Comments for the Texas Department of Insurance:

Mandatory Pre-Dispute Arbitration Provisions

In Endorsements for Homeowner's Insurance

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Introduction

The Texas Department of Insurance has asked for public comments "relating to mandatory mediation-arbitration endorsements" in homeowner's insurance policies. The following comments argue that mandatory pre-dispute arbitration provisions in homeowner's insurance policies would be detrimental to the interests of Texas homeowners and should not be permitted.[1]

Though industry proponents of mandatory pre-dispute arbitration argue that it is a positive tool for consumers—saving time and money in the resolution of disputes, and permitting companies to offer less expensive products and services—empirical evidence demonstrates that these clauses actually harm consumers' interests in many important ways. This has been demonstrated across a range of industries, from financial services to nursing home facilities.

However, consumers in the homeowner's insurance market are particularly vulnerable to the downsides of mandatory pre-dispute arbitration. First, in order to buy a home a person essentially *must* buy homeowner's insurance, meaning that consumers cannot choose to avoid a homeowner's insurance contract. Second, insurance contracts are highly standardized across all insurers in a market, meaning that consumers would have no meaningful choice between insurance policies. Thus the "option" to accept a mandatory pre-dispute arbitration endorsement would be illusory.

Permitting insurers to include these endorsements in homeowner's insurance policies will almost guarantee that Texas homeowners will be forced to accept the many harmful consequences of pre-dispute arbitration provisions. In order to adequately protect Texas consumers in this critical financial and personal decision, we urge the Department of Insurance to prohibit the inclusion of mandatory pre-dispute arbitration endorsements in policies for homeowner's insurance.

Statement of Interest of Public Justice

Public Justice pursues high impact lawsuits to combat social and economic injustice, protect the Earth's sustainability, and challenge predatory corporate conduct and government abuses.[2] To further its goal of preserving access to justice for consumers, employees, and other persons harmed by corporate misconduct, Public Justice has initiated a special project devoted to fighting abusive pre-dispute arbitration clauses.

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[1] These comments address pre-dispute arbitration provisions, which contractually bind the parties to resolve some or all future disputes in an arbitral forum. These comments are not addressed to post-dispute arbitration agreements where the parties agree to arbitrate an actual dispute after it has arisen, nor do these comments address appraisal or mediation as means for resolving insurance disputes.

[2] The Public Justice Foundation is a 501(c)(3) non-profit charitable public foundation that supports Public Justice, P.C., the law firm. For purposes of these Comments, both organizations are referred to interchangeably as Public Justice.

In connection with our project, Public Justice has litigated, investigated, researched, written and advocated about pre-dispute arbitration issues far more extensively than any other consumer law firm or advocacy organization in the U.S.

Public Justice has represented individuals in a large number of cases challenging abusive pre-dispute arbitration clauses, in state and federal courts, for more than a dozen years. Among the cases that Public Justice has won as lead or co-lead counsel are:

- *Sgouros v. TransUnion Corp.*, 817 F.3d 1029 (7th Cir. 2016) (affirming trial court's denial of motion to compel arbitration because company's website did not provide notice of arbitration provision to consumers); *Newton v. American Debt Services*, No. 12-155549, 549 Fed. Appx. 692 (9th Cir. 2013) (striking down arbitration clause that (1) required California consumers to arbitrate their claims in Tulsa, Oklahoma, (2) gave the defendant the sole say in choosing the arbitrator, (3) limited the plaintiff's statutory damages, and (4) subjected the plaintiff to the possibility of having to pay for the defendant's attorneys' fees in violation of California law); *Lee v. Intelius, Inc.*, 705 F.3d 1122 (9th Cir. 2013) (consumers did not enter into contract to arbitrate by clicking through a website to purchase a product); *Murphy v. DirecTV*, 724 F.3d 1216 (9th Cir. 2013) (non-party could not enforce co-defendant's arbitration clause against consumers); *Nagrampa v. Mailcoups, Inc.*, 469 F.3d 1257 (9th Cir. 2006) (en banc) (unconscionable to require California resident to arbitrate in Boston, court may consider fact that contract is adhesive even though that applies to the entire contract); *Lewallen v. Green Tree Servicing, LLC*, 487 F.3d 1085 (8th Cir. 2007) (finding waiver of right to compel arbitration by a lender);
- *Larkin v. New Century Auto Sales Inc.*, No. 12-13917, 2014 WL 29119 (E.D. Mich. Jan. 3, 2014) (stand-alone arbitration clause in car dealer's contract not validly formed under Michigan law); *Carideo v. Dell, Inc.*, 2009 WL 3485933 (W.D. Wash. 2009) (where selection of National Arbitration Forum was an integral term of an arbitration clause, the court struck the entire clause, rather than appoint a substitute arbitrator);
- *FIA Card Services, N.A. v. Weaver*, 62 So.3d 709 (La. 2011) (debt collector could not confirm arbitration award against consumer without proving consumer agreed to arbitration); *Rivera v. American Gen. Fin. Servs., Inc.*, 150 N.M. 398 (2011) (where selection of National Arbitration Forum was an integral term of an arbitration clause, the court struck the entire clause, rather than appoint a substitute arbitrator); *Gibson v. Nye Frontier Ford, Inc.*, 205 P.3d 1091 (Ak. 2009) (selective appeal provision unconscionable; case would only be sent to arbitration if employer would pay all substantial costs of arbitration); *Cordova v. World Fin. Corp.*, 208 P.3d 901 (N.M. 2009) (one-sided arbitration provision unconscionable); *Raymond James Fin. Servs., Inc. v. Saldukas*, 896 So.2d 707 (Fl. 2005) (broker waived right to compel arbitration, even though investor proved no prejudice); *Toppings v. Meritech Mortgage*, 569 S.E.2d 149 (W.Va. 2002) (where a lender's arbitration clause designates an arbitration forum that is paid through a case volume fee system, and

