

2010

# Arbitration's Summer Soldiers Marching into Fall: Another Look at Eisenberg, Miller, and Sherwin's Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts

Nancy Kim

*California Western School of Law*, [Nsk@cwsl.edu](mailto:Nsk@cwsl.edu)

Follow this and additional works at: <http://scholarlycommons.law.cwsl.edu/fs>

 Part of the [Contracts Commons](#), and the [Dispute Resolution and Arbitration Commons](#)

---

## Recommended Citation

Nancy S. Kim & Chii-Dean Lin, Arbitration's Summer Soldiers Marching Into Fall: Another Look at Eisenberg, Miller and Sherwin's Empirical Study of Arbitration Clauses in Consumer and Non-Consumer Contracts, 34 VT. L. REV. 597 (2010).

This Article is brought to you for free and open access by CWSL Scholarly Commons. It has been accepted for inclusion in Faculty Scholarship by an authorized administrator of CWSL Scholarly Commons. For more information, please contact [alm@cwsl.edu](mailto:alm@cwsl.edu).

**ARBITRATION’S SUMMER SOLDIERS MARCHING  
INTO FALL: ANOTHER LOOK AT EISENBERG,  
MILLER, AND SHERWIN’S EMPIRICAL STUDY  
OF ARBITRATION CLAUSES IN CONSUMER  
AND NONCONSUMER CONTRACTS**

Nancy S. Kim<sup>\*</sup> & Chii-Dean Lin<sup>†‡</sup>

ABSTRACT

Our empirical study examines the role and importance of arbitration clauses in standard form contracts, primarily with other businesses. While much has been written about the impact of mandatory arbitration clauses in consumer contracts, relatively little has been written on mandatory arbitration clauses in customer agreements where the customer was a business and not an individual consumer. In this Article, we specifically address the findings presented in Theodore Eisenberg, Geoffrey Miller, and Emily Sherwin’s study, *Arbitration’s Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*.<sup>1</sup> Our study finds that many businesses employ mandatory arbitration clauses in their customer contracts with other businesses. Our study also suggests that the primary reason for mandatory arbitration clauses in customer contracts where the customer is a business is the avoidance of expenses associated with litigation. Our study may help companies to better understand attitudes about arbitration and assist in contract negotiations. The results of our study may also help courts determine whether arbitration clauses in merchant form agreements—and changes to those clauses—are “material” under section 2-207(2) of the Uniform Commercial Code.

---

<sup>\*</sup> Associate Professor, California Western School of Law and Visiting Associate Professor, Rady School of Management, UCSD.

<sup>†</sup> Associate Professor, Dept. of Mathematics and Statistics, San Diego State University.

<sup>‡</sup> The authors sincerely thank Katherine Kawamoto and the International Association for Contract and Commercial Management (IACCM) for their assistance with the survey. For helpful comments, the authors thank Edward Dauer and Donald Smythe, and the participants at the 1st European ProActive Law Symposium, Oct. 14–15, 2009, sponsored by ICN Business School, in partnership with CEREFIGE, Universite Nancy 2, IACCM, and ProActive Think Tank, where some of the findings in this study were presented. The authors also thank Dan O’Connor for research assistance.

1. Theodore Eisenberg, Geoffrey P. Miller & Emily Sherwin, *Arbitration’s Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J.L. REFORM 871 (2008) [hereinafter Eisenberg et al.].

## INTRODUCTION

The Contracts Section of the Association of American Law Schools hosted a panel at the 2008 Annual Meeting addressing the topic of mandatory arbitration clauses.<sup>2</sup> The panel specifically focused on the use of empirical evidence to determine whether arbitration was better or worse than litigation for individual claimants.<sup>3</sup> The presentation papers were eventually published in a symposium issue of the University of Michigan Journal of Law and Reform.<sup>4</sup> In this Article, we specifically address the findings presented in one of these symposium articles. Theodore Eisenberg, Geoffrey Miller, and Emily Sherwin in their paper, *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, compare the use of arbitration clauses in 26 consumer contracts and 164 nonconsumer contracts.<sup>5</sup> The authors conclude that the data suggests arbitration clauses in consumer contracts may be an effort to preclude aggregate consumer action.<sup>6</sup>

At the time that Eisenberg, Miller, and Sherwin were conducting their study, we were conducting our own survey of company attitudes toward mandatory arbitration clauses in standard business contracts. Our study sought to determine the importance of arbitration clauses to companies and whether companies would be willing to negotiate such clauses. Given that most businesses do not negotiate standard agreements with consumers, we created a survey to test attitudes about the role and importance of arbitration clauses in standard form contracts primarily with *other businesses*. While much has been written about the impact of mandatory arbitration clauses in consumer contracts,<sup>7</sup> relatively little has been written on mandatory arbitration clauses in customer agreements where the customer was a

---

2. Association of American Law Schools, 2008 Annual Meeting: Reassessing Our Roles as Scholars and Educators in Light of Change Friday Program, <http://www.aals.org/am2008/friday/index.html> (last visited Mar. 1, 2010).

