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# PANACEA OR CORPORATE TOOL?: DEBUNKING THE SUPREME COURT'S PREFERENCE FOR BINDING ARBITRATION

JEAN R. STERNLIGHT\*

## I. INTRODUCTION: ATTENTION ALL CONSUMERS, EMPLOYEES, FRANCHISEES, AND "LITTLE GUYS"<sup>1</sup>

The next time that you try to file a lawsuit against a big company you may well find the door of the courthouse has been barred. Large companies such as banks, hospitals, brokerage houses and even pest exterminators are increasingly including mandatory binding arbitration clauses in the fine print contracts they require all customers, employees, franchisees and other little guys to sign.<sup>2</sup> While legal commentators are beginning to take note of such clauses,<sup>3</sup> the general public remains quite unaware of the importance of such

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1. As used in this Article the term "little guy" is gender neutral and refers to small companies as well as humans.

2. See, e.g., *Allied-Bruce Terminix Cos. v. Dobson*, 115 S. Ct. 834 (1995) (requiring consumer who sought to sue termite exterminator for breach of contract to arbitrate claim); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991) (requiring employee who had signed arbitration agreement in connection with registering as a securities representative to arbitrate age discrimination claim). In fact, binding arbitration has been imposed on consumers who were merely notified that arbitration would be required but never signed a single document. *Badie v. Bank of Am.*, No. 94496, 1994 WL 660730 (Cal. Super. Ct. Nov. 22, 1994).

3. See, e.g., Mark E. Budnitz, *Arbitration of Disputes Between Consumers and Financial Institutions: A Serious Threat to Consumer Protection*, 10 OHIO ST. J. ON DISP. RESOL. 267 (1995); Thomas E. Carbonneau, *Arbitral Justice: The Demise of Due Process in American Law*, 70 TUL. L. REV. 1945 (1996); Robert A. Gorman, *The Gilmer Decision and the Private Arbitration of Public-Law Disputes*, 3 U. ILL. L. REV. 635 (1995) (focusing particularly on employment disputes); Norman S. Poser, *When ADR Eclipses Litigation: The Brave New World of Securities Arbitration*, 59 BROOK. L. REV. 1095 (1993); G. Richard Shell, *ERISA and Other Federal Employment Statutes: When Is Commercial Arbitration an "Adequate Substitute" for the Courts?*, 68 TEX. L. REV. 509 (1990); Lloyd N. Shields, *The Role of Mandatory Arbitration for Financial Institutions*, 46 ARB. J., Dec. 1991, at 49; N. Sue Van Sant Palmer, Comment, *Lender Liability and Arbitration: Preserving the Fabric of Relationship*, 42 VAND. L. REV. 947 (1989). See generally *Business Law Symposium, Commercial*

agreements. Yet, from a practical standpoint, the arbitration clauses are crucial in that they not only bar judicial relief but also may allow companies to select the arbitrators,<sup>4</sup> set the arbitration in a location convenient for the company but not for the little guy,<sup>5</sup> exclude certain recoveries such as punitive damages,<sup>6</sup> shorten the statute of limitations,<sup>7</sup> deny discovery and other procedural protections,<sup>8</sup> and eliminate virtually any right to appeal.<sup>9</sup>

Nor are courts rushing to protect consumers and other little guys from these mandatory arbitration clauses. Instead, the Supreme Court itself is leading the revolutionary transition from litigation to mandatory binding private arbitration, proclaiming "federal policy favors arbitration, over litigation."<sup>10</sup> Despite consumers' and other little guys' protests that they were

*Arbitration: A Discussion of Recent Developments and Trends*, 31 WAKE FOREST L. REV. 1 (1996) (examining securities, medical malpractice and employment arbitration).

4. See Shell, *supra* note 3, at 534-40 (claims against securities brokerage houses arbitrated by persons associated with securities industry).

5. See, e.g., *Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer*, 115 S. Ct. 2322 (1995) (requiring U.S. fruit grower to arbitrate dispute in Japan); *Doctor's Assocs., Inc. v. Stuart*, 85 F.3d 975, 979 (2d Cir. 1996) (refusing to void arbitration clause that required Illinois Franchisee to travel to Connecticut for arbitration); *Casarotto v. Lombardi*, 901 P.2d 596, 597 (1995) (rejecting on other grounds arbitration clause requiring Subway sandwich shop franchisee in Great Falls, Montana to arbitrate all disputes in Bridgeport, Connecticut), *rev'd sub. nom.*, *Doctor's Assocs., Inc. v. Casarotto*, 116 S. Ct. 1652 (1996). See generally Edward A. Purcell, Jr., *Geography As A Litigation Weapon: Consumers, Forum-Selection Clauses, and the Rehnquist Court*, 40 UCLA L. REV. 423 (1992).

6. See, e.g., *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212, 1216 (1995) (holding that parties to arbitration agreement may determine whether or not they wish to provide arbitrators with power to award punitive damages); *DeGaetano v. Smith Barney, Inc.*, No. 95 Civ. 1613, 1996 WL 44226 (S.D.N.Y. Feb. 5, 1996) (requiring employee to arbitrate Title VII sex discrimination claim against employer even though arbitration agreement precluded employee from obtaining attorney's fees, punitive damages or injunctive relief).

7. See, e.g., *Graham Oil Co. v. ARCO Prods. Co.*, 43 F.3d 1244 (9th Cir. 1994) (invalidating arbitration clause that purported to waive longer statute of limitations as inconsistent with particular statute under which claim was brought but implying that such waivers might be valid under other statutes), *cert. denied*, 116 S. Ct. 275 (1995).

8. See, e.g., *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991) (upholding mandatory arbitration of employee's suit under federal age discrimination law even though discovery provided in arbitration was more limited than that available in court).

9. Pursuant to the Federal Arbitration Act, 9 U.S.C. § 10 (1994), an arbitral award may only be vacated upon a showing of narrow grounds: that it was obtained by corruption or fraud; that the arbitrator was partial; that the arbitrator's procedural misconduct substantially prejudiced a party's rights; or that the arbitrator so exceeded her power as to negate the award. Courts have interpreted these grounds extremely narrowly and virtually never reverse arbitral decisions. See generally IAN R. MACNEIL ET AL., *FEDERAL ARBITRATION LAW: AGREEMENTS, AWARDS AND REMEDIES UNDER THE FEDERAL ARBITRATION ACT* § 40.1.4 (1994).

10. See, e.g., *Mastrobuono*, 115 S. Ct. at 1215-16; *Gilmer*, 500 U.S. at 26; *Rodriguez de Quijas v. Shearson/Am. Express Inc.*, 490 U.S. 477, 481 (1989); *Volt Info. Sciences Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 475-76 (1989); *Perry v. Thomas*, 482 U.S. 483, 489-90 (1987); *Shearson/Am. Express Inc. v. McMahon*, 482 U.S. 220, 226 (1987); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625 (1985); *Southland v. Keating*, 465 U.S. 1, 10

unaware they were signing away their day in court, courts are upholding the clauses on the ground that Congress has declared arbitration the preferred method of dispute resolution.<sup>11</sup>

The Court's enunciated preference for binding arbitration over litigation in the commercial area takes several forms, all purportedly based on the 1925 Federal Arbitration Act ("FAA").<sup>12</sup> First, the Court has held that where parties have entered a contract that may or may not call for arbitration of a particular issue, any such ambiguity is to be construed in favor of arbitration rather than litigation.<sup>13</sup> Second, it has stated that where a party seeks to avoid being

(1984); *Moses H. Cone Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983).

11. Sidestepping potential constitutional concerns, courts have shown little sympathy for parties who claim they did not see, read, or understand the arbitration provision. *E.g.*, *Pierson v. Dean Witter Reynolds*, 742 F.2d 334, 339 (7th Cir. 1984) (reversing district court decision voiding arbitration clause and observing that even if plaintiffs did not read or understand the clause they should have done so); *McCarthy v. Providential Corp.*, No. C94-0627 FMS, 1994 WL 387852 (N.D. Cal. July 19, 1994) (requiring senior citizens who signed arbitration clauses in connection with deeding over homes to obtain reverse mortgage loans to arbitrate claims for violation of Federal Truth in Lending Act). The *McCarthy* court stated:

Contrary to plaintiffs' assertions, it does not take a "clairvoyant" to understand the meaning of the clause. Regrettably, plaintiffs' assumption of loans without understanding all of the terms of the contract may represent the norm and not the exception. This failure to inquire, however, will not shield them from obligations clearly and explicitly contained in the agreement.

*Id.* at 5.

A strong argument can however be made that the Supreme Court's application of the expressed preference for binding arbitration over litigation deprives persons of their jury trial right under the Seventh Amendment, their right to a "impartial judge under Article III, and their due process" rights under the Fifth and Fourteenth Amendments. *See generally* 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* (Sept. 1996) (unpublished manuscript on file with author); *see also* Lewis Maltby, *Paradise Lost—How the Gilmer Court Lost the Opportunity for Alternative Dispute Resolution to Improve Civil Rights*, 12 N.Y. L. SCH. J. HUM. RTS. 1 (1994) (arguing for imposition of minimum due process standards pursuant to the FAA).

12. Act of Feb. 12, 1925, ch. 213, 43 Stat. 883 (1925) (current version codified at 9 U.S.C. §§ 1-208 (1994)). The Act, originally known primarily as the U.S. Arbitration Act, increasingly came to be known as the Federal Arbitration Act following Congress' deletion in 1947 of the section naming the statute the USAA. IAN R. MACNEIL, *AMERICAN ARBITRATION LAW: REFORMATION, NATIONALIZATION, INTERNATIONALIZATION* 231 n.48 (1992).

13. *Moses H. Cone*, 460 U.S. at 24-25 ("[Q]uestions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration. . . . The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration. . . ."); *see also* *Armijo v. Prudential Ins. Co.*, 72 F.3d 793, 798 (10th Cir. 1995) ("Notwithstanding the ambiguity of [the arbitration provision] . . . (or perhaps more correctly, because of such ambiguity), we conclude that the most appropriate construction . . . is to apply its arbitration provisions to employment disputes involving these Plaintiffs.").

The Court has also recently relied on the policy favoring arbitration to reject arguments that claims under certain federal statutes should be non-arbitrable as a matter of public policy. *E.g.*, *Gilmer*, 500 U.S. 20 (requiring arbitration of claim brought under Age Discrimination in Employment Act); *see*

bound by an arbitration agreement on the grounds that the agreement was obtained through coercion, fraud or duress, a court should construe such defenses narrowly and favor arbitration.<sup>14</sup> Third, the Court has relied on the policy favoring arbitration to hold that the Federal Arbitration Act broadly preempts all state legislation that might attempt to limit the reach of binding arbitration.<sup>15</sup> Most recently, in *Doctor's Associates, Inc. v. Casarotto*,<sup>16</sup> the Court held that the FAA preempts a Montana statute mandating a company to state on the first page of a contract that the contract contains an arbitration clause.<sup>17</sup> Fourth, again relying on the preference for arbitration, courts have held that where a party seeks to appeal an arbitrator's determination to a court, the court should rarely grant such an appeal.<sup>18</sup>

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*infra* notes 177-210 and accompanying text.

14. *E.g.*, *David L. Threlkeld & Co. v. Metallgesellschaft Ltd.*, 923 F.2d 245, 248 (2d Cir.) (considering policy favoring arbitration in refusing to invalidate agreement as contract of adhesion), *cert. dismissed*, 501 U.S. 1267 (1991); *see also* *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 285 (9th Cir. 1988) (rejecting unconscionability defense in light of policy favoring arbitration); *Benoay v. E.F. Hutton & Co.*, 699 F. Supp. 1523, 1526 (S.D. Fla. 1988) (rejecting arguments as to unequal bargaining power, unconscionability, duress, lack of mutuality and fundamental unfairness in view of federal policy encouraging arbitration). Even where the company's agent allegedly made allaying statements to the customer, representing that the arbitration agreement was a "mere formality," one court upheld the agreement, observing that "[a] party who signs an instrument is presumed to know its contents." *Benoay*, 699 F. Supp. at 1529.

15. *E.g.*, *Southland*, 465 U.S. 1 (preempting California court's interpretation that claims under a certain California statute could not be arbitrated); *Perry*, 482 U.S. 483 (preempting California fair employment statute's proscription on arbitration); *Allied-Bruce Terminix Cos. v. Dobson*, 115 S. Ct. 834, 838 (1995) (preempting an Alabama statute that barred pre-dispute arbitration agreements); *see also* *Threlkeld*, 923 F.2d at 249 (preempting Vermont law requiring that "any agreement to arbitrate must be displayed prominently in the contract or contract confirmation and must be signed by the parties"); *Securities Indus. Ass'n v. Connolly*, 883 F.2d 1114, 1117 (1st Cir. 1989) (preempting Massachusetts securities regulations that ordered arbitration clause to be placed "conspicuously" and further demanded "full written disclosure of the legal effect of the pre-dispute arbitration contract or clause"), *cert. denied*, 495 U.S. 956 (1990); *Webb v. R. Rowland & Co.*, 800 F.2d 803, 806-07 (8th Cir. 1986) (preempting Missouri statute requiring that "arbitration clauses be introduced by a notice, in ten point capital letters, that the contract contains a binding arbitration clause"); *Mr. Mudd, Inc. v. Petra Tech*, 892 S.W.2d 389 (Mo. Ct. App. 1995) (preempting state statute requiring notice of arbitration clause to be specially stated in contract); *Woermann Constr. Co. v. Southwestern Bell Tel. Co.*, 846 S.W.2d 790 (Mo. Ct. App. 1993) (striking down state law requiring notice of binding enforceable arbitration appear in 10 point type).

16. 116 S. Ct. 1652 (1996).

17. *Id.* at 1656. The Montana Supreme Court held that because the notice requirement was consistent with the purpose of the FAA, it was not preempted. *Casarotto v. Lombardi*, 901 P.2d 596 (Mont. 1995), *rev'd sub. nom.*, *Doctor's Assocs., Inc. v. Casarotto*, 116 S. Ct. 1652 (1996). The Court reasoned that the notice requirement reflected a hostility to arbitration that was inconsistent with the purpose of the FAA. It expressly rejected the reasoning of the Montana Supreme Court that a notice requirement was consistent with the FAA's purpose of supporting a knowing choice of arbitration. *See id.*; *cf. Casarotto v. Lombardi*, 886 P.2d 931 (Mont. 1994), *vacated and remanded*, 115 S. Ct. 2552 (1995).

18. Court after court has stated that the strong federal policy favoring arbitration requires that

The language of the Court's recent decisions implies that Congress mandated a preference for arbitration over litigation many years ago, and that the Court has subsequently enforced that preference consistently.<sup>19</sup> However, Section II of this Article demonstrates that this preference for arbitration is a myth that has no historical basis.<sup>20</sup> When Congress passed the FAA in 1925, it intended only to require federal courts to *accept* arbitration agreements that had been voluntarily entered into by two parties of relatively equal bargaining power in arms' length transactions. Congress did not intend to enforce arbitration agreements that had been foisted on ignorant consumers, and it did not intend to prevent states from protecting weaker parties.<sup>21</sup>

Section II also exposes two other current myths with respect to the FAA. First, it shows that whereas the Court currently propounds the "scope" myth—that the FAA was intended to apply in state as well as federal courts—Congress originally envisioned that the Act would apply only in federal courts.<sup>22</sup> Section II further demonstrates the "substance" myth—that whereas the Court currently insists that the substantive results obtained in arbitration

arbitral awards be reviewed on a very limited basis. *See, e.g.,* Flexible Mfg. Sys. Pty. Ltd. v. Super Prods. Corp., 86 F.3d 96, 100 (7th Cir. 1996) (even clear nor gross legal errors by an arbitrator do not justify overturning her award); *Dole Ocean Liner Express v. Georgia Vegetable Co.*, 84 F.3d 772 (5th Cir. 1996); *Revere Copper & Brass v. Overseas Private Inv.*, 628 F.2d 81, 83 (D.C. Cir.), *cert. denied*, 446 U.S. 983 (1990). As a well-known arbitration treatise puts it: "Over the years, the courts have taken a fairly uniform approach to awards: Awards should be confirmed and enforced as is unless there is clear evidence of a gross impropriety." MACNEIL ET AL., *supra* note 9, § 40.1.4.

19. When the Court first announced the preferential policy in *Moses H. Cone* it stated: "Courts of Appeals have since [*Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967)] consistently concluded that questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration. We agree." *Moses H. Cone Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 25 (1983). The Court's subsequent arbitration decisions virtually all reiterate this supposed policy and imply that it has existed since 1925. *See, e.g., Southland*, 465 U.S. at 10 ("In enacting section 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration."); *see also supra* note 10. while the word "favor" might in some contexts be interpreted to mean only that arbitration be looked upon with favor, rather than favored over litigation, the Court has made clear that it uses the word in the latter sense. *Moses H. Cone Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 25 (1983).

20. *See* Cliff Palefsky, *Arbitrary Arbitration: The Founders Would Frown on Mandatory ADR*, S.F. DAILY, Mar. 1, 1995, at 4 (arguing that judges "have chosen to deal with their lack of resources by creating a fictitious new public policy that trumps all others—the policy in favor of clearing my docket"). Palefsky further states that "[a]ny claim that the FAA creates a preference for arbitration or permits courts to ignore or overrule the Constitution is a dishonest representation of Congress' clearly articulated intentions." *Id.*; *see also* Thomas E. Carbonneau, *Arbitration and the U.S. Supreme Court: A Plea for Statutory Reform*, 5 OHIO ST. J. ON DISP. RESOL. 231, 238 (Supreme Court mistakenly views arbitration as a cure-all).

21. *See infra* notes 43-76 and accompanying text.

22. *See infra* notes 58-76 and accompanying text.

are no different than those likely obtained in litigation, historically Congress and the Court have recognized significant differences between the results obtained in arbitration and in litigation.<sup>23</sup>

Breaking the Court's decisions into three distinct time periods, Section II shows that these three myths evolved gradually and simultaneously. Following a lengthy period of "original intent" and an intermediate transitional period, finally, in the early 1980s, all three myths burst into full flower. Not coincidentally, the Court's enunciation of a preference for arbitration coincided with the Court's growing concern that dockets were overloaded and with a wider, general societal acceptance of alternative dispute resolution.

One might be able to overlook the Court's skewed interpretation of history if its enchantment with binding arbitration fairly and equally served the interests of all members of our society. However, as discussed in Section III, the Court's preference for binding arbitration in the context of consumer and other little guy transactions is supported by neither theoretical arguments nor empirical evidence. In assessing the validity of the Court's new preference from a policy standpoint one must avoid two conceptual pitfalls. First, one must be careful to distinguish between unionized labor arbitration and commercial arbitration. Binding arbitration is already well ensconced in the unionized labor arena. Courts, unions and management have all generally found that it is better to resolve their disputes over contractual terms and grievances through binding arbitration than to resort to the labor strike, which is debilitating to all.<sup>24</sup> However, as the Court itself has recognized, using labor arbitration in lieu of a labor strike is entirely different than using commercial arbitration in lieu of a public court proceeding.<sup>25</sup> Second, and equally important, it is critical to distinguish between commercial arbitration voluntarily agreed to by parties of approximately equal bargaining power, and commercial arbitration forced upon unknowing consumers, franchisees,

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23. See *infra* note 77-82 and accompanying text.

24. See generally *United Steelworkers of Am. v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 581-82 (1960) (declaring that given Congressional policy favoring labor arbitration as a mode of industrial self-governance, labor contracts should be liberally construed to promote arbitration); *Textile Workers Union of Am. v. Lincoln Mills of Ala.*, 353 U.S. 448, 455 (1957) (holding that federal court has jurisdiction to order arbitration pursuant to collective bargaining agreement because "the agreement to arbitrate grievance disputes is the quid pro quo for an agreement not to strike . . . and . . . industrial peace can be best obtained only in that way").

25. *Warrior & Gulf*, 363 U.S. at 578. See generally Martin H. Malin & Robert F. Ladenson, *Privatizing Justice: A Jurisprudential Perspective on Labor and Employment Arbitration from the Steelworkers Trilogy to Gilmer*, 44 HASTINGS L.J. 1187 (1993) (contrasting rules of labor and commercial (employment) arbitrators).

employees or others through the use of form contracts.<sup>26</sup>

Given these two clarifications, Section III focuses on whether society benefits when parties of substantially different strengths and levels of knowledge resolve their commercial disputes through binding arbitration rather than through litigation. The section concludes that while binding arbitration may well be preferable from the standpoint of certain segments of society—particularly large companies that draft the terms and court administrators and judges who can reduce their own workload—there is no reason to believe that society as a whole is better off with binding arbitration. Rather, the Court's espousal of largely unregulated and unregulable mandatory binding arbitration appears likely to harm the poorest and least educated members of society.