the arbitration forum's income is dependent on continued referrals from the creditor, this so impinges on neutrality and fundamental fairness that the clause is unconscionable and unenforceable); *Wells v. Chevy Chase Bank*, F.S.B, 768 A.2d 620 (Md. 2001) (credit card issuer's arbitration clause not binding on consumer, FAA did not preempt state procedural law of appealability); *Betts v. Fastfunding Co.*, 60 So.3d 1079 (Fla. Dist. Ct. App. 2011) (where National Arbitration Forum dismissed case based upon its own rules, without considering applicable substantive law, the arbitrators' decision was vacated).

We have been counsel in two cases in the U.S. Supreme Court involving challenges to pre-dispute arbitration clauses: *Rent-A-Center West v. Jackson*, 130 S. Ct. 2772 (2010); and *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2006). We were counsel in at least half a dozen cases where the U.S. Supreme court denied petitions for certiorari where the lower court had struck down abusive arbitration clauses.

In addition to representing consumers directly, Public Justice has also assisted a large number of consumer attorneys, state government attorneys, and consumers with advice and input on how and whether to fight forced arbitration clauses. Our attorneys have responded to several thousand such requests for assistance over more than a dozen years. We have also presented on issues involving pre-dispute arbitration at more than 150 educational programs in over 30 states, always talking to participants about what they are seeing in their practices.

On a number of occasions, we have been invited to testify before legislative and administrative bodies on issues related to pre-dispute arbitration, because of our extensive expertise in that issue. Accordingly, Public Justice attorneys have testified at a number of Congressional hearings about pre-dispute arbitration clauses. *E.g.*, "Examining the CFPB's Proposed Rulemaking on Arbitration: Is it in the Public Interest and for the Protection of Consumers?" House Subcom. on Financial Institutions and Consumer Credit, May 18, 2016; "S.1782, The Arbitration Fairness Act of 2007," Subcom. on the Constitution of the U.S. Senate Judiciary Committee, Dec. 12, 2007; "Arbitration: Is It Fair When Forced," U.S. Senate Judiciary Committee Oct. 13, 2011; "Arbitration or 'Arbitrary': The Misuse of Arbitration to Collect Consumer Debts," Subcommittee on Domestic Policy of the U.S. House Committee on Oversight and Government Reform; "Mandatory Binding Arbitration Agreements: Are They Fair to Consumers?," Subcom. on Commercial And Administrative Law of the U.S. House Judiciary Committee.