3. *Id.*

4. See Omri Ben-Shahar, *How Bad Are Mandatory Arbitration Terms?*, 41 U. MICH. J.L. REFORM 777 (2008); Christopher R. Drahozal, *Arbitration Costs and Forum Accessibility: Empirical Evidence*, 41 U. MICH. J.L. REFORM 813 (2008); Eisenberg et al., *supra* note 1; Theodore St. Antoine, *Mandatory Arbitration: Why It's Better Than It Looks*, 41 U. MICH. J.L. REFORM 783 (2008); W. Mark Weidemaier, *From Court-Surrogate to Regulatory Tool: Re-Framing the Empirical Study of Employment Arbitration*, 41 U. MICH. J.L. REFORM 843 (2008).

5. Eisenberg et al., *supra* note 1, at 881.

6. *Id.* at 985; see also discussion *infra* Part I.

7. See, e.g., Amy J. Schmitz, *Legislating in the Light: Considering Empirical Data in Crafting Arbitration Reforms*, 15 HARV. NEGOT. L. REV. (forthcoming 2010) (discussing how empirical studies of consumer contracts can inform policies regarding arbitration disclosure regulations).

business and not an individual. The results of our survey are particularly interesting in light of Eisenberg, Miller, and Sherwin's findings.

This Article proceeds in five parts. In Part I, we discuss the results of Eisenberg, Miller, and Sherwin's paper. In Part II, we explain our methodology. In Part III, we summarize our survey results. In Part IV, we compare our findings to the findings in Eisenberg, Miller, and Sherwin's article. We conclude that our data in conjunction with Eisenberg, Miller, and Sherwin's study indicate that companies are more likely to include mandatory arbitration clauses to resolve disputes arising out of ordinary business transactions rather than material transactions. Companies are also more likely to include mandatory arbitration clauses in customer contracts where the customer is a consumer. Their inclusion in business customer contracts, however, suggest that companies use mandatory arbitration clauses for a variety of reasons, not solely to avoid aggregate dispute resolution. Our study may assist courts in determining whether the use of a particular arbitration clause in a company's standard form contract is a "material" alteration under section 2-207 of the Uniform Commercial Code.

## I. SUMMARY OF EISENBERG, MILLER, AND SHERWIN'S FINDINGS

### A. Data Description

Eisenberg, Miller, and Sherwin sought to determine whether firms were consistent in their use of arbitration clauses across consumer and non-consumer contracts.<sup>8</sup> They identified 21 large companies "in the telecommunications, credit, and financial services industries."<sup>9</sup> Most of these companies were in Fortune magazine's list of top 100 American companies.<sup>10</sup> They collected the standard consumer agreements for these companies through means such as the company website or by ordering a product.<sup>11</sup> The authors also reviewed negotiated agreements of these same companies, which were filed with the companies' Form 8-K and Form 10-K "during the period from January 1, 2006 to August 13, 2007."<sup>12</sup> These contracts, referred to as "material contracts" because they "materially affect the financial condition of the company[,] included stock purchase agreements, credit and security agreements, employment agreements, loan pooling and service agreements, and agreements relating to benefits for key

---

8. Eisenberg et. al., *supra* note 1, at 876.

9. *Id.* at 880, 881.

10. *Id.* at 880.

11. *Id.*

12. *Id.*

employees.<sup>13</sup> The authors then “coded both consumer agreements and negotiated contracts for the presence of mandatory arbitration clauses . . . .”<sup>14</sup> They also coded for other relevant provisions, such as jury trial waivers;<sup>15</sup> however, for the purposes of our study, we focus exclusively on their findings with respect to the arbitration clauses.

### *B. Empirical Results and Analysis*

The authors found that 76.9% of the consumer agreements included mandatory arbitration clauses compared to 6.1% of the nonconsumer, material contracts that were not employment contracts.<sup>16</sup> Including employment contracts, less than 10% of the nonconsumer material contracts contained mandatory arbitration clauses.<sup>17</sup> Thus, they concluded that their data established that large companies “overwhelmingly selected arbitration as the method for resolving consumer disputes and permitted litigation as the method for resolving business disputes.”<sup>18</sup> They stated:

The low rate of mandatory arbitration clauses in material nonlabor contracts suggests that the companies in our data set did not, in fact, view the purported advantages of arbitration as compelling when it came to resolving important business-to-business disputes. This result suggests reasons for doubting the arguments of some arbitration advocates, which would imply that rational actors would always prefer arbitration over litigation.<sup>19</sup>

They briefly entertain other, more pro-arbitration, explanations, such as bargaining dynamics.<sup>20</sup> For example, parties may not demand mandatory arbitration in order to avoid signaling that they are “inclined to breach the contract”<sup>21</sup> or because they might anticipate that they may be able to agree to arbitrate disputes when the occasion later arises.<sup>22</sup> They ultimately reject these alternative explanations and conclude that “the simplest explanation is the most plausible: the parties’ revealed preference indicates that

---

13. *Id.* at 881.

