

PRESERVING THE FEDERAL ARBITRATION ACT BY REINING IN JUDICIAL EXPANSION AND MANDATORY USE

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I. INTRODUCTION

A focus of this symposium issue on “Rethinking the Federal Arbitration Act” called upon arbitration scholars to consider whether the legal framework for arbitration set out in the Federal Arbitration Act (“FAA”) in 1925¹ appropriately addresses modern uses of arbitration. Professor Alan Rau has articulated his view, not unlike that of prominent arbitration providers and likely that of many corporate arbitration users, that “it would be far better if we were to leave the FAA completely alone.”² Professor Rau cogently argues that, over time, “courts are more likely than legislators to ‘get it right’”³ and warns of the dangers of unintended consequences that can arise, good intentions notwithstanding, with the “reform” or incremental tweaking of a federal statute.⁴

In reading the statute in its entirety and thinking about “what’s wrong with the FAA?,” the statute itself appears fairly innocuous—it provides for a *procedure* to enforce arbitration contracts and to confirm or vacate arbitration awards in U.S. (federal) courts.⁵ The purpose of the Act was to reverse judicial hostility towards arbitration and to ensure the judicial enforcement of parties’ agreements to arbitrate.⁶ That seems *fair enough*.

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¹ See 9 U.S.C. §§ 1-16 (2000). The FAA has not been significantly amended since its enactment in 1925. See, e.g., THOMAS E. CARBONNEAU, *ARBITRATION LAW AND PRACTICE* 52-53 (4th ed. 2007).

² Alan Scott Rau, *Federal Common Law and Arbitral Power*, 8 NEV. L.J. 169, 169 (2007). Representatives from AAA and JAMS were also in attendance at the Symposium, “Rethinking the Federal Arbitration Act: An Examination of Whether and How the Statute Should Be Amended,” held at the Saltman Center for Dispute Resolution at the William S. Boyd School of Law, University of Nevada, Las Vegas, on January 26, 2007. Eric Tuchman, General Counsel of the American Arbitration Association (“AAA”), and Jay Welsh, General Counsel of JAMS, commented in discussion that their respective institutions’ positions were, similar to Professor Rau’s, to leave the FAA alone.

³ Rau, *supra* note 2, at 169.

⁴ *Id.* at 170.

⁵ See *infra* Part III.

⁶ *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991); see also KATHERINE V.W. STONE, *PRIVATE JUSTICE: THE LAW OF ALTERNATIVE DISPUTE RESOLUTION* 375-78 (2000) (describing the historical background to the FAA); Margaret L. Moses, *Statutory Misconstruction: How the Supreme Court Created a Federal Arbitration Law Never Enacted by Congress*, 34 FLA. ST. U. L. REV. 99, 102-12 (2006) (urging that the FAA be viewed in historical context); Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court’s Preference for Binding Arbitration*, 74 WASH. U. L.Q. 637 (1996)

The impetus for the call to re-examine the FAA, however, may be explained by the policy concerns that arise from the application of a single statute, the FAA. Ostensibly designed to provide for the voluntary private adjudication of disputes, the FAA generates thousands of lawsuits,⁷ is vociferously challenged by consumer protection groups, widely criticized in scholarly articles, and is judicially determined to preempt and thus substantially restrict states' ability to enact legislation responsive to constituent concerns.⁸ Considering the statute's intended regard for the expediency of private adjudication, the magnitude of litigation that arises from contractual arbitration is ironic. Indeed, "[the] cries for court interference in the arbitration process are relatively common; so much so that cases submitted to arbitration often result in satellite litigation in the court system."⁹

One problem with the FAA has resulted largely from the common law; that is, how courts, led by the Supreme Court since the early 1980's, have broadly interpreted, and, arguably, *misinterpreted* the FAA as constituting a national policy favoring arbitration, and as a body of substantive law that preempts state law and that applies in state and federal courts to a broad range of statutory, employment, and consumer claims.¹⁰ Section 2 of the FAA, providing for the judicial enforcement of written agreements to arbitrate,¹¹ has

(extensively analyzing the evolution of FAA arbitration law and arguing that the Supreme Court's preference for mandatory binding arbitration lacks basis in legislative history).

⁷ See, e.g., Stephen K. Huber & E. Wendy Trachte-Huber, *Top Ten Developments in Arbitration in the 1990s*, DISP. RESOL. J., Nov. 2000-Jan. 2001, at 24, 30 (describing the explosion in consumer arbitration in a variety of areas including consumer purchases, service contracts, insurance, health-care, attorney-client disputes, and bank-customer agreements). On September 2, 2007, an on-line LexisNexis legal database search of the term "Federal Arbitration Act" that appeared in federal and state court decisions resulted in a showing of more than 3,000 cases.

⁸ See, e.g., Posting of Pam Smith to <http://www.peopleoverprofits.org/> (Nov. 7, 2005) (noting Consumer Attorneys of California opposition to mandatory arbitration). As Professor Stempel and others have documented, the new age of mass arbitration, among parties with disparate bargaining power, information access, economies of scale, and where consent is dubious, was certainly not the type of arbitration envisioned by the drafters in 1925. Jeffrey W. Stempel, *Keeping Arbitrations from Becoming Kangaroo Courts*, 8 NEV. L.J. 251, 251 (2007); see also Sternlight, *supra* note 6, at 641 ("Congress did not intend to enforce arbitration agreements that had to be foisted on ignorant consumers, and it did not intend to prevent states from protecting weaker parties.").

⁹ Vestax Sec. Corp. v. Desmond, 919 F. Supp. 1061, 1071 (E.D. Mich. 1995); see also Quinton F. Seamos, *Does Securities Arbitration Go on Forever? Eligibility and Statutes of Limitations*, INSIGHTS, May 1994, at 17 ("[A]rbitration is becoming the litigation battlefield that it was intended to avoid.").