Public Justice attorneys have also testified in a number of state legislatures on these issues. *E.g.*, Standing Comm. on Consumer Affairs & Protection and Standing Comm. on Judiciary, New York Assembly, February 10, 2016; The Federal Arbitration Act, the U.S. Supreme Court, and the Impact of Mandatory Arbitration Clauses on California Consumers and Employees, California Senate, March 1, 2016. Testimony on Assembly Bill No. 381, Nevada Legislature, March 27, 2009; Hearing on House Bill No. 322, The Fairness in Arbitration Act, Montana Legislature, February 11, 2009; Hearing on B-17-0050, "Arbitration Amendments Act of 2007," D.C. Council, March 23, 2007. Public Justice attorneys have also testified before administrative agencies at both the federal and state level. *E.g*., Public Hearing, *Arbitration Clauses in Insurance Contracts*, National Association of Insurance Commissioners Consumer Protection Working Group, New York City, June 21, 2003; Roundtable, *Debt Collection: Protecting Consumers*, Federal Trade Commission, Chicago (Aug. 6, 2009); Joint Workshop on Alternative Dispute Resolution for Online Consumer Transactions, Federal Trade Commission (Spring 2000). Public Justice also submitted comments in 2012 and 2013 to the Consumer Financial Protection Bureau in response to the agency's request for information for its study of pre-dispute arbitration agreements.

Mandatory Pre-Dispute Arbitration Harms Consumers

What can Texas's homeowners expect from the mandatory pre-dispute arbitration provisions that insurers are proposing? Industry advocates argue that the court system is slow, costly, and overtaxed. They argue that arbitration is an alternative that offers cheap, efficient and simple resolution of claims. There is some truth to these claims, and, as such, there is nothing inherently problematic with two parties choosing to resolve actual disputes in a mutually agreeable forum such as arbitration. There is also nothing objectionable about two parties of comparable bargaining strength, agreeing in an arms-length negotiation to arbitrate all future disputes.

But the vast majority of consumers purchasing products or services from large companies are not equal negotiators in an open market. Instead, they have little to no bargaining power, and are presented standardized, predetermined contracts of adhesion that they can only accept or reject as a whole. In these circumstances, arbitration presents a wide range of significant disadvantages to consumers. These comments will describe several of the chronic problems that consumers encounter in industries where mandatory pre-dispute arbitration clauses have become the norm: (1) higher costs than those found in the court system, (2) lower odds of success than in the court system, (3) built-in pro-company bias, (4) unfair clauses, and (5) lack of appellate review of decisions and awards.

These problems are not specific to any one industry, but have been found in contracts for a huge range of consumer products and services. As these comments will argue, these problems would be compounded by the unique nature of the homeowner's insurance market, where consumers have even more limited choice in the terms of their contracts than in other markets. Based on the experiences of consumers and employees in other industries, Texas homeowners can expect to encounter some or all of the following harmful features of arbitration:

1. Arbitration Can Be Prohibitively Expensive

The mantra that proponents of arbitration often repeat is that it is a faster, cheaper, and easier system for consumers and employees to resolve their disputes as compared to courts, whose dockets are crowded and whose formal procedures many people find confusing or overwhelming. There is truth to some of these assertions. An article published in 2015 in the Brooklyn Law Review by Professor Jean Sternlight found that employment cases brought in arbitration took about a year to reach a hearing whereas those filed in court took at least two years to go to trial.[3] But the notion that arbitration is cheaper for consumers and employees is far more controversial.

Because the court system is subsidized by the taxpayers, litigants must only pay a filing fee—usually a few hundred dollars—to initiate a suit, and even this fee can be waived with a showing of poverty. By contrast, arbitration is entirely private, and arbitrators are paid by the hour for their time. The parties to an arbitration also must often pay to rent the conference rooms where arbitration hearings are held and must pay all costs associated with bringing witnesses to testify, including the costs of court reporters to transcribe the testimony. None of these costs would be the parties' responsibility if the proceedings were taking place in a public court.

The way in which the costs of arbitration will be split is sometimes specified in the arbitration clause or by the rules of the arbitration service provider named in the clause, such as the American Arbitration Association ("AAA"). If the rules are not specified in advance, however, then the ultimate discretion to allocate costs will rest with the arbitrator. Perhaps the arbitrator will split costs down the middle, perhaps he or she will force the party that loses the arbitration to pay all of the costs, or perhaps he or she will require the employer or company, as the party with greater financial resources, to pay all or most of the costs. But without knowing ahead of time how this will all shake out, it is rational for a consumer, or an attorney deciding whether or not to represent a consumer, to pass on a forum where a bill for thousands of dollars might or might not come due at the end of the process, and where costs may have to be advanced along the way only to perhaps be reimbursed later if the arbitrator so chooses. This is simply not the sort of roll of the dice that most consumers, especially low-income consumers, are willing or able to make.

