REPORT OF THE 2010 COMMITTEE
STUDYING THE NEED FOR CHANGES
IN VIRGINIA'S ARBITRATION LAWS

The Boyd Graves Conference began its current consideration of arbitration in 2008, under a charge from the Steering Committee to consider whether the Conference should recommend that the General Assembly adopt a revised version of the Uniform Arbitration Act. The original Uniform Arbitration Act was adopted by the Commission on Uniform Laws in 1955 and has since been enacted into law in 49 states. The Revised Act, adopted by the Uniform Laws Commission in 2000, has received a far less enthusiastic reception, and at the time of the 2008 Boyd Graves Conference had been approved by only 13 states.

The 2008 Committee studying the Revised Uniform Arbitration Act found no compelling reason to change the current Arbitration Law in Virginia and declined to recommend that the Revised Act be approved. Nevertheless, the conference directed the Committee to continue its study of arbitration for an additional year with the objective of determining whether more modest changes should be made in the existing law.

The 2009 Committee found no widespread dissatisfaction with the current Virginia Arbitration Laws, but it did identify several issues related to arbitration that in its opinion need to be addressed. Included among the most significant of those issues is the widespread inclusion of mandatory arbitration clauses in consumer contracts. The recommendations of the 2010 Committee should be considered in the context of the following discussion of this issue in the Report of the 2009 Committee:

> **"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:**
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> > ***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.***
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> **Consumer contracts containing mandatory arbitration 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, 3d 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 F.3d 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 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.

[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 as the entity named in the mandatory arbitration clauses that was upheld in *March v. Tysinger Motor Company, supra.*"**

The 2009 Conference directed the Arbitration Committee to continue its study of this issue in the light of pending appeals in several cases involving mandatory arbitration clauses and in the light of potential federal legislation.

The attention of the 2010 Committee was initially focused on two cases involving mandatory arbitration clauses then pending before the U.S. Supreme Court and the status of the Arbitration Fairness Act of 2009 — federal legislation that, as noted in our 2009 report, will likely have a profound effect on the use of mandatory arbitration clauses in consumer contracts. During the course of our study, however, Congress passed comprehensive financial reform legislation which, though directed primarily at the sometimes exotic activities of the banking industry, contains provisions creating a Consumer Protection Agency with explicit authority to regulate financial products containing mandatory arbitration clauses.

For purposes of clarity, this report will address each of these subjects separately.

The Arbitration Fairness Act of 2009

Somewhat different versions of this Act are currently pending in the Senate and the House. Although both versions contain provisions addressing the viability of mandatory arbitration clauses in consumer contracts, the legislation is stalled and there appears to be little or not chance that either version will be approved during the current session of Congress.

Restoring American Financial Stability Act of 2010

This Act, one of President Obama's top legislative priorities, passed Congress in the late summer. Among other things, the Act creates a Consumer Financial Protection Agency, with the explicit authority to regulate financial instruments containing mandatory pre-dispute arbitration clauses. The legislation is brand new. The Consumer Protection Agency has not yet been created, and it appears obvious that it will be many months before the regulatory scheme contemplated by the statute will be up and running. Moreover, the statute creating the Agency contains language requiring that considerable deference be given to state laws with provisions more restrictive than the federal regulations.

Although the Financial Stability Act clearly gives the new Consumer Protection agency the authority to regulate mandatory arbitration clauses, it is impossible to predict the form the regulations will take, when they will be adopted, or the effect they will have on competing state law. Also unclear is whether the new regulations, which are intended to cover financial instruments, will be sufficiently broad to cover the consumer contracts with which we have been primarily concerned.