14. *Id.* at 882.

15. *Id.*

16. *Id.* at 883. They found that over 90% of employment agreements included arbitration clauses. *Id.*

17. *Id.*

18. *Id.*

19. *Id.* at 887.

20. *Id.*

21. *Id.*

22. *Id.*

arbitration, for them, is often seen as less desirable than litigation as a means for resolving disputes.”<sup>23</sup>

The authors also discuss the contrast between the high rates of mandatory arbitration terms in consumer contracts with the low rates of such terms in material nonemployment contracts and conclude that the “most plausible explanation here is that companies wish to avoid aggregate dispute resolution.”<sup>24</sup> Here also, the authors discuss and dismiss alternative explanations for the differences in arbitration rates between consumer and material non-labor contracts.<sup>25</sup> The first alternative explanation is that because there is no bargaining over contract terms in consumer contracts, there is no negative signaling of inclination to breach and thus, no reason to “omit an arbitration clause.”<sup>26</sup> The authors find this explanation “implausible.”<sup>27</sup> A second possible explanation that the authors consider is that companies favor the litigation system for material contracts that “may generate major litigation[,]” whereas they are willing to trade access to the most costly and reliable litigation system for smaller consumer contracts where there is less at risk.<sup>28</sup> In response, they state:

[I]t is not obvious why the tradeoff should favor arbitration for small-scale disputes and litigation for large-scale ones (small claims court may be just as inexpensive as arbitration, for example). More importantly, the hypothesis has a somewhat fictional quality because few consumers will in fact exercise their rights under arbitration clauses.<sup>29</sup>

The authors conclude that “concern over class actions remains the most likely explanation for the prevalence of arbitration clauses in consumer agreements.”<sup>30</sup> Furthermore, they believe that “the companies in our sample do not view consumer arbitration as offering a superior combination of cost savings, expeditious decision-making, consistency, and justice. Rather, they view consumer arbitration as a way to save money by avoiding aggregate dispute resolution.”<sup>31</sup>

---

23. *Id.*

24. *Id.* at 888.

25. *Id.* at 890.

26. *Id.*

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.* at 894.

31. *Id.* at 894–95.

The authors also state that “corporations’ selective use of arbitration clauses against consumers, but not against each other, suggests that their use of mandatory arbitration clauses may be based more on strategic advantage than on a belief that corporations are better serving their customers.”<sup>32</sup>

## II. Our Methodology and Data Description

### A. The Sample

The International Association for Contract and Commercial Management (IACCM) is a non-profit foundation that works with corporations, and public and academic institutions to establish “best practices” in contracting standards.<sup>33</sup> The membership of the IACCM is comprised of individuals at various management levels from 1,600 corporations and public sector organizations in over 90 countries.<sup>34</sup> IACCM members may elect to become part of a “Community of Interest.” These “Communities of Interest are worldwide networks of professionals who share particular areas of expertise.”<sup>35</sup> In June 2007, IACCM sent out, on our behalf, a survey to members in the following Communities of Interest: Contract Clauses, Model Agreements, Contract Standards, Dispute Management, Alternative Dispute Resolution (ADR), Global & International Agreements, and Sales Policy.<sup>36</sup> Ninety-seven members responded to the survey.<sup>37</sup>

The respondent companies were based all over the world, with two-thirds of them headquartered in the United States, as set forth in Table 1:

#### Where is your company headquartered?

United States	67%
Canada	3%
Latin America	1%
Europe	19%

---

32. *Id.* at 895.

33. See IACCM Background, <http://www.iaccm.com/background.php> (last visited Feb. 9, 2010). For more information about the IACCM, see IACCM Home Page, <http://www.iaccm.com> (last visited Jan. 25, 2010).

34. IACCM Background, *supra* note 33.

35. IACCM Community of Interest, <http://www.iaccm.com/communities.php> (last visited Mar. 26, 2010).

36. *Id.*

37. All survey questions and respondents’ answers to survey questions are on file with the authors and the *Vermont Law Review*.

Asia	4%
Africa	0%
Other	6%

The customers of respondent companies were also based all over the world, with the majority based in the United States, as set forth in Table 2:

**Where are most of your customers based?**

United States	60%
Canada	3%
Latin America	0%
Europe	17%
Africa	0%
Asia	4%
Other	16%

Respondent companies sold to both businesses and consumers, as set forth in Table 3:

**Does your company sell products and/or services to:**

Businesses	56%
Consumers	3%
Both	41%

The amount of an average purchase made by a customer varied, as set forth in Table 4:

**What is the amount of an average purchase made by a customer?**

\$0 to \$99	1%
\$100 to \$999	6%
\$1,000 to \$9,999	10%
\$10,000 to \$99,999	15%
\$100,000 to \$999,999	31%
\$1,000,000 or more	37%

The companies represented the particular industries, as set forth in Table 5:



**What industry is your company in?**

Software / Technology	27%
Services / Outsourcing	16%
Oil / Gas / Utilities	10%
Aerospace	7%
Financial Services	6%
Manufacturing	9%
Electronics	4%
Transport	1%
Other	19%

The majority of respondents represented companies with gross annual revenues above \$500 million, as set forth in Table 6:

**What are your company's average gross annual revenues?**

Less than \$50 Million	9%
\$50M to \$499M	11%
\$500M to \$999M	11%
\$1B to \$9B	26%
\$10B to \$49B	24%
\$50B to \$99B	9%
More than \$100 Billion	12%

The individual respondents held a variety of positions at their companies, as set forth in Table 7:

**What is your role/title at your company?**

CXO <sup>38</sup>	2%
Vice-President	3%
General Counsel/ Associate General Counsel	14%
Director	12%
Manager	40%
Professional	28%

In addition, 35% of respondents were licensed attorneys.

---

38. C-level executives are chief executive officers, chief financial officers, or chief operating officers.

Finally, 94% of respondents used standard form customer agreements and 45% of those form agreements contained mandatory arbitration clauses.<sup>39</sup> Of those respondents whose standard form agreements contained mandatory arbitration clauses, 38% had headquarters in the United States and 59% had headquarters in countries other than the United States. Thirty-nine percent of the respondents using mandatory arbitration clauses had customers based in the United States, compared to 57% with customer bases outside the United States.<sup>40</sup>

### III. OUR SURVEY FINDINGS

The objective of our survey was to determine the importance of mandatory arbitration clauses to businesses. A potential weakness in our study is that our survey required respondents to self-report. The data we receive is thus subject to flaws in perception or knowledge and bias. We tried to minimize self-reporting problems by submitting our survey only to members of a reputable international organization that have legitimate, large corporations as members. The survey was sent out by IACCM and was identified as a joint study with the academic institution of one of the authors.<sup>41</sup> We explained the purpose of the survey in general terms as “conducting research on the impact of mandatory arbitration clauses on businesses” to avoid guiding responses. The estimated time for survey completion was a short three minutes to encourage participation. Finally, we promised anonymity.

We discuss (1) the substance and type of respondents' mandatory arbitration clauses; (2) the nature and extent of negotiated changes to mandatory arbitration clauses; and (3) attitudes toward mandatory arbitration. We also compare our survey findings with those set forth in the Eisenberg, Miller, and Sherwin study.

---

39. To be more precise, 43 out of 96 respondents or 44.79% of the total respondents to the question stated that their form agreements contained mandatory arbitration clauses; one of the respondents declined to answer the question.

40. For all of our calculations, we used the software SAS to create the statistical frequency table.

41. E-mail from Nancy S. Kim, Associate Professor, California Western School of Law and Visiting Associate Professor, Rady School of Management, UCSD, to Michael Stanley, Production Coordinator, Vermont Law Review, at Attachment 1 (Jan. 28, 2010, 8:30:00 EST) (on file with authors and Vermont Law Review) [hereinafter Attachment 1].

*A. Substance and type of respondents' mandatory arbitration clauses*

Those survey respondents at companies with mandatory arbitration clauses were asked whether their arbitration clause looked substantially similar to the following clause:

The parties agree that any controversy or claim between the parties which arises under this Agreement, shall be settled by arbitration in accordance with the rules for commercial arbitration of the American Arbitration Association (or a similar organization) in effect at the time such arbitration is initiated. A list of arbitrators shall be presented to the Claimant and Respondent from which one will be chosen using the applicable rules. The hearing shall be conducted in the [LOCATION], unless both parties agree otherwise. The decision of the arbitrator shall be final and binding upon all parties.

The prevailing party shall be awarded all of the filing fees and related administrative costs. Administrative and other costs of enforcing an arbitration award, shall be added to, and shall constitute part of, the amount due pursuant to this Agreement.<sup>42</sup>

Fifty-two percent of survey respondents answered affirmatively compared to 48% of survey respondents who responded negatively.

Survey respondents were also asked to identify the arbitration organization mentioned in their company's mandatory arbitration clause, and they responded as follows in Table 8:

**What arbitration organization is mentioned in your company's mandatory arbitration clause (check all that apply):**

American Arbitration Association (AAA)	22%
National Arbitration Forum (NAF)	0%
Judicial Arbitration and Mediation Services (JAMS)	5%
International Council for Commercial Arbitration (ICCA)	4%
International Centre for Dispute Resolution (ICDR)	5%
London Court of International Arbitration (LCIA)	13%
Association for International Arbitration (AIA)	2%
No organization is specified	7%
Other	10%

---

42. *Id.*

The vast majority of survey respondents stated that their company used a paper contract, which required a signature, as set forth in Table 9:

**What type of standard form agreement does your company use?<sup>43</sup>**

Paper based contract with signature required	90%
Paper based contract with no signature required	6%
Electronic agreement with click acceptance required	10%
Electronic agreement with no click acceptance required	6%