Section IV demonstrates that the Court's application of its preference for binding arbitration to preempt state protective legislation also raises serious federalism concerns. As several Justices have pointed out, although Congress never expressly stated an intent to preempt state arbitration legislation, the Court's recent interpretations of the FAA endanger virtually all such state legislation.<sup>27</sup> Having voided a mere notice provision last Term in *Casarotto*,<sup>28</sup> the Court has left states almost powerless to regulate unfair binding arbitration provisions.<sup>29</sup>

Despite these hesitations, the advocates of binding arbitration are correct that properly regulated binding arbitration has the potential to greatly improve our system of justice. This Article does not advocate reviving the old hostility toward binding arbitration. Rather, as detailed in Section V, the Court should once again apply the FAA as it was intended to be applied: to accept binding arbitration where it is fair and has been accepted by the parties, and to reject binding arbitration where it has been foisted unfairly upon a weaker party.<sup>30</sup> If

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26. See generally Jeffrey W. Stempel, *Reflections on Judicial ADR and the Multi-Door Courthouse at Twenty: Fait Accompli, Failed Overture, or Fledgling Adulthood?*, 11 OHIO ST. J. ON DISP. RESOL. 297, 334-40 (1996) (contrasting "new" and "old" ADR); Sternlight, *supra* note 11 (arguing that courts' implementation of the preference for binding arbitration may often result in consumers and other little guys being deprived of their constitutional rights to a jury trial, an Article III judge, and due process).

27. See *infra* notes 148-76, 349-56 and accompanying text.

28. 116 S. Ct. 1652 (1996).

29. See *supra* notes 16-17 and accompanying text; *infra* notes 145-47, 387-95 and accompanying text.

30. Some commentators, recognizing the potential unfairness of mandatory binding arbitration, have advocated prohibiting altogether the arbitration of certain categories of claims. See, e.g., Shell, *supra* note 3 (arguing that discrimination claims brought under Title VII and under the Age Discrimination in Employment Act should not be subject to arbitration); Stewart E. Sterk, *Enforceability of Agreements to Arbitrate: An Examination of the Public Policy Defense*, 2 CARDOZO



the Court fails to change its course, Congress should step in to ensure that binding arbitration is used to further rather than defeat justice.

## II. THE EVOLUTION OF BINDING ARBITRATION—THE POWER OF MYTH AND PERSUASION

### A. *The Period of Original Intent (1925-1966)*

The enactment of the Federal Arbitration Act in 1925 marked a significant milestone in the emergence of arbitration in this country. To understand the limitations as well as the importance of the FAA as originally envisioned by Congress, one must place the FAA in its proper legal and economic historical context.<sup>31</sup>

Prior to the passage of the FAA and the adoption of similar acts by state legislatures, it was generally impossible for two merchants with equal bargaining power to enter a binding contract to resolve their future disputes through arbitration. American courts, following English precedents, would allow two willing parties to submit a dispute to arbitration but generally refused to enforce a pre-dispute arbitration agreement ("PDAA") where one

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L. REV. 481, 486 (1981) (asserting that rather than making all arbitration more legalistic we should refuse to enforce arbitration agreements where the statute or case law at issue "has aims other than promoting justice between the parties" and where "a party to the agreement belongs to a class peculiarly subject to imposition by the class to which the other party belongs"). *But see* Jeffrey W. Stempel, *Pitfalls of Public Policy: The Case of Arbitration Agreements*, 22 ST. MARY'S L.J. 259 (1991) (opposing reliance on public policy exclusion to void arbitration agreements). Others argue that certain due process protections must be appended to arbitration. For example, various groups including the ABA Section of Labor and Employment Law, the American Arbitration Association, the Society of Professionals in Dispute Resolution, and the National Employment Lawyers Association have endorsed *A Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of the Employment Relationship*, which calls for voluntary, informal agreements; a prohibition on waivers of statutory rights; a right to representation and discovery; and a diverse group of arbitrators trained in the law. *Section Endorses the Due Process Protocol*, LAB. & EMPLOYMENT L. (ABA Lab. & Employment Sec.) Winter 1996; *see also* U.S. DEP'T OF LABOR & U.S. DEP'T OF COMMERCE, REPORT AND RECOMMENDATIONS OF THE COMMISSION ON THE FUTURE OF WORKER-MANAGEMENT RELATIONS 25-33 (1994) [hereinafter DUNLOP COMMISSION REPORT] (arbitration of employment disputes is fair only where employees are guaranteed such protection as a neutral arbitrator, adequate discovery, range of remedies equal to those available through litigation, right to counsel, a written opinion, and adequate judicial review); Gorman, *supra* note 3 (discussing need for formal procedural standards such as discovery, written opinions, and improved appeal where public law disputes are arbitrated); Maltby, *supra* note 11 (calling for due process standards). The approach taken in this Article is different and more fundamental than these approaches in that it calls upon the Court to rethink its premise that there is a societal preference for binding arbitration.

31. Fortunately, Professor Ian Macneil has recently published an excellent history of the FAA and its development that proved very helpful in drafting this section. *See* MACNEIL, *supra* note 12.

party had changed its mind and no longer wanted to arbitrate.<sup>32</sup> While courts would generally enforce an actual arbitration *decision*,<sup>33</sup> the nonenforceability of the contractual clause allowed either party to the contract the option to choose litigation over arbitration at any time, regardless of prior agreement.<sup>34</sup>

As business began to boom in the early 20th century, and as courts became increasingly overloaded, business groups began to lobby for the option of using enforceable arbitration clauses in their contracts.<sup>35</sup> The reformers worked on two fronts—state and federal.<sup>36</sup> The reformers soon learned, however, that the passage of state laws alone would not preserve their contractual arbitration agreements unless federal courts would honor such state laws.<sup>37</sup> Working through an American Bar Association committee, the reformers produced a draft federal statute that was approved by the ABA

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32. MACNEIL ET AL., *supra* note 9, § 4.1.2; Linda R. Hirshman, *The Second Arbitration Trilogy: The Federalization of Arbitration Law*, 71 VA. L. REV. 1305, 1309 (1985); Henry C. Strickland, *The Federal Arbitration Act's Interstate Commerce Requirement: What's Left for State Arbitration Law?*, 21 HOFSTRA L. REV. 385, 389 (1992). The courts based their refusal to enforce consensual arbitration agreements either on the theory that private parties could not lawfully usurp court jurisdiction, *see* Zhaodong Jiang, *Federal Arbitration Law and State Court Proceedings*, 23 LOY. L.A. L. REV. 473, 478 n.20 (1990); Hirshman, *supra*, at 1309-11, or on the theory that appointment of an arbitrator, like appointment of an agent, was always revocable, Hirshman, *supra*, at 1309. Pursuant to English law, pre-dispute arbitration agreements are still invalid in the consumer context. Carbonneau, *supra* note 3, at 1955 n.30.

33. MACNEIL ET AL., *supra* note 9, § 4.1.2; Strickland, *supra* note 32, at 389.

34. Strickland, *supra* note 32, at 389. A party could also use the *threat* of litigation to obtain an advantage in settlement negotiations. *See generally* Julius H. Cohen & Henry Dayton, *The New Federal Arbitration Law*, 12 VA. L. REV. 265, 270 (1926) (discussing how a party might refuse to abide by arbitration agreements to gain strategic advantage).

35. Cohen & Dayton, *supra* note 34, at 266; MACNEIL, *supra* note 12, at 25-27 (observing that arbitration reform movement grew substantially out of commercial interests); Hirshman, *supra* note 32, at 1311. As Justice Black observed, dissenting in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 407, 409 n.2 (1967), "principal support for the Act came from trade associations dealing in groceries and other perishables and from commercial and mercantile groups in major trading centers."

36. At the state level the merchants initially advocated passage of a state arbitration act in New York and then sought adoption of a similar uniform act for consideration by all of the states. They were elated when the highest court in New York upheld the 1920 New York act in the face of numerous constitutional challenges. *Berkovitz v. Arbib & Houlberg, Inc.*, 130 N.E. 288 (N.Y. 1921) (New York act does not violate right of trial by jury, does not impair jurisdiction of New York courts, and does not impair obligation of contract). The court upheld the New York law in part on the ground that it was procedural and remedial, as opposed to substantive. *Id.*

37. In *Atlantic Fruit Co. v. Red Cross Line*, 276 F. 319, 323 (S.D.N.Y. 1921), *aff'd*, 5 F.2d 218 (2d Cir. 1924), the federal court for the Southern District of New York held that despite a contractual agreement to arbitrate and despite the New York law, one merchant could sue another in federal court because the state remedial and procedural statute did not govern admiralty cases brought in federal court.

in 1922 without dissent.<sup>38</sup> Congress adopted the statute, also with very little change, in 1925.<sup>39</sup>

The centerpiece of the FAA is section 2 of the Act:

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.<sup>40</sup>

Sections 3 and 4 provide the enforcement mechanisms, instructing United States courts to *stay* any action brought in court that should have been arbitrated,<sup>41</sup> and instructing federal courts to *compel* arbitration when one party is inappropriately refusing to arbitrate a dispute.<sup>42</sup>

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38. MACNEIL ET AL., *supra* note 9, § 8:2.

39. *Id.* § 8:3. *See generally* Cohen & Dayton, *supra* note 34 (article by drafters of statute summarizing their view of the new statute).

40. 9 U.S.C. § 2 (1994). Significantly, the FAA creates a body of federal substantive law and yet does not create any independent federal-question jurisdiction. Federal courts have jurisdiction over FAA issues only to the extent that the case involves issues or parties that would otherwise provide a basis for federal jurisdiction. *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 25 n.32 (1983).

41. Section 3 states:

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C. § 3 (1994).

42. Section 4 states:

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. . . .

9 U.S.C. § 4 (1994). The remainder of the section spells out details of how the court is to determine whether arbitration should be compelled.

*1. Policy/Purpose of FAA: To Support Genuine and Knowing Selection of Arbitration by Parties*

Most commentators have concluded that the FAA was envisioned as applying to consensual transactions between two merchants of roughly equal bargaining power, and not necessarily to transactions between a large merchant and a much weaker and less knowledgeable consumer.<sup>43</sup> In 1925, the economy looked substantially different than it looks today. There were very few transactions between large merchants and individual consumers that would have involved interstate commerce and thus fallen under the jurisdiction of the FAA.<sup>44</sup> In fact, when one Senator raised a concern that arbitration contracts might be “offered on a take-it-or-leave-it basis to captive customers or employees,” the Senator was reassured by the bill’s supporters that they did not intend to cover such situations.<sup>45</sup>

The Supreme Court’s decisions initially were consistent with the premise that arbitration should be based on voluntary, knowing consent by both parties, and that such consent was critical given the public interest in justice. At the time of the FAA’s passage, in the 1920s, business was booming and very popular.<sup>46</sup> There was therefore little concern that allowing businesses knowingly to enter into arbitration agreements would have any detrimental effect on either individual consumers or on the public at large.<sup>47</sup> However, as the Roaring 20s gave rise to the Depression of the 1930s, as well as to concerns regarding the strengthening of German business interests, several critics began to question whether business interests might use one-sided arbitration agreements to gain an advantage over weaker parties and thereby undermine the public interest in justice.<sup>48</sup>

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43. Jiang, *supra* note 32, at 483; Stempel, *supra* note 26, at 334-38; *see also* *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 407, 409 (1967) (Black, J., dissenting) (arguing that the FAA was primarily intended to cover merchants engaged in interstate commerce).

44. Strickland, *supra* note 32, at 459 (observing that Congress may well have felt regulation of consumer disputes exceeded their power under the commerce clause). Further, assuming for the moment that the FAA was only intended to apply in federal court, and even assuming the parties were from diverse states, few large merchant/small consumer transactions could have met the federal court amount in controversy requirement in effect in 1924 of \$3,000. *Id.*

45. *Prima Paint*, 388 U.S. at 414 (Black, J., dissenting) (citing *Hearing on S. 4213 and S. 4214 before the Subcommittee of the Senate Committee on the Judiciary*, 67th Cong., 4th Sess. 9-11 (1923)).

46. As President Coolidge reportedly said, “the business of America is business.” JEROLD S. AUERBACH, *JUSTICE WITHOUT LAW?* 111-12 (1983).

47. MACNEIL, *supra* note 12, at 61.

48. *See id.* at 61-63; AUERBACH, *supra* note 46, at 113 (discussing concern that “[d]ominant business interests . . . would use compulsory arbitration clauses as a shield for their efforts to control prices, suppress competition, and thwart legislative regulation while they removed their private rules from public supervision”); Heinrich Kronstein, *Business Arbitration—Instrument of Private*

*Wilko v. Swan*,<sup>49</sup> the Supreme Court's first interpretation of the scope of the FAA,<sup>50</sup> reflected such critics' concerns that arbitration must be genuinely consented to and must serve the public interest. A 7-2 majority explained that the FAA allowed transactional participants to secure arbitration "if the parties are willing to accept less certainty of legally correct adjustment."<sup>51</sup> The Court went on to prohibit arbitration with respect to a customer's securities fraud action against a brokerage house, interpreting the Securities Act of 1933 as a Congressional determination that customers lacked the information to knowingly select arbitration in the securities context.<sup>52</sup> In the Court's words, the Securities Act of 1933 "was drafted with an eye to the disadvantages under which buyers labor"<sup>53</sup>—specifically, the fact that sellers possess more relevant information than buyers.<sup>54</sup>

The Court's decision in *Bernhardt v. Polygraphic Co. of America*<sup>55</sup> also illustrates the Court's concern during this first period with protecting consumers and workers from unknowingly or non-consensually selecting arbitration. By ruling the FAA inapplicable,<sup>56</sup> the Court refused to force a discharged employee to bring his claim in arbitration.<sup>57</sup> Although the Court

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*Government*, 54 YALE L.J. 36, 68 (1944) (arguing that modern arbitration is "[a]n instrument of cartels and monopolistic trade associations" and that courts have abrogated their duty to enforce the Constitution and ensure justice by condoning private organizations' usurpation of judicial power); Philip G. Phillips, *Rules of Law or Laissez-Faire in Commercial Arbitration*, 47 HARV. L. REV. 590 (1934) (arguing that it is undesirable to allow private interests to shield their practices from public control); Philip G. Phillips, *The Paradox in Arbitration Law: Compulsion as Applied to a Voluntary Proceeding*, 46 HARV. L. REV. 1258 (1933) (asserting that enforced arbitration is not really arbitration).

49. 346 U.S. 427 (1953).

50. *Wilko* was not the Court's first discussion of the FAA. See *Shanferoke Coal & Supply Corp. v. Westchester Serv. Corp.*, 293 U.S. 449 (1935) (holding that a federal court sitting in diversity had power to stay an action, pending arbitration, even though court would not have had jurisdiction to compel arbitration); *Marine Transit Corp. v. Dreyfus*, 284 U.S. 263 (1932) (affirming lower court's confirmation of arbitral award in maritime case despite challenges to applicability of FAA and constitutionality of statute as applied).

51. *Wilko*, 346 U.S. at 438.

52. *Id.*

53. *Id.* at 435.

54. *Id.* The court implied that the arbitration agreements buyers signed were all identical form margin agreements, *id.* at 429, casting doubt on the position that buyers knowingly negotiated the clause.

55. 350 U.S. 198 (1956).

56. The Court found the FAA inapplicable because interstate commerce had not been established, even though plaintiff, a New York citizen who had moved to Vermont by the time he brought suit, had contracted to perform certain services in Vermont for a New York corporation. *Id.* at 200-01.

57. The Supreme Court remanded the case to the district court to assess whether New York contract law applied, under which the arbitration agreement would be irrevocable, or Vermont contract

did not explicitly reference a policy of protecting consumer choice, the Court was concerned with protecting the employee from a result he had not anticipated when signing the agreement.

## 2. *Scope of the FAA: Federal Court Only*

Most commentators believe that the FAA was intended to govern only disputes as to arbitration agreements that were brought in federal court.<sup>58</sup> While the legislative history on this point is not entirely clear<sup>59</sup> and the U.S. Supreme Court ultimately reached a contrary conclusion,<sup>60</sup> virtually all those who have studied the history of the Act in its context have concluded that the FAA was viewed at the time as a procedural and remedial statute governing only federal courts.<sup>61</sup> The fact that the same groups that sought passage of the FAA were working simultaneously on state laws that would have been superfluous if the FAA were truly intended to govern the state forum as well

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law governed, under which the arbitration clause was revocable. *Id.* at 205.

58. See, e.g., *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 417-18 (1967) (Black, J., dissenting) (citing legislative history); Hirshman, *supra* note 32, at 1305 ("For years, courts and commentators agreed that the statute applied only in the federal courts and so governed only the few contract suits that happened to involve diversity or admiralty jurisdiction."); Strickland, *supra* note 32, at 391 ("Few if any commentators . . . thought that state courts were obligated to apply the Act.").

59. See Hirshman, *supra* note 32, at 1315 ("Little emerges from the legislative history other than unhappiness with prior law.") Given the fact that *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938), had not yet been decided, it is perhaps not surprising that Congress did not succinctly enunciate whether the law was substantive or procedural, by what constitutional provision it was authorized, or whether the FAA was intended to displace state law. Until *Erie*, such distinctions had little significance. See Hirshman, *supra* note 32, at 1313-15 (noting that it is not clear whether FAA was based on procedural powers under Article III, substantive powers to determine federal law under Article III, or substantive powers under Commerce Clause and admiralty provisions). The drafters of the FAA were also ambiguous in a law review article written immediately after passage of the Act. They stated that Congress had

ample power to declare that all arbitration agreements connected with interstate commerce or admiralty transactions shall be recognized as valid and enforceable even by the State courts. . . .

Even if, however, it should be held that Congress has no [such] power . . . the present statute is not materially affected. The primary purpose of the statute is to make enforceable in the Federal courts such agreements for arbitration, and for this purpose Congress rests solely upon its power to prescribe the jurisdiction and duties of the Federal courts.

Cohen & Dayton, *supra* note 34, at 277-78.

60. Led by Justice Burger, in *Southland v. Keating*, 465 U.S. 1 (1984), a majority of the Supreme Court concluded that the FAA was intended to apply in state as well as federal courts. Justice O'Connor wrote a vigorous dissent. 465 U.S. at 21.

61. MACNEIL, *supra* note 12, at 117 (arguing that "the hearings [regarding the proposed FAA] confirm what is already clear from the prior background and the bills themselves: the proposed USAA was intended to apply only in federal courts"); see also *Southland*, 465 U.S. at 21 (O'Connor & Rehnquist, JJ., dissenting); *Prima Paint*, 388 U.S. at 401 (Black, J., dissenting).

as the federal bolsters this conclusion.<sup>62</sup>

Moving beyond the legislative history, from 1925 until 1945 no federal or state court even seems to have contemplated applying the FAA to an action brought in state court.<sup>63</sup> Although the Supreme Court did not directly address the issue, its 1932 decision in *Marine Transit Corp. v. Dreyfus*<sup>64</sup> strongly implied that the FAA was a procedural statute that would apply in federal but not state courts.<sup>65</sup>

As this era continued, from 1945 through 1959, courts still assumed that the FAA was applicable in federal but not state courts. Professor Macneil found just five cases around the country that even considered applying the FAA to state court actions during this period.<sup>66</sup> Further, only one of the five found that the FAA displaced state arbitration law, absent an agreement to that effect by the parties.<sup>67</sup>

While courts were failing even to consider the applicability of the FAA to

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62. See generally MACNEIL, *supra* note 12, at 34-57 (noting that arbitration reformers worked to achieve state law reforms both prior and subsequent to passage of the FAA).

63. MACNEIL, *supra* note 12, at 127-28. Arbitration actions brought in state court were governed by the states' own arbitration laws, which often were much less hospitable to arbitration and pre-dispute arbitration agreements than was the FAA. See *id.* at 54-57 (discussing individual states' passage of modern arbitration acts).

64. 284 U.S. 263 (1932).