This uncertainty around the costs of arbitration no doubt explains, at least in part, why the Consumer Financial Protection Bureau found, in its 2015 study of pre-dispute arbitration in the financial services industry, that between 2010 and 2012 consumers filed twice as many non-class-action cases in federal court regarding credit cards, payday loans and other financial products than in arbitration. This trend became especially pronounced for relatively low-value claims, as the CFPB found that the AAA handled only around 25 arbitrations per year by consumers seeking damages of $1,000 or less.[4] The New York Times uncovered a similar dearth of low-value arbitrations in a study that it conducted for

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[3] Jean R. Sternlight, *Disarming Employees: How American Employers are Using Mandatory Arbitration to Deprive Workers of Legal Protection*, 80 BROOK. L. REV. (2015). Available at http://brooklynworks.brooklaw.edu/blr/vol80/iss4/3.

[4] *See* CONSUMER FINANCIAL PROTECTION BUREAU, ARBITRATION STUDY: REPORT TO CONGRESS, PURSUANT TO DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT § 1028(a) 10 (2015) (hereinafter "CFPB Study")

a series of articles on arbitration published last year: between 2010 and 2014, only 505 consumers went to arbitration over disputes of $2,500 or less.[5]

2. Consumers Have Low Odds of Success in Arbitration

Another common element of the pro-arbitration narrative that does not stand up to actual data is the question of arbitration outcomes. Industry advocates often argue that arbitration is a forum where consumers can expect to find good chances of success. But the empirical evidence paints a very different picture.

The CFPB studied all of the arbitrations handled by AAA between 2010 and 2012 in the consumer financial markets that it regulates and found that of the 158 disputes in which an arbitrator issued a decision on a consumer's affirmative claim, the consumer received some relief in 20.3% of cases, winning an average of 57 cents for every dollar claimed across those 32 cases and an average of 12 cents for every dollar claimed across all 158 cases.[6] Meanwhile companies did exceptionally well in arbitration: of the 244 disputes involving corporate claims or counterclaims resolved by the arbitrator in this same sample of AAA arbitrations, the company won in 93% of cases and received 91 cents for every dollar claimed.[7]

The figures are equally stark when it comes to employment arbitrations. Professor Alexander Colvin found in a comparison of AAA arbitrations with federal and state court judgments that employees' win rate was 21.4 % in AAA arbitration, 36.4% in federal court employment discrimination cases, and 57% in state court non-civil rights cases.[8] Employees also won notably smaller damage awards in arbitration even when they did prevail: comparing mean damages, including cases in which plaintiffs recovered nothing, Colvin found a mean recovery of $109,858 in AAA arbitration, $394,223 in federal court employment discrimination cases, and $575,453 in state court non-civil rights employment cases.[9]

3. Arbitration Incentivizes Anti-Consumer Bias

Employers and companies that participate in multiple arbitrations, and the lawyers who represent those companies, are not outsiders to the process. Rather, they appear frequently before the same arbitrators or arbitral services time and again, giving them a sense of what arguments an arbitrator is likely to favor, and allowing them to select, in advance, an arbitrator who they believe will support their position. A federal court in the

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[5] Jessica Silver-Greenberg & Robert Gebeloff, *Arbitration Everywhere, Stacking the Deck of Justice*, N.Y. TIMES, Oct. 31, 2015, http://www.nytimes.com/2015/11/01/business/dealbook/arbitration-everywhere-stacking-the-deck-of-justice.html
[6] *See* CFPB Study, *supra* note 3, at 13.
[7] *See id.* at 14.
[8] *See* Alexander J.S. Colvin, *An Empirical Study of Employment Arbitration: Case Outcomes and Processes*, 8 J. EMPIRICAL LEG. STUDS. 1, 5 (2011).
[9] *See id.*

Ninth Circuit Court of Appeals has acknowledged that this non-transparent system of arbitration may be unfair to consumers because it perpetuates a disparity in knowledge between consumers and businesses. If a business repeatedly has cases before a particular set of arbitrators, it will know much more than consumers about which arbitrators to select. When a situation is created where only corporate repeat players have ready access to information about arbitration decisions, consumers are disadvantaged. Such a system puts the corporate repeat player "in a vastly superior legal posture since as a party to every arbitration it will know every result and be able to guide itself and take legal positions accordingly, while each [consumer] will have to operate in isolation and largely in the dark."