*B. Nature and Extent of Negotiated Changes to  
Mandatory Arbitration Clauses*

The survey asked respondents whether they permitted any changes to their mandatory arbitration clauses. Only 5% of respondents “never” permitted changes and only 6% “always” permitted changes. Of the respondents who had mandatory arbitration clauses, the majority of respondents permitted some type of change with varying degrees of frequency, as set forth in Table 10:

**Does your company allow changes to the mandatory arbitration clause?**

Always	6%
Often	15%
Sometimes	44%
Rarely	31%
Never	5%

The type of negotiated changes ranged from major changes, such as removal of the mandatory arbitration clause altogether (28%), to minor changes, such as grammatical or typographical changes (24%). “Mandatory” arbitration clauses were not actually “mandatory” for 43% of respondents who permitted major changes, such as deleting the clause or changing arbitration from “mandatory” to “optional,” as set forth in Table 11:

---

43. Some companies use more than one form, which is why totals exceed 100%.

**If your company negotiates changes to the mandatory arbitration clause, what type of changes are allowed? (check all that apply)**

Deletion of the clause	28%
Changing arbitration from mandatory to optional	15%
Procedural or geographical changes	47%
Grammatical or typographical changes	24%
Allocation of the costs of arbitration	16%
Other (please specify)	10%

Eighty-five percent of respondents negotiated changes with their business customers only; however, 15% negotiated changes with both business and consumer customers. See Table 12:

**If your company negotiates changes to the mandatory arbitration clause, is it with:**

Businesses only	85%
Consumers only	0%
Both Business and Consumers	15%

*C. Company Attitudes toward Mandatory Arbitration*

Fifty-six percent of respondents stated that the primary reason that their companies used mandatory arbitration clauses was to reduce litigation costs. See Table 13:

**What is the primary reason for your company's mandatory arbitration clause?<sup>44</sup>**

Customer preference	6%
To reduce litigation costs	56%
Internal Law Department requirement	8%
Don't know	0%
Other (please explain)	10%

The percentage is actually larger because many of the respondents who marked "other" explained that reduction of litigation costs was only one of

---

44. The actual question in the survey was: "If you answered "yes" (to the preceding question regarding whether the respondent's company's form agreement contained a mandatory arbitration clause), what is the primary reason for the arbitration clause?" For purpose of brevity and clarity, we have rephrased the question for this Article.

several proffered reasons. In other words, they marked "other" to indicate reasons *in addition* to reduction of litigation costs. For example, one respondent stated as follows:

We have mandatory arbitration clauses in our online consumer contracts to try to reduce litigation costs. We also have mandatory arbitration in our international contracts. This is primarily because we feel more comfortable in arbitration than in a foreign court, but also because of the greater certainty of enforcement of an arbitration award versus an award by a court.

Another respondent stated:

To both reduce litigation costs and also minimize the possibility of detrimental publicity that court cases may cause.

A third respondent also marked "other" in order to include other reasons in addition to reduction of litigation costs:

In addition to reduce litigation costs, it's also to expedite the process through ADR.

There were other reasons cited by respondents. For example, several respondents cited the avoidance of jury trials:

To provide for a more sophisticated trier of fact than a jury (and therefore, in theory, less uncertainty)- would use jury trial waiver instead if enforceable in CA.

Confidentiality; avoiding jury trials in US; more business-oriented resolution of the dispute; ability to appoint one of the arbitrators.

Avoid jury trials.

Other cited reasons included industry custom, confidentiality, and the difficulty of enforcing judgments in foreign countries.

Of all the 97 respondents queried, 73% said that they, on behalf of their companies, had signed another company's agreement containing a mandatory arbitration clause, whereas 27% had not. The 27% figure does not, however, mean that the respondents' companies had not signed another

company's arbitration agreement, but only that the individual respondent had not signed the agreement on their company's behalf.

For 33% of companies, the primary reason to permit changes to the mandatory arbitration clause was customer insistence. Fifty-eight percent did not view requested changes as "deal-breakers." Interestingly, only 3% accommodated requested changes because they believed that their competitors permitted such changes. See Table 14:

**What is the primary reason your company permits changes to the mandatory arbitration clause?**

Customer insistence	33%
It is not viewed internally as a deal-breaking change	58%
We believe competitors routinely allow changes	3%
Other (please specify)	5%

Finally, 45% of respondents believed that mandatory arbitration clauses were "very important" or "important." See Table 15:

**In general, how important do you think the mandatory arbitration clause is to your company?**

Very important	11%
Important	34%
Somewhat Important	28%
Not very important	16%
Not at all important	11%

*D. Arbitration Clauses and Product Pricing*

Inclusion of mandatory arbitration provisions in company agreements generally did not affect the commercial terms of the transaction. Seventy-eight percent of respondents stated that the inclusion of a mandatory arbitration clause does not affect their company's standard product pricing. See Table 16.