65. In this maritime case the Court affirmed a lower federal court's confirmation of an arbitral award, holding that the confirmation was covered by the statute's terms as a maritime matter. *Id.* at 271-77. It further held that the FAA itself was constitutional as applied because Congress has the power to impose procedural remedies with respect to maritime matters. *Id.* at 277-79. A second Supreme Court case, *Shanferoke Coal & Supply Corp. v. Westchester Serv. Corp.*, 293 U.S. 449 (1935), also failed to address the question of whether the FAA would apply in state courts, while stating that it did apply to diversity claims involving state law that were brought in federal court. In focusing on the FAA as an exercise of procedural rather than substantive authority, the Court strongly implied that it would apply in federal but not state courts under *Erie*. MACNEIL, *supra* note 12, at 132. Professor Macneil also notes that FAA drafters Julius Henry Cohen and Kenneth Dayton submitted an amicus brief on behalf of the New York Chamber of Commerce in *Marine Transit* which emphasized that the FAA was purely procedural in nature. *Id.*

66. MACNEIL, *supra* note 12, at 127-30. *French v. Petrinovic*, 54 N.Y.S.2d 179 (App. Div. 1945) (holding that the FAA may be applicable but only because parties had agreed to its application); *Wilson & Co. v. Fremont Cake & Meal Co.*, 43 N.W.2d 657 (Neb. 1950) (applying Nebraska law despite defendant's argument that FAA must be followed), *cert. denied*, 342 U.S. 812 (1951); *Parsons & Whittemore, Inc. v. Rederiaktiebolaget Nordstjernen*, 143 N.Y.S.2d 74 (App. Term.) (per curiam), *aff'd*, 145 N.Y.S.2d 466 (App. Div. 1955) (reversing lower court's refusal to grant stay of action pending arbitration under FAA); *In re Omnium Freighting Corp.*, 185 N.Y.S.2d 857 (Sup. Ct. 1958) (considering and denying appeal under FAA in which federal court consented to concurrent state jurisdiction); *Deep S. Oil Co. v. Texas Gas Corp.*, 328 S.W.2d 897, 906 (Tex. Civ. App. 1959) (refusing to apply FAA where it was not clear from parties' conduct or intent that interstate commerce would be involved).

67. Although *Parsons & Whittemore* did apply the FAA, it did not discuss whether the FAA would preempt New York's own arbitration statute. 145 N.Y.S.2d 466.

state courts, legal developments were taking place that would soon require consideration of this issue. In 1938, the Court decided *Erie Railroad v. Tompkins*,<sup>68</sup> holding that federal courts should apply federal procedural law in all their cases but that state substantive law rather than federal common law would govern cases brought pursuant to the federal courts' diversity jurisdiction.<sup>69</sup> After *Erie*, much would turn on two questions that had mattered very little when Congress passed the FAA: whether the statute was construed as "procedural" or "substantive" and whether the statute was premised on Congress' authority to regulate federal courts or rather on its power to regulate interstate commerce. If the FAA were truly procedural, the Constitution would prohibit application of the Act to state courts.<sup>70</sup> But if the FAA were to be interpreted as substantive, and based perhaps upon the Commerce Clause, then there would seem to be little logical way to prevent it from being applied in state as well as federal courts.

The Supreme Court began to wrestle with the ramifications of *Erie* for the FAA in *Bernhardt v. Polygraphic Co. of America*.<sup>71</sup> In that diversity case, the Court's application of *Erie* led it to limit the scope of the FAA.<sup>72</sup> Specifically concluding that arbitration was "substantive" rather than "procedural" under the "outcome determinative test" of *Guaranty Trust Co. of New York v. York*,<sup>73</sup> the Court held the FAA inapplicable to the case at hand because it found the transaction at issue did not involve interstate commerce.<sup>74</sup> Justice Douglas, writing for the Court, found the FAA *must* be interpreted narrowly to avoid impinging on the states' right to regulate substantive law.<sup>75</sup> Although *Bernhardt* itself did to apply the FAA in state courts, in categorizing the FAA as substantive rather than procedural it did lay the groundwork for the Court's

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68. 304 U.S. 64 (1938).

69. *Id.* at 78.

70. *See Erie*, 304 U.S. 64 (finding unconstitutional Congress' or courts' attempts to impose on states rules that are not supported by specific constitutional provisions).

71. 350 U.S. 198 (1956).

72. *Id.*

73. 326 U.S. 99 (1945).

74. *Bernhardt*, 350 U.S. at 200-01. Although the Court's analysis is based primarily on statutory interpretation, it also addresses the constitutional implications of *Erie*. *Id.* at 202. Note that by today's standards the Court's conclusion that the transaction did not involve interstate commerce is somewhat puzzling, in that the case involved a contract dispute between a New York corporation and its employee who, although he was a New York resident at the time he entered the contract, had subsequently moved to Vermont and was to perform the contract in Vermont. *Id.* at 198.

75. *Id.* at 202-04 (emphasis added). Justice Frankfurter, concurring, took the *Erie* analysis further, concluding that to avoid having to decide whether it was unconstitutional for the federal government to require a state law claim to be taken to arbitration, the FAA should be interpreted not to apply to diversity cases at all. *Id.* at 208.



subsequent decisions that would do just that.<sup>76</sup>

### 3. *Significant Substantive Differences Between Litigation and Arbitration*

In both *Wilko* and *Bernhardt* the Court emphasized the substantive differences between the arbitral and judicial fora. *Wilko* found as a matter of law that arbitration would provide a less favorable forum than would litigation for a plaintiff alleging securities fraud by the brokerage.<sup>77</sup> The Court stated: "Even though the provisions of the Securities Act, advantageous to the buyer, apply, their effectiveness in application is lessened in arbitration as compared to judicial proceedings."<sup>78</sup>

Similarly, in *Bernhardt*, Justice Douglas flatly rejected the conclusion that "arbitration is merely a form of trial."<sup>79</sup> Instead, he found the choice of arbitration over litigation could "make a radical difference in ultimate result."<sup>80</sup> For this reason the Court found the choice between arbitration and litigation to be substantive rather than procedural in the sense of *Erie*.<sup>81</sup> Justice Douglas apparently presumed arbitration would benefit the employer when he noted that in arbitration there would be no jury trial, no instruction of arbitrators as to the law, no statement of reasons nor record to support an appeal, and no requirement that arbitrators follow the rules of evidence.<sup>82</sup>

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76. Following the *Bernhardt* decision, more and more state courts began to consider the applicability of the FAA to state court proceedings. MACNEIL, *supra* note 12, at 227 n.54.

77. *Wilko v. Swan*, 346 U.S. 427 (1953).

78. *Id.* at 435. The Court specifically noted that the arbitrators are not given judicial instruction, *id.* at 436, nor even required to follow the law, *id.* at 434. The Court additionally noted that the arbitrators need write no opinion, need not make a complete record of the proceeding, and could not easily be reversed. *Id.* at 436. In dissent, Justice Frankfurter adopted the contrary position that would come to be the law of the land by the 1980s:

There is nothing in the record before us, nor in the facts of which we can take judicial notice, to indicate that the arbitral system as practiced in the City of New York, and as enforceable under the supervisory authority of the District Court for the Southern District of New York, would not afford the plaintiff the rights to which he is entitled.

*Id.* at 439 (Frankfurter, J., dissenting); *cf.* *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 231 (1987) (citing Justice Frankfurter's dissent in *Wilko* to support the proposition that arbitration may properly be used to resolve claims of securities fraud).

79. *Bernhardt*, 350 U.S. at 202.

80. *Id.* at 203.

81. *Id.* at 202-03.

82. *Id.* Perhaps Justice Douglas' sympathy for the employee, who may not have understood the effect of the arbitration clause he had signed, led the Court to remand the case to the district court which had already ruled favorably to the employee, rather than to the appellate court, as would have been more usual. Justices Frankfurter and Harlan, concurring, both argued that the case should have been remanded to the court of appeals and not to the district court. *Id.* at 205, 211.

*B. Seeds of Myths are Planted (1967-1982)*

*1. Policy/Purpose of the FAA: Not only to Support Knowing Choice but also to Support Public Policy*

Whereas the Court had previously found arbitration agreements enforceable only to the extent they were genuinely accepted by the parties, the Court in this second era began to evaluate the extent to which arbitration was consistent with certain other societal, as well as individual, interests. While the Court did not always find social policy *avored* arbitration, its focus on various social policies marked a significant shift from its exclusive focus on individual consent.

*a. Cases Limiting the Scope of Arbitration*

In a series of cases involving statutory claims asserted by individual unionized employees against their employers, the Court relied on social policy to limit the reach of arbitration. In three separate cases beginning with *Alexander v. Gardner-Denver Co.*,<sup>83</sup> the Court held that employees whose union contracts contained arbitration clauses could nonetheless take certain statutory claims to court, even if they had already lost on those claims in arbitration. The three statutes expressly exempted from arbitration in this context were Title VII of the Civil Rights Act of 1964,<sup>84</sup> the Fair Labor Standards Act ("FLSA"),<sup>85</sup> and the Civil Rights Act of 1871.<sup>86</sup>

The Court's treatment of the *Gardner-Denver* cases crucially illustrates the Court's early differentiation between labor arbitration and commercial arbitration. Just a few years earlier, in *Textile Workers Union of America v. Lincoln Mills of Alabama*<sup>87</sup> and the *Steelworkers Trilogy*<sup>88</sup> of cases, the Court

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83. 415 U.S. 36 (1974).

84. *See id.* (permitting union member to pursue race discrimination claim in court, even though he had previously filed a grievance alleging violation of his employment contract).

85. *See Barrentine v. Arkansas-Best Freight Sys., Inc.*, 450 U.S. 728 (1981) (allowing employees to bring minimum wage claim under FLSA even though they had unsuccessfully submitted wage claim based on same underlying facts to joint labor/management grievance committee).

86. *See McDonald v. City of W. Branch, Mich.*, 466 U.S. 284 (1984) (permitting discharged city police officer to raise claim of violation of First Amendment and Due Process Clause pursuant to § 1983 even though an arbitrator had previously ruled against the officer). I have included *McDonald* in this section even though the decision was handed down in 1984, thus falling slightly outside my arbitrary definition of the second period. It is noteworthy that two of the three decisions were unanimous. *Alexander*, 415 U.S. 36, was authored by Justice Powell, and *McDonald*, 466 U.S. 284, was penned by Justice Brennan. *Barrentine*, 450 U.S. 728, was decided by a margin of 7-2, with Justice Brennan writing the majority opinion and Justices Burger and Rehnquist dissenting.

87. 353 U.S. 448 (1957).

had interpreted the text of the Labor Relations Management Act to heartily endorse binding arbitration in the unionized labor context as a mechanism for ensuring industrial peace.<sup>89</sup> While at first glance the Court's preference for binding arbitration in the *Steelworkers* cases might seem inconsistent with the Court's rejection of arbitration in the *Gardner-Denver* line of cases, in fact there is no contradiction. Rather, the Court is simply distinguishing between labor arbitration, which is essentially used in lieu of the labor strike as a mode of governing the workplace, and individual or commercial arbitration, which is used in lieu of litigation.<sup>90</sup>

Thus, the *Gardner-Denver* line of cases required the Court to determine whether the arbitration of individual employees' statutory claims looked more like labor grievance arbitration, which the Court favored as furthering industrial peace, or like individual or commercial arbitration, to which a different set of policy analyses would be relevant. Concluding that the statutory grievances were more akin to individual or commercial grievances, and that a union had no power to waive individual employees' statutory right to non-discrimination,<sup>91</sup> the Court went on to examine whether, as a matter of social policy, the employees should be required to arbitrate their individual

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88. *United Steelworkers of Am. v. Enterprise Wheel and Car Corp.*, 363 U.S. 593 (1960); *United Steelworkers of Am. v. Warrior & Gulf Navigation Co.*, 363 U.S. 574 (1960); *United Steelworkers of Am. v. American Mfg. Co.*, 363 U.S. 564 (1960).

89. In the 1957 *Lincoln Mills* decision the Court explained that because grievance arbitration is a "quid pro quo for an agreement not to strike" and because industrial peace can best be achieved through enforcement of such arbitration agreements, section 301 of the Labor Management Relations Act of 1947 should be interpreted to provide federal courts with jurisdiction to order specific enforcement of such agreements. 353 U.S. at 451-52. In the 1960 *Steelworkers Trilogy* the Court went on to enunciate that all doubts as to the scope of a labor arbitration agreement should be resolved in favor of coverage, *Warrior & Gulf*, 363 U.S. at 581-82, that courts should review arbitration decisions only in an extremely limited manner, *Enterprise Wheel*, 363 U.S. at 595-98, and that claims which a court might well reject as invalid could nonetheless be upheld by an arbitrator, applying the "law of the shop," *Warrior & Gulf*, 363 U.S. at 579-82.

90. The Court explained the distinction in *United Steelworkers v. Warrior & Gulf Navigation Co.*:

Thus the run of arbitration cases, illustrated by *Wilko v. Swan* becomes irrelevant to our problem. There the choice is between the adjudication of cases or controversies in courts with established procedures or even special statutory safeguards on the one hand and the settlement of them in the more informal arbitration tribunal on the other. In the commercial case, arbitration is the substitute for litigation. Here arbitration is the substitute for industrial strife. Since arbitration of labor disputes has quite different functions from arbitration under an ordinary commercial agreement, the hostility evinced by courts toward arbitration of commercial agreements has no place here. For arbitration of labor disputes under collective bargaining agreements is part and parcel of the collective bargaining process itself.

363 U.S. at 578 (citations omitted).

91. *Alexander v. Gardner-Denver Co.*, 415 U.S. 36, 51 (1974).

statutory claims.<sup>92</sup>

In assessing whether arbitration should be mandated in the *Gardner-Denver* line of cases the Court used an analysis that was different from that which it had employed in *Wilko*. Whereas *Wilko* focused exclusively on the rights and knowledge of the individual securities customers,<sup>93</sup> the *Gardner-Denver* cases looked beyond individual employees' interests to consider broader social interests. Specifically, *Gardner-Denver* emphasized that "the private litigant not only redresses his own injury but also vindicates the important congressional policy against discriminatory employment practices."<sup>94</sup> This focus on societal interests, initially used to void arbitration agreements, would eventually be used to justify broad enforcement of binding arbitration agreements.<sup>95</sup>

*b. Cases Expanding the Scope of Arbitration*

In this same period, the Court looked to broader social policies to expand the role of arbitration. In *Scherk v. Alberto-Culver*,<sup>96</sup> the Court found that social policy favoring the use of arbitration in the international commercial context was relevant to require arbitration of a section 10(b) securities claim where it might not have been required in a domestic context.<sup>97</sup> Rather than

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92. The Court considered whether the courts should "defer" to an arbitration decision. *Id.* at 55.

93. See *supra* notes 49-54 and accompanying text.

94. *Gardner-Denver*, 415 U.S. at 44. The Court further observed that "waiver of these rights would defeat the paramount congressional purpose behind Title VII." *Id.* at 51. Similarly in *Barrentine*, the Court implied that even if the employees had knowingly and voluntarily agreed to resolve their statutory claims exclusively through arbitration, such an agreement would be forbidden by social policies favoring courts' resolution of such claims. 450 U.S. 728, 740 (1981). It stated: "[W]e have held that FLSA rights cannot be abridged by contract or otherwise waived because this would 'nullify the purposes' of the statute and thwart the legislative policies it was designed to effectuate." *Id.* In *McDonald*, the Court stated that "according preclusive effect to arbitration awards in § 1983 actions would severely undermine the protection of federal rights that the statute is designed to provide." 466 U.S. 284, 292 (1984). Consequently, the Court held that parties could not agree to private arbitration of their § 1983 disputes. *Id.*

These three cases also address the issue of genuine consent, which arises when union leadership waives a statutory right to litigate on behalf of each of its members. See *Gardner-Denver*, 415 U.S. at 58 n.19 (noting union's exclusive control over manner and extent to which an individual grievance is presented); *Barrentine*, 450 U.S. at 741 (noting that a union might, even acting in good faith, choose not to present individual's claim in arbitration); *McDonald*, 466 U.S. at 290 (same).

95. See *infra* notes 126-36 and accompanying text.

96. 417 U.S. 506 (1974).

97. *Alberto-Culver*, an American company, had entered into a contract with Fritz Scherk, a German citizen and owner of three interrelated businesses organized under the laws of Germany and Liechtenstein. *Id.* at 506. Difficulties arose in the relationship, and Alberto-Culver attempted to sue Scherk for securities fraud under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b)(1994). Alberto-Culver sought to avoid the arbitration clause it had signed by relying on the Court's earlier holding in *Wilko* that securities fraud claims under section 12(2) of the Securities Act of

reach the issue of whether section 10(b) claims should be held nonarbitrable, as had been section 12(2) claims in *Wilko*,<sup>98</sup> the Court, in a 5-4 decision, instead found disputes between two international businesses more readily arbitrable than disputes between two domestic entities.<sup>99</sup> The Court based its decision on the social policies of avoiding both choice of law chaos<sup>100</sup> and U.S. parochialism.<sup>101</sup>

Thus, whether it was broadening or limiting the scope of arbitration, the Court in the second era began to look beyond individual intent to other social policies such as fighting discrimination or deterring U.S. parochialism. Meanwhile, writing in dissent in *Barrentine*, Justices Burger and Rehnquist emphasized another social policy that would soon prove extremely influential: the goal of reducing court backlogs and resolving disputes more cheaply and more quickly.<sup>102</sup>

## 2. *The Scope of the FAA: Growing Domestically and Internationally*

In the period from 1967 to 1982 the Court also planted seeds that would eventually flower into a dramatic expansion in the *scope* of the FAA. As noted earlier, the Supreme Court's *Erie* decision, holding that federal substantive but not procedural law should be applied in state courts, would eventually lead to a great expansion in the scope of the FAA.<sup>103</sup> The Court's 1967 decision in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*<sup>104</sup> was an important part of the expansion. A 6-3 majority of the Court stated that the FAA was unquestionably based on Congress' power to regulate interstate commerce, and not upon an assertion of general federal common law or upon federal procedural powers.<sup>105</sup> Although *Prima Paint* was a

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1933 could not be forced into arbitration.

98. *Scherk*, 417 U.S. at 514 n.8, 515-16.

99. *Id.* at 517.

100. *Id.* ("Whatever recognition the courts of this country might ultimately have granted to the order of the foreign court, the dicey atmosphere of such a legal no-man's-land would surely damage the fabric of international commerce and trade, and imperil the willingness and ability of businessmen to enter into international commercial agreements.").

101. *Id.* at 517 & n.11 ("To determine that 'American standards of fairness' . . . must nonetheless govern the controversy demeans the standards of justice elsewhere in the world, and unnecessarily exalts the primacy of United States law over the laws of other countries."). The Court also found that because *Alberto-Culver* could not count on the normal advantages of litigation in the international context, arbitration should be permitted. *Id.* at 518.

102. 450 U.S. 728, 746 (1981) (Burger, C.J., & Rehnquist, J., dissenting).

103. See *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938); see *supra* notes 68-70 and accompanying text.

104. 388 U.S. 395 (1967).

105. *Id.* at 405. The Court held in *Prima Paint* that whereas a claim of fraud in the inducement of the arbitration provision itself may be heard by a court, a claim as to fraud in the inducement of the

federal diversity claim, and thus could not expressly hold that the FAA should apply in state court, the conclusion that the FAA was substantive law based on the Commerce Clause would predictably require application of the FAA in state court under the Supremacy Clause.<sup>106</sup> Justices Black, Stewart and Douglas vigorously dissented in *Prima Paint*, recognizing that the majority's conclusion would eventually impel the FAA into state courts.<sup>107</sup>

During this second era, the Court and Congress also expanded the scope of the FAA significantly with respect to international disputes. In 1970, the United States adopted the United Nations Convention on Recognition and Enforcement of Foreign Arbitral Awards (also known as the New York Convention)<sup>108</sup> and enacted Title 2 of the FAA to allow implementation of the New York Convention in the United States.<sup>109</sup> The Convention generally requires contracting countries to recognize arbitration agreements entered into between citizens of contracting states,<sup>110</sup> but it also contains language which appears to limit the Convention's superiority to national law.<sup>111</sup> Given these limitations, one might have expected that the Court would have been at least

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contract as a whole may only be heard by the arbitrators. *Id.* at 403-04. This division has come to be known as the "separability doctrine." See generally MACNEIL ET AL., *supra* note 9, § 14.2.3.

106. U.S. CONST. art. VI, § 2.

107. The dissenters concluded that Congress based the FAA primarily on its Article III power to "create general federal rules to govern federal courts," *Prima Paint*, 388 U.S. at 418, and that "there are clear indications in the legislative history that the Act was not intended to make arbitration agreements enforceable in state courts. . . ." *Id.* at 420 (footnote omitted).

108. A special conference of the United Nations had adopted the Convention on June 10, 1958. See *Scherk v. Alberto-Culver*, 417 U.S. 506, 520 n.15 (1974) (citing Convention on the Recognition and Enforcement of Foreign Arbitral Awards, S. Exec. Doc. E, 90th Cong., 2d Sess. (1968)); Leonard V. Quigley, *Abcession by the United States to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 70 YALE L.J. 1049 (1961).

109. Foreign Arbitral Awards Convention, Pub. L. No. 91-368, § 1, 84 Stat. 692 (1970) (codified at 9 U.S.C. §§ 201-208 (1994)). Section 201 provides, "The Convention on the Recognition and Enforcement of Foreign Arbitral Awards of June 10, 1958, shall be enforced in United States courts in accordance with this chapter." 9 U.S.C. § 201 (1994).