One particularly troubling aspect of the repeat-player syndrome is the tendency of corporate repeat-players to blackball arbitrators who might rule against them. This tendency was revealed by a study of mandatory arbitration in managed care cases in California, which found a small number of cases in which an arbitrator awarded a plaintiff more than one million dollars against a health maintenance organization (HMO).[10] In each instance, that was the only HMO case that the arbitrator ever handled, suggesting that every time an arbitrator entered a substantial verdict against an HMO, the arbitrator was unable to get any further work from an HMO in the state. That same study also found that arbitrators were twenty times more likely than judges to enter summary judgment for defendant HMOs.

The reverse pattern has also been observed, where the same arbitrators are selected over and over again by the same companies who know the arbitrators will rule in their favor. A 2015 report from the Economic Policy Institute described a study of 2,802 employment-related arbitrations, conducted pursuant to mandatory pre-dispute arbitration clauses, between 2003 and 2014. The study found that when the employer and employee were both appearing before an arbitrator for the first time, the employee had a 17.9% chance of winning. But once the employer had appeared before that same arbitrator four times, the employee in the fifth case had only a 15.3% chance of winning, and by the time the employer had appeared before the same arbitrator 25 times, the twenty-sixth employee's chance of winning dropped to 4.5%.[11]

Evidence of widespread bias is not limited to academic analyses. For years, the largest provider of consumer arbitration in the country was the National Arbitration Forum (NAF). The company had direct financial ties to a major debt collector whose cases it arbitrated, and it marketed itself directly to creditors. Unsurprisingly, debt collectors sent the NAF hundreds of thousands of cases a year, and the Forum ruled for the collectors

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[10] MARCUS NIETO & MARGARET HOSEL, ARBITRATION IN CALIFORNIA: MANAGED HEALTH CARE SYSTEMS 22-23 (2000), *available at* https://www.library.ca.gov/crb/00/09/00-009.pdf.

[11] KATHERINE V.W. STONE & ALEXANDER J.S. COLVIN, ECONOMIC POLICY INSTITUTE, THE ARBITRATION EPIDEMIC: MANDATORY ARBITRATION DEPRIVES WORKERS AND CONSUMERS OF THEIR RIGHTS (2015), *available at* http://www.epi.org/publication/the-arbitration-epidemic/.

almost every time. This racket was only stopped when the Minnesota Attorney General sued the NAF for fraud. The company settled and agreed to stop handling consumer disputes, but the structural incentives that led to the NAF's bias haven't changed.

4. Arbitration Provisions Can Impose Numerous Unfair Clauses on Consumers

The Department's call for comments was initiated by a request from the Farm Bureau to include a proposed endorsement including a mandatory pre-dispute arbitration clause ("the Sample Endorsement") for the Department's approval. The Sample Endorsement should be understood as just that: a sample. Even if it does not reflect the unfair provisions discussed below, there is nothing stopping insurers from adding them to future endorsements. Because insurers are the parties that draft these endorsements and present them to consumers as contracts of adhesion, they can add the following unfair clauses at any time. And if the experience of other industries is any lesson, insurers will. At that point it may be too late to protect Texas consumers.

a. Unfair cost- or fee-sharing provisions

While some arbitration agreements provide that the corporation must bear some or all costs (undoubtedly with the knowledge that they will still save money by requiring arbitration), others require the consumer to share at least some of the cost. Some courts have struck down arbitration clauses that impose excessive costs on consumers, finding that high costs would prevent a consumer from pursuing a valid claim in arbitration.

For example, in *Chavarria v. Ralphs Grocery Co.*, the Ninth Circuit examined an arbitration provision in an employment contract that required each party to pay its own attorneys' fees, and to split the cost of any arbitrator's fees.[12] The court noted that the arbitrator fees were estimated at between $7,000 and $14,000 per day, and concluded that this made the provision substantively unconscionable because it "imposes great costs on the employee" and "mak[es] many claims impracticable."[13]

b. Restrictions on claims

Some arbitration provisions limit the kinds of claims that can be arbitrated or litigated. Here, the scope of the Sample Endorsement has been explicitly restricted to disputes over the "value of the [consumer's] claim under [the] policy," and applies to both parties. But there is nothing to stop future endorsements from applying to any and all claims arising from the policy, nor anything to stop future limitations that apply only to the insured, while permitting the insurer to utilize the court system.

[12] *Chavarria v. Ralph's Grocery Co.*, 733 F.3d 916 (9th Cir. 2013).
[13] *Id.* at 925.