¹⁰ Other scholars have written on these subjects and provided persuasive analyses of judicial misinterpretations of the FAA. See, e.g., Edward Brunet, *The Minimal Role of Federalism and State Law in Arbitration*, 8 NEV. L.J. 326 (2007); Thomas E. Carbonneau, *Arbitral Justice: The Demise of Due Process in American Law*, 70 TUL. L. REV. 1945, 1955-67 (1996); Moses, *supra* note 6; Larry J. Pittman, *The Federal Arbitration Act: The Supreme Court's Erroneous Statutory Interpretation, Stare Decisis, and a Proposal for Change*, 53 ALA. L. REV. 789 (2002); David S. Schwartz, *Correcting Federalism Mistakes in Statutory Interpretation: The Supreme Court and the Federal Arbitration Act*, 67 LAW & CONTEMP. PROBS. 5 (2004).

¹¹ 9 U.S.C. § 2 (2000) ("A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such con-

been judicially decreed tantamount as a license to anoint adhesion contracts requiring arbitration of a broad scope of claims, often in terms and forms far less favorable to parties of less bargaining power than those in a judicial forum.¹² If anything, the direction the common law has taken towards interpreting the application of this congressional arbitration statute has resulted in considerable controversy and consternation.¹³ Regrettably, this turn primarily affects those most in need of protection of their legal rights and fair process.

The criticisms with contemporary uses of arbitration, particularly manifest in the consumer and employment settings and when mandatory and binding, are being heard by state and federal lawmakers. The early efforts of the Montana legislature to address concerns of consumer surprise at having “agreed” to arbitration via a standard consumer transaction contract by a simple conspicuous notice requirement were quashed by the U.S. Supreme Court’s ruling that the FAA preempted state legislation deemed anti-arbitration.¹⁴ Similarly, the Supreme Court has declared broad FAA preemption over state legislation that imposes conditions upon arbitration or that has sought to ensure judicial resolution of certain types of claims and thereby excludes or restricts enforcement of arbitration agreements.¹⁵ In *Circuit City Stores, Inc. v. Adams*, the Court effectively shut down state regulatory efforts to restrict the arbitration of employment cases by reading, despite clear legislative intent otherwise, that the express exemption in section 1 of the FAA, which excludes “contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce,” applies only to transportation employees.¹⁶ Bound to follow this precedent, lower state and federal courts

tract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”)

¹² Justice Black, in dissenting to the majority’s announcement of the separability doctrine, asserted that the Court has regarded arbitration agreements as “super” contracts, “elevate[d] . . . above all other contractual provisions.” *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 411 (1967) (Black, J., dissenting). Although most consumer pre-dispute arbitration contracts are arguably not voluntary or the product of negotiation or consent, United States Supreme Court precedent holds that such mandatory arbitration contracts are enforceable, unless other contractual defenses (such as unconscionability, duress, or fraud) apply to negate the arbitration contract. *See, e.g., Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79 (2000).

¹³ *See, e.g., David S. Schwartz, Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33; Jean R. Sternlight, *Rethinking the Constitutionality of the Supreme Court’s Preference for Binding Arbitration: A Fresh Assessment of Jury Trial, Separation of Powers, and Due Process Concerns*, 72 TUL. L. REV. 1 (1997).

¹⁴ *Doctor’s Assocs., Inc. v. Casarotto*, 517 U.S. 681, 683 (1996) (quoting MONT. CODE ANN. § 27-5-114(4) (1995) (enforcing an agreement, under the FAA, preempting the state statute that required “[n]otice that [the] contract is subject to arbitration” . . . [and shall be] ‘typed in underlined capital letters on the first page of the contract’”).

¹⁵ *See Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995) (holding that the FAA preempts Alabama law denying enforcement of predispute arbitration contracts); *Southland Corp. v. Keating*, 465 U.S. 1 (1984) (declaring that the FAA preempts state legislation requiring judicial resolution of franchise disputes).

¹⁶ *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 109 (2001); *see, e.g., Moses, supra* note 6, at 105-06 (recounting legislative discussion that indicates FAA supporters did not intend the Act to apply to workers at all or to consumer transactions); *Pittman, supra* note 10, at 887 (asserting that “[t]he Court’s judicial economy rationale in support of [employment]

reject claimants seeking judicial recourse, even if provided for by state law or for claims arising under federal employment statutory laws.¹⁷

Given the preemptive effect accorded to the FAA, the ability of the states to enact protective legislation to ensure fairness in arbitration or access to the courts has been significantly, and unduly, limited.¹⁸ Nonetheless, state legislatures continue to grapple with how to protect potential abuses in arbitration via state legislation.¹⁹ In 2002, for example, the California Assembly undertook hearings to examine concerns of arbitration abuses. Although it could not directly ban consumer arbitration, the California legislature approved legislation regulating provider institutions and adopting detailed ethics and disclosure rules for arbitrators.²⁰

A comprehensive effort to examine arbitration law was conducted by the Drafting Committee for the Revised Uniform Arbitration Act (“RUAA”). Most state arbitration laws have been based upon the Uniform Arbitration Act (“UAA”), promulgated in 1955, which largely tracked the FAA.²¹ The impetus

arbitration is contrary to Congress’s intent which, unlike the Court’s intent, does not favor arbitration over court adjudication, and which through section 1’s exclusion sought to exempt from the FAA’s coverage all employees whose work affects interstate commerce”).

¹⁷ See, e.g., *S&G Elec., Inc. v. Normant Sec. Group, Inc.*, No. 06-3759, 2007 WL 210517 (E.D. Pa. Jan. 24, 2007) (ruling that the FAA preempts state law barring out of state arbitrations by subcontractors); *Shepard v. Edward Mackay Enters.*, 56 Cal. Rptr. 3d 326, 327 (Ct. App. Mar. 22, 2007) (holding that FAA preempts state statute barring arbitration of home construction disputes); *Bungard v. Rural Mut. Ins. Co.*, 537 N.W.2d 433 (Wis. Ct. App. 1995) (holding that, although fired employee whose employment contract required arbitration would have a right under the state arbitration statute to pursue his federal and state discrimination claims in court, court must compel arbitration under U.S. Supreme Court precedent in *Southland Corp. v. Keating* and *Gilmer v. Interstate/Johnson Lane Corp.*).

