

Buyer Beware

As Arbitration Spreads To Consumer Purchases, A Court Battle Looms

Attorneys Lead a Backlash Against Corporate Practice That Reduces Lawsuits

A Case of an Unread Mortgage

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UNION SPRINGS, Ala.—Larketta Randolph didn't decide to sue her mortgage company until she learned she had signed away her right to do so.

Ms. Randolph, a 38-year-old mother of three, bought a four-bedroom double-wide mobile home in 1994 for \$38,958, most of it borrowed from Green Tree Financial Corp. For months, she lived contentedly amid the pine and sweetgum trees in this deer-hunting and bass-fishing haven in rural Bullock County.

One day, a neighbor, Ms. Randolph says, suggested that since big lenders sometimes take advantage of borrowers, it would be a good idea to show the mortgage papers to a lawyer. Ms. Randolph did so, and the attorney pointed out two things: She was required to pay an annual \$15 repossession-insurance fee that might not have been properly disclosed. And she had agreed to settle any disputes with Green Tree through binding arbitration, not a lawsuit.

So, she sued, following the advice of a pair of plaintiffs' lawyers who smelled a lucrative consumer-rights fight. They made her the lead plaintiff in a would-be class-action suit against Green Tree, the nation's top mobile-home lender, which has since been bought by Conseco Inc., Carmel, Ind. Green Tree, now called Conseco Finance Corp., countered she couldn't sue individually, let alone on behalf of thousands of other borrowers, each claiming damages on the order of \$15 or \$30.

Now the U.S. Supreme Court is poised to hear arguments in Ms. Randolph's case early next month, when the justices launch their 2000-2001 term.

Lawyer-Led Backlash

Ms. Randolph's suit has become a centerpiece in a nascent backlash by consumers and lawyers against a spreading business practice: mandatory-arbitration clauses that protect corporations from big legal bills.

The Supreme Court in recent decades has promoted arbitration as a thrifty alternative to civil suits, and the justices aren't likely to change course entirely. But major business groups such as the U.S. Chamber of Commerce, American Bankers Association and National Home Equity Mortgage Association, say they fear the justices may use the Randolph case to begin a gradual turn against mandatory arbitration. A defeat in the case could become "the beginning of the slippery slope to undermine business's ability to enter into arbitration agreements," says Robin Conrad, senior vice president of the chamber's litigation center in Washington.

The plaintiff-oriented Association of Trial Lawyers of America and groups such as the American Association of Retired Persons and Public Citizen, a consumer-advocacy organization, are siding with Ms. Randolph. "What's at stake is whether consumers can have access to the legal system to protect themselves," says Joseph Sellers, a Washington class-action specialist who will argue Ms. Randolph's case before the high court.

The mandatory-arbitration fight is part of the larger "tort-reform" war that has raged in courts and legislatures for two decades with no clear winner. Business has succeeded in curtailing certain types of consumer and employee lawsuits, but overall, plaintiffs haven't been stopped from mounting large and innovative court actions.

Arbitration developed in the 1920s as a tool for businesses to resolve disputes with each other quickly and inexpensively. Instead of dragging each other to court, adversaries agree to hire an independent, private arbitrator to make a quick binding decision. Businesses tend to favor the streamlined approach because it saves on legal fees and may avoid the unpredictability of juries.

Employers such as brokerages and some large retailers have long tried to enforce mandatory arbitration of worker grievances. In recent years, businesses have imposed the practice on consumers in contracts involving such products as cars, credit cards and even rental videos.

Action on Multiple Fronts

But plaintiffs' lawyers, who view arbitration as a way to limit awards to their clients, are now fighting back on multiple fronts. Just last month, the California Supreme Court limited the ability of managed health-care companies to force unhappy patients into binding arbitration. Weeks earlier, a county circuit court in Michigan blocked General Motors Corp. from imposing arbitration on GM workers who bought discount autos from the company.