110. See 9 U.S.C. § 202 ("An arbitration agreement or arbitral award arising out of a legal relationship, whether contractual or not, which is considered as commercial, including a transaction, contract, or agreement described in section 2 of this title, falls under the Convention."). It also limits its scope to those relationships involving foreign parties, property located abroad, or where performance or enforcement must be secured abroad. *Id.*

111. See MACNEIL, *supra* note 12, at 162-63. For example, courts are not required to enforce arbitration agreements that are "null and void, inoperative or incapable of being performed." Convention on the Recognition and Enforcement of Foreign Arbitral Awards, art. II, para. 3. In addition, courts are not required to enforce arbitral awards that are invalid under the law selected by the parties or, absent such selection, laws that are invalid under the law of the country where the award was made. *Id.* art. V, para. 1. Nor are courts required to recognize or enforce awards in which the subject matter is not capable of settlement by arbitration, or if "recognition or enforcement of the award would be contrary to the public policy of that country." *Id.* para. 2.

as willing to void international arbitration agreements or to deny enforcement of international awards as it would have been to take such actions in the domestic context. Instead, the new emphasis on international arbitration appeared to encourage the Court to allow private parties broad leeway in entering into arbitration agreements.

First, in *Scherk*, the Court explicitly found that the FAA's support of arbitration clauses went further in the international context than in the domestic context.<sup>112</sup> The Court held that a securities claim that might not be arbitrable if brought domestically would be arbitrable if the contractual dispute had international implications.<sup>113</sup> Second, in *M/S Bremen v. Zapata Off-Shore Co.*,<sup>114</sup> the Court found that where a sophisticated U.S. company and a sophisticated foreign company agreed in arm's length negotiations to resolve disputes in a particular forum,<sup>115</sup> this agreement would be enforceable absent compelling and countervailing reasons to void the agreement.<sup>116</sup> While not an arbitration decision, *M/S Bremen* affected FAA jurisprudence because, as many courts and commentators have noted, an arbitration clause may itself be seen as a type of forum selection.<sup>117</sup> Thus, the Court's decision to allow private forum selection was a move toward a privatized dispute resolution process.<sup>118</sup>

### 3. *Differences Between Arbitration and Litigation Vary with the Circumstances*

Whereas in the first era of the FAA the Court emphasized the significant differences between litigation and arbitration, in this second era the Court instead opined that the two fora might or might not differ substantially,

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112. 417 U.S. 506 (1974).

113. *Id.* at 515-16; see *supra* notes 96-101 and accompanying text.

114. 407 U.S. 1 (1972).

115. The parties had agreed to litigate any disputes arising out of their contract before the London Court of Justice. *Id.*

116. *Id.* at 11.

117. *Scherk*, 417 U.S. at 519; see also Lee Goldman, *My Way and the Highway: The Law and Economics of Choice of Forum Clauses in Consumer Form Contracts*, 86 NW. U. L. REV. 700, 736 (1992).

118. See generally Linda S. Mullenix, *Another Choice of Law: Consensual Adjudicatory Procedure in Federal Court*, 57 FORDHAM L. REV. 291 (1988) (criticizing trend toward privatization). But cf. Michael E. Solimine, *Forum Selection Clauses and the Privatization of Procedure*, 25 CORNELL INT'L L.J. 51 (1992) (praising the trend). *M/S Bremen* also emphasized the obligation of the U.S. not to parochially insist that disputes be resolved in our own courts, a theme that was picked up in some of the later arbitration decisions including *Scherk*. The *M/S Bremen* Court stated: "[t]he expansion of American business and industry will hardly be encouraged if, notwithstanding solemn contracts, we insist on a parochial concept that all disputes must be resolved under our laws and in our courts." 407 U.S. at 9.

depending on the circumstances. In certain labor cases involving individual workers' statutory claims, the Court repeatedly found that arbitration was significantly different from (and from the worker's perspective likely inferior to) litigation of federal statutory claims.<sup>119</sup> Thus, in 1974 in *Gardner-Denver* the Court stated:

[T]he fact finding process in arbitration usually is not equivalent to judicial fact finding. The record of the arbitration proceedings is not as complete; the usual rules of evidence do not apply; and rights and procedures common to civil trials, such as discovery, compulsory process, cross-examination, and testimony under oath, are often severely limited or unavailable. And . . . "[a]rbitrators have no obligation to the court to give their reasons for an award."<sup>120</sup>

The Court further observed that "the specialized competence of arbitrators pertains primarily to the law of the shop, not the law of the land."<sup>121</sup> The Court expressed similar views in *Barrentine*<sup>122</sup> and *McDonald*.<sup>123</sup>

However, in some of its other decisions during this period the Court began to emphasize that commercial arbitration can be just as good for decision making as can litigation. Thus, in *Prima Paint* the Court rejected the dissent's argument that arbitrators, most likely non-lawyers, were not capable of adjudicating the legal validity of a contract.<sup>124</sup> Similarly, in *Scherk* the Court

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119. See, e.g., *McDonald v. City of W. Branch, Mich.*, 466 U.S. 284 (1984); *Barrentine v. Arkansas-Best Freight Sys.*, 450 U.S. 728 (1981); *Alexander v. Gardner-Denver Co.*, 415 U.S. 36 (1974).

120. 415 U.S. at 57-58 (citations omitted) (quoting *United Steelworkers of Am. v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 598 (1960)).

121. *Id.* at 57.

122. *Barrentine*, 450 U.S. at 743-44 ("Although an arbitrator may be competent to resolve many preliminary factual questions, such as whether the employee 'punched in' when he said he did, he may lack the competence to decide the ultimate legal issue whether an employee's right to a minimum wage or to overtime pay under the statute has been violated."). The Court further noted that "arbitrators very often are powerless to grant the aggrieved employees as broad a range of relief [as could a judge]." *Id.* at 745.

123. *McDonald*, 466 U.S. at 290 (holding that "although arbitration is well suited to resolving contractual disputes, our decisions in *Barrentine* and *Gardner-Denver* compel the conclusion that it cannot provide an adequate substitute for a judicial proceeding in protecting the federal statutory and constitutional rights that § 1983 is designed to safeguard").

124. Compare *Prima Paint Corp. v. Flood & Conklin Mfg.*, 388 U.S. 395, 407 (1967) (Black, Douglas and Stewart, JJ., dissenting) ("The Court holds, what is to me fantastic, that the legal issue of a contract's voidness because of fraud is to be decided by persons designated to arbitrate factual controversies. . . . [These persons] in all probability will be non-lawyers, wholly unqualified to decide legal issues, and even if qualified to apply the law, not bound to do so.") with *Prima Paint*, 388 U.S. at 403-04 (Fortas, J.) (requiring issue of fraud to be determined by arbitrators, rather than court, unless the claim is for fraud in the inducement of the arbitration clauses itself, as opposed to the contract as a



found that arbitrators were capable of ruling on a securities fraud claim pursuant to federal law, at least in the context of an international transaction.<sup>125</sup>

*C. The Myths Fully Develop (1983-Present)*

*1. Policy/Purpose of the FAA: To Favor Arbitration*

During this third period the Court significantly recharacterized the policy and purpose of the FAA, proclaiming the myth that commercial arbitration served a substantial public purpose and should be favored regardless of the parties' intentions.<sup>126</sup> In *Moses H. Cone Memorial Hospital v. Mercury Construction*<sup>127</sup> in 1983, Justice Brennan enunciated the myth for the first time:

[Q]uestions of arbitrability must be addressed with a healthy regard for the federal policy *favoring* arbitration. . . . The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability.<sup>128</sup>

Significantly, the Court did not provide an explicit rationale for *why* arbitration should be favored over litigation. Most of the lower court cases it

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whole).

125. *Scherk v. Alberto-Culver*, 417 U.S. 506 (1974); *see also* *Shell*, *supra* note 3 (contrasting labor arbitration and commercial arbitration).

126. Attorney Cliff Palefsky notes: "There is a big difference between eliminating a hostility and stating a preference, with a whole lot of room in between." Palefsky, *supra* note 20, at 4. Chief Justice Burger previewed the new line of decisions in a 1982 address to the American Arbitration Association, praising the numerous advantages of arbitration over litigation. Warren E. Burger, *Isn't There a Better Way?*, 68 A.B.A. J. 274 (1982); *see also* Warren E. Burger, *Using Arbitration to Achieve Justice*, ARB. J., Dec. 1985, at 3, 4-5 (discussing use of arbitration to relieve flooding of courts); Warren E. Burger, *Agenda for 2000 A.D.—A Need for Systematic Anticipation*, 70 F.R.D. 83, 93-96 (1976). Even earlier Justice Rehnquist wrote an article comparing litigation and arbitration, concluding that the former was far more costly than the latter. William Rehnquist, *A Jurist's View of Arbitration*, ARB. J., Mar. 1977, at 1.

127. 460 U.S. 1 (1983).

128. *Id.* at 24-25 (emphasis added). In *Moses H. Cone*, a contractor sought arbitration of its dispute with its client, a hospital. The hospital sued in state court, arguing no liability and no duty to arbitrate. *Id.* at 6. The contractor then sued in federal court seeking arbitration. *Id.* Although the district court denied arbitration, pending resolution of the state court claim, the Supreme Court affirmed the appellate court's reversal of this decision. *Id.* at 1.

cited as favoring arbitration also provided no rationale for this favoritism.<sup>129</sup>

In the absence of any other rationale, it appears that the Court was swayed or at least influenced by a desire to conserve judicial resources. One of the cases cited by the Court to support favoritism toward arbitration does explicitly base the policy on a desire to conserve judicial resources.<sup>130</sup> Further, Justice Burger, having dissented in *Barrentine* just two years earlier, argued vehemently that arbitration should be favored to help reduce the courts' workload.<sup>131</sup> Certainly the Court has not offered any reason for preferring arbitration to litigation *other* than reducing both judicial caseloads and parties' presumed monetary and temporal investments in litigation.

The Court has relied upon this policy of favoritism toward arbitration in many of its subsequent cases. During the course of its decision in *Mitsubishi Motors*, allowing the arbitration of an antitrust claim in the international context, the Court found that although "the parties' intentions control . . . those intentions are generously construed as to issues of arbitrability."<sup>132</sup> The Court has relied on the preference not only to interpret the terms of an arbitration agreement broadly but also to reject proposed statutory exemptions

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129. See *Dickinson v. Heinold Sec., Inc.*, 661 F.2d 638, 643 (7th Cir. 1981) (stating as established federal policy that "when construing arbitration agreements, every doubt is to be resolved in favor of arbitration"); *Wick v. Atlantic Marine, Inc.*, 605 F.2d 166, 168 (5th Cir. 1979) (stating that a stay for judicial proceedings should be granted unless the arbitration clause is "not susceptible" to an interpretation that would properly bring the issue to arbitration); *Becker Autoradio U.S.A., Inc. v. Becker Autoradiowerk GmbH*, 585 F.2d 39, 43-45 (3d Cir. 1978) (citing a policy of favoring arbitration agreements in the absence of "positive assurance" that a dispute was not meant to be arbitrated). Perhaps these courts failed to take note of the distinction between labor and commercial arbitration.

130. *Hanes Corp. v. Millard*, 531 F.2d 585, 598 (D.C. Cir. 1976) (stating that a policy of liberally construing arbitration agreements serves to ease court congestion).

131. After recounting the importance of reducing courts' caseloads and extolling the virtues of arbitration, Justice Burger wrote:

The Court seems unaware that people's patience with the judicial process is wearing thin. Its holding [restricting arbitration] runs counter to every study and every exhortation of the Judiciary, the Executive, and the Congress urging the establishment of reasonable mechanisms to keep matters of this kind out of the courts. . . . Approving an extrajudicial resolution procedure "is not a question of first-class or second-class . . . means. It is a matter of tailoring the means to the problem that is involved."

*Barrentine v. Arkansas-Best Freight Sys.*, 450 U.S. 728, 752 (1981) (Burger, C.J., dissenting) (citations omitted) (quoting Resolution of Minor Disputes, Joint Hearings Before the Subcomm. on Courts, Civil Liberties and the Administration of Justice of the House Comm. on the Judiciary, and Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce, 96th Cong., 1st Sess. 28 (1979) (testimony of Assistant Attorney General Meador)).

Although Justices Burger and Rehnquist actually dissented in *Moses H. Cone*, they did so on other grounds, arguing that arbitration could be fostered by state as well as by federal courts. See 460 U.S. at 30-36.

132. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985).

to arbitration.<sup>133</sup>

As the Court has become more concerned with the public utility of arbitration and less concerned with whether the parties actually agreed to arbitration, the Court has at times also rejected as irrelevant the question of whether an inequality in bargaining power affected the parties' agreement to arbitrate.<sup>134</sup> While the Court in theory continues to allow parties to use claims of bargaining inequality to support a showing of fraud or coercion in a particular case,<sup>135</sup> the Court will no longer rule out whole categories of cases on the assumption that the parties lacked equal bargaining power.<sup>136</sup>

At the same time that the Court was enunciating a policy of favoritism toward arbitration, in another line of cases it was reiterating the idea that arbitration agreements are based upon a policy of freedom of contract. In *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*,<sup>137</sup> the Court held that parties could contractually choose to be governed by state arbitration laws rather than the FAA so long as the state law does not actually conflict with the FAA.<sup>138</sup> Emphasizing that "[a]rbitration is a matter of consent, not coercion,"<sup>139</sup> the Court affirmed reliance on a California statute that permitted a stay of arbitration pending resolution of

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133. *Id.* at 626 (allowing arbitration of antitrust claim in international context); *see also* *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212, 1214 (1995) (holding that policy favoring arbitration supports allowing arbitrators to award punitive damages); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991) (citing federal policy favoring arbitration in ruling that ADEA claims are arbitrable); *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 481 (1989) (taking note of federal policy of favoring arbitration in reversing *Wilko* and holding that securities fraud claims can be arbitrated); *Shearson/Am. Express Inc. v. McMahon*, 482 U.S. 220, 227 (1987) (stating that given federal preference for arbitration "[t]he burden is on the party opposing arbitration . . . to show that Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue").

134. *See, e.g., McMahon*, 482 U.S. at 230 (finding that *Wilko* was concerned not with overreaching or bargaining inequalities but only with whether the party had waived benefits that were non-waivable pursuant to securities law). Given this reading of *Wilko*, the Court found it was permissible to send to arbitration both section 10(b) securities fraud and RICO claims despite arguments that the arbitration agreement had been imposed on the weaker party. *Id.*

135. *See, e.g., Allied-Bruce Terminix Cos. v. Dobson*, 115 S. Ct. 834, 843 (1995); *Gilmer*, 500 U.S. at 33. Significantly, the Court has not actually voided any arbitration agreements based on such a defense.

136. *Gilmer*, 500 U.S. at 32-33; *cf. id.* at 39 (Stevens, J., dissenting) (arguing that the FAA should not apply to employment-related disputes in part because such contracts are often not entered into voluntarily).

137. 489 U.S. 468 (1989).

138. *Id.* at 477-78.

139. *Id.* at 479. Along a similar line, the Court explained that the federal policy was "to ensure the enforceability, *according to their terms*, of private agreements to arbitrate." *Id.* at 476 (emphasis added). The Court further observed that "[t]here is no federal policy favoring arbitration under a certain set of procedural rules." *Id.*

related litigation.<sup>140</sup>

The Court has also emphasized the central importance of the parties' knowing consent in *Mastrobuono v. Shearson Lehman Hutton, Inc.*,<sup>141</sup> holding that the parties may determine whether punitive damages should be available,<sup>142</sup> and in *First Options of Chicago v. Kaplan*,<sup>143</sup> holding that the parties may determine whether the arbitrators or the court should decide any questions that arise pertaining to arbitrability.<sup>144</sup>

While the Court has never directly discussed or attempted to reconcile the differences between the *Moses H. Cone* line of cases preferring arbitration and the *Volt* line of cases emphasizing the importance of the parties' consent, the Court's recent decision in *Doctor's Associates, Inc. v. Casarotto*<sup>145</sup> implicitly chooses the *Moses H. Cone* preference for arbitration. The Montana Supreme Court found that Montana's notice provision was necessary to ensure knowing consent to arbitration and was consistent with *Volt*.<sup>146</sup> The U.S. Supreme Court reversed and held that any state law that was targeted specifically to void arbitration agreements, and not contracts in general, was preempted by the FAA, even if the purpose of the state's law may have been to promote the knowing choice of arbitration.<sup>147</sup>

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140. *Id.* at 476-78. This "stay" effectively rendered unnecessary any arbitration. Most interestingly, the arbitration agreement reached between the parties did not actually specify that California rather than federal arbitration law should apply. Nonetheless, the Court interpreted such an intent into the general choice-of-law clause, which provided that "[t]he Contract shall be governed by the law of the place where the Project is located." *Id.* at 470.

141. 115 S. Ct. 1212 (1995).

142. The Court explained in *Mastrobuono* that "[a]rbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit." *Id.* at 1216. The Court read the ambiguous arbitration contract in favor of the customer, and not to exclude punitive damages, in part because "[a]s a practical matter, it seems unlikely that petitioners were actually aware of New York's bifurcated approach to punitive damages, or that they had any idea that by signing a standard-form agreement to arbitrate disputes they might be giving up an important substantive right." *Id.* at 1219.

143. 115 S. Ct. 1920 (1995).

144. A unanimous Court stated: "Just as the arbitrability of the merits of a dispute depends upon whether the parties agreed to arbitrate that dispute, so the question 'who has the primary power to decide arbitrability' turns upon what the parties agreed about *that* matter." *Id.* at 1923 (citations omitted). However, the Court held that whereas any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, arbitrators would only be permitted to resolve arbitrability if the parties gave them such power clearly and unmistakably. *Id.* at 1924. The Court justified this distinction on the ground that parties are unlikely to have given any thought to who should decide the issue of arbitrability. *Id.* at 1924-25.

145. 116 S. Ct. 1652 (1996).

146. *Casarotto v. Lombardi*, 901 P.2d 596, 597-98 (Mont. 1995).

147. *Doctor's Assocs.*, 116 S. Ct. at 1656 (declaring that Montana Supreme Court misread *Volt Info. Sciences Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468 (1989)).

## 2. *Scope of FAA: Broadened to Cover State Courts and Virtually All Federal and State Claims*

### a. *The FAA Applied to State Court Proceedings*

The Supreme Court dramatically increased the scope of the FAA during this third period by expounding the dual myths that the FAA applies to actions brought in state court and that the FAA prohibits states from enacting legislation hostile to arbitration. While the FAA only governs transactions involving interstate commerce, cases decided in this third period have established that this limitation barely restrains the FAA.<sup>148</sup>

*Southland Corp. v. Keating*<sup>149</sup> was the landmark Supreme Court case that first applied the FAA to state courts. Justice Burger, in a 7-2 decision,<sup>150</sup> held that the FAA not only applied to state courts but also preempted the California Supreme Court's interpretation of a California statute to the effect that claims under that law could only be brought in court, and not through arbitration.<sup>151</sup> Justice Burger based these conclusions on the Court's earlier decision in *Prima Paint* that the FAA rests on Congress' authority to enact substantive rules under the Commerce Clause<sup>152</sup> as well as on his reading of legislative history.<sup>153</sup> Most commentators disagree with his assessment of the legislative history.<sup>154</sup>

148. See *infra* notes 158-62 and accompanying text.

149. 465 U.S. 1 (1984).

150. Justice Stevens concurred in part but dissented in part, concluding that while the FAA applies to the states, it does not necessarily preempt those state laws not inconsistent with the FAA. *Id.* at 21.

151. The plaintiffs, 7-Eleven franchisees, sued franchisor Southland in state court, alleging Southland had violated disclosure requirements of the California Franchise Investment Law., see CAL. CORP. CODE §§ 31000-31516 (West 1994). When Southland sought an order to compel arbitration, the California Supreme Court held that the Franchise Investment Law required claims to be brought in court, and therefore refused to order arbitration. See *Southland*, 465 U.S. at 5.

152. *Southland*, 465 U.S. at 10 (citing *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967)).

153. The Court states: "Although the legislative history is not without ambiguities, there are strong indications that Congress had in mind something more than making arbitration agreements enforceable only in the federal courts." *Southland*, 465 U.S. at 12. Justice Burger fully recognized the significance of this conclusion, noting that just 2% of civil litigation is brought in the federal courts. *Id.* at 15 n.8.