¹⁸ Although virtually every state has arbitration statutes, these statutes have largely adopted the form of the Uniform Arbitration Act of 1955. See RUAA, UNIFORM ARBITRATION ACT, prefatory note (revised 2000) (noting that as of 2000, “[f]orty-nine jurisdictions have arbitration statutes; 35 of these have adopted the UAA and 14 have adopted substantially similar legislation”). States have not been as eager to adopt the RUAA in its entirety. Since promulgation by NCUSL in 2000, the RUAA has been adopted in twelve states, and is pending passage in fourteen states. CARBONNEAU, *supra* note 1, at 89.

¹⁹ A number of states have attempted to outlaw mandatory employment arbitration. See, e.g., ARIZ. REV. STAT. ANN. § 12-1517 (2007) (restricting arbitration of employment claims); KAN. STAT. ANN. § 5-401(c)(2) (2006) (same); N.Y. GEN. BUS. LAW § 399-c (McKinney 2007) (prohibiting arbitration in consumer contracts). Under *Circuit City*, 532 U.S. 105, these laws are preempted by the FAA. See *supra* note 16.

²⁰ See CAL. CIV. PROC. CODE § 1281.92 (West 2007) (prohibiting providers from administering consumer arbitrations where the provider has a financial relationship with a party); *Id.* § 1281.96 (requiring publication of consumer arbitration information by providers); *Id.* § 1284.3 (prohibiting providers from administering arbitrations with loser-pay requirements); CAL. CT. R., ETHICS STANDARDS FOR NEUTRAL ARBITRATORS IN CONTRACTUAL ARBITRATION (2002).

²¹ RUAA, UNIFORM ARBITRATION ACT, prefatory note. Some have posited that this parallel legislation was intentional, such that the FAA was to apply to federal courts, while the UAA would apply as adopted by the states for enforcement of arbitration contracts in state courts. See *Moses*, *supra* note 6, at 101-02 (describing FAA drafters “three step plan” for promoting arbitration at state, federal, and international levels, via the UAA, FAA, and New York Convention, respectively). Under the Supreme Court’s rulings that the FAA was enacted pursuant to Congress’s commerce powers, the FAA is deemed to preempt conflicting state arbitration laws.

for the National Conference of Commissioners on Uniform State Laws (“NCCUSL”) to appoint a committee to consider revising the Act was due to the “increasing use of arbitration, the greater complexity of many disputes resolved by arbitration, and the developments of law in this area.”²² Cognizant of the Supreme Court’s preemption rulings, the RUAA drafters recognized their limitations in drafting state arbitration legislation to address policy issues regarding mandatory arbitration. Thus, the RUAA addresses largely procedural and arbitration management issues. As adopted, the RUAA addresses fourteen specific areas not addressed in the UAA (and therefore, the FAA).²³ Despite the concerted efforts of the RUAA drafters, the statute has not been received as the cure for arbitration’s ills.²⁴

Even with passage of the RUAA and bolder attempts at regulating state arbitration laws, state lawmakers, the courts, lawyers, and parties remain perplexed as to what they can do to respond to concerns of potential abuses in arbitration. Given the broad preemptive effect and construction accorded by the Supreme Court to the FAA, the states’ ability to enact protective measures is greatly hindered, or, as characterized, perhaps correctly albeit controversially, by Professor Rau, virtually “irrelevant.”²⁵

The tide in some courts is shifting, as courts must deal with challenges to contracts that require arbitration of claims between parties of disparate bargaining power and also increasingly to provisions that purport to waive (or ban) rights to class actions and legal remedies, and which essentially deprive parties of any fair forum at all.²⁶ While a judicial trend may eventually develop to address troubling application of the FAA, the penalty upon those who are caught now in the process is exacting. States and the courts have created laws to fill in many of the gaps not addressed by the FAA, but that results in a patchwork of varying laws, all operating under the specter of preemption. What is perhaps most disconcerting is that the broad and effectively unreviewable powers accorded to private arbitrators to determine “arbitrability” issues as

²² RUAA, UNIFORM ARBITRATION ACT, prefatory note.

²³ *Id.* Unlike the UAA, the RUAA contains provisions regarding a range of issues, including: arbitrability, provisional remedies, initiation of an arbitration proceeding, consolidation, arbitrator disclosures, arbitrator immunity, arbitrator testimony, prehearing management, arbitral remedies, waiver, subpoena power, vacatur, and notice standards.

²⁴ For example, the RUAA does not address issues regarding the enforceability of adhesion contracts in employment and consumer contexts. See CARBONNEAU, *supra* note 1, at 89 (criticizing the RUAA for addressing “a number of controversial developments in the law either by taking a side . . . or by determining that it should not take any action at all . . .”).

²⁵ Rau, *supra* note 2, at 176.

²⁶ See, e.g., *Ting v. AT&T*, 319 F.3d 1126 (9th Cir. 2003) (holding as unconscionable arbitration provision which, inter alia, limited remedies and eliminated class actions); *Hooters of Am., Inc. v. Phillips*, 173 F.3d 933 (4th Cir. 1999) (refusing to enforce arbitration process as too biased); *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669 (Cal. 2000) (voiding arbitration clause which limited recoverable damages as unconscionable); see CARBONNEAU, *supra* note 1 (noting the reluctance of a minority of courts, in particular in California, to enforce adhesionary arbitration contracts frequently voided on basis of unconscionability and lack of mutuality); see also *Nagrampa v. MailCoups, Inc.*, 469 F.3d 1257 (9th Cir. 2006) (en banc) (holding class action waiver provision unconscionable); *Kinkel v. Cingular Wireless LLC*, 857 N.E.2d 250 (Ill. 2006) (summarizing unconscionability rulings on class action waivers). *But cf.* *Muhammad v. County Bank of Rehoboth Beach, Del.*, 912 A.2d 88 (N.J. 2006) (class action waiver not per se unconscionable).

well as all legal rights of the parties and classes of claimants portends that the courts, and thus the public, may never see or know how arbitration issues are determined, or how parties in an arbitration are treated.²⁷

Absent an abrupt shift by the Supreme Court, only Congress has the power to prevent usurpation of the FAA and to preserve the FAA. Some in Congress are listening, and hopefully the contributions of this Symposium re-examining the FAA will further propel federal legislators to act. In the proposed Arbitration Fairness Act of 2007, recently introduced by Senator Russ Feingold (D-WI) and Representative Hank Johnson (D-GA), pre-dispute agreements to arbitrate employment, consumer, and franchise disputes are unenforceable.²⁸ Would this legislation cure the complaints about the FAA?

