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Practice Guideline 17: Guidelines for Arbitrators dealing with cases involving consumers and parties with significant differences of resources

1 Summary

1.1 Arbitrations involving consumers and parties with significant differences of resources raise issues about jurisdiction and about how arbitrators should handle the case generally.

1.2 In the European Union, Council Directive 93/13 on unfair terms in consumer contracts creates a presumption that pre-dispute arbitration clauses in consumer contracts are unfair and, therefore, invalid. The reason for this is inequality of bargaining power and the consequential inability on the part of most consumers to negotiate clauses, including those relating to dispute resolution, in consumer contracts. UK, Swedish and German law go further in protecting consumers. In the UK, clauses are presumed unfair (and therefore unenforceable against a consumer) in low value claims, currently below £5,000; while, in Sweden, arbitration clauses are prohibited in contracts concerning the sale of goods or services for private use: and in Germany, a consumer arbitration agreement will only be enforceable if separately agreed to by the consumer (either by being contained in a separate, signed document or in a fully notarised contract.)

1.3 The European Court of Justice has ruled that a court and, therefore, presumably an arbitral tribunal must take a jurisdictional point under the Unfair Terms in Consumer Contracts Directive of its own motion.

1.4 Caselaw in Germany can render an arbitration agreement unenforceable where one party lacks the resources to present his or her case. US court decisions invalidate an arbitration clause for unconscionability or on public policy grounds where one party is inherently unlikely to be able to afford to bring a claim or the agreement is inherently unfair. The USA has been

considering legislation affecting the use of arbitration clauses in consumer contracts for some time.

1.5 Where there are significant differences of resources, the arbitrator's primary duty is to do justice in the case. He must do this while ensuring that he shows no bias in favour of any party. The arbitrator must not assume the role of advocate for any party. He can achieve all this by researching points, asking questions and suggesting amendments to claims and the way in which a case is presented where this is necessary to achieve the primary objective. He must, though, ensure that all parties are given an opportunity to present submissions on any point not raised by a weaker party which form part of the decision.

2 Introduction

2.1 Arbitrations involving consumers and parties with significantly different resources pose particular problems to arbitrators. First, the European Union and other countries have rules prohibiting, to some degree, the enforcement against consumers of agreements to submit future disputes to arbitration. In addition, various legal systems may invalidate an arbitration agreement or a reference to arbitration on the basis that the agreement is unfair, otherwise invalid or incapable of being performed. So, there may be unusual jurisdictional issues.

2.2 Secondly, one side may have difficulties affording professional help in presenting their claims and their case generally. The arbitrator has to decide how much help he can give without compromising his actual or appearance of neutrality. The second problem applies equally to cases where there is a significant difference in resources between the parties. These considerations are not limited to a situation in which one of the parties is a consumer. They may equally apply to a small business, a not-for-profit organisation or other class of party which may not be able to present its claims or defences effectively because of a lack of resources.

3 Jurisdiction

3.1 The Issues

There are two distinct issues here. First, there may be applicable statutory provisions limiting the validity or enforceability of an arbitration agreement. Secondly, the law or the arbitrator

may consider that one party's lack of resources so disable him from presenting his case that the arbitration is inherently unfair. State legal aid facilities are usually unavailable for arbitration.

3.2 Statutory Provisions

3.2.1 Council Directive 93/13/EEC on unfair terms in consumer contracts

3.2.1.1 In the European Union, Council Directive 93/13/EEC on unfair terms in consumer contracts creates a presumption that arbitration clauses contained in contracts concluded between a seller or a supplier and a consumer are not binding on the latter. (In the UK, this Directive is currently implemented by the Unfair Contract Terms in Consumer Contracts Regulations 1999.) Article 3(1) of the Directive says:

“A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.”

3.2.1.2 Under Article 3(3), the Annex contains “an indicative and non-exhaustive list of the terms which may be regarded as unfair.” Annex 1(q) refers to terms:

“excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions...”

3.2.1.3 Equally, though, Article 4(1) insists that “the unfairness of a contractual term shall be assessed, taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent.”

3.2.1.4 So while it can be assumed from Annex 1(q) that a pre-dispute arbitration clause is “unfair” and therefore not binding under Article 6, a party seeking to rely on the clause can argue that in the circumstances attending the conclusion of the contract, the clause is fair. In *Mylicrist Builders Limited v Mrs G Buck* [2008] EWHC 2172 (TCC), Ramsey J invalidated an arbitration clause under the UK version of the Directive pointing out that for consumer

transactions, the arbitration clause and its effect need to be more fully, clearly and prominently set out than through just a box in the contract listing all the terms.

3.2.1.5 Article 6(1) of the Directive makes an unfair contract term not binding on the consumer. However, it does not have the same effect on the other parties who cannot rely on the Directive. One final point is that a choice of law cannot be used to exclude the effect of the Directive.