154. Scholars Ian Macneil, Richard Speidel and Thomas Stipanowich sharply criticize the legislative history put forth by Justice Burger, calling it a "pillar of sand." MACNEIL ET AL., *supra* note 9, § 10.5.3. Professor Macneil, writing on his own, is even more blunt:

[T]he majority used the artifacts of the history of the USAA in building their arguments just as a mason uses stone in building a stone wall—picking ones that are useful, ignoring ones that are not, discarding troublesome ones, chipping away offensive spurs on otherwise useful pieces, twisting and turning each stone until it best fits, and above all, covering up the chinks and defects with a mortar of words. . . . The result is pathological history.

MACNEIL, *supra* note 12, at 170; see also Strickland, *supra* note 32, at 391 (finding that when the FAA

Ten years after *Southland*, the Court's decision to apply the FAA to state courts and to preempt state legislation was still extremely controversial. Thus, when the Court granted certiorari in *Allied-Bruce Terminix Cos. v. Dobson*,<sup>155</sup> twenty state attorney generals joined together in an amicus brief to ask the Court to reverse its earlier holding in *Southland*.<sup>156</sup> However, the Court refused the invitation.<sup>157</sup>

*Terminix* is a significant decision in that it not only refused to overrule *Southland* but also expanded the scope of the FAA further into the realm of state court jurisprudence. Following *Southland* there had been a dispute among courts as to the scope of the FAA in light of the statute's limited application to a "written provision in any maritime transaction or a contract evidencing a transaction involving commerce."<sup>158</sup> The Supreme Court, again purporting to rely on legislative history, adopted the broadest possible definition of interstate commerce, concluding that the FAA should be interpreted to cover the full range of Congress' authority and to regulate all "commerce in fact."<sup>159</sup> That is, regardless of party intent, the FAA applies to

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was enacted, few if any commentators thought that the FAA would apply in state courts).

155. 115 S. Ct. 834 (1995).

156. The twenty states were Alabama, Alaska, Arkansas, Colorado, Florida, Illinois, Hawaii, Massachusetts, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, North Dakota, Pennsylvania, South Carolina, Utah, and Vermont. Brief Amici Curiae for the Attorneys General in Support of Petitioners, *Terminix*, 115 S. Ct. 834 (1995) (No. 93-1001). Observing that the Court had issued its opinion in *Southland* without the benefit of parties' briefing on the issue of the scope of the FAA, *id.* at 1-2 & n.2, the amici argued that states should have the power to determine how proceedings in their own courts should be handled, and that specifically they should be allowed to protect "consumers and others of unequal bargaining power or information," *id.* at 3 & n.5, 19 & n.25.

157. It stated:

Nothing significant has changed in the 10 years subsequent to *Southland*; no later cases have eroded *Southland's* authority; and, no unforeseen practical problems have arisen. Moreover, in the interim, private parties have likely written contracts relying upon *Southland* as authority. Further, Congress, both before and after *Southland*, has enacted legislation extending, not retracting, the scope of arbitration. For these reasons, we find it inappropriate to reconsider what is by now well-established law.

*Terminix*, 115 S. Ct. at 839 (citations omitted).

158. 9 U.S.C. § 2 (1994). Some courts had interpreted the reference to interstate commerce very broadly. *E.g.*, *Foster v. Turley*, 808 F.2d 38, 40 (10th Cir. 1986); *Robert Lawrence Co. v. Devonshire Fabrics Inc.*, 271 F.2d 402, 406-07 (2d Cir. 1959), *cert. dismissed*, 364 U.S. 801 (1960). Others had interpreted the phrase more narrowly. The Supreme Court of Alabama in *Terminix* had found that the Act applies to a contract only if "'at the time . . . [the parties] entered into the [contract] and accepted the arbitration clause, they contemplated substantial interstate activity.'" *Allied-Bruce Terminix Cos. v. Dobson*, 628 So. 2d 354, 355 (Ala. 1993) (quoting *Metro Indus. Painting Corp. v. Terminal Constr. Co.*, 287 F.2d 382, 387 (2d Cir.) (Lumbard, C.J., concurring), *cert. denied*, 368 U.S. 817 (1961); *see also* *R.J. Palmer Constr. Co. v. Wichita Band Instrument Co.*, 642 P.2d 127, 130 (Kan. Ct. App. 1982); *Burke County Pub. Sch. Bd. of Educ. v. Shaver Partnership*, 279 S.E.2d 816, 821-23 (N.C. 1981).

159. *Terminix*, 115 S. Ct. at 841.

any transaction Congress would have the power to regulate directly under its commerce power. In *Terminix*, the Court applied this rule to cover an agreement reached between a homeowner and a local pest extermination company.<sup>160</sup> In light of the extremely broad interpretation that has been given to the Commerce Clause,<sup>161</sup> it is now quite difficult to conjure up many transactions that would *not* be regulated by the FAA.<sup>162</sup>

*b. The FAA Interpreted to Preempt Protective State Laws*

*Southland* not only found that the FAA applied in state court, but also invalidated California's interpretation of its own Franchise Act, to prohibit arbitration of claims under the Act, as preempted by the FAA.<sup>163</sup> Justice Burger found that the California Supreme Court's interpretation of its own statute<sup>164</sup> conflicted directly with the FAA by purporting to invalidate an arbitration clause for reasons other than those existing at law or equity.<sup>165</sup> As Justice Stevens pointed out in dissent, the Court could have interpreted the preemptive scope of the FAA far more narrowly than it did.<sup>166</sup> Subsequently, in *Perry v. Thomas*, the Court again invalidated a California statute it found

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160. *Id.* at 843 (noting that the parties did not contest that the transaction in fact involved interstate commerce). *But see* Brief of Respondents at 2 & n.5, *Terminix*, 115 S. Ct. 834 (1995) (No. 93-1001) (emphasizing local nature of transaction).

161. Although the Court in *United States v. Lopez*, 115 S. Ct. 1624 (1995), struck down a federal law attempting to prohibit gun possession near schools, few doubt that the Court will continue to interpret the Commerce Clause quite broadly. *See, e.g.*, *United States v. Robertson*, 115 S. Ct. 1732 (1995) (upholding RICO conviction despite argument that operation of gold mine in Alaska did not sufficiently implicate interstate commerce).

162. *But see* *Columbus Anesthesia Group v. Kutzner*, 459 S.E.2d 422 (Ga. Ct. App. 1995) (finding no interstate commerce sufficient to bring FAA into play where dispute involved contract for doctor to join a Georgia professional corporation providing medical services in Georgia, even though doctor himself came from outside Georgia and contract required him to contribute equipment manufactured outside Georgia to the corporation).

163. *Southland v. Keating*, 465 U.S. 1 (1984).

164. CAL. CORP. CODE §§ 31000-31516 (West 1994). The statute did not explicitly require that claims could only be resolved through litigation, but was so interpreted by the California Supreme Court. *See* *Keating v. Superior Court of Alameda County*, 645 P.2d 1192 (Cal. 1982) (en banc), *jurisd. postponed*, 459 U.S. 1101 (1983), *appeal dismissed in part and rev'd in part*, 465 U.S. 1 (1984).

165. Justice Burger stated: "In enacting § 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Southland*, 465 U.S. at 10. Section 2 of the FAA provides that arbitration agreements are valid except "upon such grounds as exist at law or in equity for revocation of any contract." 9 U.S.C. § 2 (1994).

166. *Southland*, 465 U.S. at 18-21. Justice Stevens argued that the FAA should be interpreted to preempt those state statutes that were directly at odds with the FAA, but that states should be allowed to regulate arbitration in ways consistent with the purpose of the FAA, particularly to express important state interests such as protecting franchisees.

inconsistent with the FAA<sup>167</sup> in that California sought to preserve an employee's right to bring certain wage collection actions in court.

Whereas *Southland*, *Perry*, and *Terminix* made it clear that, except with respect to purely local transactions, a state could not require certain categories of claims to be resolved through litigation rather than through arbitration, *Doctor's Associates, Inc. v. Casarotto* interpreted the preemptive scope of the FAA even more broadly, thereby devastating virtually all state attempts to protect consumers, franchisees, and other weaker parties.<sup>168</sup> *Doctor's Associate* held that even a mere requirement that an arbitration clause be "typed in underlined capital letters on the first page of the contract"<sup>169</sup> was inconsistent with the FAA and therefore preempted.<sup>170</sup> In an 8-1 decision<sup>171</sup> the Justices found the rule quite clear: "Courts may not . . . invalidate arbitration agreements under state laws applicable *only* to arbitration provisions."<sup>172</sup> The Court's ruling explicitly rejected the Montana Supreme Court's finding that the notice provision was consistent with and thus not preempted by the FAA in that the goal of the FAA is not to promote

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167. 482 U.S. 483 (1987) (holding that the FAA preempts provision of California Labor Law which stated that wage collection actions could be maintained in court without regard to existence of private agreement to arbitrate).

168. Lower federal and state courts had already invalidated numerous state statutes. *See supra* note 15 and *infra* notes 387-95 and accompanying text; *see generally* Rita M. Cain, *Preemption of State Arbitration Statutes: The Exaggerated Federal Policy Favoring Arbitration*, 19 CONTEMP. L. 1 (1993).

169. MONT. CODE ANN. § 27-5-114(4) (1993).

170. Plaintiff Paul Casarotto was a Subway sandwich shop franchisee who brought suit against franchisor Doctor's Associates for breach of contract, fraud, and various business torts. *Casarotto v. Lombardi*, 886 P.2d 931, 933 (1994). Plaintiff alleged, specifically, that whereas defendant had promised him an exclusive right to run a Subway Sandwich Shop in Great Falls Montana, Defendant subsequently allowed another franchisee to open a store at a more desirable location. *Id.* at 932-33. When plaintiff brought suit in state court, defendants filed a motion to dismiss or stay judicial proceedings pending arbitration, pointing to the arbitration clause contained at paragraph 10(c) on page 9 of the franchise agreement. *Id.* at 933. Pursuant to the clause, arbitration would have taken place in Connecticut, the headquarters state for Doctor's Associates. *Id.* Plaintiff Casarotto argued that the clause was in violation of Montana law and thus invalid in that the first page of the contract failed to provide him with notice of the arbitration clause contained within the contract. *Id.*

171. The sole dissenter, Justice Thomas, stated simply that he did not believe the FAA applied at all to proceedings brought in state court. *Doctor's Assocs., Inc. v. Casarotto*, 116 S. Ct. 1652, 1657 (1996).

172. *Id.* at 1656. The court cited language from *Southland*, *Perry*, and *Terminix* to support its conclusion that states may not regulate arbitration contracts more strictly than they would regulate other contracts. *Id.* at 1656-47; *see Terminix*, 115 S. Ct. at 842-43; *Perry*, 482 U.S. at 492 n.9; *Southland*, 465 U.S. at 10. However, in none of these decisions has the Court ever enunciated why a state should not be particularly protective of parties' waiver of a constitutional right, as compared to other more ordinary types of contracts. *Cf.* Sternlight, *supra* note 11 (arguing that courts have failed properly to apply Supreme Court's waiver decisions in arbitration context).



arbitration at any cost, but rather to promote arbitration that is knowingly selected by the parties.<sup>173</sup> Assuming the Court's decision in *Doctor's Associates* is neither overturned by Congress<sup>174</sup> nor later reversed as constitutionally misguided,<sup>175</sup> state legislatures will be permitted to protect consumers and others from unfair binding arbitration clauses only to the extent they regulate purely local transactions, or draft legislation that addresses arbitration jointly with other concerns.<sup>176</sup>

*c. Eradication of Public Policy Exclusion*

The Court began the third era by making further inroads on public policy exclusions in the international context. Reiterating its conclusion in *Scherk*

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173. The Montana Supreme Court's first ruling in the case is contained at 886 P.2d 931 (Mont. 1994). After the Supreme Court vacated and remanded the decision for reconsideration in light of *Terminix* the Montana Supreme Court issued a second opinion again holding the Montana notice provision was not preempted by the FAA. 901 P.2d 596 (Mont. 1995). It stated that "[t]he FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration," 901 P.2d at 597-98 (quoting the prior decision, 886 P.2d at 938-39), and that "[p]resumably . . . the . . . Court would not find it a threat to the policies of the Federal Arbitration Act for a state to require that before arbitration agreements are enforceable, they must be entered knowingly. To hold otherwise would be to infer that arbitration is so onerous as a means of dispute resolution that it can only be foisted upon the uninformed." *Id.*

The *Casarotto* case is further complicated by the fact that the franchise agreement at issue contained a "a choice of law" provision calling for the application of Connecticut law. *Id.* at 933. Because Connecticut does not require particular notice be provided as to an arbitration clause contained within a contract, defendants argued the Montana statute was irrelevant, as well as preempted. *Id.* at 934. However, citing its own prior decision in *Youngblood v. American States Ins. Co.*, 866 P.2d 203, 205 (Mont. 1993), as well as the RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2) (1971), the Montana Supreme Court found that "this State's public policy will ultimately determine whether choice of law provisions in contracts are 'effective.'" 886 P.2d at 934. Looking to the history of Montana's provision, the Montana court found Montana legislators had been extremely concerned both that Montanans not waive their constitutional right to court access unknowingly, and that Montanans not be required to arbitrate disputes at distant locations. *Id.* at 935. Upon noting that the specific clause at issue would have required Casarotto to arbitrate all disputes, no matter how small, in Connecticut, and that the costs of such travel would be expensive, *id.* at 935, and upon further observing that the arbitration itself lacked procedural and evidentiary protections provided in Montana, the Montana Supreme Court concluded that application of Connecticut law would violate Montana public policy and thus voided that choice of law. *Id.* at 935.

174. See *infra* notes 385-411 and accompanying text.

175. See Sternlight, *supra* note 11.

176. The Court has implied, for example, that a state could permissibly prohibit *all* adhesive contracts, even though it may not focus particularly on adhesive arbitration agreements. *Terminix*, 115 S. Ct. at 843. More realistically, perhaps a state could require certain notice as to all waivers of constitutional rights, including but not limited to waivers of the right to jury trial. Or, the state might require certain notice as to unexpected provisions contained in adhesion contracts. Counsel for Casarotto asserted at oral argument that the Montana Supreme Court's decision could be justified under this broad rule, but the Court concluded that in fact the lower court's decision was based entirely on the narrow arbitration statute and thus prohibited. *Doctor's Assocs.*, 116 S. Ct. at 1656 n.3.

that international transactions should be treated differently,<sup>177</sup> the Court in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*<sup>178</sup> held that even if antitrust claims could not be arbitrated domestically,<sup>179</sup> they should be arbitrable in the context of international transactions.<sup>180</sup>

Although the Court purported to base its decisions in *Scherk* and *Mitsubishi Motors* on the special nature of international transactions, the Court subsequently used these decisions to cut back, if not eliminate, the domestic public policy exception it had established in *Wilko* with respect to Securities Act claims.<sup>181</sup> First, in *Shearson/American Express, Inc. v. McMahon*,<sup>182</sup> the Court held that a consumer's claims against a brokerage house brought under both section 10(b) of the Securities Exchange Act of 1934<sup>183</sup> and the Racketeer Influenced and Corrupt Organizations Act ("RICO")<sup>184</sup> were arbitrable. Refusing to extend *Wilko* to cover these claims,<sup>185</sup> the *McMahon* Court reasoned that it had allowed arbitration of a section 10(b) securities fraud claim in *Scherk* because "under the circumstances of that case, arbitration was an adequate substitute for adjudication as a means of enforcing the parties' statutory rights."<sup>186</sup> The Court then cited its *Mitsubishi Motors* decision to show that an agreement to arbitrate is not a waiver of substantive rights<sup>187</sup> and that arbitrators are fully

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177. See *Scherk v. Alberto-Culver*, 417 U.S. 506, 518-19 (1974).

178. 473 U.S. 614 (1985).

179. The Court chose not to reach the question of whether antitrust claims would be arbitrable if brought in the domestic context. *Id.*

180. Noting that "federal policy applies with special force in the field of international commerce," *id.* at 631, the Court stated, "[W]e conclude that concerns of international comity, respect for the capacities of foreign and transnational tribunals, and sensitivity to the need of the international commercial system for predictability in the resolution of disputes require that we enforce the parties' agreement, even assuming that a contrary result would be forthcoming in a domestic context," *id.* at 629. The Court further explained that if international arbitration is to "take a central place in the international legal order, national courts will need . . . to subordinate domestic notions of arbitrability to the international policy favoring commercial arbitration." *Id.* at 638-39 (citations omitted).

181. See *Wilko v. Swan*, 346 U.S. 427 (1953). The Court in *Wilko* had held claims brought under section 12(2) of the Securities Act of 1934 were not arbitrable. See *supra* notes 49-54 and accompanying text.

182. 482 U.S. 220 (1987).

183. 15 U.S.C. § 78j(b)(1994).

184. 18 U.S.C. §§ 1961-1968 (1994).

185. *McMahon*, 482 U.S. at 238-42. Although *McMahon* did not overrule *Wilko*, it did state that "the mistrust of arbitration that formed the basis for the *Wilko* opinion in 1953 is difficult to square with the assessment of arbitration that has prevailed since that time." *Id.* at 233.

186. *Id.* at 229. The Court found that pursuant to *Scherk* "*Wilko* must be understood . . . as holding that the plaintiff's waiver of the 'right to select the judicial forum' was unenforceable only because arbitration was judged inadequate to enforce the statutory rights created by section 12(2)." *Id.* at 228-29 (quoting *Wilko v. Swan*, 346 U.S. 427, 435 (1953)).

187. *McMahon*, 482 U.S. at 229-30 (discussing *Mitsubishi Motors Corp. v. Soler Chrysler-*

capable of following the law and handling complex legal and factual claims.<sup>188</sup>

Two years later, in a 5-4 decision in *Rodriguez de Quijas v. Shearson/American Express, Inc.*,<sup>189</sup> the Supreme Court took the final step and overruled *Wilko*.<sup>190</sup> The Court held that because the securities customers, now plaintiffs, had signed a customer agreement accepting arbitration, they could not bring their section 12(2) fraud claims in court.<sup>191</sup> The majority rejected *Wilko* because of its judicial hostility to arbitration.<sup>192</sup> Quoting Justice Frankfurter's dissent in *Wilko*, the Court announced: "There is nothing in the record before us, nor in the facts of which we can take judicial notice, to indicate that the arbitral system . . . would not afford the plaintiff the rights to which he is entitled."<sup>193</sup>

Then, in the controversial decision of *Gilmer v. Interstate/Johnson Lane Corp.*,<sup>194</sup> the Court held that arbitration clauses must even be enforced to prevent a plaintiff from bringing suit pursuant to the federal Age Discrimination in Employment Act ("ADEA").<sup>195</sup> Citing the Court's decision

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Plymouth, Inc., 473 U.S. 614 (1985)).

188. *McMahon*, 482 U.S. at 232, 239. The Court similarly cited *Scherk* as holding that arbitrators are fully capable of resolving section 10(b) claims. *Id.* at 232 (discussing *Scherk v. Alberto-Culver*, 417 U.S. 506 (1974)).

189. 490 U.S. 477 (1989). Plaintiffs in *Rodriguez de Quijas* were two individuals who had sued the Shearson brokerage house and its broker-agent for unauthorized and fraudulent transactions. *Id.* at 478.

190. The Court overruled *Wilko* even though plaintiffs' facts were extremely sympathetic. Plaintiffs were "a group of first-time investors that included widows, retirees, minors, and 'individuals without the ability to understand English.'" G. Richard Shell, *Contracts in the Modern Supreme Court*, 81 CAL. L. REV. 433, 459 (1993) (quoting Brief for Petitioners at 2, *Rodriguez de Quijas*, 490 U.S. 477 (1989) (No. 88-385)). Further, the broker was alleged to have concealed the arbitration clause from the plaintiffs when he presented them with documents for their signature. *Id.* at 459-60. Nonetheless, the Court found plaintiffs had made "no factual showing" to support a showing that the agreement was adhesive. *Rodriguez de Quijas*, 490 U.S. at 484.

191. *Rodriguez de Quijas*, 490 U.S. at 483.

192. *Id.* at 480.

193. *Id.* at 483 (quoting *Wilko v. Swan*, 346 U.S. 427, 439 (1953) (Frankfurter, J., dissenting)). Referring back to its own analysis in *McMahon*, the Court explained that arbitrators are well capable of deciding securities fraud disputes, particularly given the oversight role played by the Securities and Exchange Commission. *Id.* at 483.

194. 500 U.S. 20 (1991).