**Does the inclusion of the mandatory arbitration clause affect your company's product pricing?**

Yes	8%
No	78%
Don't know	14%

Where the company permitted a change to the mandatory arbitration clause, 51% said that accommodating such a request never affected pricing to that customer, and 39% said it rarely affected pricing to the requesting customer. See Table 17:

**If your company permits changes to the mandatory arbitration clause at a customer's request, does it affect the price charged to that customer?**

Always	0%
Often	0%
Sometimes	10%
Rarely	39%
Never	51%

*E. The Materiality of Arbitration Clauses Under Section 2-207*

Under Uniform Commercial Code section 2-207, which addresses the “battle of the forms” scenario, a term in the offeree’s form which “materially alters” a term in the offeror’s form does not become part of the contract between the contracting parties.<sup>45</sup> Is a mandatory arbitration clause such a material alteration? The courts appear split.

For example, in *Frances Hosiery Mills, Inc. v. Burlington Industries, Inc.*, the Supreme Court of North Carolina found that an arbitration provision in an invoice included with a product shipment was not binding.<sup>46</sup> In that case, the parties entered into valid, complete oral contracts for the sale of yarn, by telephone.<sup>47</sup> The defendant made multiple shipments of yarn with invoices, which contained mandatory arbitration provisions.<sup>48</sup> The court noted that “the plaintiff did not sign and return to the defendant any copy of such document, nor did it any time otherwise manifest to the defendant its consent to the arbitration provision, unless its failure to object thereto constitutes such a manifestation of assent.”<sup>49</sup> The court held that the arbitration provision was “[b]eyond question”<sup>50</sup> a material alteration as it

---

45. U.C.C. § 2-207 (2000). Section 2-207 of the UCC was amended in 2003 but the amendment has not been adopted by many states as of the date of this publication.

46. *Frances Hosiery Mills, Inc. v. Burlington Indus., Inc.*, 204 S.E.2d 834, 842 (N.C. 1974). Cf. *Marlene Indus. Corp. v. Carnac Textiles, Inc.*, 380 N.E.2d 239, 242 (N.Y. 1978) (finding that an arbitration clause is material and may only become part of a contract if the parties expressly assent).

47. *Frances Hosiery Mills*, 204 S.E.2d at 841.

48. *Id.* at 836.

49. *Id.* at 842.

50. *Id.*



would force the plaintiff to present its claim to an arbitration board in New York rather than to a North Carolina court.<sup>51</sup>

Other cases, however, suggest a willingness to enforce such provisions in similar situations.<sup>52</sup> In *Aceros Prefabricados, S.A. v. TradeArbed, Inc.*, the United States Court of Appeals for the Second Circuit expressly rejected the district court's finding that "[a]s a matter of law, an arbitration provision materially alters ones' [sic] legal rights under a contract."<sup>53</sup> The Second Circuit Court of Appeals found that the inclusion of an arbitration provision in a contract did not constitute a material alteration under UCC section 2-207, even though it was not expressly accepted by the plaintiff, because it did not result in surprise or hardship to the plaintiff.<sup>54</sup> In reaching its conclusion, the court stated that "[u]nder New York law, an arbitration agreement does not result in surprise or hardship where arbitration is the custom and practice within the relevant industry."<sup>55</sup> The court further found that in the steel business arbitration clauses are commonplace and the norm.<sup>56</sup>

Our survey findings suggest that the inclusion or deletion of mandatory arbitration clauses may be material to companies even though such clauses are generally not viewed as "deal-breakers." In other words, the addition or deletion of mandatory arbitration clauses may be important or somewhat important even if it is not so critically important as to prevent contract formation. On the other hand, certain modifications to arbitration clauses, such as changing the arbitration organization, may be minor and included as part of the parties' agreement.

#### IV. COMPARING THE RESULTS OF THE TWO STUDIES

##### *A. Summarizing Significant Differences Between the Two Studies*

Eisenberg, Miller, and Sherwin make several conclusions in their study. In this Part, we examine their conclusions and discuss how our study

---

51. *Id.*

52. See *N & D Fashions, Inc. v. DHJ Indus., Inc.*, 548 F.2d 722, 729 (8th Cir. 1976) (upholding arbitration agreement in confirmation notice); *Aceros Prefabricados, S.A. v. TradeArbed, Inc.*, 282 F.3d 92, 98 (2d Cir. 2002) (finding that arbitration provisions in seller's confirmation orders became part of contract between the parties). The courts' opinions accord with comment 4 of section 2-207 of the UCC, which states that "[e]xamples of typical clauses which would normally materially alter the contract and so result in surprise or hardship if incorporated without express awareness by the other party . . . ." U.C.C. § 2-207 cmt. 4 (2000).

53. *Aceros Prefabricados, S.A.*, 282 F.3d at 99-100 (quoting *Aceros Prefabricados, S.A. v. TradeArbed, Inc.*, No. 00 Civ. 9387, 2001 U.S. Dist. LEXIS 3445, at \*6 (S.D.N.Y. Mar. 28, 2001)).

54. *Id.* at 100-01.

55. *Id.* at 101.

