contracts containing mandatory arbitrations clauses are often signed by individuals who do not have even a basic understanding of the terms to which they have agreed. The Committee is unanimous in concluding that it is fundamentally unfair to enforce a mandatory arbitration agreement signed under such circumstances, particularly when the facts make it clear that the contract involved is an adhesion contract entered into by parties with dramatically different levels of sophistication and dramatically different levels of bargaining power.

Although those who advocate the inclusion of mandatory arbitration clauses in consumer contracts contend that arbitration is fairer, quicker, and less expensive, their true motive appear to be far less altruistic. The authors of the *Judicature* article mentioned above, after summarizing the arguments for and against mandatory arbitration clauses, reached the following conclusion:

> *Overall, our study suggests that the asserted benefits of arbitration – fair outcomes arrived at faster and at lower cost – are not the dominant motives for inclusion of arbitration clauses in consumer contracts in the industries we studied. Firms that required arbitration of consumer disputes did not favor arbitration in their non-consumer contracts. The most likely explanation for the pattern we observed is that firms value arbitration clauses for their effects in suppressing aggregate proceedings by consumers, and perhaps averting liability for widespread but low-value wrongs.*

Otherwise stated, the authors of the study felt that including mandatory arbitration clauses in consumer contracts is intended primarily to avoid class action liability.

Although the Committee unanimously agreed that the inclusion of mandatory arbitration and class action waiver clauses in consumer contracts is inherently unfair, many members of the Committee were concerned that an attempt to address the problem legislatively might be preempted by Section 2 of the Federal Arbitration Act. This section of the FAA provides that an agreement to arbitrate in a transaction involving commerce "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

The Committee's concern over the effect of Section 2 of the Federal Arbitration Act on Virginia's ability to deal with this problem legislatively was substantially ameliorated by the discovery of three recent federal court of appeals decisions, two by the Ninth Circuit and one by the Third Circuit which deal with this precise issue. The decisions (*Chalk v. T-Mobile USA, Inc.*, 560 F.3d 1087, 9th Circuit 2009; *Homa v. American Express Company*, 558 F.3d 225, 3rd Circuit 2009; *Laster v. T-Mobile USA, Inc.*, 252 Fed. Appx. 777, 9th Circuit, 2007) and a host of related decisions in both the state and federal courts, make it clear that mandatory arbitration clauses accompanied by class action waiver are invalid if, under applicable state law, the court concludes that the clauses are

unconscionable. Importantly, the cases are unanimous in holding that the question of whether clauses of this type are unconscionable is almost always a matter of state law.

At present, state courts in West Virginia, Alabama, California, Ohio, Florida, Washington, and New York, and a federal district court applying Michigan law, have held that a mandatory arbitration clause which includes a class action bar is unconscionable and unenforceable. Unfortunately, the cases do not make clear whether a mandatory arbitration clause not including a class action bar would be held unconscionable. Although we have found no decision of the Virginia Supreme Court directly in point, the Federal Court of Appeals for the 4th Circuit, applying West Virginia law, has concluded that a waiver in a consumer contract of the right to file a class action is not unconscionable. The case, *Adkins v. Labor Ready, Inc.*, 303 F3d 503, 4th Circuit, 2002, may be at odds with a decision of the West Virginia Supreme Court in *Dunlap v. Berger*, 567 S.E. 2d 265, also decided in 2002, but is nevertheless of particular significance to Virginia lawyers because it has been cited twice by U.S. District Courts in Virginia as authority for the proposition that mandatory arbitration with class action waiver in contracts of adhesion are not unconscionable. Neither of the District Court opinions are published, but may be reviewed at *March v. Designer Motor Company*, Civil No. 3:07-cv-508, 2007 U.S. Dist. LEXIS 91202 (END. Va. 12/12/07) and *Freeman v. Capital One Bank*, Civil No. 3:08-cv-242-HEH, 2008 U.S. Dist LEXIS 51249 (E.D. Va. 7/3/08). In short, even though the two District Court opinions cite a 4th Circuit case that applied West Virginia law, both of the District Court cases purport to apply Virginia law in holding that mandatory arbitration clauses that include class action waiver are not unconscionable.

Without regard to whether such clauses can be successfully challenged as unconscionable under current Virginia law, it appears clear that there is no obvious impediment to the adoption by the General Assembly of remedial legislation proscribing the inclusion of mandatory arbitration clauses in contracts of adhesion governed by Virginia law. Whether Boyd Graves should recommend that the General Assembly do so was not an issue to which the Committee gave the in-depth consideration it manifestly deserves. The Committee is not therefore in a position to make a recommendation, one way or the other, with respect to legislative action.