Examples of such unbalanced claim limitations are not hard to find. For instance, an arbitration clause used by a Florida nursing home preserved the facility's right to a judicial remedy to collect fees for outstanding bills—and even stated that the nursing home could make the resident pay all the costs of the case, including the nursing home's attorneys' fees—while forcing residents to utilize arbitration for all other claims.[14] Such one-sided clauses have been struck down by courts in some cases, but enforced by others.

c. Class action bans

Many arbitration clauses explicitly or implicitly bar consumers from joining with others to bring a lawsuit seeking systemic reform. These clauses are designed not only to prevent class actions, but to deter claims generally, as many individuals will be unable to take on a major corporation alone unless the underlying claims are quite large.[15] Prior to the U.S. Supreme Court's decision in *AT&T Mobility v. Concepcion*, 563 U.S. 333 (2011), many courts across the country had struck down class action bans on grounds that they served to exculpate corporations for unlawful behavior and prevented individuals from obtaining justice, but class action bans are now generally enforceable.

d. Shortened statutes of limitation.

Some arbitration clauses have a term requiring that any claim not filed within a certain number of days after the incident are forever barred. As many courts have recognized, these shortened statutes of limitation—which are sometimes a mere 30 days—make it less likely an offending company will be held accountable for wrongdoing.

e. "Loser pays" provisions.

Some clauses contain "gotcha" terms providing that if the consumer brings a claim and the company wins, the consumer will be on the hook for the costs of arbitration—including, sometimes, the company's attorneys' fees. Often such terms are directly contrary to state consumer protection laws, which typically provide that only a prevailing plaintiff is entitled to recover costs and fees. Some companies take it even further and include a term saying that if the consumer challenges the arbitration clause and loses, she will have to pay the company's costs. Such clauses are designed to intimidate consumers who might be contemplating opposing an unfair arbitration clause. While they have been held unenforceable by some courts, there are undoubtedly many more instances where the term has its intended effect of discouraging consumers from fighting the arbitration clause at all.

f. Clauses that strip statutory remedies.

[14] *See* Robert Hornstein, *The Fiction of Freedom of Contract—Nursing Home Admissions Contract Arbitration Agreements: A Primer on Preserving the Right of Access to Court Under Florida Law*, 16 ST. THOMAS L. REV. 319, 330 & n. 75 (Winter 2003).

[15] *See, e.g.*, *Carnegie v. Household Int'l, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004) (Posner, J.) ("The realistic alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for $30.")

Arbitration clauses are sometimes used to force consumers to give up legal remedies to which they would be entitled in court. For example, some courts have struck down clauses that expressly limit the drafting party's liability by, for example, providing that the arbitrator cannot award punitive damages or attorneys' fees.

g. Limitations on discovery

Arbitration agreements frequently limit the amount of pre-trial discovery (fact gathering, witness testimony, etc.) that parties can conduct. This feature is typically touted as a way to streamline the process so that the parties can get a decision faster. This is designed to make it impossible for the consumer to gather the facts she needs to prove the company acted wrongfully.

h. Distant forum provisions

Some companies seek to further skew the dispute resolution in their favor by requiring that the arbitration, if there is a hearing, take place at a location that is most advantageous for them—for instance, the state where their headquarters is located. While courts have struck terms like this down and they are not as common as they used to be, we continue to see them pop up in contracts from time to time.

i. Difficulty in challenging unfair terms

Unfortunately, several trends in the law have made it more difficult for consumers to challenge arbitration clauses in court, even when the clauses strip them of their ability to effectively vindicate their rights. First, the Supreme Court's decision in *Rent-A-Center West, Inc. v. Jackson*, 130 S. Ct. 2772 (2010), held that a company can draft a contract that gives the arbitrator, rather than a court, the power to determine whether the arbitration clause is unfair or invalid. It is illogical for arbitrators to decide whether an arbitration clause was validly formed, because without an agreement to arbitrate, the arbitrator has no power to decide anything. But thanks to *Rent-A-Center*, companies are increasingly drafting contracts that require consumers who want to challenge an unlawful or unfair arbitration clause to go through the very arbitration process they allege is unlawful.

Second, the Supreme Court's decision in *AT&T Mobility v. Concepcion*, 563 U.S. 333 (2011), held that a company is free to use a contract term in an arbitration clause to take away people's rights, so long as the term is "fundamental to arbitration"—in that case, a requirement that arbitration be conducted on a one-on-one basis rather than permitting injured consumers to band together in a class action. While certainly many kinds of abusive contract terms are not inherent to arbitration, some have been held to be. The result is that even where a clause is patently unfair, sometimes courts have no choice but to enforce the clause anyway.

