IADC Committee Newsletter

ALTERNATIVE DISPUTE RESOLUTION

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A common ground on which arbitration agreements are challenged is the defense that arbitration is "prohibitively expensive." Given the prevalence of contingency fee agreements, the costs of arbitration may be completely covered by claimant's attorney. This article discusses the "prohibitive costs" argument and explores the potential "contingency agreement" defense and provides citation to its successful use.

Defending the Defense of "Prohibitive Expense" – Arbitration Costs vs. Contingency Fee Agreements

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ABOUT THE COMMITTEE

The Alternative Dispute Resolution Committee serves all members who use mediation and arbitration to resolve disputes, as well as those who have become mediators or arbitrators in their own practices. The Committee publishes newsletters and is developing as a global resource for our international members, corporate counsel and insurance executives, to offer expertise on negotiating and drafting alternative dispute resolution provisions and on the effective use of alternative forms of dispute resolution.
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Introduction

Some claimants will fight tooth-and-nail to invalidate arbitration agreements in order to keep their claim in court. Why? Arbitration is an attractive alternative to litigation as a method of dispute resolution. Arbitration agreements have become standard in employment, consumer and commercial transactions. The United States Supreme Court endorses a "liberal . . . policy favoring arbitration agreements" whenever possible.[1] Arbitration is usually faster and overall less costly than litigation. Why claimants fight enforcement of arbitration agreements is an interesting question best left to legal analysts and scholars. More important to the legal practitioner seeking to enforce an arbitration agreement is ***how*** claimants will fight. We must know the defenses to arbitration agreements in order to fight back.

A common ground on which arbitration agreements are challenged is the defense that arbitration is "prohibitively expensive."[2] There are several general aspects to this argument. It is generally claimant's burden to prove "prohibitive expense" via individualized financial and cost evidence such that he could not effectively vindicate his rights in arbitration.[3] The proponent of the arbitration agreement may defend the cost-based argument by attacking claimant's proof or even agreeing to pay the entire cost of the arbitration.[4] However, there is an even more logical defense that seems to be overlooked: The costs of arbitration may be completely covered via a contingency agreement between claimant and his attorney.[5]

This article will provide a brief overview of the "prohibitive costs" argument and how it is analyzed by the courts. It will then explore the potential "contingency agreement" defense and provide citation to its successful use.

Green Tree and "Prohibitive Costs"

In the seminal case, *Green Tree Financial Corp. – Alabama v. Randolph*, the Supreme Court simultaneously rejected and endorsed a cost-based challenge to a consumer arbitration agreement.[6] The claimant in *Green Tree*, Randolph, obtained a loan from Green Tree Financial Corporation. Randolph's contract with *Green Tree* included an arbitration clause silent as to the potential costs of arbitration or who would bear those costs. Randolph filed a class action lawsuit against Green Tree claiming violation of the Truth in Lending Act. The district court granted Green Tree's motion to compel arbitration. The Eleventh Circuit reversed, holding "the agreement to arbitrate posed a risk that [Randolph's] ability to vindicate her statutory rights would be undone by the 'steep' arbitration costs, and therefore, was unenforceable."[7]

The Supreme Court rejected Randolph's cost-based argument, stating:

> It may well be that the existence of large arbitration costs could preclude a litigant such as Randolph from

[1] *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983).
[2] *Green Tree Financial Corp. - Alabama v. Randolph,* 531 U.S. 79, 92 (2000).
[3] *Id* at 90.
[4] *See generally Phillips v. Associates Home Equity*, 179 F.Supp.2d 840, 847 (N.D.Ill 2001).
[5] *See generally* Christopher R. Drazohal, *Arbitration Costs and Contingent Fee Contracts*, 59 Vand. L. Rev. 729 (2006) (hereinafter "*Arbitration Costs*").
[6] *See generally Green Tree*.
[7] *Id* at 84.

> effectively vindicating her statutory rights in the arbitral forum. But the record does not show that Randolph will bear such costs if she goes to arbitration.[8]
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> [W]e believe that where . . . a party seeks to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive, that party bears the burden of showing the likelihood of incurring such costs.[9]

This decision opened the door to invalidate arbitration agreements based on prohibitive expense, but left the details to the lower courts. The Federal circuits and state courts have taken varying approaches on how to invalidate an agreement based on cost.[10] But the majority of jurisdictions apply a case-by-case analysis examining three main factors: (1) the claimant's individual financial situation and ability to pay the arbitration fees and costs; (2) the expected cost differential between arbitration and litigation; and (3) whether this cost differential precludes the claimant from bringing the claim in arbitration.[11]

Although the approach differs slightly among jurisdictions, the essential question is the same: **Taking all the evidence as a whole, will this potential litigant be able to vindicate his or her rights if an arbitration agreement is enforced?** Proponents of arbitration agreements want this question to be answered in the affirmative. Proof of a contingency fee agreement between claimant and his attorney may do just that.