As the Committee was concluding its work on this Report, it learned that there is currently pending in both Houses of the United States Congress legislation entitled *The Arbitration Fairness Act of 2009* (S 931 and HR 1020) which, if enacted into law, would severely restrict the use of mandatory arbitration clauses in consumer, employment, and franchise contracts. Other legislation currently pending in Congress would create a Consumer Financial Protection Agency and, among other things, give it broad authority to adopt regulations governing the use of such contractual provisions in instruments issued by a financial institution subject to the Agency's regulatory authority. The Committee cannot predict whether any of this legislation will be enacted into law, or the form it will take if it becomes law.

The problems created by the routine inclusion in a variety of consumer contracts of mandatory arbitration clauses with class action waivers are very real. The Committee

believes that many ordinary people are being subjected to abuse and that the problem deserves serious consideration.[1] However, in view of the pending federal legislation and the fact that the Committee has not had an opportunity to consider in detail the merits of a potential change in Virginia law governing the validity of such clauses, it is our recommendation that the question of whether the problems we have identified should be addressed by a change in Virginia law be referred to a new committee for in depth study and analysis.

2. **Should the Virginia Code be amended so as to conform with the 2000 Revised Uniform Arbitration Act with respect to the recovery of attorney fees?**

Subsection (c) of Section 25 of the 2000 Revised Uniform Arbitration Act adds new language permitting the prevailing party to recover reasonable attorney fees in a contested judicial proceeding seeking to confirm, vacate, modify or correct an arbitration award. The Committee has considered whether the Conference should recommend that similar language be added to the current Virginia Code.

In explaining their decision to include provisions in the Revised UAA giving the Judge the discretionary authority to award attorneys fees under certain specified circumstances, the Commissioners on Uniform State Laws included the following comment:

> *Section 25 (c) promotes the statutory policy of finality of arbitration awards by adding a provision for recovery of reasonable attorney's fees and reasonable expenses of litigation to prevailing parties in contested judicial actions to confirm, vacate, modify or correct an award. Potential liability for the opposing parties' post-award litigation expenditures will tend to discourage all but the most meritorious challenges of arbitration awards. If a party prevails in a contested judicial proceeding over an arbitration award, Section 25 (c) allows the court discretion to award attorney's fees and litigation expenses.* Blitz v. Bath Isaac Adas Israel Congregation, *352 Md. 31, 720 A.2d 912 (1998) (permitting award of*

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[1] Recent events have highlighted the validity of the concern over forced arbitration in consumer debt disputes. In July, 2009, two of the largest arbitration firms, the National Arbitration Forum (NAF) and the American Arbitration Association (AAA) announced that they were withdrawing from arbitrating consumer debt-collecting disputes. The Minnesota attorney general had filed suit against the NAF alleging fraud, false advertising, and deceptive trade practices. The lawsuit claimed that, although the NAF held itself out as impartial, it in fact worked closely with creditors to insert forced arbitration clauses in consumer agreements, and then to have the NAF appointed as the arbiter. The suit further alleged that the NAF maintained close ties with the banking and debt collection industries, as well as with the particular debt collection firms that regularly appeared as parties in NAF arbitrations. Additionally it appears that a hedge fund maintained cross-ownership of the NAF and some major debt collection firms. A week after the suit was filed, NAF settled with the Minnesota attorney general and agreed to a nationwide withdrawal from arbitrating consumer debt disputes. A few days later, the AAA announced that it would stop participating in consumer debt collection disputes until guidelines are put in place. Ironically, the National Arbitration Forum was the entity named in the mandatory arbitration clause that was upheld in *March v. Tysinger Motor Company, supra.*

*attorney's fees in both the trial and appeal of an action to confirm and enforce an arbitration award against party who refused to comply with it).*

The proponents of an amendment permitting the prevailing party to recover attorney's fees in a judicial proceeding to enforce an arbitration award argue that the provision will promote finality in arbitration awards by discouraging frivolous challenges, including frivolous appeals. The opponents respond that the provision is contrary to the American rule, which is with certain limited exceptions followed in Virginia, concerning the recovery of attorney fees and other litigation expenses. They also note that frivolous pleadings and motions are already subject to sanctions under Virginia Code § 8.01-271.1. Finally, the opponents observe that the parties to an arbitration agreement, if they are so inclined, are free to include in the agreement provisions permitting the prevailing party to recover attorney fees.

The Committee received correspondence from a member of the Conference complaining that he has frequently been the victim of frivolous judicial attacks on the finality of arbitration awards in domestic relations cases, and suggesting that the ability of the prevailing party in such cases recover attorney fees would discourage such attacks.

The Committee has considered at length both the arguments for an amendment to the Virginia Code permitting the recovery of attorney fees under the circumstances described in Section 25(c) of the 2000 Revised Uniform Arbitration Act, and the arguments against such a change. The Committee concluded that egregious cases of obviously frivolous attacks on a final arbitration award can currently be addressed under § 8.01-271.1 of the Code, and that in the absence of some other justification for what would be a significant departure from current Virginia practice, the Committee would not recommend such an amendment.