Third, even where the terms of an arbitration clause are "unconscionable" under state law—meaning they are substantively unfair or oppressive—courts in many states will nonetheless enforce the clause unless the consumer can show that there was unfairness in the contracting process. This is known as "procedural unconscionability." In the past, many courts would find an arbitration clause unenforceable if it was presented to the weaker party on a take-it-or-leave-it basis; it was hidden in the fine print, so that a consumer would be surprised to realize it was there; or the consumer was hurried through the process of signing and did not have an opportunity to understand what she was signing. However, some savvy corporations realized that if they added an "opt-out" term—for example, some more fine print indicating that the arbitration clause was only optional, or that the consumer could opt out of pre-dispute arbitration by mailing a certified letter to a certain address within 15 days—courts would hold that the arbitration clause was not adhesive and thus enforce the clauses.

5. <u>Arbitration Lacks Error- and Bias-Correcting Review</u>

Finally, the problems associated with arbitration are compounded by the fact that arbitral awards are insulated from almost any sort of appellate scrutiny. Judicial review of arbitration is less than minimal; it approaches non-existent. The general rule is that judicial review of arbitrators' decisions "is very narrow; one of the narrowest standards of judicial review in all of American jurisprudence." *Lattimer-Stevens Co. v. United Steelworkers of Am. Dist. 27*, 913 F.2d 1166, 1169 (6th Cir. 1990). Consider a couple of illustrations:

- The U.S. Court of Appeals for the Seventh Circuit remarked that courts should not review arbitrators' interpretations of contracts even if they are "wacky," so long as the arbitrator attempted to "interpret the contract at all." *Wise v. Wachovia Securities, Inc.*, 450 F.3d 265, 269 (7th Cir. 2006).
- The U.S. Court of Appeals for the Third Circuit considered an arbitrator's decision that "inexplicably" cited and relied upon language that was not included in a key document. The court held, though, that "such a mistake, while glaring, does not fatally taint the balance of the arbitrator's decision in this case. . . ." *Brentwood Medical Associates v. United Mine Workers of America*, 396 F.3d 237 (3d Cir. 2005).
- In a case involving baseball player Steve Garvey, the U.S. Supreme Court held that "courts are not authorized to review the arbitrator's decision on the merits" even if the arbitrator's fact finding was "silly." *Major League Baseball Players Ass'n v. Garvey*, 532 U.S. 504, 509 (2002).
- In another case, the California Supreme Court held that even when an arbitrator's decision would "cause substantial injustice" on its face, it was not subject to judicial review. *Moncharsh v. Heily & Blase*, 3 Cal. 4th 1 (1992).

The law governing judicial review of arbitration also encourages arbitrators not to give any reasons for their decisions, because then it is entirely impossible to attack their decisions.[16] As a result, many arbitrators have reported that they are discouraged by the major arbitration firms from producing written decisions, because doing so basically gives arbitrators a means of putting themselves beyond any scrutiny. The upshot of all this is clear – arbitration is largely a system above and beyond the law.

The Unique Nature of the Homeowner's Insurance Market

While mandatory pre-dispute arbitration clauses are common—and even ubiquitous—in other consumer markets, they would be especially harmful in the context of the homeowner's insurance market because consumers in this market already have so little freedom of choice in the terms of their policies. Unlike other products or services, consumers wishing to buy a home must also buy homeowner's insurance. Furthermore, the market is highly standardized, especially in the forms and terms of coverage. This gives consumers very little ability to make even the basic take-it-or-leave-it choice that they could theoretically make in other contexts. Permitting insurers to include endorsements that force consumers to accept the insurers' terms of dispute resolution would eliminate one of the few remaining choices that consumers have in this rigid and standardized market.

For the millions of Texans who own or wish to own a home, securing homeowner's insurance is a task equaled in importance only by actually buying and financing their house. Nearly all homes in the United States are covered by a homeowner's insurance policy.[17] One of the central reasons for this uniformity is that mortgages are *required* to be insured in order to be sold on the secondary market created by the federal mortgage agencies Fannie Mae and Freddie Mac.[18] Indeed, if a homeowner refuses to obtain insurance, fails to secure sufficient insurance, or becomes delinquent in their payments, the mortgage holder will often buy a policy on the homeowner's behalf, also known as a forced-placed policy.[19]

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[16] *See Fellus v. AB Whatley, Inc.*, 2005 WL 9756090 (N.Y. Sup. Ct. Apr. 15, 2005) (in the absence of a reasoned decision supporting an arbitration award, there was no basis for the court to decide whether the arbitrator manifestly disregarded the law); *H&S Homes v. McDonald*, 2004 WL 291491 (Ala. Dec. 17, 2004) (in the absence of an explanation of damages awarded by the arbitrator, the court had no basis to determine whether the arbitrator manifestly disregarded the law; the arbitrator's failure to give reasons for the award did not itself constitute manifest disregard of the law).