Defeating the "Prohibitive Costs" Argument with Proof of a Contingency Fee Agreement

Contingency fee agreements are widely used in a wide variety of cases. "A typical contingent fee contract provides that in exchange for the attorney's legal representation, the claimant will pay the attorney some percentage (often although not always 33%) of any recovery obtained in the case. If the claimant recovers nothing, no fee is owed."[12] However, a claimant usually gets more than just legal services under a contingency fee agreement. As Herbert M. Kritzer explained:

> The normal hourly fee or flat fee simply purchases the services of a lawyer. Under a contingency fee arrangement, the client also purchases additional services. The first is financing . . . By their nature, contingency fees are not normally collected until the matter is closed. Very often, lawyers also defer the collection of expenses until the close of a case. Thus, the contingency fee lawyer finances the litigation for the client while the case is pending.
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> The second additional service that the client purchases is a form of

[8] *Id* at 90.
[9] *Id* at 92.
[10] Michelle Eviston & Richard A. Bales, *Capping the Costs of Consumer and Employment Arbitration*, 42 U. Tol. L. Rev. 903, 904 (2011). Most federal court challenges utilizing the cost-based argument are based on the apparent inability for a claimant to vindicate his statutory rights. In state courts, the cost-based argument is based upon the theory of unconscionability. However, the analysis under either theory is substantially the same. *See Arbitration Costs*, *supra* note 5, at 742 – 757.
[11] *See generally Bradford v. Rockwell Semiconductor Systems, Inc.*, 238 F.3d 549 (4th Cir. 2001); *Arbitration Costs*, *supra* note 5.
[12] *Arbitration Costs*, *supra* note 5, at pg. 767.

> insurance. While in many states clients are liable for expenses regardless of the outcome of a case, the reality is that lawyers who pursue a case unsuccessfully on a contingency basis seldom collect those expenses (or even seek to collect them). Thus, the lawyer effectively insures the client for the expenses associated with pursuing a claim.[13]

It is therefore typical under contingency fee agreements that the claimant's attorney will advance all fees and costs associated with bringing a claim, whether it is in arbitration or litigation. "On the face of it, there is no reason to expect contingent fee contracts to treat arbitration costs differently than they treat other litigation expenses. One would expect lawyers to advance arbitration costs for their clients, just like any other litigation expense – provided that the claim is economically viable based in the expected award and the expected total costs of arbitration."[14]

So, if a claimant has a contingency fee agreement with his counsel that covers all fees and costs associated with maintaining a claim, whether in litigation or arbitration, there is no way claimant can argue that he cannot vindicate his rights in arbitration because it is "prohibitively expensive."

Such an easy and logical argument, but it seems to be overlooked. This author could only find four (4) cases even mentioning contingency fee agreements or the fact that arbitration may be financed by claimant's attorney:[15]

- *Rollins, Inc. v. Foster*, 991 F.Supp. 1426, 1439 (1998) – Claimant did not show that "because of the arbitration provision, no attorney is willing to take her case on a contingency basis, and, on that basis, assume the costs of arbitration."
- *Harrington v. Pulte Home Corp*, 119 P.3d 1044, 1056 (Ariz. App. 2005) - The Court noted that the "appellees who provided affidavits assert that even $1,000 in costs would preclude them from arbitrating their case. Appellees do not explain how they expect to litigate (as opposed to arbitrate) claims of $500,000 to $1,000,000 for less than $1,000 in costs. One obvious possibility is that an attorney would take the case on a contingency basis and advance costs. That same possibility would apply to arbitration."
- *Estate of Heiny v. Life Care Centers of America*, 2013 WL 1846599, 4(Ariz. App. 2013) (unpublished decision) – Affirming lower courts finding that claimant's attorneys "might be advancing [the costs of arbitration], this allowing her to fully arbitrate her claims rather than preclude arbitration."
- *Zephyr Haven Health & Rehab Center, Inc. v. Hardin*, 122 So.3d 916, 923 (Fl. Dis. 2013) – Proponents of arbitration argued that if claimant's attorneys were advancing all costs, then claimant could not prove "prohibitive expense." Court agreed.

[13] Herbert M. Kritzer, *The Wages of Risk: The Returns of Contingency Fee Legal Practice*, 47 DePaul L. Rev. 267, 270 (1998).

[14] *Arbitration Costs*, *supra* note 5, at pg. 768 – 769 (citing anecdotal evidence that contingent fee contracts also cover arbitration costs).

[15] This was not an exhaustive search. It is based on Westlaw query using key words: "Green Tree" & "contingen!"

Proponents of arbitration agreements must make every effort to ensure that the agreement is enforced. When faced with a "prohibitive costs" argument, it is advisable to investigate whether the claimant is represented by an attorney on a contingency fee basis. If it can be proven that claimant's attorney is advancing all costs associated with the claim, whether in litigation or arbitration, the "prohibitive costs" argument may be defeated.

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