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# Kluwer Arbitration Blog

## Consumer Arbitration - Will The Two Different Worlds Across The Ocean Converge?

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The United States (“US”) and European Union (“EU”) demonstrate major differences in relation to consumer arbitration. In December 2015, the US Supreme Court rendered a judgment in *Direct, Inc. v. Imburgia et al.*, an important precedent for consumer arbitration, which may make the law of these two jurisdictions diverge even further. This blog post discusses what has provoked these major jurisdictions to take different routes, and considers whether there are reasons to reach a unified approach in the future.

### Different approaches

The EU requires Member States’ courts to presume that the arbitration agreement in consumer contracts is an unfair term, if it was not individually negotiated by the parties after the dispute arose (see [Directive 93/13/EEC of 05/03/1993](#)).

In the meantime, the US Federal Arbitration Act (“FAA”) - which applies to domestic arbitration more broadly, as well as consumer arbitration - does not set any restrictions for the consumers to conclude an arbitration agreement prior to the arising of the dispute. The US provides a freedom for business entities to incorporate arbitration clauses into contracts where the consumer has an option of either accepting the clause, or rejecting the entire contract.

### Initiatives to make changes

The US has faced increasing criticism for its regulation of consumer arbitration, and some initiatives have been initiated in order to provide greater protection to the consumers. For example, a reviewed version of Arbitration Fairness Act has been introduced to Congress in April 2015, which would have a similar effect to the EU directive - it would prohibit pre-dispute arbitration agreements in disputes relating to employment, consumer or civil rights, and anti-trust. However, as for now, the legislative procedure has not moved [forward](#). The first attempts to implement this rule within the US legal system were made in 2007, and things have not been changed since then, except for the fact that such amending legislation was presented for a number of times in different wordings.

## Recent case law development within the US

After the New York Times published a range of articles criticizing consumer and employment arbitration in the beginning of last December, the US legal community was looking forward to see what effect the problems raised might have, and whether this could make some changes to the present attitude taken by the US federal courts towards arbitration. The question of whether consumers should receive priority to refer their cases to courts by ignoring pre-dispute arbitration agreements was at stake, and some US states had already passed laws that would render class-arbitration waivers unenforceable.

The US Supreme Court had a recent opportunity to address some of these problems in a case called *Direct*. That case arose in 2008, when Californian consumers initiated a class-action lawsuit against DirecTV. An arbitration clause was incorporated into DirecTV's standard service agreement. It set forth a waiver of class-arbitration, stating that the claims could not be joint or consolidated as well as adding that if the "law of your state" makes a waiver of class-arbitration unenforceable, then the entire arbitration provision "is unenforceable." At the time when the agreement was concluded and the litigation was initiated, Californian law made class-action waivers unenforceable according to the California Supreme Court's judgment in *Discover Bank*, rendered in 2005.

In 2011, as the DirecTV case was already being examined in Californian courts, the US Supreme Court decided in *AT&T Mobility* that the FAA preempts state rules that render class-arbitration waivers unenforceable. Therefore, the rule of *Discover Bank*, which made class-arbitration waivers in consumer contracts unconscionable, was no longer relevant. The enforceability of a waiver of class-action arbitration clause was reaffirmed in *American Express*, rendered in 2013.

After the *AT&T Mobility* judgment was published, DirecTV moved to stay or dismiss the plaintiff's claim and refer the case to arbitration. The US Supreme Court decided 6:3 that the *Discover Bank* rule (i.e. the rule stating that a class-action arbitration waiver is unenforceable) is preempted by the FAA, and therefore Californian Law that is not preempted by federal regulations cannot set any restrictions on the arbitration clause to be applied for the parties' dispute. Therefore, the waiver of the class-action arbitration clause was compulsory to the consumers.

### Two attitudes

The main reason for the majority's position towards consumer arbitration was rather clear. The US Supreme Court required consumers to stick to their contractual obligations, including an obligation to arbitrate disputes, which arose from the contract they have concluded.