[17] Robert H. Jerry II, *Dispute Resolution, Insurance, and Points of Convergence*, 2015 J. OF DISPUTE RESOLUTION 255, 272 (2015) ("In 2013, 95 percent of the nation's 75 million owner-occupied homes were insured.")

[18] *See* Kenneth S. Klein, *When Enough Is Not Enough: Correcting Market Inefficiencies in the Purchase and Sale of Residential Property Insurance*, 18 VA. J. SOC. POL'Y & L. 345, 351 (2011) ("Because of the structure of the secondary markets in mortgages, having a mortgage equates to having homeowner's insurance."); Daniel J. Neppl, *Developments in Forced-Placed Insurance*, 2013 INSURANCE & REINSURANCE LAW REPORT (Siddley Austin, LLP), at 4.

[19] *See* Neppl, *supra* note 7, at 4-6.

These policies that Texas homeowners are obliged to buy are based largely on the standard form policies produced by the Insurance Services Office ("ISO").[20] While one study of standardization in the homeowner's insurance market suggests that there may be greater variation in policies than is commonly assumed, the findings still do not present an optimistic picture for consumers.[21] The variation away from the standard ISO homeowner's form largely entailed a race to the bottom, with more large national insurers providing less generous coverage for consumers than those providing more generous coverage.[22]

Lessons from other industries also strongly suggest that once mandatory pre-dispute arbitration clauses begin to appear in homeowner's insurance policies, the practice will become widespread. The CFPB's study on arbitration agreements in the financial services and products industry found that they are extremely widespread. For example, arbitration clauses are found in contracts for nearly 50% of credit cards and checking accounts, more than 90% of prepaid cards, and nearly 100% of payday loans and mobile phone contracts.[23] Other studies have found that companies offering long-term services subject to written contracts are much more likely to adopt mandatory pre-dispute arbitration clauses.[24]

Conclusion

According to the Texas Department of Insurance's most recent published figures from 2009, more than 4.1 million homeowner's insurance policies are in force across the state.[25] This number is now surely even higher as the US Census Bureau approximates that there are currently about 10.58 million housing units in Texas, roughly 62% of which are owner-occupied.[26] For these millions of Texans, the purchase of homeowner's insurance is one of the most significant steps towards completing their dream of becoming homeowners. Throughout this process, they have little freedom to choose the options that work best for them.

The Department of Insurance has a unique opportunity to preserve Texas homeowners' right to resolve disputes in the forum that they feel will best serve their interests, not just the interests of their insurers. Time and again, companies have used

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[20] Steven M. Klepper, *Whose Conception of Insurance?*, 162 UNIV. PA. ONLINE L. REV. 83, 89 n.35 (2013); Daniel Schwarz, *Reevaluating Standardized Insurance Policies*, 78 UNIV. CHICAGO L. REV. 1263, 1273 (2013).
[21] *See* Schwarz, *supra* note 8, at 1266; *see also id.* at 1263 ("[C]onsumer insurance policies in property and casualty insurance markets (or 'personal lines') are often described as 'super contracts of adhesion.'")
[22] *See id.* at 1314-15.
[23] *See* CFPB Study, *supra* note 3, at 7.
[24] *See* Linda J. Demaine & Deborah R. Hensler, *"Volunteering" to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience*, 67 LAW & CONTEMPORARY PROBLEMS 55, 62-63 (2004).
[25] Texas Dep't of Ins., Homeowners Insurance in Texas By the Numbers (2009), http://www.helpinsure.com//home/ho1bynumbers.html
[26] United States Census Bureau, Quick Facts: Texas, http://www.census.gov/quickfacts/table/HSG010215/48.

mandatory pre-dispute arbitration clauses to tilt the odds even further in their favor. Though the Sample Endorsement submitted by the Farm Bureau does not represent the worst of what arbitration clauses have to offer, it should also not be allowed to be a foot in the door for later abuses. We urge the Department to prohibit mandatory pre-dispute arbitration clauses in endorsements for homeowner's insurance, and to protect Texas homeowners' right to a fair, equal choice for how they will resolve disputes.