This Article considers the rationale for arbitration reform, as well as the arguments for no reform at all. Part II sets out the FAA's basic framework and discusses the Supreme Court decisions, which have arguably expanded the scope of the FAA and enabled a controversial use of modern arbitration. Part III considers specific proposals warranting congressional attention, including pending legislation under the proposed Arbitration Fairness Act of 2007. Part IV concludes in offering final thoughts for arbitration reform.

II. THE FEDERAL ARBITRATION ACT AND ITS JUDICIAL AFTERMATH

Much has been written about the FAA, its legislative history, and Supreme Court decisions giving broad construction to the FAA.²⁹ This section attempts only to set forth the basic elements of the statute, against the backdrop that the essential purpose of the FAA, substantially unchanged since 1925, was to provide for the enforcement of voluntary agreements to arbitrate.³⁰ Within this framework, key Supreme Court decisions interpreting the FAA are analyzed.

A. *The FAA Basics*

The basic provisions and operation of the FAA are relatively straightforward.

²⁷ Because of an expansive definition of "arbitrability," the scope of matters that are "arbitrable" is broad. In holding that courts are merely to decide whether the parties agreed to arbitrate and that all other matters are for the arbitrator, the Supreme Court has avoided ruling on controversial arbitration policy issues. *See, e.g.*, *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2006) (affirming the separability doctrine in ruling that arbitrators decide fraud challenges to the validity of a contract); *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444 (2003) (holding that the arbitrator decides, as a matter of contract interpretation, whether parties intended to forbid class arbitration and implicitly approving of class arbitration); *First Options of Chi., Inc. v. Kaplan*, 514 U.S. 938 (1995) (ruling that arbitrator should decide procedural defense of whether statute of limitations barred agreement); *see also* Alan S. Rau, *Arbitral Jurisdiction and the Dimensions of Consent*, *ARB. INT'L* (forthcoming 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1001708.

²⁸ *See infra* Part III.B.

²⁹ *See supra* notes 6 and 10.

³⁰ *See, e.g.*, *Moses, supra* note 6, at 102-12 (analyzing FAA legislative history and concluding that the drafters intended the FAA to provide for a procedure in federal courts for voluntary agreements, among merchants or parties of equivalent bargaining power, to arbitrate contractual disputes).

Section 1 of the Act sets out definitions for “maritime transactions,” “commerce,” and the “employment” exception (which the Court has interpreted as exempting only transportation industry employees).³¹ The heart of the statute lies in section 2, which provides for the validity and enforcement of written agreements to arbitration, “save upon such grounds as exist at law or in equity for the revocation of any contract.”³² Section 3 provides for a stay of any lawsuit brought “in any of the courts of the United States” where any issue therein is referable to arbitration.³³ Section 4 permits a party to an arbitration agreement to petition to U.S. district courts, otherwise having jurisdiction,³⁴ to compel arbitration.³⁵ Section 5 provides for the judicial appointment of an arbitrator or arbitrators where needed.³⁶ Section 6 provides that applications and motions pertaining to arbitration are heard in the same manner as court motions.³⁷ Under section 7, arbitrators are granted subpoena powers equivalent to a court of law.³⁸ Section 8 addresses maritime litigation.³⁹ Section 9 authorizes a party, within one year of entering the arbitral award, to seek judicial confirmation of the award, upon which a judgment of the award is decreed.⁴⁰ Section 10 specifies four grounds upon which a federal court may vacate an arbitral award.⁴¹ Section 11 permits courts to correct or modify awards con-

³¹ 9 U.S.C. § 1 (2000); *see* *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001).

³² 9 U.S.C. § 2.

³³ *Id.* § 3.

³⁴ Unlike any other federal statute, the FAA does not provide an independent basis for subject matter jurisdiction. Despite cogent arguments that this fact negates treatment for preemption, the Court has found FAA preemption is justified pursuant to Congress’s commerce power. *See* *Rules of Decision Act*, 28 U.S.C. § 1652 (2000); *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938); Pittman, *supra* note 10, at 792; Schwartz, *supra* note 10, at 7. *But cf.* Christopher R. Drahozal, *In Defense of Southland: Reexamining the Legislative History of the Federal Arbitration Act*, 78 NOTRE DAME L. REV. 101 (2002).

³⁵ 9 U.S.C. § 4.

³⁶ *Id.* § 5.

³⁷ *Id.* § 6.

³⁸ *Id.* § 7 (providing that “[t]he arbitrators . . . may summon . . . any person”) (emphasis added). The federal courts are divided on whether this section authorizes arbitrators to subpoena nonparties for prehearing discovery requests. *Compare* *Hay Group, Inc. v. E.B.S. Acquisition Corp.*, 360 F.3d 404 (3d Cir. 2004) (holding arbitrator lacked such authority), *with* *Stolt-Nielsen SA v. Celanese AG*, 430 F.3d 567 (2d Cir. 2005) (construing section 7 to authorize broad arbitral subpoena powers).

³⁹ 9 U.S.C. § 8.

⁴⁰ *Id.* § 9.