195. *Id.* at 30-33. Gilmer sued with respect to his discharge claiming violation of the ADEA, 29 U.S.C. §§ 621-634 (1988). *Gilmer*, 500 U.S. at 23. Gilmer had worked as Manager of Financial Services for Interstate/Johnson Lane. Pursuant to his employment, Gilmer registered with the New York Stock Exchange ("NYSE"). *Id.* The application contained an arbitration provision, under which Gilmer agreed to arbitrate any claims that the exchange rules required to be arbitrated. *Id.* The NYSE, in turn, had a rule that required arbitration of any employment disputes. *Id.*

in *Gardner-Denver*,<sup>196</sup> Mr. Gilmer argued that “compulsory arbitration of ADEA claims pursuant to arbitration agreements would be inconsistent with the statutory framework and purpose of the ADEA.”<sup>197</sup> The Supreme Court disagreed, finding that public policies can be vindicated in the arbitral forum,<sup>198</sup> that Mr. Gilmer would not be precluded from filing a charge of discrimination with the EEOC,<sup>199</sup> that the availability of arbitration provides potential claimants with more options,<sup>200</sup> and that there was no showing that the arbitration procedures would be inadequate in that particular case.<sup>201</sup> In the wake of *Gilmer*, lower courts have issued numerous decisions holding that employees may be held to have contracted to arbitrate their Title VII claims as well.<sup>202</sup>

Finally, in *Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer*,<sup>203</sup> the Court reversed a long-standing set of circuit court precedents to hold that although the federal Carriage of Goods by Sea Act voids “[a]ny clause, covenant, or agreement in a contract of carriage relieving the carrier or the ship from liability for loss or damage . . . or lessening such liability,”<sup>204</sup> this statutory provision should not render moot a contractual provision requiring plaintiff to seek relief through Japanese arbitration.<sup>205</sup> The Court found that although plaintiff’s transaction costs in bringing the claim might be substantially increased by the requirement to bring the claim in Japan, such

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196. *Alexander v. Gardner-Denver Co.*, 415 U.S. 36 (1974); see *supra* notes 83-95 and accompanying text.

197. *Gilmer*, 500 U.S. at 27.

198. *Id.* at 28.

199. *Id.*

200. *Id.* at 29.

201. *Id.* at 30-32. The Court rejected Gilmer’s assertion that the panels would be biased, that discovery would be insufficient, that the unavailability of written arbitrators’ awards would stifle development of the law, or that the arbitrators would be unable to fashion equitable relief. *Id.*

202. See, e.g., *Bender v. A.G. Edwards & Sons, Inc.*, 971 F.2d 698 (11th Cir. 1992); *Mago v. Shearson Lehman Hutton Inc.*, 956 F.2d 932 (9th Cir. 1992); *Wilis v. Dean Witter Reynolds, Inc.*, 948 F.2d 305 (6th Cir. 1991); *Alford v. Dean Witter Reynolds, Inc.*, 939 F.2d 229 (5th Cir. 1991); *DeGaetano v. Smith Barney, Inc.*, No. 95 Civ. 1613, 1996 WL 44226 (S.D.N.Y. Feb. 5, 1996) (requiring arbitration of Title VII claim by plaintiff securities analyst even though arbitration agreement required plaintiff to waive substantive rights to attorney fees, injunctive relief, and punitive damages).

203. 115 S. Ct. 2322 (1995).

204. 46 U.S.C. app. § 1303(8) (1994).

205. *Sky Reefer*, 115 S. Ct. at 2326-30. As the Court observed, following Judge Friendly’s decision in *Indussa Corp. v. S.S. Ranborg*, 377 F.2d 200 (2d Cir. 1967) (en banc), the courts of appeals without exception had invalidated foreign forum selection clauses under section 3(8) of the COGSA. *Sky Reefer*, 115 S. Ct. at 2326. The Court further noted that “[a]s foreign arbitration clauses are but a subset of foreign forum selection clauses in general, the *Indussa* holding has been extended to foreign arbitration clauses as well.” *Id.* (citations omitted).

increased costs would not constitute a "lessening of liability," as precluded by statute.<sup>206</sup> The Court further found it wrong to assume that the Japanese arbitrators would not fairly apply the U.S. statute, observing that in any event the district court would retain jurisdiction to review the finding of the Japanese arbitrators at the award enforcement stage.<sup>207</sup>

At this point the only remaining vestige of the public policy exception to arbitration is the *Gardner-Denver* line of cases, holding that where a union signs an employment contract containing a grievance provision, individual employees may nonetheless file individual complaints in court.<sup>208</sup> While the Supreme Court has said Congress could explicitly preclude arbitration under a specific federal statute,<sup>209</sup> the Supreme Court has failed to so interpret any statutes except the three labor statutes in the context of arbitration negotiated by a union.<sup>210</sup>

### 3. *Arbitration Is Just as Appropriate, If Not More Appropriate, Than Litigation for Most Disputes*

In *Mitsubishi Motors*, the Court initially enunciated the myth that arbitration is as appropriate for virtually all disputes as is litigation.<sup>211</sup> It stated:

By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum. It trades the

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206. *Sky Reefer*, 115 S. Ct. at 2327-28 (citing *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991) (upholding a forum selection clause applied to a cruise passenger)).

207. *Sky Reefer*, 115 S. Ct. at 2329-30. However, as Justice Stevens pointed out in dissent, this retention of jurisdiction provides only small comfort to the American distributor who, having spent thousands of dollars to pursue a claim in Japan, would likely have to wait years to have even a chance of reversing the arbitrators' award under the difficult appellate standard for vacating an arbitrator's award. *Id.* at 2332-33.

208. See *supra* notes 83-95 and accompanying text.

209. E.g. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991) (noting that Congress could preclude arbitration of claims under a particular statute).

210. But see *Prudential Ins. Co. v. Lai*, 42 F.3d 1299, 1304 (9th Cir. 1994), *cert. denied*, 116 S. Ct. 61 (1995) (holding that employees did not knowingly forego their statutory remedies under Title VII in signing the securities registration form, and thus could not be required to arbitrate such claims); *Graham Oil Co. v. ARCO Prods. Co.*, 43 F.3d 1244 (9th Cir. 1994) (invalidating arbitration clause that purported to waive longer statute of limitations, right to recover exemplary damages, and attorney fees under federal Petroleum Marketing Practices Act, 15 U.S.C. §§ 2801-2841 (1994), on ground that such waiver would be inconsistent with the Act).

211. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985).

procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration.<sup>212</sup>

The Court also analyzed arbitrators' capabilities as decision makers in some detail. It found that "potential complexity should not suffice to ward off arbitration,"<sup>213</sup> particularly because "adaptability and access to expertise are hallmarks of arbitration."<sup>214</sup> The Court also rejected the proposition that arbitrators would tend to be biased.<sup>215</sup> Finally, to the extent there are differences between the arbitral and judicial fora, the Court observed that parties may often be willing to forego the judicial remedies in order to keep down costs.<sup>216</sup>

The Court has repeated its *Mitsubishi Motors* analysis in many subsequent contexts, including claims for securities fraud, RICO violations, and age discrimination. In these cases, the Court has observed that arbitration, while different, does not forego any substantive rights,<sup>217</sup> that arbitrators can handle complex legal, as well as factual, matters,<sup>218</sup> and that arbitrators are not inherently biased.<sup>219</sup> Significantly, the Court has not based these assertions on any empirical data. Rather, the Court has simply announced its own opinion that arbitrators are as capable as judges and thereby shifted the burden to a party seeking to demonstrate the inferiority of arbitration. The Court's analysis is also noteworthy for its failure to differentiate between contracts involving two equally knowledgeable businesspeople, who agree to arbitration to save litigation costs for all, and contracts used by a more powerful party to inflict its will upon a weaker party.

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212. *Id.*

213. *Id.* at 633.

214. *Id.*

215. *Id.* at 634.

216. *Id.* at 633. The Court further stated "so long as the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function." *Id.* at 637.

217. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 27-28 (1991); *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 481-83 (1989); *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 229-30 (1987).

218. *McMahon*, 482 U.S. at 231-32.

219. *Gilmer*, 500 U.S. at 30-31; *see also Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer*, 115 S. Ct. 2322 (1995) (holding that contract of adhesion requiring fruit distributor to pursue negligence claim against ship owner through arbitration brought in Japan does not violate Carriage of Goods by Sea Act, 46 U.S.C. app. § 1303 (1994), by lessening liability under that statute).

### D. Conclusion

To sum up, the Court's current interpretation of the FAA is not supported by the legislative history. Rather, the Court's preference for arbitration over litigation, its conclusion that the FAA preempts all protective state legislation, and its assurance that arbitration is just as fair a forum as litigation for resolution of legal complaints are myths that the Court has expounded since 1983. However, the mere fact that the Court's conclusions are new does not necessarily mean they are wrong as a matter of policy. Some would argue that even though Congress in 1925 may not have intended the FAA to be interpreted as it is currently, the modern interpretations are nonetheless desirable.<sup>220</sup> Viewed in a broader context, the Court's decisions in these cases can be seen as expressing a law and economics philosophy favoring the alienability of court access rights.<sup>221</sup> In the section which follows, however, this Article demonstrates that none of the policy justifications that have been offered support the Court's extreme advocacy of unregulable arbitration.

### III. THE COURT'S PREFERENCE FOR BINDING ARBITRATION IS NOT SUPPORTED BY LEGITIMATE POLICY ARGUMENTS

Four major policy arguments can be articulated in defense of a preference for binding arbitration. First, some might propound a genuine or free will freedom of contract argument, asserting that where all parties have knowingly agreed to arbitrate the court should enforce that agreement.<sup>222</sup> Second, some contend that even if all parties have not knowingly agreed to binding arbitration, they will nonetheless all benefit from the process because arbitration will save all parties time and money. Third, some argue that even though sellers might want to use the arbitration process to gain an advantage over consumers, the operation of the market will prevent them from doing so, and that arbitration will again benefit all. Fourth, some might contend that even if a few parties are harmed by binding arbitration, the gains for society

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220. See, e.g., Larry E. Ribstein, *Choosing Law By Contract*, 18 J. CORP. L. 245 (1993) (defending private selection of arbitration as well as choice of law on law and economic grounds).

221. See Shell, *supra* note 190, at 458; Mullenix, *Another Choice of Forum*, *supra* note 118, at 296-97 ("the supremacy of contract law over long-established jurisdictional doctrines has significantly eroded certain fundamental litigation rights").

222. I distinguish in this Article between what I call a genuine or pure freedom of contract argument, which depends upon all parties having *knowingly* accepted the terms of a contract, and a second argument which contends that even absent knowledge by all consumers, the free market will protect their interests. Although some would also characterize this second argument as a freedom of contract argument, to avoid confusion I will not do so.

as a whole outweigh any such individual losses. This section discusses and critiques each argument, showing that none justifies imposing unregulable arbitration on nonconsenting consumers and other little guys.

*A. A Preference for Binding Arbitration Is Not Justified by Genuine Freedom of Contract*

Advocates of binding arbitration have long argued that parties who prefer this legal process over litigation should have the freedom to select binding arbitration.<sup>223</sup> The Supreme Court particularly emphasized this freedom of contract idea in some of the cases involving international business, explaining that companies doing business abroad needed to be able to work out mutually satisfactory ways of avoiding uncertainty and chaos in the international context.<sup>224</sup> The Court also echoed this freedom of contract theme in *Volt*, *Mastrobuono*, and *First Options*, holding that parties should have the right to choose to be governed by state rather than federal arbitration law,<sup>225</sup> to determine the availability of punitive damages,<sup>226</sup> and to decide whether courts or arbitrators should interpret the arbitrability of a particular issue.<sup>227</sup> The Court has expressed a similar philosophy in enforcing parties' contractual choice of a particular litigation forum.<sup>228</sup> Law and economics devotees would argue that allowing parties to contract freely is preferable not only because the contract provides certainty,<sup>229</sup> but also because it allows

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223. For example, the business forces who helped secure passage of the FAA emphasized their own right to structure their business dealings. See generally MACNEIL, *supra* note 12, at 25-58 (discussing important role of Chamber of Commerce and other business interests in securing passage of FAA and comparable state laws).

224. See *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 630 (1985) (allowing arbitration of antitrust claim in international context given general presumption in favor of freely negotiated choice of forum provisions and particular importance of that policy in international context); *Scherk v. Alberto-Culver*, 417 U.S. 506 (1974) (applying binding arbitration agreement between two companies involved in international business to resolve securities claim, even though such a dispute might not have been arbitrable in a domestic context).

225. *Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989) (alluding to "the FAA's primary purpose of ensuring that private agreements to arbitrate are enforced according to their terms").

226. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212, 1216 (1995).

227. *First Options of Chicago, Inc. v. Kaplan*, 115 S. Ct. 1920, 1923 (1995).

228. In *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972), the Court took note of "ancient concepts of freedom of contract," *id.* at 11, in holding that two international businesses, negotiating at arm's length and absent "fraud, undue influence, or overweening bargaining power," *id.* at 12, should be able to select their own forum, *id.* at 14-15. The Court observed that the agreement might not have been enforceable had the parties chosen to resolve their local disputes in a remote alien forum, in which case the remoteness might have suggested that the contract was adhesive in nature. *Id.* at 16.

229. See JOHN D. CALAMARI & JOSEPH M. PERILLO, *THE LAW OF CONTRACTS* § 9-42 (3d ed.



parties to act free of state constraint and will maximize the efficiency and utility of society as a whole.<sup>230</sup>

While the pure freedom of contract rationale has some appeal as applied to two entities engaging in an arm's length transaction, it cannot realistically be used to justify imposing binding arbitration through contracts of adhesion on unwitting consumers.<sup>231</sup> Few, if any, would be foolish enough to argue that most employees and consumers actually read and understand the form contracts that they sign which commit them to binding arbitration.<sup>232</sup> With respect to arbitration agreements in particular, even a consumer who reads the clause might well lack the legal sophistication to understand its significance, perhaps not recognizing that appeals from arbitration are virtually unwinnable and that little or no discovery may be made available in an arbitration proceeding.<sup>233</sup> Moreover, the very essence of form contracts is that they can rarely, if ever, be renegotiated by the consumer.<sup>234</sup> Thus, one cannot with a

1987).

230. Melvin A. Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211, 211 (1995); Goldman, *supra* note 117, at 714-15; see also RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW* 10-11 (4th ed. 1992); Michael I. Meyerson, *The Efficient Consumer Form Contract: Law and Economics Meets the Real World*, 24 GA. L. REV. 583, 623-25 (1990).

231. This Article uses the terms "form contract" and "contracts of adhesion" interchangeably to describe contracts prepared in advance and offered to consumers on essentially a take-it-or-leave-it basis. See 3 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 559C (Supp. 1994) (noting that adhesion contracts may be voided to prevent injustice to an innocent party); Goldman, *supra* note 117, at 701. I characterize a contract as a contract of adhesion even if one or two key terms, such as color and price, are subject to negotiation, where the contract contains many subordinate terms that are prepared in advance and not subject to negotiation. See generally Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1173, 1176-80 (1983) (defining adhesion contracts and arguing that adhesion contracts should be presumptively unenforceable); Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom to Contract*, 43 COLUM. L. REV. 629, 637 (1943).

232. The Restatement (Second) of Contracts explicitly notes that "[a] party who makes regular use of a standardized form of agreement does not ordinarily expect his customers to understand or even to read the standard terms." RESTATEMENT (SECOND) OF CONTRACTS § 211 cmt. b (1979); see also Alex Y. Seita, *Uncertainty and Contract Law*, 46 U. PITT. L. REV. 75, 133 (1984). One author estimated in 1971 that 99% of all contracts were standard form agreements. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529, 529 (1971). One would assume that the percentage of form contracts has increased rather than decreased since 1971, as our society has become more automated and complex. Cf. Patricia Sturdevant & Dwight Golann, *Should Binding Arbitration Clauses be Prohibited in Consumer Contract?*, DISP. RESOL. MAG., Summer 1994, at 4, 4 (asserting that consumers often do not have the vaguest idea of the consequences of what they are signing when they "agree" to arbitration). Of course, consumers may be aware of the content of certain key terms, such as price, but ignorant as to other more obscure provisions in the contract. Rakoff, *supra* note 231, at 1177.

233. Eisenberg, *supra* note 230, at 241-43 (a rational form taker will typically choose to remain ignorant of the terms because the verbal and legal obscurity of understanding form contract provisions is exceptionally high, the probability of the clause becoming relevant is low, the cost of research relative to the value of the contract is high, and the chances of negotiating a revision are low).

234. Goldman, *supra* note 117, at 717-18; Meyerson, *supra* note 230, at 599.

straight face justify enforcement of form arbitration agreements imposed by sellers on consumers on the ground that the consumers actually accepted the contract with knowledge of those terms.

Indeed, the Supreme Court itself has recognized that a pure freedom of contract rationale cannot be used to defend a contract imposed in an adhesive situation. In *Carnival Cruise Lines v. Shute*<sup>235</sup> the Court was asked to determine whether, by accepting a cruise ticket which, in the small print of a three page document, required any claims to be brought in Florida, cruise passengers had waived their right to bring a claim against the cruise line in another forum. The Court without hesitation found that the rationale of *M/S Bremen*, a previous forum selection case involving two companies,<sup>236</sup> was inapplicable and that the passengers could not be assumed to have freely and knowingly contracted for the forum selection clause.<sup>237</sup>

*B. A Preference for Binding Arbitration Is Not Justified by the Argument that Binding Arbitration Is Necessarily Better for All Parties Involved in the Transaction*

Some advocates of binding arbitration argue that regardless of whether consumers and other little guys know that they are agreeing to binding arbitration, arbitration does in fact serve their best interests. In economic terms, the argument is that binding arbitration is "Pareto optimal" as compared to litigation, meaning that all parties are better off in binding arbitration and none are worse off.<sup>238</sup> Such advocates as former Chief Justice

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235. 499 U.S. 585 (1990).

236. See *supra* notes 114-18 and accompanying text.

237. The Court stated:

In this context, it would be entirely unreasonable for us to assume that respondents—or any other cruise passenger—would negotiate with petitioner the terms of a forum-selection clause in an ordinary commercial cruise ticket. Common sense dictates that a ticket of this kind will be a form contract the terms of which are not subject to negotiation, and that an individual purchasing the ticket will not have bargaining parity with the cruise line.

*Shute*, 499 U.S. at 593. Nonetheless, while rejecting the freedom to contract rationale, the Court went on to validate the forum selection clause in that the consumer had failed to show that it was unreasonable or void as a contractual matter. *Id.* at 593-94. This conclusion has been sharply criticized. See, e.g., Goldman, *supra* note 117; Linda S. Mullenix, *Another Easy Case, Some More Bad Law: Carnival Cruise Lines and Contractual Presumed Jurisdiction*, 27 TEX. INT'L L.J. 323 (1992). But see Ribstein, *supra* note 220. Solimine, *supra* note 118.

238. "Efficiency," in the sense used by economists, is a technical term. However, economists have recognized that there are multiple potential definitions of efficiency. A system is "Pareto" efficient where one party cannot be made better off without making another party worse off. A system is Pareto inefficient where one or more parties could be made better off without making another party worse off. See POSNER, *supra* note 230, at 11-15. Sometimes economists also use another definition of efficiency,

Warren Burger claim, for example, that arbitration is quicker, cheaper, and more final than litigation, and thus allows all of the parties to save on legal fees and costs.<sup>239</sup> Some emphasize that because arbitration is cheaper, than litigation, many persons who would not even be able to pursue a claim in litigation will be able to arbitrate the claim.<sup>240</sup> Arbitration advocates also argue that the private and more conciliatory nature of arbitration may often help all parties protect their reputations, maintain better morale, and protect valuable working relationships.<sup>241</sup> Moreover, quicker resolution of disputes arguably allows all involved to get on to more productive uses of their time.

There are two major flaws with the argument that binding arbitration is necessarily better for all parties. First, although most would agree that arbitration can often be superior, as an empirical matter it is not clear that binding arbitration is necessarily faster, cheaper, and otherwise better than litigation. Unfortunately, most of the studies focusing on binding arbitration have examined attitudinal responses rather than objective measures, and even these show somewhat mixed results. Professor Thomas J. Stipanowich surveyed some of these studies in 1988 and concluded that while participants in commercial arbitration generally believed arbitration to be faster and cheaper than litigation,<sup>242</sup> many respondents disagreed.<sup>243</sup> In particular, Stipanowich found less satisfaction with the speed and cost of arbitration relative to litigation as the size of the arbitration increased and as the

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known as "Kaldor-Hicks" or "potential Pareto efficiency." Here, a situation is said to be efficient if the benefit accrued by one party would permit that party to fully compensate the loser, even if this transfer does not in fact take place. *See id.* at 13-14; *see also* Gregory S. Crespi, *The Mid-Life Crisis of the Law and Economics Movement: Confronting the Problems of Nonfalsifiability and Normative Bias*, 67 NOTRE DAME L. REV. 231 (1991). Neither definition of efficiency speaks to distributional equities or inequities in a system.