3.2.2 Section 91 Arbitration Act 1996 and other national laws

3.2.2.1 Section 91(1) of the Arbitration Act 1996 extends the application of the Directive by declaring unfair any contract term submitting to arbitration an existing or future dispute insofar “as it relates to a claim for a pecuniary remedy which does not exceed the amount specified by order for the purposes of this section.” Currently, the relevant order (SI 1999/2167) places the limit at £5000. Since the section does not indicate the effect to be given to an unfair term under the Directive and extends the Directive to cover this type of case, it must be assumed that the section only gives a remedy to a consumer party involved in a dispute covered by Section 91 in line with Article 6(1). The section does, though, prevent a non-consumer from arguing that the arbitration clause is fair where an objection has been raised by the consumer in the context of a dispute concerning a low-value claim covered by an order made under Section 91. Section 90 extends the Regulations further by applying them to legal persons as well as natural persons. This, for example would include companies entering into contracts for purposes which are outside their trade, business or profession.

3.2.2.2 Section 6 of the Swedish Arbitration Act 1999 goes further. It bans all pre-dispute arbitration agreements in contracts concerning goods or services supplied principally for private use. Arbitral clauses in leases are dealt with under a statutory scheme. An old German provision, Article 1031(5) of the ZPO, requires all consumer arbitration agreements to be in a separate document signed by the consumer personally unless the whole contract is notarised.

3.3 Caselaw developments

3.3.1 German caselaw – revoking references because of a party’s lack of resources

German caselaw contains instances where courts have struck down references to arbitration where one party is unable to present its case due to resource difficulties. The Bundesgerichtshof (III ZR 33/00 9 April 2000) reversed a decision to refer the parties to arbitration on the basis that the arbitration agreement in question was incapable of being performed because of the Respondent's inability to pay the costs involved (which would be met in ordinary litigation by legal aid). In taking this view, it was following its earlier decision of 12 November 1987 (*NJW* 1987, p 1215).

3.3.2 Contrasting US and English law on the invalidity of arbitration clauses for reasons of unconscionability or unfairness

3.3.2.1 A similar argument has prevailed in the USA in both consumer and employment cases. Courts have held an arbitration agreement which provides for a procedure a consumer is unlikely to be able to afford (or will cost more than any likely dispute) is contrary to public policy or void for unconscionability. Such an arbitration clause prevents the effective enforceability of his rights in a situation where a consumer had no choice as to whether to enter into the contract. The validity of the clause is judged at the time of the agreement, not, as in Germany, at the time of the arbitration.

3.3.2.2 In *Green Tree Financial Corp. v. Randolph*, 531 U.S. 79 (2000), the Supreme Court reversed such a finding by the 11th Circuit but only on the basis that the consumer had failed to provide adequate evidence that arbitration would be prohibitively expensive. The idea is that the arbitration clause itself is contrary to public policy if it provides for a forum in which the consumer or employee is unable to vindicate his rights. This leaves the existing caselaw intact: *Alexander & Freeman v. Anthony International, L.P.*, 341 F.3d 256 (3rd Cir. 2003). In an employment contract, the 9th Circuit has decided that any clause which requires the employee to pay more to file a claim with the arbitrator than a court is void for unconscionability. In the same case, the court concluded that an agreement that would result in the employee running the risk of incurring a costs award in the event of an unsuccessful claim would also render the agreement invalid: *Ingle v. Circuit City Stores Inc.*, 328 F.3d 1165, 1179 (9th Cir.), cert. denied, 124 S.Ct. 1169 (2004) & *Al-Satin v. Circuit City Stores. Inc.*, 394 F.3d 1254 (9th Cir. 2005).

3.3.2.3 By contrast, under Section 60 of the English Arbitration Act 1996, an agreement which has the effect that a party is to pay the whole or part of the costs of the arbitration in any event,

is only valid if made after the dispute in question has arisen. Equally, the Court of Appeal in *Paczy v. Haendler & Natterman GmbH* *1981+ 1 Lloyd's Rep 302 ruled that the impecuniosity of one party does not make an arbitration agreement incapable of being performed.

3.3.2.4 A further problem, discussed in US caselaw, is that an arbitration agreement may contain clauses that are inherently unfair, preventing the tribunal from holding an acceptable arbitration: *Pine Ridge Homes, Inc. v. Stone*, 2004 WL 1730170 (Tex. App. - Dallas 2004. no pet.)

3.4 A party failing to take a jurisdictional point

3.4.1 A party who is under-resourced may not be aware of a jurisdictional point in his favour. It seems appropriate in such a case and, in a situation covered by the Directive 93/13/EEC on unfair terms in consumer contracts, imperative for an arbitrator who thinks that a jurisdictional point should be taken to draw this to the parties' attention and enquire whether either party wishes to challenge his jurisdiction. While this approach creates risks of allegations of bias from the stronger party, any other behaviour creates a risk that any resulting award will be set aside on public policy grounds.