56. *Id.* at 102.

complements and extends or limits their findings. There are several significant differences between Eisenberg, Miller, and Sherwin's study and our own that make such comparisons between the studies particularly interesting. Eisenberg, Miller, and Sherwin's study examined companies in the "telecommunications, credit, and financial services industries."<sup>57</sup> Our study examined companies in a broader range of industries. Our findings, therefore, may extend the applicability of Eisenberg, Miller, and Sherwin's findings to other industries or may limit them to their studied industries.<sup>58</sup> Interestingly, in our survey 67% of respondents in the financial services sector responded that their form agreements contained mandatory arbitration clauses. This finding suggests that companies in the financial services sector may be more prone to include mandatory arbitration clauses in their contracts than companies in other sectors, thus limiting Eisenberg, Miller, and Sherwin's findings of pro-mandatory arbitration clauses to the industries they studied. Unfortunately, we hesitate to make such a conclusion as only 6% of our respondents came from the financial services sector.<sup>59</sup>

Furthermore, their study examined only *consumer* customer contracts and compared those contracts with material, nonlabor contracts.<sup>60</sup> Our study, on the other hand, examined only customer contracts, the vast majority of which were with other *businesses*. Our study, therefore, may help explain whether the disparity between consumer contracts and material-nonemployee-contracts, established in Eisenberg, Miller, and Sherwin's study, is due to the difference between material and customer contracts or the result of bargaining unevenness between businesses and consumers. In other words, comparing the results of our two studies may help identify whether it is the *type* of contract (customer or material) or the *status* of the parties (individual consumer or large business) that determines the prevalence of mandatory arbitration clauses.

Finally, our study specifically asked respondents their views about arbitration, whereas Eisenberg, Miller, and Sherwin's extrapolated companies'

---

57. Eisenberg et al., *supra* note 1, at 880.

58. Eisenberg, Miller, and Sherwin indicate that their study should have broader implication for policy beyond the studied industries:

Corporations regularly defend their use of mandatory consumer arbitration clauses by asserting arbitration's superior fairness and efficiency over traditional litigation. However, corporations' selective use of arbitration clauses against consumers, but not against each other, suggests that their use of mandatory arbitration clauses may be based more on strategic advantage than on a belief that corporations are better serving their customers.

*Id.* at 895.

59. See pp. 603–04, at tbl. 5.

60. Eisenberg, Miller, and Sherwin do not expressly define consumer.

views from their data.<sup>61</sup> Our findings regarding companies' self-reported views about mandatory arbitration clauses may be helpful in relation to Eisenberg, Miller, and Sherwin's conclusions regarding company views.

*B. Prevalence of Mandatory Arbitration Clauses in Customer Contracts*

In Eisenberg, Miller, and Sherwin's study, 76.9% of consumer contracts contained mandatory arbitration clauses, whereas 23.1% of such contracts did not.<sup>62</sup> They also found that only 6.1% of nonconsumer, nonemployee material contracts contained mandatory arbitration clauses, whereas 93.9% did not.<sup>63</sup> Because their study compared customer contracts with non-customer, material contracts, this differential could be attributable to the type of transaction rather than to an inconsistent attitude regarding arbitration.<sup>64</sup>

By comparison, our study found that of the 94% of respondent companies that used standard form agreements, 45% of those agreements contained mandatory arbitration clauses.

In addition, 36% of the 39 respondents that sell products only to other businesses use mandatory arbitration clauses, compared to 51% of all of the 53 respondents that sell products to both businesses and consumers. Our findings suggest that companies that sell products only or primarily to other businesses are 15% less likely to use mandatory arbitration clauses than those companies that sell to both businesses and consumers. This number, however, is not statistically significant.<sup>65</sup> Of course, the use of mandatory arbitration clauses with business customers must be viewed in light of business customers' ability to negotiate changes. Most significantly, 15% of respondents permit changing arbitration from mandatory to optional, and 28% of respondents permit deletion of the arbitration clause altogether. Therefore, while businesses may attempt to impose mandatory arbitration clauses upon their business customers, they are also willing to accommodate

---

61. There are, of course, weaknesses inherent in any self-reporting. Because we are testing companies' opinions, we are constrained by what companies report, subject to the potential for biases, faulty perceptions, and dishonesty inherent in all self-reports.

62. Eisenberg et al., *supra* note 1, at 883.

63. *Id.*

64. In response to Eisenberg, Miller, and Sherwin's research, Professor Ware observed that: "If it's a big, important contract, then you don't put in an arbitration clause . . . . It's entirely possible that businesses are being consistent in using arbitration more for immaterial contracts than for material contracts . . . ." Jonathan D. Glater, *Companies Unlikely to Use Arbitration With Each Other*, N.Y. TIMES, Oct. 6, 2008, at B4.

65. The resultant p-value equals 0.146. Again, we used the software SAS to calculate this figure.

those business customers who insist upon changes.<sup>66</sup> Of course, it is simply impractical for companies to accommodate such requests from consumer customers because of the transaction costs of doing so on a mass scale.