The United States Supreme Court

When our Committee first began its work, two cases were pending before the U.S. Supreme Court that were thought likely to address at least some of the issues involved in the use of mandatory arbitration clauses in consumer contracts. The first case, Rent-A-Center v. Jackson, 561 U.S. ____ (2010) was decided on June 21, 2010. At first blush, the decision was greeted with dismay by the opponents of mandatory arbitration clauses. On closer examination however, it appears that the political implications of the case may be greater than its legal impact. The arbitration agreement in Rent-A-Center included a clause delegating arbitration challenges to the arbitrator. The Supreme Court held that under those circumstances, a threshold challenge to the validity or unconscionability of an arbitration agreement was for the arbitrator, not the courts, to decide. In reaching this conclusion, the court simply expanded on the severability concept established in Prima Point Corp. v. Flood & Conklin Mfg Co., 388 U.S. 395 (1967), in which the court held that an "agreement to arbitrate is severable from the contract of which it is a part, and that the validity of the arbitration agreement could be separately considered." Viewed in this light, it can be argued that Rent-A-Center does not really change existing law and that despite the publicity it has received, the case is likely to have limited impact on future cases involving the inherent invalidity of mandatory arbitration clauses.

Despite its limited legal reach, Rent-A-Center is widely viewed as a pro-business anti-consumer defeat for the little guy. As a result it has provided considerable impetus for curative federal legislation.

The second Supreme Court case considered by the Committee, AT&T Mobility v. Concepcion, 2010 WL 303962 Docket 09-893 (May 24, 2010), has not yet been decided but is very likely to have a profound impact on the validity of mandatory arbitration clauses.

The dispute in AT&T arose when AT&T offered to provide customer-free cell phones, but then charged them a sales tax on the phones, provoking a class action. Citing a provision in the

contract signed by each customer receiving a telephone, AT&T demanded that each claim be separately arbitrated. Both the District Court and the Ninth Circuit held the mandatory arbitration clause to be unconscionable. On May 24, 2010, the Supreme Court granted certiorari.

The question presented in AT&T is: "whether the Federal Arbitration Act preempts states from conditioning the enforcement of an arbitration agreement on the availability of particular procedures – here, class-wide arbitration – when those procedures are not necessary to ensure that the parties to the arbitration agreement are able to vindicate their claims."

Both sides of the debate on this issue share the opinion that the decision in AT&T is likely to have a far greater impact than Rent-A-Center. The outcome of the case is unpredictable (and a decision is months off) but a broad decision one way or the other could have an enormous legal and political effect, including the imposition of severe limitations on the authority of the states to legislate on the issue. On the other hand, a narrowly crafted decision based on the court's interpretation of California law might have limited impact beyond California. In any event, until the AT&T case is decided, any effort to predict its impact would be pure conjecture.

CONCLUSION

The members of the Committee had little difficulty in reaffirming their 2009 conclusion that the practice of including mandatory arbitration clauses in consumer contracts is inherently unfair.* Nevertheless, in view of the currently unsettled state of federal law, the Committee was divided over whether it would be appropriate to recommend curative legislation to the General Assembly at this time. Some members favored moving now to recommend legislation unequivocally declaring mandatory arbitration clauses in consumer contracts to be unconscionable and therefore unenforceable. Others favored legislation declaring such clauses to be unconscionable but only under specified conditions designed to avoid potential conflict with the Federal Arbitration Law. Still others thought that it would be unwise to recommend any legislation until we know what the Supreme Court decides in the AT &T case and until we have determined the scope and reach of the regulations yet to be adopted by the yet to be established Consumer Protection Agency created by the just-passed Financial Stability Act. A majority of the Committee was able to agree on a single legislative recommendation only by eliminating the option of doing nothing until the federal picture has been clarified.

Under the circumstances, the Committee is unanimous in recommending that the Conference take no action on the issue of including mandatory arbitration clauses in consumer contracts, at least until the Supreme Court has decided the AT&T case and there has been some clarification of what, if anything, the federal Consumer Protection Agency intends to do with respect to regulating this activity. The Committee wishes to emphasize, however, its unanimous view that this practice is unconscionable and that if pending action at the federal level does not preempt the ability of the states to adopt curative legislation, the Conference should give further consideration to that question. The Committee therefore recommends that it be continued for an additional year for the sole purpose of reporting to the next session of the Conference with

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* A news article from the August 27, 2010 editionof the Virginian Pilot, a copy of which is appended to this report, illustrates but one of the continuing problems these provisions are causing.

respect to intervening federal legislative, regulatory, or judicial action relevant to the issues discussed in this report, and the effect of any such action on Virginia's ability to address those issues legislatively.

Respectfully submitted,

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