3.4.2 In *Mostaza Claro v. Centro Móvil Milenium SL* (C-168/05) (2006 ECJ CELEX LEXIS 610, October 26, 2006), the European Court of Justice ruled that "a national court seized of an action for annulment of an arbitration award must determine whether the arbitration agreement is void and annul that award where that agreement contains an unfair term, even though the consumer has not pleaded that invalidity in the course of the arbitration proceedings, but only in that of the action for annulment." If the court can take the point on an annulment application even though no argument has been presented to the arbitrator, this suggests that the arbitrator should raise the jurisdictional point of his own motion. Otherwise, he will run the risk that his award will be unenforceable subsequently. For this reason, it is much safer for the arbitrator to agree a terms of reference or similar document in consumer cases. This will tend to deal with the prohibition on pre-dispute agreements in some countries.

3.5 Summary on jurisdiction

In summary, on jurisdiction, an arbitrator must be aware that specific laws such as the European Directive may render unenforceable the arbitration clause concerned if it involves a consumer.

Secondly, other law may have the same effect where an imbalance in the contract terms renders the clause contrary to public policy or in some countries where events make a fair procedure impossible. Finally, a valid voluntary post-dispute arbitration might overcome these issues in circumstances where a possible prohibition of pre-dispute arbitration clauses could be an obstacle to arbitration.

4. Handling the procedure

4.1 The arbitrator in handling a case where the parties have unequal resources has to balance two obligations:

- 1) to do justice between the parties applying the applicable law or standards; and
- 2) to treat each party equally and provide a fair and unbiased procedure.

4.2 The first problem arises when considering the parties' claims and defences. If an under-resourced claimant has asked for or asserted in its defence less than he is probably entitled to, the arbitrator has a dilemma. If he makes an award for more or for a remedy other than that which has been claimed, the award may be capable of being set aside on the basis that he has exceeded his jurisdiction.

4.3 The arbitrator can suggest, in the presence of the other party, an amendment to the claim to leave the amounts and remedies unrestricted. He can even point out heads of claim and remedies which can be requested in the arbitration. He must, though, do so while indicating that he has not considered the merits of any amendment and cannot even consider its admissibility unless it has been requested. This type of situation is simpler where arbitration rules provide that the arbitrator will assist in the formulation of the parties' claims or it has become an expectation of the type of arbitration that this will happen. Ultimately, the arbitrator must be entitled to provide information to both parties on which the weaker party may wish to act to his advantage. However, the arbitrator must not show favouritism to an under-resourced party.

4.4 The arbitrator is not entitled to reach a conclusion on a point not put to the unsuccessful party: *A. c/ B. Ltd*, Tribunal fédéral, 30 September 2003 ATF 130 III 35. However, caselaw in a variety of jurisdictions stresses the fact that the arbitrator may draw the parties'

attention to arguments and points that have not been raised by either of them and ask they be addressed. The arbitrator must give each party the opportunity to present evidence and make submissions on these matters before reaching a conclusion. A difficult issue is the extent to which it is appropriate for an arbitrator to research matters of his own motion. Normally, an arbitrator should be reluctant to do this. However, where a party clearly has resource problems, some degree of research is probably appropriate in order to ensure that the party with an economic advantage is not leading the arbitrator into error. While a court could set aside an award on natural justice grounds where an arbitrator shows bias in favour of the weaker party, the opposite may also be true. An award could be annulled if a court takes the view that it has resulted from an oppressive procedure in which the losing party never stood a reasonable chance. A difficult balance must be struck.

4.5 One solution can be for the arbitrator to indicate at an early stage the extent to which he will be involved in investigating the facts and law in the light of the differences in the party's resources. While arbitration schemes involving consumers, small businesses, not-for-profit organisations or similar types of party can and ideally should have provisions covering these types of issues, in the absence of any agreement, the arbitrator has to make up his own mind on the subject.

4.6 We suggest that since the arbitrator's primary duty is to do justice between the parties; his task in this type of situation is to inform himself as far as he can as to the possible grounds of success of a party who is unable to represent itself effectively. The arbitrator must raise the points and anything he has discovered through his own research with all the parties and invite them to present arguments on them. In doing so, he must not indicate his view on the merits of the points. He can then reach his decision on the basis of the parties' submission and his own research.

4.7 On the general presentation of the case, the arbitrator can provide some assistance by asking questions of witnesses and of the weaker party which will enable it to present its case equally and fairly. The arbitrator should be at least as accommodating to a weaker party as a court would be under similar circumstances. As with all these observations, though, the arbitrator must be extremely careful not to show bias towards one of the parties. As with all

matters of procedure, the attitude of the arbitrator must be one of listening and attempting to seek out the truth and reach the correct decision rather than promoting either side's case.