3. **Should § 8.01-581.016 be amended so as to permit an appeal from an order granting or denying an application to compel arbitration?**

Section 8.01-581.016(1) of the Code permits an appeal of an order denying an application to compel arbitration but does not permit an appeal of an order granting an application to compel arbitration.

The current provisions of § 8.01-581.016(1) are consistent with the provisions of the 1955 version of the Uniform Arbitration Act. The Committee has been informed that there were no official explanatory comments to the 1955 Act, but that the Act does contain a "Prefatory Note," the last sentence of which addresses the issue of appeals. The pertinent portion of the note reads:

*The Section on Appeals is intended to remove any doubts as to what orders are appealable and to limit appeals prior to judgment to those instances where the element of finality is present*

Section 8.01-581.016 was the focus of the decision of the Supreme Court of Virginia in *Seguin v. Northrop Grumman Systems Corp.*, 277 Va. 244, 672 S.E.2d 877 (2009). In response to the appellant's argument that an order compelling arbitration is a final

judgment order of the type contemplated by § 8.01-670(A)(3), the Supreme Court observed:

> *Finally, we turn to Seguin's contention that the order compelling arbitration in this case was a final judgment order contemplated by Code § 8.01-670(A)(3) which permits an appeal from a 'final judgment in any other civil case.' There is no merit to this contention. An order that compels arbitration pursuant to the Virginia Uniform Arbitration Act is not a final judgment order. Pursuant to Code § 8.01-581.010, the circuit court retains jurisdiction to vacate an arbitration award; pursuant to Code §8.01-581-011, the circuit court retains jurisdiction to modify or correct an arbitration award.*

The Committee concluded that the rationale of the *Seguin* decision with respect to appellate review of an order compelling arbitration is consistent with the apparent intent of the authors of the 1955 model act upon which the Virginia Arbitration Act is predicated. The Committee also concluded that there is no need to amend the law to provide for an immediate appeal of an order compelling arbitration. Accordingly, the Committee does not recommend that § 8.01-581.016 be amended to permit an appeal from an order compelling arbitration.

During its consideration of the appeal issue, several members of the Committee expressed concern over what they consider to be the ambiguous provisions of § 8.01-582.010(5). That subsection of the Code reads, in pertinent part:

> *Upon application of a party, the court shall vacate an award where:*
>
> *(5) There was no arbitration agreement and the issue was not adversely determined in proceedings under §8.01-581.02 and the party did not participate in the arbitration hearing without raising the objection.*

It appears from this language that in a situation where a circuit court has issued an order compelling arbitration, the party objecting to the arbitration cannot thereafter seek to vacate the award based on the issue of arbitrability, even though that may be the only ground upon which the award can be challenged. If this analysis is correct, the party seeking to vacate the award may be precluded by § 8.01-581.02(5) from seeking appellate review of the arbitrability issue. This potentially undesirable result can be avoided by eliminating the words "*and the issue was not adversely determined in proceedings under § 8.01-581.02*" from § 8.01.581.02(5), so that the section would then read:

> *Upon application of a party, the court shall vacate an award where:*
>
> *(5) There was no arbitration agreement and the party did not participate in the arbitration hearing without raising the objection.*

The Committee unanimously recommends that the Conference approve this amendment and endorse its adoption by the General Assembly.

## 4. Other Issues

Two other issues arising under the current Virginia arbitration law were brought to the attention of the Committee and were considered by the Committee:

(a) Under the present law, may a Virginia arbitrator grant summary judgment in favor of a party who consented to the arbitration; and

(b) Prior to the entry of a final award, may a Virginia arbitrator reconsider a decision or ruling made during the course of the arbitration proceedings?

The Committee has found nothing in the Virginia Code which would permit summary disposition of the issues in an arbitration proceeding without a hearing. Virginia Code § 8.01-581.04 requires the arbitrator to conduct a hearing and entitles the parties to participate in the hearing. Indeed, in *Bates v. McQueen*, 270 Va. 95, at 103; 613 S.E. 2d 566, at 570, the Supreme Court observed that *"a hearing is a fundamental part of the arbitration process"* and the failure to have a hearing, absent agreement of the parties, is reversible error.

Accordingly, the Committee does not believe that the Code should be amended to provide for summary judgment in arbitration proceedings.

Finally, with respect to the question of whether a Virginia arbitrator can reconsider a decision or ruling made during the course of the arbitration proceedings, the Committee notes that once an award is made, Virginia Code § 8.01-581.08 precludes modification except under very narrow and limited circumstances relating to such technical matters as form, evident errors of computation or calculation, and errors in the description of parties or property. However, prior to the issuance of a final award, the Committee has found nothing which prevents the arbitrator from reconsidering rulings made during the course of the proceedings.

The Committee does not believe that either of these issues evinces a problem requiring a change in the current law and the Committee does not recommend any change.

Respectfully submitted,

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