⁴¹ *Id.* § 10 (providing for vacatur of an arbitral award on the grounds of (1) fraud or undue means; (2) evident partiality; (3) arbitral misconduct in the proceedings; or (4) where the arbitrators exceeded their powers). The standard for vacatur is extremely high and relates to significant deficiencies in the arbitral process rather than to substantive errors on the merits. There is debate whether the statutory grounds for vacatur are exclusive; some courts recognize common law exceptions for awards in “manifest disregard of the law,” “contrary to public policy,” and by state statutes that provide additional grounds for vacatur. *See* *Wallace v. Buttar*, 378 F.3d 182 (2d Cir. 2004); RUA, UNIFORM ARBITRATION ACT, prefatory note (revised 2000). A related issue concerns a debate percolating before the Supreme Court as to whether parties may contract for increased (or limited) judicial review of arbitral awards. *See, e.g.,* *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*, 341 F.3d 987 (9th Cir. 2003) (enforcing provision). The Supreme Court has agreed to decide if parties can contract for expanded judicial review. *See* *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 196 F. App’x 476 (9th Cir. 2006), *cert. granted*, 127 S. Ct. 2875 (2007).

taining evident formalistic or technical errors.⁴² Under section 12, notice of motions to vacate or modify awards must be made within three months after the award is filed.⁴³ Section 13 sets forth administrative requirements for filing papers with motions seeking relief under the Act.⁴⁴ Section 14 clarifies that the Act was not retroactive to 1926.⁴⁵ Section 15 speaks to the “[i]napplicability of the Act of State doctrine.”⁴⁶ Finally, section 16 provides for a right of interlocutory appeals that may be taken from orders essentially denying arbitration.⁴⁷

The foregoing provisions do not appear particularly problematic. In essence, the FAA provides for a procedure for the judicial enforcement of agreements to arbitrate. Granted, the statute does not address the plethora of policy, legal, and practical issues that have arisen as a result of the FAA’s provision for arbitration. Should it? Are the courts doing their job by appropriately interpreting the statute consistent with the purpose of the law?

B. *FAA Expansion via Judicial Construction*

A number of commentators have argued that the need for FAA reform is driven by Supreme Court jurisprudence that misinterprets the FAA, expands the FAA beyond its intended application, and thus has enabled a use and industry for mandatory arbitration that was never envisioned.⁴⁸ The “findings” section of the proposed Arbitration Fairness Act of 2007 echoes this sentiment, providing:

- (1) The Federal Arbitration Act (now enacted as chapter 1 of title 9 of the United States Code) was intended to apply to disputes between commercial entities of generally similar sophistication and bargaining power.
- (2) A series of United States Supreme Court decisions have changed the meaning of the Act so that it now extends to disputes between parties of greatly disparate economic power, such as consumer disputes and employment disputes. As a result, a large and rapidly growing number of corporations are requiring millions of consumers and employees to give up their right to have disputes resolved by a judge or jury, and instead submit their claims to binding arbitration.⁴⁹

Although the Supreme Court was initially reluctant to interpret the FAA expansively,⁵⁰ this judicial hostility towards arbitration turned to an apparent infatuation. In subsequent decisions, the Court announced that the FAA estab-

⁴² 9 U.S.C. § 11.

⁴³ *Id.* § 12.

⁴⁴ *Id.* § 13.

⁴⁵ *Id.* § 14.

⁴⁶ *Id.* § 15; see CARBONNEAU, *supra* note 1, at 80-81 (explaining that the section is “inappositely situated in the domestic section of U.S. law of arbitration,” and clarifying that “the Act of State doctrine, although it could preclude the enforcement of an ordinary judicial judgment, cannot be used to challenge a judicial judgment that provides for the enforcement of an arbitral award”).

⁴⁷ 9 U.S.C. § 16; see CARBONNEAU, *supra* note 1, at 82 (explaining that the section, added in 1988, authorizes interlocutory appeal that exists against court orders antagonistic to the pursuit of arbitration, such as an order refusing to stay litigation or to compel arbitration).

⁴⁸ See *supra* notes 6 and 13.

⁴⁹ Arbitration Fairness Act of 2007, S. 1782, 110th Cong. § 2(1)(2) (2007).

⁵⁰ *Wilko v. Swan*, 346 U.S. 427, 437 (1953) (noting that the purpose of the Securities Act was to protect investors and thus holding that the Act prohibits a waiver of a judicial remedy by a pre-dispute arbitration agreement), *overruled by* *Rodriguez de Quijas v. Shearson/Am.*

lished a “national policy favoring arbitration.”⁵¹ Based upon this policy and the FAA’s text, the Court has determined the FAA’s preeminence over state law,⁵² declared the statute applicable in state courts,⁵³ and upheld the enforcement of mandatory pre-dispute arbitration agreements in a variety of contexts, including for the private adjudication of statutory and common law claims in employment and consumer transactions.⁵⁴ This endorsement of contractual arbitration triggered an exponential growth in the use of arbitration beyond the commercial context to adhesion contracts in employment and consumer cases. “[G]eneralized attacks” about potential unfairness in arbitration, however, are not deemed sufficient to permit escape from the arbitration obligation.⁵⁵

III. THOUGHTS FOR REFORM

A. Correct Judicial Misinterpretations Expanding the FAA

The questionable Supreme Court precedent attributable to the call for FAA reform can be classified into three areas: (1) the preemption rulings; (2) the narrow reading of the section 1 employment exception in *Circuit City v. Adams*;⁵⁶ and (3) the enforcement of arbitration contracts that are not realistically voluntary.⁵⁷ In analyzing areas for FAA reform (or preservation), the following identifies the central Supreme Court decisions or issues that warrant statutory reconsideration.

1. *Say Southland Corp. v. Keating Is Wrong (and Return Power to the States)*

The controversial determination that the FAA preempts conflicting state law can be traced to *Southland v. Keating*.⁵⁸ In *Southland*, the Supreme Court

Express, Inc., 490 U.S. 477, 481 (1989) (relying on the federal policy of favoring arbitration in reversing *Wilko* and holding that securities claims are arbitrable).

⁵¹ See, e.g., *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991) (citing federal policy favoring arbitration in ruling that federal age discrimination claims are arbitrable).

⁵² *Southland Corp. v. Keating*, 465 U.S. 1 (1984); see *infra* Part III.A.