239. *See, e.g.,* Burger, *Isn't There a Better Way*, *supra* note 126; *see also* Dwight Golann, *Developments in Consumer Financial Services Litigation*, 43 BUS. LAW. 1081, 1091 (1988) (arguing that arbitration is potentially faster, cheaper, and more private for all parties); Sturdevant & Golann, *supra* note 232, at 5-6 (finding that a cheaper, quicker, more final justice system is better for all and allows consumers who could not otherwise afford to sue to secure some relief).

240. *E.g.,* DUNLOP COMMISSION REPORT, *supra* note 30, at 25-26 (concluding that problems with high cost and combative nature of litigation have led both employers and employees to seek alternatives to litigation); Ann C. McGinley, *Rethinking Civil Rights and Employment At Will: Toward a Coherent National Discharge Policy*, 57 OHIO ST. L.J. (forthcoming 1996) (proposing a federal "just cause" statute that would require employees to arbitrate disputes with employers while providing various substantive and procedural safeguards).

241. *See generally* STEPHEN B. GOLDBERG ET AL., *DISPUTE RESOLUTION: NEGOTIATION, MEDIATION, AND OTHER PROCESSES* 200 (2d ed. 1992) (discussing theoretical advantages of arbitration over litigation).

242. Thomas J. Stipanowich, *Rethinking American Arbitration*, 63 IND. L.J. 425, 460 (1988).

243. *Id.* at 452-76.

respondents gained more experience.<sup>244</sup> The more objective studies performed on court-attached arbitration also fail to show that arbitration is clearly better than litigation.<sup>245</sup> Dr. Deborah Hensler concluded: "The efficiency gains from court-annexed arbitration . . . appear mixed: The fiscal savings to courts from diverting cases from trial may be outweighed by the costs of running an efficient ADR program, and savings in lawyer time are often modest and not necessarily passed on to litigants through lower legal fees."<sup>246</sup>

Second, even assuming for the sake of argument that arbitration is cheaper, quicker, and even better for society as a whole, it may still not serve the interests of all parties. Some could argue that a system of slavery would be more efficient for society as a whole,<sup>247</sup> but that certainly does not mean that the system would be just or fair to the slaves. This Article asserts that any social gains achieved by forcing binding arbitration on unknowing little guys are outweighed by the distributional inequities and injustices also incurred.

Those who believe binding arbitration is better for everybody rarely seem troubled by the fact that the arbitration may have been imposed on unknowing consumers through form contracts. Rather, they argue that form contracts are desirable because it is too costly for suppliers and consumers to negotiate contracts on an individual basis.<sup>248</sup> Form contracts are arguably particularly desirable for consumer contracts, because the transaction involves a "one-shot" rather than continuing relationship and the amount at stake is relatively small. In this context it may make little sense for either party to invest a great deal in negotiating individual contract terms.<sup>249</sup>

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244. *Id.* at 460, 471-72. Respondents observed that scheduling difficulties often delayed resolution of arbitrations. *Id.* at 461.

245. Of course, the success of court-attached arbitration, which is generally non-binding, is not entirely relevant to assessing the success of binding arbitration.

246. Deborah R. Hensler, *A Glass Half Full, A Glass Half Empty: The Use of Alternative Dispute Resolution in Mass Personal Injury Litigation*, 73 TEX. L. REV. 1587, 1593 (1995) (noting, however, that disputants felt their process concerns were better met through arbitration than in court); see also Kim Dayton, *The Myth of Alternative Dispute Resolution in the Federal Courts*, 76 IOWA L. REV. 889, 896 (1991) (finding that comparisons of federal districts that do and do not use ADR "conclusively show that ADR has not resulted in speedier resolution of federal civil cases, has not reduced backlogs, and has not affected the incidence of civil trials").

247. See ROBERT W. FOGEL & STANLEY L. ENGERMAN, *TIME ON THE CROSS: THE ECONOMICS OF AMERICAN NEGRO SLAVERY* (1974) (arguing that slavery, while efficient, is not necessarily morally acceptable).

248. See POSNER, *supra* note 230, at 114. They implicitly argue that the default regime supplied by litigation to enforce contractual obligations is prohibitively expensive. Ribstein, *supra* note 220; see also *Allied-Bruce Terminix Cos. v. Dobson*, 115 S. Ct. 834, 842 (1995) (arbitration is desirable because it avoids the delay and expense of litigation).

249. See Meyerson, *supra* note 230, at 594-95 (arguing that form contracts may "benefit both consumers and sellers by reducing the cost of negotiation and by limiting the time each party has to

Whether one employs common sense or the more technical language of economists, it is clear that mandating binding arbitration in form contracts does not necessarily serve the interests of consumers or other little guys. The argument has three components: (1) procedural factors influence and sometimes determine substantive outcomes; (2) the party that drafts an agreement will try to draft it so as to achieve maximum advantage for itself, which may well entail imposing disadvantage on the opposing party; and (3) competition will neither prevent businesses from taking advantage of little guys nor ensure that gains from lower liability exposure will be passed on to the little guys.

*1. Procedure Influences Substance*

Every litigator knows that procedural rules affect substantive outcomes. Litigators learn that judges' determinations on such matters as venue, discovery, whether a matter may proceed as a class action, and whether a claim should be dismissed on summary judgment will likely determine the outcome of the case. Savvy litigators can use procedural tools to force opponents to try a case in a hostile arena, to split up a claim so that it is no longer economically viable, or to require opponents to try their case on a piecemeal basis. In short, as Professor Purcell has argued with respect to forum selection clauses, procedural mechanisms can be used as a "litigation weapon."<sup>250</sup>

*2. The Drafter of the Agreement Will Attempt to Draft the Procedures to Take Advantage of its Opponent*

The profit-maximizing company will attempt to draft a dispute resolution contract so as to maximize its profits and minimize its losses. The company will seek an agreement that will minimize the likelihood of having any claims made against it at all. In addition, where claims are to be brought, the company will attempt to minimize both its own transaction costs of engaging in dispute resolution and the cost of the actual payout upon loss of a claim to the consumer.<sup>251</sup>

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spend on bargaining").

250. Purcell, *supra* note 5, at 486-95 (arguing that forum selection clauses are a powerful litigation weapon used by large-scale corporate defendants to decrease consumers' likelihood of success in their substantive claims). See generally Mullenix, *supra* note 237, at 364-66 (discussing substantial burdens placed on distant plaintiff).

251. In a study performed on five California banks by the Rand Institute for Civil Justice the banks frankly admitted they had instituted arbitration to reduce the likelihood of large plaintiff verdicts. ERIK MOLLER ET AL., PRIVATE DISPUTE RESOLUTION IN THE BANKING INDUSTRY 7-8, 11

Advocates of binding arbitration emphasize the argument that binding arbitration will reduce transaction costs for both businesses and consumers. They note specifically that businesses seek a process that is quicker, cheaper, more final and more expert.<sup>252</sup> They urge that consumers, as well, are better off with a quicker, cheaper system of justice.<sup>253</sup> Businesses also generally prefer the greater privacy offered by arbitration to avoid publicity and to protect trade secrets.<sup>254</sup> Some might urge that privacy is also better for consumers because it preserves relationships between the company and the consumer.<sup>255</sup>

Few would deny that consumers would benefit from a quicker, cheaper system of justice, all else being equal. However, all else is not equal. The truth is that businesses opt for arbitration not only to reduce transactions costs that may or may not accrue equally to consumers, but also to reduce their payouts. Any reduction in payout is likely to come out of the pockets of the consumers and other little guys who bring the claims.<sup>256</sup>

(1993).

252. The House of Representatives stated:

The advantages of arbitration are many: it is usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties; it is often more flexible in regard to scheduling of times and places of hearings and discovery devices. . . .

*Terminix*, 115 S. Ct. at 843 (quoting H.R. REP. NO. 542, 97th Cong., 2d Sess. 13 (1982)); see also James L. Guill & Edward A. Slavin, Jr., *Rush to Unfairness: The Downside of ADR*, JUDGES' J., Summer 1989, at 8, 9 (noting that proponents of arbitration cite advantages of informality, lower cost, speed, lack of publicity, and finality); Shields, *supra* note 3, at 49 (citing advantages of speed, economy, finality, expertise, and privacy). However, not all agree that arbitration is necessarily quicker or cheaper than arbitration. See Richard S. Bayer & Harlan S. Abrahams, *The Trouble with Arbitration*, LITIG., Winter 1985, at 30; James Lyons, *Arbitration, The Slower, More Expensive Alternative*, 7 AM. LAW., Jan.-Feb. 1985, at 107 (quoting AAA President Robert Coulson as stating "People used to promote arbitration [for its speed, economy, and justice] . . . like religious zealots. . . . I don't think any of those words are entirely accurate."); cf. *Engalla v. Permanente Med. Group, Inc.*, 43 Cal. Rptr. 2d 621, 640 (Cal. Ct. App. 1995) (concluding that substantial evidence showed HMO deliberately delayed appointment of a neutral arbitrator until after claimant's death).

253. *E.g.*, *Terminix*, 115 S. Ct. at 842 (implying that consumers would benefit from arbitration as much as businesses).

254. See ROBERT COULSON, BUSINESS ARBITRATION—WHAT YOU NEED TO KNOW 9-10 (3d ed. 1987) (discussing value of privacy as to trade secrets); Hugh R. Jones, *Arbitration From the Viewpoint of the Practicing Attorney: An Analysis of Arbitration Cases Decided by the New York State Court of Appeals From January, 1973 to September, 1985*, 14 FORDHAM URB. L.J. 523, 526 (1986) (praising virtue of privacy as to fact of controversy and result).

255. See Joseph T. McLaughlin, *Resolving Disputes in the Financial Community: Alternatives to Litigation*, 41 ARB. J. 16, 21 (1986).

256. Theoretically, a business's gains might come exclusively from the pocket of the consumer's attorney, leaving the consumer's recovery untouched. In practice, however, as most plaintiffs' attorneys work on a contingent fee basis, the lower recovery would hurt both the plaintiff and her attorney.

To understand how businesses use binding arbitration to reduce their payout one must consider the nature of consumer and little guy claims against businesses.<sup>257</sup> Imagine that a consumer and a company have entered into a contract in which the company agrees to provide banking or financial services, medical care, or pest control. One can expect a certain number of routine disputes to arise where the company accuses the consumer of failing to pay for a service that has been provided. Where non-payment is the only issue, the dispute will generally be settled relatively simply and expeditiously. The consumer, by contrast, might want to bring a more complicated action for damages, malpractice, or violation of a federal statute.<sup>258</sup> Moreover, the consumer is likely to be much more ignorant about the specifics of the dispute than is the company providing the service or product.

Given this basic scenario, companies might use two interrelated approaches to reduce their own payouts. First, the company might seek to discourage or prevent the consumer from bringing any action at all. Second, the company might directly attempt to limit its payout, assuming the consumer does bring a claim.<sup>259</sup>

*a. Discouraging Consumer Claims*

The company might discourage the consumer from using the arbitration remedy not only by reducing the consumer's expected recovery,<sup>260</sup> as will be discussed in the following section, but also by increasing the consumer's own transaction costs. Such transaction costs may be increased in a variety of ways. For example, the agreement might require the consumer to bring the action in a distant forum, under laws different from those applicable in the consumer's own jurisdiction, or even in a language foreign to the consumer.<sup>261</sup> If the consumer cannot afford to hire a distant lawyer or travel to a distant location, the consumer may drop the claim.<sup>262</sup> Studies have shown

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257. Although, for simplicity, this section focuses on consumer claims, the same arguments generally apply regarding claims by employees, franchisees and other little guys.

258. See Budnitz, *supra* note 3, at 309-18 (describing disputes that might likely arise between consumers and financial institutions).

259. By minimizing payouts the company will also further discourage consumers from bringing any claims. If consumers have a low expected value of success, they will not find it in their economic interest to sue. Moreover, consumers who have a low likelihood of success will find it much more difficult to retain lawyers to represent them.

260. A consumer's "expected recovery" is the product of her expected likelihood of success times the expected value of her recovery if successful.

261. *Supra* notes 5, 203-07 and accompanying text.

262. See Goldman, *supra* note 117, at 712 (noting that cost of transporting witnesses, hiring local counsel, and attending trial in distant location make pursuit of legitimate consumer claims

that some companies do methodically use distant forum selection clauses in order to discourage individuals from bringing claims against them.<sup>263</sup> Also, the company might ensure that the consumer has to pay a substantial amount for the arbitrator's time. As one lawyer noted, at least when one goes to court the judge is free.<sup>264</sup> Finally, the company might seek to prevent consumers from joining together in a class action, thereby forcing each plaintiff to bear the full burden of litigation costs on her own.<sup>265</sup> Often, suits that cannot be brought as a class action cannot economically be brought at all.<sup>266</sup>

*b. Minimizing Payout on Claims That Are Brought*

Second, the companies can be expected to structure the arbitration to minimize their liability exposure if claims are brought. The company would rationally seek to reduce the likelihood of a plaintiff victory and also to decrease a plaintiff's recovery in the event of a verdict. One way defendants can decrease a consumer's expected return is to prevent the consumer from engaging in adequate discovery. Because the consumer will be more needful of discovery than will the company, which maintains the relevant records and has continuing access to the decision makers, even a seemingly neutral

impractical); Gorman, *supra* note 3, at 664 (arguing that private attorneys will be reluctant to handle employment arbitration cases unless arbitrators award attorneys' fees in appropriate cases); Mullenix, *supra* note 237, at 364-66 (discussing burdens of hiring local counsel, traveling to participate in a case, and conducting discovery in a distant location); Purcell, *supra* note 5, at 446, 456 (noting that geography may be used to increase costs and that contingent fee attorneys are less likely to take a case as costs increase or likely payoffs decrease); cf. Shields, *supra* note 3, at 52 (citing study showing 23 of 35 cases sent to arbitration by courts were dropped by the plaintiffs). A small study done by the Rand Civil Institute of Justice tends to support this fear. It showed that after a California bank adopted mandatory arbitration, substantially fewer consumers filed claims against that bank. MOLLER ET AL., *supra* note 251, at 21-23.

263. See Purcell, *supra* note 5, at 453-54.

264. Ellie Winninghoff, *Consumers' Arbitration Risks Debated*, N.Y. TIMES, Oct. 24, 1994, at 37.

265. See MOLLER ET AL., *supra* note 251, at 6-9 (finding that California banks adopted arbitration to avoid large verdicts and plaintiff class actions); Budnitz, *supra* note 3, at 286. Courts are split on whether class actions can be pursued in arbitration. Compare *Gammara v. Thorp Consumer Discount Co.*, 828 F. Supp. 673, 674-75 (D. Minn. 1993), *appeal dismissed*, 15 F.3d 93 (8th Cir. 1994) and *McCarthy v. Providential Corp.*, No. C 94-0627 FMS, 1994 WL 387852, at \*9 (N.D. Cal. July 18, 1994) (refusing to permit class actions in arbitration) with *Dickler v. Shearson Lehman Hutton, Inc.*, 596 A.2d 860, 864-67 (Pa. Super. Ct. 1991) and *Izzi v. Mesquite Country Club*, 231 Cal. Rptr. 315, 321 (Cal. Ct. App. 1986) (allowing class actions in arbitration). See generally Note, *Classwide Arbitration: Efficient Adjudication or Procedural Quagmire?*, 67 VA. L. REV. 787, 800-01 (1981).

266. *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156 (1974), is a classic case. An estimated class of 6 million odd-lot traders, each of whom had blocks of less than 100 shares, brought claims for violations of antitrust and securities laws. The Supreme Court's ruling that potential plaintiffs must receive individualized notice, paid for by the class, effectively prevented plaintiffs from pursuing the litigation either as a class or individually. See generally RICHARD L. MARCUS ET AL., *CIVIL PROCEDURE: A MODERN APPROACH* 308-09 (2d ed. 1995).



restriction on discovery will affect consumers adversely.<sup>267</sup>

Large companies will also attempt to select a decision maker likely to decrease their likely payout. One of the company's chief goals in selecting arbitration over litigation is generally to avoid a jury trial.<sup>268</sup> Potential defendants, like potential plaintiffs, believe juries will often be sympathetic to the claims of a consumer against a large company.<sup>269</sup> Beyond avoiding the jury trial, the company will also seek an arbitrator or panel favorably disposed toward the company. This does not mean that companies will select arbitrators who are corrupt. The FAA provides that an arbitral award is to be vacated where the arbitrator is actually biased.<sup>270</sup> However, the company will likely select arbitrators who are at least unconsciously biased toward the company. Arbitration agreements frequently provide that the arbitrator shall be a current or former manager from the company's field of business,<sup>271</sup> and courts have repeatedly held that mere selection of a former manager from a particular industry is not evidence of bias.<sup>272</sup> Although such an individual may well do her best to decide the case fairly, she will probably be able to see the company's position more easily than the little guy's position.<sup>273</sup> In

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267. Budnitz, *supra* note 3, at 283-84; see Gorman, *supra* note 3, at 661-62 (emphasizing importance of discovery for worker, who will typically possess far less access to workplace information than will employer); cf. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 31-32 (1991) (basing acceptance of mandatory arbitration of age discrimination claim in part on fact that particular arbitration process provided for adequate discovery). As Professor Gorman notes, adequate discovery is even more important for individual claimants than for those represented by a union in a labor arbitration because the union will typically have secured a body of expertise about workplace practices over the years, and will also have continued access to current employees. Gorman, *supra* note 3, at 661-62.

268. Sturdevant & Golann, *supra* note 232, at 5 ("Corporations often write arbitration clauses into consumer contracts to avoid high litigation costs, inept judges, and, let's be candid, juries.").

269. Golann, *supra* note 239 (observing that consumers are disadvantaged in arbitration by the loss of a jury).

270. 9 U.S.C. § 10(a)(2) (1994).

271. See, e.g., *Bakri v. Continental Airlines, Inc.*, No. CV92-34876 SVW(K), 1992 WL 464125, at \*1 (C.D. Cal. Sept. 24, 1992) (requiring all hearing panel members to be company employees); *Broemmer v. Otto*, 821 P.2d 204 (Ariz. Ct. App. 1991) (requiring arbitrator to be obstetrician/gynecologist), *rev'd*, 840 P.2d 1013 (Ariz. 1992) (en banc); *Ditto v. Re/Max Preferred Properties, Inc.*, 861 P.2d 1000, 1001 (Okla. Ct. App. 1993) (arbitration to be heard by Re/Max employees selected by manager). One law firm set up an internal dispute resolution process but required that the arbitrators had to be partners from law firms with 50 or more lawyers. *More Law Firms Seek Arbitration for Internal Disputes*, WALL ST. J., Sept. 26, 1994, at B13.

272. See, e.g., *Gilmer*, 500 U.S. at 30 (refusing to assume securities arbitrators will be biased).

273. See Dwight Golann, *Taking ADR to the Bank: Arbitration and Mediation in Financial Services Disputes*, ARB. J., Dec. 1989, at 3, 6 (noting that arbitrators, steeped in industry customs rather than in following legal rules, may wipe out a generation of protective consumer legislation). A General Accounting Office report concluded that most arbitrators who decided employment discrimination cases brought against the securities industry were white males with an average age of

addition, arbitrators may be consciously or unconsciously influenced by the fact that the company, rather than the consumer, is a potential source of repeat business.<sup>274</sup> An arbitrator who issues a large punitive damages award against a company may not get chosen again by that company or others who hear of the award. Finally, even if the arbitrators are not biased, the consumer, likely a "one-shot" player, will be less able to make an informed selection of arbitrators than will the "repeat-player" company.<sup>275</sup> Whereas companies can afford to keep track of an arbitrator's record, individual consumers and employees cannot. One empirical study has confirmed that employees recover less in their claims against repeat-player companies, defined as companies that use arbitration more than once in a year, than they do against non-repeat players.<sup>276</sup>

Defendants will also attempt to reduce their payout by drafting the arbitration agreement expressly to limit the arbitrator's right to award certain damages. For example, the Supreme Court has held that parties may use an arbitration agreement to prohibit the award of punitive damages,<sup>277</sup> and companies will sometimes write the arbitration agreement to prohibit such damages.<sup>278</sup> Courts have also held that parties may use an arbitration agreement to alter substantive law by, for example, shortening a statute of

60. GENERAL ACCOUNTING OFFICE, PUB. NO. GAO/HEHS-94-17, EMPLOYMENT DISCRIMINATION: HOW REGISTERED REPRESENTATIVES FARE IN DISCRIMINATION DISPUTES 2 (1994). This may be true even where arbitrators are drawn from outside a specific industry. For example, a sex discrimination plaintiff has alleged that the AAA panels are biased against plaintiffs in that the vast majority of arbitrators are white, male defense lawyers who primarily represent management. Margaret A. Jacobs, *Woman Claims Arbiters of Bias Are Biased, Too*, WALL ST. J. Sept. 19, 1994, at B10. See generally Linda Krieger, *The Content of Our Categories: A Cognitive Bias Approach to Discrimination and Equal Employment Opportunity*, 47 STAN. L. REV. 1161 (1995) (focusing on cognitive antecedents to unconscious discrimination); Charles R. Lawrence III, *The Id, the Ego and Equal Protection: Reckoning with Unconscious Racism*, 39 STAN. L. REV. 317 (1989) (discussing phenomenon of unconscious discrimination and citing to psychology literature).