In addition to the Randolph case, the U.S. Supreme Court has agreed to hear arguments in two other arbitration cases this fall. Plaintiffs prevailed in lower courts in all three of these suits.

Congress, meanwhile, is considering several bills that would restrict compulsory arbitration. Democratic victories in the fall races for control of the White House and Congress would give the legislation a boost.

An Arbitration Confrontation

Heads to Supreme Court

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The issue is already creating fissures within the business world. Auto dealers, who commonly demand that their customers agree to arbitration, resent having car makers impose the process on them. The dealers are fighting for a separate bill in Congress that would effectively eviscerate arbitration clauses in contracts between them and manufacturers.

In Alabama, binding arbitration has become the flash point in a clash for control of the state Supreme Court. Once known as a plaintiff-friendly judiciary, the Alabama bench tilted dramatically to the right during the 1990s, as business interests contributed heavily to favored candidates in judicial elections.

In 1998, Republicans won control of the nine-member state Supreme Court for the first time since the Civil War. A study of the court's 106 arbitration cases from 1994 to 1999 shows that Republicans supported by business generally promote the out-of-court process, while Democrats backed by plaintiffs' lawyers typically oppose it, says Steven Ware, author of the study and a law professor at Samford University in Birmingham.

This year, with five state supreme-court seats in play, plaintiffs' lawyers are trying to tap the populist strain that runs through Alabama politics by highlighting the arbitration issue. These lawyers are helping pay for a \$10,000-a-month campaign of television commercials and red, white and yellow billboards throughout the state that brand arbitration as a corporate "license to steal."

Business advocates say that suits such as Ms. Randolph's are just the sort they are trying to avoid with binding arbitration clauses: massive class-actions built on relatively minor individual complaints. But consumer advocates argue that her case illustrates how binding arbitration shields businesses from being held accountable for harm that can seem trivial in a single instance, but is suffered by large numbers of people who have no way of fighting back on their own.

Ms. Randolph, a soft-spoken high-school graduate who has worked for an audio-electronics firm for nearly 20 years, said in a December 1996 deposition in her case, "I feel like I have been done wrong, and there are other people out there who have been done wrong also, so I will be representing all of us."

Her mobile home, 70 feet long, air-conditioned and neatly decorated in green and beige, has a spacious recreation room added onto the back, where her two younger children play and do schoolwork. Ms. Randolph acknowledges that when she bought the home six-and-a-half years ago, she didn't read the arbitration clause, or much else, in her mortgage contract.

A few months later, she says, she had that chat with her neighbor about ordinary people winning big damage awards over complaints about their mortgages and TV satellite dishes. Ms. Randolph subsequently visited the storefront office of one of the two law firms in the tiny antebellum downtown of Union Springs.

A Question of Disclosure

Attorney Lynn Jinks III homed in on the annual \$15 insurance fee, imposed to cover Green Tree's costs if it ever had to repossess Ms. Randolph's home. It was disclosed in the mortgage contract, but not as a "finance" charge. Under the federal Truth in Lending Act, charges related to mortgages that benefit only the lender must be listed as finance charges.

Ms. Randolph says she considers herself to have been "overcharged." She adds, "I trusted the gentleman who helped me make this purchase."

Robert Huffaker, Green Tree's lawyer in the case, says that the insurance charge was properly disclosed. But even if the company erred in how it labeled the amount, he adds, "it was within the tolerance limit that the Truth in Lending Act permits."

Mr. Jinks figured that Ms. Randolph was one of thousands of people who signed standard Green Tree contracts that didn't list such fees as finance charges. But the binding arbitration clause presented an obstacle to suing. So, Mr. Jinks called C. Knox McLaney III, a Montgomery attorney who specializes in consumer-lending cases. The two lawyers shaped a strategy to avoid arbitration and in January 1996, filed a suit seeking class-action status on behalf of Ms. Randolph and others like her in federal district court in Montgomery.