⁵³ Because the FAA does not provide an independent basis for federal subject matter jurisdiction, in practice many claims concerning arbitration are heard by state courts, which must determine whether to apply the FAA (which only speaks to federal courts) and/or state arbitration laws. See *Southland*, 465 U.S. 1.

⁵⁴ *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001) (holding that statutory claims are also subject to a pre-employment arbitration agreement contained in an employment application); *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79 (2000) (requiring arbitration of consumer statutory claims).

⁵⁵ *Gilmer*, 500 U.S. at 30. Claims by the plaintiff in *Gilmer* that compulsory arbitration of statutory discrimination claims is inconsistent with the statutory framework, that it deprives claimants of a judicial forum, that panels will be biased, that discovery is limited, and that effective review is unavailable, were deemed “generalized attacks” insufficient to preclude enforcement of arbitration agreements, despite the parties’ unequal bargaining power. *Id.* at 27-31.

⁵⁶ *Circuit City*, 532 U.S. 105.

⁵⁷ This list is obviously not exhaustive or represented as new or provocative. But a re-examination of the FAA should consider that a critical mass of scholarly criticism and cries from affected litigants and the public challenge arbitration on these grounds. See, e.g., Jean R. Sternlight, *Creeping Mandatory Arbitration: Is it Just?*, 57 STAN. L. REV. 1631 (2005).

⁵⁸ *Southland*, 465 U.S. at 10.

held that the FAA preempted the California Franchise Investment Law, which required judicial adjudication of claims brought under the state statute. The Court announced that “[i]n creating a substantive rule applicable in state as well as federal courts, Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements.” In short, *Southland* and its progeny establish that the FAA is an exercise of Congress’s commerce power, preempts conflicting state law, and applies in state and federal courts, despite the fact that the Act’s text is directed to the federal courts presumably as a procedural statute and does not provide an independent basis for federal subject matter jurisdiction.⁵⁹

A number of Justices are highly critical of the decision that the FAA is a substantive provision applicable in state courts and concede that the preemption rationale set forth in *Southland* is erroneous.⁶⁰ Over ten years later, Justices Scalia and Thomas remain ardently opposed to the ruling that the FAA applies in state courts.⁶¹ According to Justice Scalia, “Adhering to *Southland* entails a permanent unauthorized eviction of state-court power to adjudicate a potentially large class of disputes.”⁶²

A legislative correction of *Southland*⁶³ and a declaration that the FAA applies only to the federal courts would realign the statute to comport with its intended scope and with federalism principles regarding the function of the states.⁶⁴ Granted, such a move would involve a significant unraveling of precedent.⁶⁵ Although the preemption rationale under *Southland* remains dubious, FAA preemption has been justified under the Commerce Clause (if not simply engrained as *stare decisis*).⁶⁶ And it may make sense, in a national and global economy, to have a uniform federal law that governs arbitration agreements.⁶⁷

⁵⁹ See also *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265 (1995) (affirming *Southland*’s federalism policy); *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213 (1985).

⁶⁰ See *Southland*, 465 U.S. at 21-36 (O’Connor, J., dissenting) (explaining that the Court’s analysis is inconsistent with FAA legislative history, as well as the mandates that Congress cannot regulate procedures in state courts under *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938), and the Rules of Decision Act, 28 U.S.C. § 1652).

⁶¹ *Allied-Bruce*, 513 U.S. at 284 (1995) (Scalia, J., dissenting) (“For the reasons set forth in Justice Thomas’ opinion, which I join, I agree with the respondents (and belatedly with Justice O’Connor) that *Southland* clearly misconstrued the Federal Arbitration Act. I do not believe that proper application of *stare decisis* prevents correction of a mistake.”).

⁶² *Id.* at 284-85.

⁶³ Professor Schwartz has quite convincingly demonstrated the failings of the *Southland* decision. Schwartz, *supra* note 10, at 54. *But cf.* Drahozal, *supra* note 34, at 105.

⁶⁴ See, e.g., Schwartz, *supra* note 10, at 15.

⁶⁵ The FAA preemption doctrine has become entrenched *stare decisis* and accepted as precedent, notwithstanding objections to the rationale in *Southland*. See *Allied-Bruce*, 513 U.S. at 282-84 (O’Connor, J., concurring). Justice Thomas does not view overruling *Southland* as problematic. *Id.* at 286 (Thomas, J., dissenting).

⁶⁶ See Moses, *supra* note 6, at 109 (describing statement of Julius Cohen, drafter of FAA in 1925 legislative hearings as testifying that “Congress probably does have ‘ample power to declare that all arbitration agreements connected with interstate commerce . . . as valid and enforceable even by the State courts’”).

⁶⁷ Despite protestations, Justice O’Connor acquiesces with the majority’s ruling that the FAA applies in state courts: “In the end, my agreement with the Court’s construction of § 2 rests largely on the wisdom of maintaining a uniform standard.” See *Allied-Bruce*, 513 U.S. at 282 (O’Connor, J., concurring).

If the FAA is a substantive law, based on Congress's commerce power, and if state courts are to apply the FAA, then an amended FAA should (1) omit references to "United States" courts in enforcement sections of the Act; (2) define the scope of the FAA by providing an objective standard for determining when a transaction "involves interstate commerce" so that state courts know when to apply the FAA or state arbitration law; and (3) clarify matters that remain within state purview to regulate.⁶⁸

2. *Say Circuit City Stores, Inc. v. Adams Is Wrong (and Preserve the FAA's Employment Exception)*⁶⁹

Under section 1, the FAA shall not "apply to contracts of employment of seamen, railroad employees, or *any other class of workers* engaged in foreign or interstate commerce."⁷⁰ A plain reading, whether reinforced by consistent legislative history or not, should find this to mean that employment (like labor) contracts are not subject to the FAA.⁷¹ The Court in *Circuit City* found the reading of this text an "insurmountable textual obstacle,"⁷² although refusing to consider legislative history, and concluded that the employment exception was to be narrowly construed to except only workers directly involved in the interstate transport of goods and services.⁷³ An amended FAA can clarify what plain reading and legislative history confirm: that the FAA does not apply to employment contracts. The magnitude of litigation over employment arbitration, the arbitration of statutory rights, and charges of unconscionable arbitration practices should underscore the need to address this area.⁷⁴

3. *Consider a Specific Exception or Due Process Treatment for Mandatory Arbitration of Employment and Consumer Statutory Claims*

As many of the unfairness claims derive from the FAA's application to arbitration required by adhesion contracts in employment and consumer cases, an amended FAA should consider an explicit exception for arbitration that is effectively mandatory and that involves the adjudication of consumer and employee statutory claims.⁷⁵ It is particularly problematic for the statutory

⁶⁸ Such amendments would clarify the ambiguities raised in cases such as *Allied Bruce* as well as assist state lawmakers and the courts in understanding the role of state regulation.

