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Insights

IS YOUR COMPANY VULNERABLE TO A MASS ARBITRATION ATTACK?

WHAT IT IS AND HOW TO PREVENT IT

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A recent trend in litigation has emerged that is causing companies to re-think conventional wisdom. Until now, it has been a widely adopted best practice for retailers and other consumer-facing companies to include mandatory arbitration provisions in their Terms of Service and other consumer agreements. Arbitration is thought to be more efficient and less costly than litigating in court and, in states like California, inclusion of an arbitration provision is critical to the ability to enforce a class action waiver. The tide is turning, however, as plaintiffs' counsel have taken advantage of consumer-friendly provisions of the California Arbitration Act ("CAA") to target companies with arbitration provisions, manufacturing meritless mass arbitration claims that force the company to foot the bill and give plaintiff's counsel leverage in settlement discussions.

The trend in favor of mass arbitration surfaced several years ago when a flood of claims brought by rideshare drivers were compelled into arbitration. In a be-careful-what-you-wish-for scenario, plaintiffs' counsel responded by pursuing hundreds or thousands of individual arbitrations, creating massive administrative headaches and imposing enormous costs on defendants. That strategy has now metastasized into the realm of privacy litigation, with plaintiffs' counsel zeroing in on companies with arbitration provisions in their Terms and initiating arbitrations asserting claims under state or federal wiretap laws, the Telephone Consumer Protection Act, the Video Privacy Protection Act, and more, based upon a mere visit to a website or an errant text message. Plaintiffs have traditionally preferred to be in court, owing to the more fulsome discovery available in litigation. But pursuing meritless claims in court also entails downside risk in the form of unfavorable precedent, possible sanctions, or even a claim for malicious prosecution. Eager to avoid this, some plaintiffs' counsel are choosing to proceed in arbitration in the first instance, claiming to represent a "consumer" and relying upon the provisions of the CAA and favorable fee schedules adopted by leading arbitration providers to bring claims on behalf dozens, or in some cases, thousands, of individuals. Freed from the risk of sanctions, plaintiffs' counsel have shown no qualms about pursuing knowingly meritless claims while forcing companies to bear the lion's share of the substantial filing fees, arbitrator fees, attorneys' fees, and other costs of arbitration, which can easily run into the tens or even hundreds of thousands of dollars. And because California's

robust litigation privilege protects plaintiffs' counsel from claims of unfair competition, extortion, or other ethical violations, and the California Supreme Court holds that an arbitration award is not a favorable disposition, unscrupulous plaintiffs' counsel see all upside and no downside to this new tactic.

Companies have begun to fight back, but there is no "one size fits all" response to this issue. A handful of companies have sought relief in court, suing the claimants, the plaintiffs' firm, and in one case, the American Arbitration Association, seeking a judicial declaration that claimants are not entitled to pursue arbitration based upon a mere visit to a website, that the AAA improperly applied its rules on consumer arbitrations, or that claimants violated the Computer Fraud and Abuse Act by accessing a website without authorization. Although this strategy has met with limited success in one case, the ruling's prospects on appeal are uncertain and the argument that claimants cannot enforce the arbitration provision is a double-edged sword, as it may hamper the company's ability to rely on its website terms or privacy policy disclosures in defending itself in court.

Other companies have amended their arbitration provisions to require claimants to participate in informal dispute resolution efforts prior to initiating arbitration, which may provide an opportunity for early resolution or, if that fails, time to pursue preemptive litigation. Other companies have bulked up their arbitration clauses with lengthy, detailed provisions tailored to mass arbitrations which purport to establish a "bellwether" process for staggering consideration of claims, may require mediation prior to proceeding with subsequent claims, or have an escape clause that allows for resolution in court when a specified number of similar claims has been asserted. At least one court has tentatively blessed a variant of this approach, but in so doing, noted that if the process leads to undue delay in resolution of clais, it may ultimately be deemed unconscionable. Whether these provisions will stand up in the end is undetermined, but regardless, they represent an imperfect solution, and may do little to avoid the enormous costs of ultimately resolving large numbers of individual arbitrations.

Concerned about companies abandoning arbitration, both the AAA and JAMS have recently adopted rules aimed at streamlining mass arbitrations. These rules set up a process for appointment of a Process Arbitrator to handle administrative matters and one or more Merits Arbitrators, though they differ as to the threshold necessary to trigger their application. Both sets of rules reserve to the arbitration provider (AAA) or the Process Arbitrator (JAMS) the right to appoint a single Merits Arbitrator to resolve multiple claims, though the rules are concerningly ambiguous as to the circumstances under which claims will be consolidated and the thresholds for application are sufficiently high that a company can face enormous financial strain before they kick in. Both sets of rules are also supplemented by newly adopted mass arbitration Fee Schedules, which should result in reduced initial filing and other fees, but the extent to which the Rules and Fee Schedule mitigate the potentially crippling financial impact of mass arbitration will depend primarily whether claims are consolidated for resolution before a single arbitrator; an issue over which the company may

have little control. These new rules are a welcome step in addressing this new trend, but their ultimate impact remains to be determined.

Some companies are also now considering a move that would have previously been unthinkable: eliminating the arbitration provision altogether and requiring claimants to pursue their claims in court. Many defendants have realized that the promised benefits of arbitration, including reduced litigation costs, have often proven illusory, and for some, this new trend has tipped the balance in favor of eliminating broad arbitration requirements by default. However, any decision to abandon arbitration should involve a company-specific assessment of the risk and benefits, including potential exposure to routine class actions that arbitration would have otherwise prevented.

Which of the foregoing options is right for your company will depend upon many factors, including the regulatory environment in which the company operates, its litigation history, and other company or sector-specific variables. What is clear, however, is that all companies, especially those selling directly to consumers, should be reevaluating their existing arbitration provisions with an eye to mitigating the risk of mass arbitration and working with counsel to find the solution that is right for you.

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