Although present case law of the US Courts treats consumers' contracts and dispute resolution clauses as made under free will, an alternative opinion exists as well. Justice Ginsburg, who dissented in *Direct*, criticized the majority's opinion: "it has become routine <...> for powerful economic enterprises to write into their form contracts with consumers and employees no class-action arbitration clauses." Justice

Ginsburg's criticism mirrors the EU position, according to which an arbitration agreement may only be concluded after the dispute has arisen.

Therefore, although no class-arbitration agreements are respected in the US at the moment, both legislative and judiciary powers in the US are engaged in ardent discussions whether an opposite path should be taken.

### **Are there underlying policy arguments why consumer arbitration agreements should be upheld?**

Recent case law of the US judiciary, which dealt with consumer arbitration agreements, analyzed no class-action agreements too. The courts had to answer the double question whether the "no class-action" and "arbitration" jurisdictional clause is compulsory to the consumers. As the US Supreme Court answered in the affirmative to both parts of the question, and as class-action remained a major instrument for consumer rights protection (where a no class-action clause was absent), it is relevant to analyze whether there are reasons to have a negative attitude towards class-action suits.

The main incentive for the enterprise to seek a no class-action agreement relates to the risks which are created by class-action litigation.

Firstly, Federal Rules of the Civil Procedure set the "opt-out" system in class-action lawsuits as the standard option. This allows bringing high stake claims against the enterprise in the name of significantly large in number classes of consumers.

In comparison, most European countries either have an "opt-in" system as the standard in consumer class-actions (Austria, France, Germany, Italy, Lithuania, Poland, Spain, Sweden, Switzerland, etc.), or provide only a limited "opt-out" system (United Kingdom in anti-trust disputes). Only a few European countries (Bulgaria, Netherlands) have implemented an "opt-out" system in consumer class-actions.

The "opt-out" system, which is used in the US, by considering the significant size of the US market, grants a right for litigants to initiate lawsuits with extremely large claims. Such claims force enterprises to seek settlement, as the risk of loss provides a great danger for the company at stake. According to a recent [report](#) (see p. 351) prepared by the Consumer Financial Protection Bureau, the weighted average claims rate in the class-action cases where settlement was reached was 11% (4%, if Trans Union settlement is included).

Secondly, criticism is presented in relation to the lawyers' role in litigating class-actions, as a significant amount from the settlements is used to cover the legal fees. A [report](#) (see p. 357) shows that when there is a monetary settlement, on average, 24% of the money goes to the plaintiffs' lawyers. Lawyers' rates raised discussions of who are the real plaintiffs in class-action lawsuits and whether lawyers manage to deal properly with the "agency" tension between an interest to receive compensation for their clients and remuneration for themselves.

Courts' support of the enforcement of no class-action arbitration clauses allowed to remove the "agency" problem. Past experience of class-actions could be an underlying

argument, which lends support to no class-action arbitration clauses.

As European countries have not implemented an “opt-out” system, consumer disputes are reserved for the states’ courts, unless otherwise agreed after the dispute arises. This is based on (i) the consensual nature of arbitration and (ii) weak consumers’ interest and capabilities to resolve the question of dispute resolution at the time of concluding the main agreement. However, these arguments remain unanalyzed within the present US case law.

## Conclusions

Recent US case law development reminds the movement of a pendulum, where, after having experienced extensive class-actions jurisprudence, it switches to supporting the interest of business entities to enforce their no class-action arbitration agreements.

No class-action agreements remove the tensions created by class-actions, but the arbitration clauses also raise significant challenges to the consumers’ right to a fair trial. The present US case law does not correspond to the challenges identified by the EU in relation to pre-dispute arbitration agreements, in particular, whether consumers are able to decide how and where they would like to have their disputes solved before the disputes actually arise.

Heated discussions are taking place on whether the present US attitude to consumer arbitration is a proper one. There are strong arguments left to be considered in that discussion, which suggests that the future might bring some changes, and both the EU and US jurisdictions could converge.

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