⁶⁹ *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001) (holding that the exclusion applies only to contracts of workers directly involved in the interstate transport of goods and services).

⁷⁰ 9 U.S.C. § 1 (2000) (emphasis added).

⁷¹ See *Moses*, *supra* note 6, at 108.

⁷² *Circuit City*, 532 U.S. at 114.

⁷³ *Id.* at 118-19; see also *Moses*, *supra* note 6, at 110, 147-48 (describing legislative history and Court's refusal to consider it).

⁷⁴ See, e.g., *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79 (2000) (rejecting employee's complaint of prohibitively high arbitration costs); *Circuit City Stores, Inc. v. Mantor*, 335 F.3d 1101 (9th Cir. 2003) (finding arbitration agreement unconscionable); *Ingle v. Circuit City Stores, Inc.* 328 F.3d 1165, 1176 (9th Cir. 2003) (same); see also *Moses*, *supra* note 6, at 146-52 (criticizing *Circuit City v. Adams*).

⁷⁵ The proposed Arbitration Fairness Act of 2007 does exempt consumer, employment, and franchise pre-dispute arbitration contracts. See *infra* Part IV.

rights of consumers and employees to be decided in arbitration. The protective function that statutes are designed to serve cannot be adequately assured in a process which lacks transparency, accountability, or review.⁷⁶

Absent a blanket exclusion, an amended FAA should consider a separate provision for the treatment of employment and consumer arbitrations, where higher levels of procedural protection or review may be warranted.⁷⁷ For one, the Act should make unenforceable arbitration contracts that seek to limit an employee or consumer's right to statutory remedies.⁷⁸ Moreover, the lack of process protections, coupled with the narrow grounds for reviewing or vacating an arbitral award, while helpful to ensure finality, pose a significant risk that the rights of those most in need of protection are disregarded. Accordingly, the Act should provide for due process protocols specific to employment and consumer arbitrations.⁷⁹

An amended FAA must also address the availability and treatment of class actions and class arbitrations, specifically the practice in contracts that purport to ban or waive a party's right to proceed collectively, whether in a class action or a class arbitration.⁸⁰ An adhesive, pre-dispute agreement to arbitrate should not be the means to eviscerate a vital procedural vehicle. As noted by the Eleventh Circuit Court of Appeals, "Corporations should not be permitted to use class action waivers as a means to exculpate themselves from liability for small-value claims."⁸¹ If class arbitration is deemed appropriate under the FAA, the statute should set forth parameters for class arbitration to ensure consistency in administration and due process protection for all class members.⁸²

⁷⁶ See Maureen A. Weston, *Reexamining Arbitral Immunity in an Age of Mandatory and Professional Arbitration*, 88 MINN. L. REV. 449 (2004).

⁷⁷ For example, California has specific rules relating to consumer arbitrations. See *supra* note 20.

⁷⁸ See *Kristian v. Comcast Corp.*, 446 F.3d 25 (1st Cir. 2006); David S. Schwartz, *Understanding Remedy-Stripping Arbitration Clauses: Validity, Arbitrability, and Preclusion Principles*, 38 U.S.F. L. REV. 49, 58 (2003).

⁷⁹ Due Process protocols for consumer and employment arbitrations have been promulgated and adopted by respected arbitration provider institutions; however, compliance in non-sponsored arbitrations is not guaranteed. See, e.g., AM. ARBITRATION ASS'N, CONSUMER DUE PROCESS PROTOCOL (1998), available at <http://www.adr.org/sp.asp?id=22019>; AM. ARBITRATION ASS'N, EMPLOYMENT DUE PROCESS PROTOCOL (1995), available at <http://www.adr.org/sp.asp?id=28535>.

⁸⁰ See, e.g., Jean R. Sternlight & Elizabeth J. Jensen, *Using Arbitration To Eliminate Consumer Class Actions: Efficient Business Practice or Unconscionable Abuse?*, 67 LAW & CONTEMP. PROBS. 75 (2004). Courts have differed over the highly litigated question of whether express bans on class actions contained in consumer arbitration agreements are enforceable under the FAA or subject to state contract law defenses such as unconscionability or contrary to public policy. Recent cases refusing to enforce class action waivers in consumer arbitration clauses include *Dale v. Comcast Corp.*, 498 F.3d 1216 (11th Cir. 2007); *Shroyer v. New Cingular Wireless Services, Inc.*, 498 F.3d 976 (9th Cir. 2007); and *Gentry v. Superior Court*, 165 P.3d 556 (Cal. 2007) (holding, in a 4-3 ruling, the class action waiver in Circuit City agreement invalid under California law).

⁸¹ *Dale*, 498 F.3d at 1224.

⁸² See, e.g., Maureen A. Weston, *Universes Colliding: The Constitutional Implications of Arbitral Class Actions*, 47 WM & MARY L. REV. 1711, 1717 (2006).

B. Proposals Under the Arbitration Fairness Act of 2007

As the criticisms of mandatory arbitration have mounted, some members of Congress are listening. Although a number of bills have been introduced in Congress to prohibit use of mandatory arbitration in particular areas, to date the only such bill passed by Congress denies enforceability of arbitration provisions in contracts imposed by automobile manufacturers on dealer/franchisees.⁸³

On July 12, 2007, a bill seeking to amend the FAA entitled the “Arbitration Fairness Act of 2007,” was introduced in both the House of Representatives and the Senate.⁸⁴ The proposed Act would prohibit enforcement of predispute arbitration agreements in employment, consumer, and franchise cases.