Thus, our findings both support and qualify Eisenberg, Miller, and Sherwin's findings in several ways. Our study supports Eisenberg, Miller, and Sherwin's finding that companies are more likely to use mandatory arbitration clauses with individual consumers than with other businesses. The disparity, however, is not as stark as their study indicates. Our study suggests that companies are more likely to use mandatory arbitration clauses in standard customer contracts than in material agreements even when the customer is another business. They are even more likely to do so where the customer is a consumer rather than a business.

### *C. Rationale for Inclusion of Mandatory Arbitration Clauses*

After considering other possible explanations, Eisenberg, Miller, and Sherwin conclude that companies use mandatory arbitration clauses as a means to avoid aggregate dispute resolution, namely class action law suits.<sup>67</sup> In our study, we found the primary reason for including mandatory arbitration clauses was to avoid litigation costs. Eight of the 15 respondents (53%) who did business with both companies and consumers, chose reduced litigation costs as the primary reason for using mandatory arbitration clauses. Seventeen respondents (55%) who did business solely with companies chose reduced litigation costs as the primary reason for using mandatory arbitration clauses.<sup>68</sup>

The respondents' answers in our study to the question "what is the primary reason for the arbitration clause," is not necessarily inconsistent with Eisenberg, Miller, and Sherwin's conclusion. As previously noted, our survey was sent out prior to the publication of their study. Consequently, we did not tailor our questions to their findings, and did not provide the avoidance of aggregate dispute resolution as a possible reason for arbitration clauses. Those respondents who have both businesses and consumers as customers may have been thinking of class action law suits when they answered that the primary reason for the arbitration clause was to reduce litigation costs, as defending such suits tends to be costly. In addition, because our respondents dealt primarily with business customers, their primary concern may not have been the avoidance of aggregate

---

66. *See supra* p. 610, at tbl. 14.

67. Eisenberg et al., *supra* note 1, at 893.

68. Some respondents checked more than one response, which explains why total percentages for this question exceed 100%.

dispute resolution. Thus, for those businesses that deal primarily with consumer customers, the primary purpose for mandatory arbitration clauses may indeed be the avoidance of aggregate dispute resolution.

The frequent inclusion of mandatory arbitration clauses in business customer contracts, however, does suggest there are reasons other than the avoidance of aggregate dispute resolution for their inclusion in customer contracts. Eisenberg, Miller, and Sherwin do not specify where their subject companies conduct business or whether they have international customers. Our study suggests that for companies that conduct business internationally, arbitration with a familiar arbitral organization may be preferable to the vagaries and uncertainties of foreign law in a foreign court. For example, of the 20 companies that have international customers (i.e., in a country other than where the company is headquartered), 11 of them, or 55%, use mandatory arbitration clauses, which hints that the use of such clauses may be a norm in international transactions. In other words, if non-U.S. companies tend to regularly use mandatory arbitration clauses, U.S. companies that deal with these companies may incorporate such clauses in their agreements in order to conform with internationally accepted commercial standards.<sup>69</sup>

In addition, as previously noted, 73% of respondents stated that they had agreed to mandatory arbitration clauses in other company contracts on behalf of their own companies. Their willingness to do so—and that they were asked to do so at all—indicates that mandatory arbitration clauses are not confined to consumer customer contracts.

#### CONCLUSIONS

The findings in our study may help companies to better understand attitudes about arbitration and assist in contract negotiations. Our findings, in conjunction with the Eisenberg, Miller, and Sherwin study, indicate that businesses are more likely to include mandatory arbitration clauses in their standard customer contracts than in their material-nonemployee contracts

---

69. Home state familiarity and convenience is a consideration even domestically. See Florencia Marotta-Wurgler, “Unfair” Dispute Resolution Clauses: *Much Ado About Nothing?* in *BOILERPLATE: FOUNDATIONS OF MARKET CONTRACTS* 64 (Omni Ben-Shahar, ed., 2007). Marotta-Wurgler notes that arbitration clauses were “rare” in her sample of consumer contracts and that sellers who select arbitration invariably select the law of the state in which they are headquartered. The same is true for arbitration location. In fact, about 50 percent of arbitration clauses in the EULAs of consumer-oriented products select California law and California venue. As is well known, California affords many protections to consumers in arbitration.

*Id.*

with other businesses. The preference for mandatory arbitration clauses in customer contracts appears to be somewhat greater where the customer is a consumer rather than a business. Our study also suggests that the primary reason for mandatory arbitration clauses in customer contracts where the customer is a business is the avoidance of uncertainty and expenses associated with litigation, especially in a foreign jurisdiction. This finding may suggest an additional or alternative rationale to Eisenberg, Miller, and Sherwin's conclusion that the primary reason for mandatory arbitration clauses in customer contracts with consumers is the avoidance of aggregate dispute resolution.

Finally, our study may help courts determine the materiality of arbitration clauses in standard form agreements between two commercial entities under UCC section 2-207. Our study indicates that the addition or deletion of arbitration clauses is material, but that certain alterations to these clauses, such as change of arbitration body, are not.