In addition to asserting that Green Tree violated the lending act by failing to label the insurance charge properly, the suit alleged that the arbitration clause was "unenforceable" because the company had tucked it away in small print "in an inconspicuous place" on the last page of a four-page contract.

The suit also made a third argument: that Green Tree had failed to specify which side would pay the administrative fees for an arbitration service to resolve any potential disputes. Such fees could have totaled \$500 in 1995 in Ms. Randolph's case, according to her attorneys. That amount has fallen to about \$125 today, as private arbitration services have tried to lower barriers to consumer complaints.

The trial judge didn't buy the Randolph team's pitch. In 1997, he threw out the suit and ordered Ms. Randolph to submit to arbitration.

But Ms. Randolph and her lawyers didn't give up. They took her case to the Eleventh U.S. Circuit Court of Appeals in Atlanta, which in June 1999 reversed the trial judge's action and said the Randolph suit could move forward.

The appeals court ruled that Green Tree's failure to explain how any arbitration process would be paid for negated the company's ability to rely on the out-of-court practice. The company's omission raised the prospect of Ms. Randolph's rights being "undone by steep filing fees, steep arbitrators' fees, or other high costs of arbitration," the Eleventh Circuit said. The ruling stopped short of saying that a corporate defendant necessarily should pay such fees.

The appeals court rejected Green Tree's argument that it hadn't been obliged to specify who would pay for arbitration because ordinarily, an arbitrator apportions fees at a case's conclusion, based on a common-sense standard of fairness. The Eleventh Circuit didn't address the issues of the conspicuousness of the arbitration clause or the labeling of the insurance charge.

Ms. Randolph's attorneys point out that many consumer complaints involve small amounts of money. If individuals are forced to pay arbitration fees exceeding \$100 to vindicate a claim of \$15 or \$30, legitimate complaints will never get heard, the attorneys maintain.

Although arbitration is designed to offer simpler procedures than a trial, many consumers would still need the help of an attorney, and plaintiffs' lawyers' economic interests become a part of the equation. Mr. Jinks says that "no lawyer would undertake a fight" in which his out-of-pocket expenses would be greater than the potential winnings for his client. Arbitration clauses should be allowed in consumer contracts only if there is an opportunity for class-action arbitration, according to Ms.

Randolph's legal team. Class-action procedures, in which one or more plaintiffs represent the interests of others, have been used in some arbitration cases, according to the American Arbitration Association, a private group that provides arbitration services.

Mr. Huffaker, the Green Tree lawyer, says the Eleventh Circuit was mistaken to assume that his client's failure to specify who would pay for arbitration would lead to a "worst-case scenario" for consumers—meaning they would foot the entire bill. "In the real world," he adds, "we hold an arbitration, the decision is made and the arbitrator then apportions the fees as he deems equitable under the circumstance." Mr. Huffaker also says that the arbitration clause was sufficiently conspicuous in the Randolph mortgage.

Green Tree appealed to the U.S. Supreme Court, asking the justices to decide two narrow questions: Was the Eleventh Circuit correct in allowing Ms. Randolph to appeal the trial court's ruling before she actually went to arbitration? And was the

appeals court correct in ruling that the arbitration clause was unenforceable because it didn't make clear who would pay for the process?

Messrs. Jinks and McLanely raised the stakes by bringing in Mr. Sellers, a partner with Cohen, Milstein, Hausfeld & Toll, a Washington class-action powerhouse. In his brief, Mr. Sellers has asked the high court to address a third, broader issue: whether binding-arbitration clauses interfere with consumers' rights to resolve disputes through class-action suits.

The high court hasn't indicated how broadly it will frame the case. But the fact that Cohen Milstein, the plaintiffs' lawyers association and influential consumer groups had joined forces got business advocates' attention.

Ms. Conrad of the U.S. Chamber of Commerce put out the word that a suit once viewed as a procedural matter had blossomed into a major threat. "This involves the intersection of two issues," she says, "that are hugely important to the business community: class actions and arbitration."