The Findings section of the proposed Act is particularly tuned into the concerns of mandatory consumer arbitration and critical of Supreme Court rulings that have “extend[ed the reach of the FAA] to disputes between parties of greatly disparate economic power.”⁸⁵ It adds that “[a]s a result, a large and rapidly growing number of corporations are requiring millions of consumers and employees to give up their right to have disputes resolved by a judge or jury, and instead submit their claims to binding arbitration.”⁸⁶ The bill further states:

[M]ost consumers and employees have little or no meaningful option whether to submit their claims to arbitration. Few people realize, or understand the importance of the deliberately fine print that strips them of rights; and because entire industries are adopting these clauses, people increasingly have no choice but to accept them. They must often give up their rights as a condition of having a job, getting necessary medical care, buying a car, opening a bank account, getting a credit card, and the like. Often times, they are not even aware that they have given up their rights.⁸⁷

According to the bill, mandatory arbitration undermines the development of public law for protecting civil rights and consumer rights due to its lack of transparency and of meaningful judicial review of arbitrators’ decisions.⁸⁸ In addition, “[w]hile the American civil justice system features publicly accountable decision makers who generally issue written decisions that are widely available to the public, arbitration offers none of these features.”⁸⁹

The primary impact of the bill would amend section 2 of the FAA to provide:

- (b) No predispute arbitration agreement shall be valid or enforceable if it requires arbitration of—
- (1) an employment, consumer, or franchise dispute; or

⁸³ Motor Vehicle Franchise Contract Arbitration Fairness Act of 2001, Pub. L. No. 107-273, § 11028, 116 Stat. 1758, 1835-36 (2002) (codified at 15 U.S.C. § 1226).

⁸⁴ Arbitration Fairness Act of 2007, S. 1782, 110th Cong. (2007).

⁸⁵ *Id.* § 2(2).

⁸⁶ *Id.*

⁸⁷ *Id.* § 2(3).

⁸⁸ *Id.* § 2(5) (further providing “[w]ith the knowledge that their rulings will not be seriously examined by a court applying current law, arbitrators enjoy near complete freedom to ignore the law and even their own rules”).

⁸⁹ *Id.* § 2(6).

(2) a dispute arising under any statute intended to protect civil rights or to regulate contracts or transactions between parties of unequal bargaining power.⁹⁰

This proposed legislation certainly has the support of consumer advocates. To some, this bill would “preserve the integrity of arbitration and restore the original intent of the FAA.”⁹¹

IV. CONCLUSION

The use of arbitration has changed significantly since the FAA’s inception in 1925, from the traditional model involving voluntary arbitration between parties of relatively equal bargaining power, to a system where arbitration is imposed upon consumers and employees and where arbitration has become a profession and commercialized industry. Meanwhile, a significant body of federal and state law, both statutory and common, has since developed to protect civil rights, market competition, employees, and consumers. Congress should be concerned that these rights are being adjudicated, if at all, in a forum not necessarily of both parties’ volition. If we accept that the FAA is a substantive law, based on Congress’s commerce power, and agree that state courts are to apply the FAA, then at a minimum, an amended FAA should provide more guidance on significant issues that have arisen since 1925, particularly those relating to consumer and statutory claims.⁹²

Legislative change, such as that proposed herein and in the Arbitration Fairness Act of 2007, if passed, would radically change the current landscape of corporate uses of arbitration provisions in contracts with employees, consumers, and franchisees. As a practical matter, the supporters of arbitration status quo may be more mobilized to convince federal lawmakers that the FAA is alright as is.

A saving grace in Supreme Court arbitration jurisprudence has been its assurance that, by agreeing to arbitrate, parties do not agree to forego their substantive rights.⁹³ But a fair process is inextricably tied to one’s ability to vindicate substantive rights. Granted, a statute cannot, and need not, provide a level of detail to address or anticipate all issues that may arise. But where a federal statute is interpreted and used to authorize arbitration practices that raise questions of fairness and a potential deprivation of public rights, congressional attention is warranted.

⁹⁰ *Id.* § 4 (“An issue as to whether this chapter applies to an arbitration agreement shall be determined by Federal law. Except as otherwise provided in this chapter, the validity or enforceability of an agreement to arbitrate shall be determined by the court, rather than the arbitrator, irrespective of whether the party resisting arbitration challenges the arbitration agreement specifically or in conjunction with other terms of the contract containing such agreement.”).

⁹¹ Justin Kelly, *Bills to Limit Pre-Dispute Arbitration Under FAA Before Congress*, ADR World.com, July 17, 2007, <http://adrworld.com/sp.asp?id=41281> (registration required) (quoting attorney Cliff Palefsky).

⁹² See Weston, *supra* note 82.

⁹³ See *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991) (By “agreeing to arbitrate a statutory claim, a party does not forego the substantive rights afforded by the statute; it only submits their resolution in an arbitral, rather than a judicial, forum.” (citation omitted)).

If anything, the FAA should return to its roots and require informed and voluntary “consent” to arbitration.⁹⁴ Then, freedom to contract would have meaning and arbitration legitimacy.

⁹⁴ See Andrew M. Kepper, *Contractual Waiver of Seventh Amendment Rights: Using the Public Rights Doctrine to Justify a Higher Standard of Waiver for Jury-Waiver Clauses than for Arbitration Clauses*, 91 IOWA L. REV. 1345 (2006); Jeremy Senderowicz, *Consumer Arbitration and Freedom of Contract: A Proposal to Facilitate Consumers’ Informed Consent to Arbitration Clauses in Form Contracts*, 32 COLUM. J.L. & SOC. PROBS. 275, 296-99 (1999); Jean R. Sternlight, *Gateway Widens Doorway to Imposing Unfair Binding Arbitration on Consumers*, FLA. B.J., Nov. 1997, at 8, 10, 12.