274. See Gorman, *supra* note 3, at 656; Guill & Slavin, *supra* note 252, at 11; see also Michael A. Hiltzik & David R. Olmos, *'Kaiser Justice' System's Fairness is Questioned*, L.A. TIMES, Aug. 30, 1995, at pt. A, 1, available in Westlaw, LATIMES database (because its arbitrations can make-up nearly half of an active arbitrators' annual fees, arbitrators are afraid to issue decisions adverse to Kaiser, which arbitrates approximately 700 claims per year in California).

275. Gorman, *supra* note 3, at 656; Guill & Slavin, *supra* note 252, at 9-10. See generally Marc Galanter, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change*, 9 LAW & SOC'Y REV. 95 (1974) (discussing multiple advantages of "repeat players" over "one shotters" in our legal system).

276. Lisa B. Bingham, *Employment Arbitration: The Effect of Repeat-Player Status, Employment Category and Gender on Arbitration Outcomes* (1996) (unpublished study, on file with author).

277. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212 (1995).

278. *MOLLER ET AL.*, *supra* note 251, at 13 (finding that banks opted for arbitration to avoid punitive damages); Budnitz, *supra* note 3, at 285-86.

limitations, eliminating a remedy, or even eliminating a cause of action.<sup>279</sup> To the extent defendants use arbitration to limit their own liability, they will, of course, decrease plaintiffs' expected payout.

The typical arbitral requirement of privacy can itself be viewed as a substantive term that favors the company over the consumer. Where one party wants publicity and the other party wants privacy, it is likely to be the plaintiff/consumer who favors publicity, as a way of informing others of the way in which she was harmed by an unethical broker, a negligent pest exterminator, or a careless doctor. The consumer may also wish to set a precedent to prevent the company from engaging in future similar wrongdoing or to publicize wrongdoing by the company. Further, a consumer's attorney often relies on public information gained from other lawsuits to build her own claims of negligent or intentional misconduct. Repeat-player companies can gain similar information through private channels. Thus, by requiring private arbitration the company may again deprive the consumer of certain relief she might have obtained through litigation.<sup>280</sup>

Finally, having used the arbitration agreement to limit discovery, to pick favorable decision makers, and to select favorable substantive law, the company can consolidate these gains by depriving the consumer of a significant opportunity to appeal. The appeal right is most important to the party likely to have been disadvantaged in the original proceeding. Therefore, the strict limit on appeals contained in the FAA and possibly enhanced in private arbitration agreements also cuts against the consumer.

### *3. Competitive Market Forces Will Not Be Able to Prevent Businesses from Gaining an Advantage over Consumers*

Some defenders of mandatory binding arbitration, while recognizing that businesses would perhaps like to use form contracts and binding arbitration to benefit themselves at the expense of the consumer, argue that competitive

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279. See, e.g., *DeGaetano v. Smith Barney, Inc.*, No. 95 Civ. 1613 (DLC), 1996 WL 44226 (S.D.N.Y. Feb. 5, 1996) (upholding applicability of arbitration clause as applied to employment discrimination claims, even though clause waived plaintiff's right to punitive damages, attorney fees, and injunctive relief); cf. *Graham Oil Co. v. ARCO Prods. Co.*, 43 F.3d 1244 (9th Cir. 1994) (refusing to enforce arbitration agreement because waiver of longer statute of limitations, attorney fees, and punitive damages was inconsistent with federal law under which claim was brought), *cert. denied*, 116 S. Ct. 275 (1995).

280. Budnitz, *supra* note 3, at 312-13 (arguing that lack of public filings will prevent consumer protection agencies from doing their jobs and will also prevent other members of the public from hearing of the danger alleged in the lawsuit).

market forces will prevent companies from achieving those goals. These free marketeers argue that if the terms of consumer contracts were in fact unduly and inefficiently biased toward the supplier, then other suppliers, in order to benefit themselves, would step in and offer a contractual provision that treated the consumer more generously.<sup>281</sup> The free marketeers further contend that the market will ensure that any benefits secured by the suppliers through imposition of an arbitration provision will be passed on to the consumers.<sup>282</sup> Thus, if mandatory arbitration provisions are common in form contracts, it is because the greater speed and lower cost of arbitration benefits all parties and is therefore efficient and preferable.<sup>283</sup>

Although the Supreme Court has not explicitly applied this market analysis to binding arbitration provisions, it has used a similar economic analysis to justify enforcement of a forum selection clause in a consumer form contract. In *Carnival Cruise Lines*,<sup>284</sup> the Court held that a forum selection clause buried within a three page, single-spaced ticket for a trip on a cruise ship was enforceable even though there was no showing that the passengers had read or understood the clause, and even though the court of appeals had concluded that the clause would effectively deny the consumers their day in court.<sup>285</sup> The Court proclaimed that the clause was justifiable

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281. See Meyerson, *supra* note 230, at 594-95 (presenting argument that even where form contracts are used, resources will be distributed efficiently). See generally Posner, *supra* note 230, at 11-12 (asserting that absent barriers to free flow of resources, prices will fall to ensure zero profits).

282. For example, assume that the price of a widget, absent an arbitration clause, would be \$1000. Assume further that the seller's cost would fall by \$50 per widget if the seller included a binding arbitration clause in the sales contract. If the average cost imposed by the binding arbitration clause on the consumer is less than \$50, then the seller would reduce the price from \$1000 to \$950 and both parties would be better off. On the other hand, if the cost to the consumer of imposition of the clause exceeded \$50, then the seller would sell the widget for \$1000 and leave out the binding arbitration clause. The free market will ensure that the savings are passed along and that the cost is born by the party best able to bear that cost. Goldman, *supra* note 117, at 714-15 (critiquing the argument). Free market advocates further argue that there will be competition as to a non-price term even where the market is noncompetitive. POSNER, *supra* note 230, at 278-79; Goldman, *supra* note 117, at 715.

283. Sturdevant & Golann, *supra* note 232, at 5-6 (arguing that consumers, as well as companies, are better off with arbitration). Professor Golann attempts to counter the argument that if arbitration were so wonderful for all concerned, then mandatory clauses would not be necessary. He argues essentially that lack of information and lawyer self-interest will often prevent parties from selecting arbitration after a dispute has already arisen, even though such arbitration would be mutually beneficial. *Id.* at 6.

284. *Carnival Cruise Lines v. Shute*, 499 U.S. 585 (1991).

285. *Id.* at 589-90. The Shutes, residents of Washington, had purchased cruise tickets to sail from Los Angeles to Puerto Vallarta, Mexico. Mrs. Shute suffered an injury on board the ship and subsequently filed suit in Washington. *Id.* at 587-88. Although the Ninth Circuit had upheld jurisdiction in Washington, the Supreme Court reversed, concluding the Shutes were bound by the forum selection clause designation of Florida that was contained on the ticket. *Id.* at 589.

because the savings it generated for the cruise ship would have been passed on to the consumers.<sup>286</sup> In light of the fact that the Court has called arbitration clauses a type of forum selection clause,<sup>287</sup> it seems likely that the Court would use the same efficiency analysis to justify imposition of a form arbitration clause.

This story of "free market to the rescue" is significantly flawed in that it rests on a set of assumptions that cannot be shown to exist.<sup>288</sup> Most importantly, the competitive defense of form contracts depends on an assumption that consumers read, understand, and evaluate the cost of the binding arbitration clause being imposed by the seller.<sup>289</sup> Instead, it seems generally true that while consumers may be well informed about certain key contractual terms, such as price or color or engine size, they generally know very little about the subordinate contract terms, commonly known as "boilerplate."<sup>290</sup> If the consumer is not aware of the existence or significance

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286. *Id.* at 594. The Court stated:

[A] clause establishing *ex ante* the forum for dispute resolution has the salutary effect of dispelling any confusion about where suits arising from the contract must be brought and defended, sparing litigants the time and expense of pretrial motions to determine the correct forum and conserving judicial resources that otherwise would be devoted to deciding those motions. Finally, it stands to reason that passengers who purchase tickets containing a forum clause like that at issue in this case benefit in the form of reduced fares reflecting the savings that the cruise line enjoys by limiting the fora in which it may be sued.

*Id.* at 593-94 (citation omitted). Professor Mullenix notes the irony of the contrast between the Court's willingness to make a sweeping empirical assumption regarding the extent to which costs would be passed on, as compared to its refusal to accept the Ninth Circuit's conclusion that Mrs. Shute would be seriously inconvenienced if compelled to litigate her case in Florida. Mullenix, *supra* note 237, at 343-44.

287. *Scherk v. Alberto-Culver*, 417 U.S. 506, 519 (1974) ("An agreement to arbitrate . . . is, in effect, a specialized kind of forum-selection clause that posits not only the situs of suit but also the procedure to be used in resolving the dispute."); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 630 (1985).

288. See generally Goldman, *supra* note 117 (critiquing free market defense of forum selection clauses, but observing that arbitration clauses may be more defensible); Meyerson, *supra* note 230 (critiquing free market defense of forum selection clauses for failing to recognize use of geography as litigation weapon). The free marketeers do not adequately take account of the fact that information is costly and transaction costs are high. As one commentator put it: "Without empirical support, efficiency is in the eye of the beholder." Shell, *supra* note 190, at 519.

289. Unless consumers read and understand the clauses, they cannot choose the product that truly maximizes their utility, nor can competitors successfully market a better product. See Eisenberg, *supra* note 230, at 242 (rational consumer will remain ignorant as to terms of form). This problem of asymmetrical information is a variant of the "lemons problem" discussed in George A. Akerlof, *The Market For "Lemons": Quality, Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970); see also Walter Kamiat, *Labor and Lemons: Efficient Norms in the Internal Labor Market and the Possible Failures of Individual Contracting*, 144 U. PA. L. REV. 1953 (1996) (applying "lemons" concept to explain absence of "just cause" contracts in non-union workplace).

290. Meyerson, *supra* note 230, at 595; Rakoff, *supra* note 231, at 1179. Several empirical studies

of the clause, the supplier is free to impose a term that benefits the supplier but significantly harms the consumer.<sup>291</sup> In fact, economists generally recognize that where one party lacks information as to the cost of a non-price term in a contract, there will be two inefficiencies: a quantity effect and a quality effect.<sup>292</sup> The quantity effect will cause the consumer to purchase too much of the item because she will not recognize its full cost.<sup>293</sup> The quality effect will cause the parties to enter into the wrong contract—one containing a binding arbitration clause—even in circumstances where a fully knowledgeable consumer would have refused to accept such an agreement.<sup>294</sup>

Further, one cannot fairly argue that the consumer made the deliberate choice to forego reading the contract and thus may rightly be penalized. Given the high cost of obtaining and understanding information in a complex economy, the consumer's behavior may reflect rational economic behavior. Specifically, the marginal cost of obtaining information about a particular contractual clause may exceed the expected marginal benefit from such information.<sup>295</sup> To obtain such information the consumer would not only have to read the fine print, but would also likely have to obtain legal advice to assist her in understanding its significance.<sup>296</sup> Given her limited knowledge

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also show that consumers rarely read and understand form contracts. See, e.g., Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 59 (1963) (study involved business persons); William C. Whitford, *Strict Products Liability and the Automobile Industry: Much Ado About Nothing*, 1968 WIS. L. REV. 83, 143-53 (study of automobile consumers).

291. Given the consumer's inability to evaluate the cost of the risk, the seller would be irrational not to shift as many such costs as possible to the consumer. Meyerson, *supra* note 230, at 605-06; Eisenberg, *supra* note 230, at 242 (rational form giver will spend a significant amount of time and money ensuring that form contract, which will be used repeatedly, is maximally advantageous). Consistent with this view, Allen Farnsworth, Reporter for the *Restatement (Second) of Contracts* noted that in his personal experience "no one in any of the corporations or in the law firm ever suggested that the forms should be drafted other than as one-sidedly in the interests of the corporate client as possible." Allen Farnsworth, *On Trying to Keep One's Promises: The Duty of Best Efforts in Contract Law*, 46 U. PITT. L. REV. 1, 44 (1984).

292. See generally POSNER, *supra* note 230, at 180-82 (contending that information asymmetry explains need for strict liability with respect to defective products); Allen Schwartz, *Proposals for Products Liability Reform: A Theoretical Synthesis*, 97 YALE L.J. 353, 358 (1988) (discussing significance of misinformation in context of product liability); Steven Shavell, *Strict Liability Versus Negligence*, 9 J. LEGAL STUD. 1, 5 (1980).

293. See Goldman, *supra* note 117, at 718.

294. See *id.*

295. See also Melvin A. Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461, 1474 (1989) (concluding that for many shareholders the cost of reading and understanding proposals will exceed the benefits); Robert Ellickson, *Of Coase and Cattle: Dispute Resolution Among Neighbors in Shasta County*, 38 STAN. L. REV. 623, 667-68 (1986) (observing that people lack perfect legal knowledge due to both cost of legal research and limits of human cognitive capacity). See generally Eisenberg, *supra* note 230.

296. Goldman, *supra* note 117, at 717; Meyerson, *supra* note 230, at 598-99. Nor will the

and her hope that she will not need to sue the seller,<sup>297</sup> and also recognizing the difficulty of finding or negotiating an alternative clause in any event,<sup>298</sup> the rational consumer will not attempt to comprehend most form contractual terms.<sup>299</sup>

The free market advocates have responded to this lack of information with several arguments, none of which is convincing.<sup>300</sup> According to the

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consumer necessarily realize that she ought to obtain legal advice. For example, prior to the Supreme Court's decision in *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212 (1995), several courts had held that where a form contract simply provided that New York choice of law applied, the contract should be interpreted to prohibit the arbitrator from awarding any punitive damages. See *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 20 F.3d 713 (7th Cir. 1994), *rev'd*, 115 S. Ct. 1212 (1995); *Barbier v. Shearson Lehman Hutton, Inc.*, 948 F.2d 117 (2d Cir. 1991). Few consumers could have anticipated this interpretation; thus, few would have recognized a need to seek legal advice to ensure the availability of punitive damages. *Cf. Mastrobuono*, 115 S. Ct. 1212 (interpreting ambiguous contract in favor of consumer).

297. This effect is amplified by psychologists' insights into individuals' behavior, demonstrating that individuals are not always the rational profit maximizers economists like to assume. Rather, individuals view risk of prospective gain differently than they view risk of prospective loss. In general, they are willing to gamble more on a prospective loss, and seek a surer thing with respect to gains. Eisenberg, *supra* note 230, at 217 (decisionmaker's preference between two options depends how issue is framed); Richard L. Hasen, Comment, *Efficiency Under Informational Asymmetry: The Effect of Framing on Legal Rules*, 38 UCLA L. REV. 391, 396 (1990). Thus, individuals might well take an irrational gamble that they would not need to sue a seller anyway and thus need not concern themselves with the terms of a binding arbitration clause.

298. See Goldman, *supra* note 117, at 717-18.

299. I myself, for example, recently received a mailing from my bank. The mailing consisted of two items: a glossy color brochure, designed to encourage customers to think seriously about applying for a loan; and a small black and white sheet with tiny print. If one actually took the trouble to read the sheet (as I never would have done had I not been writing this Article), one found in the seventh paragraph on page two in very small print a clause stating:

If either you or we have any unresolvable dispute or claim concerning your account, it will be resolved by binding arbitration under the expedited procedures of the Commercial Financial Disputes Arbitration Rules of the American Arbitration Association (AAA) and Title 9 of the US Code. Arbitration hearings will be held in the city where the dispute occurred or where mutually agreed to. A single arbitrator will be appointed by the AAA and will be a retired judge or attorney with experience or knowledge in banking transactions. The arbitrator will award the filing and arbitrator fees to the prevailing party. A judgment on the award may be entered by a court.

(Information on file with author). Although the clause is not as egregious as it might be, I would have preferred to retain my option to take the bank to court. Nonetheless, I have not yet taken the time to determine whether other local banks do not require arbitration, nor to switch my account to such an institution. Most consumers are probably not aware of the many arbitration clauses to which they are already a party with respect to insurance, banking, credit cards, health care, and pest extermination services. Few would take the time to look for such clauses and fewer would seek legal advice. *Cf. Catherine L. Fisk, Lochner Redux: The Renaissance of Laissez-Faire Contract in the Federal Common Law Benefits*, 56 OHIO ST. L.J. 153, 198 n.169 (1995) (describing authors' own attempt to learn about, much less negotiate, the terms of her benefit package prior to accepting a new position).

300. See generally Edward Brunet, *Arbitration and Constitutional Rights*, 71 N.C. L. REV. 81, 105-07 (1992) (concluding that arbitration clause is not necessarily efficient given lack of perfect

“knowledgeable minority” defense, even though many consumers do not read form contracts, enough consumers do read such contracts and evaluate the advantages and disadvantages of their respective terms to ensure that suppliers will not be able to inflict unfair terms.<sup>301</sup> If a supplier did try to impose a detrimental arbitration clause without lowering its price sufficiently to make the clause acceptable to a knowledgeable consumer, the portion of consumers who read such clauses would notice the detrimental provision and either insist on its being changed or switch to another supplier.<sup>302</sup>

There are several flaws to this Pollyannaish defense. First, it seems likely that the “knowledgeable minority” is an extremely small minority. Arbitration clauses are often buried in seemingly insignificant places, camouflaged as insignificant junk mail, written in very small print, and written in technical terms not likely to be meaningful to most.<sup>303</sup> If the knowledgeable minority is sufficiently small, the supplier may well make enough money from taking advantage of the majority to more than justify losing the minority’s business.<sup>304</sup> Further, if the seller is in a position to be able to discriminate as to contractual terms between consumers, the seller could satisfy the well-informed consumers while still imposing a binding arbitration clause on the other more ignorant consumers.<sup>305</sup> In addition, because different consumers

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information, significant transaction costs, and lack of real competition); Shell, *supra* note 190, at 511 (arguing that “the Court quietly ignores the degree of misinformation and institutional unresponsiveness . . . in the real world”); see also Purcell, *supra* note 5, at 486-95 (arguing that forum selection clauses are not mutually advantageous but rather benefit company and disadvantage consumer).

301. Goldman, *supra* note 117, at 716; Meyerson, *supra* note 230, at 601; Allen Schwartz & Louis L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630, 652-55 (1979).

302. Meyerson, *supra* note 230, at 601. Alternatively, such consumers might purchase first party insurance to cover their potential losses.

303. For example, many employees in positions related to the securities industry have been required to participate in arbitration even though they never signed an arbitration clause explicitly covering their claim. See, e.g., *Armijo v. Hourigan*, 72 F.3d 793 (10th Cir. 1995) (requiring insurance company employees to arbitrate discrimination claims against their employer because, in order to qualify to sell mutual funds, they had signed a U-4 Form stating that they would arbitrate disputes as required under the by-laws of any organizations with which they registered). Similarly, the arbitration provision contained in the form sent to me by my own bank was buried in paragraph 7 on the back of a document in small print. See *supra* note 299. In *Casaratto* the arbitration clause appeared on page 9 of a multi-page franchise agreement. *Casaratto v. Lombardi*, 886 P.2d 931, 932 (Mont. 1994).

304. One set of researchers suggested that if one third of the consumers in a market comparison shop, by reading contract terms and investigating alternatives, the market will behave competitively. Schwartz & Wilde, *supra* note 301, at 652-55. However, even assuming this is true, it is quite unlikely that such a large proportion of consumers read and understand their form contracts, much less that they actively investigate alternatives. Eisenberg, *supra* note 230, at 243-44.

305. Goldman, *supra* note 117, at 716. See generally George L. Priest, *A Theory of the Consumer Product Warranty*, 90 YALE L.J. 1297, 1346-47 (1981); Schwartz & Wilde, *supra* note 301. The



have different tastes for risk and other features, a knowledgeable minority cannot necessarily look out for the interests of the majority.<sup>306</sup>

The free marketeers may also seek to counter the fact that consumers lack knowledge with the argument that sellers will use advertising to educate the consumers. Some economists argue that where one seller seeks to gain a competitive advantage by lowering quality in order to lower price, the underpriced seller will expose the tactic through advertising.<sup>307</sup> The problem with this argument is that, realistically, no seller is likely to call attention to possible problems with its own product by telling consumers that "if it explodes you can sue us in court, not just through an arbitration." In other words, by publicizing the risks relevant to the arbitration clause the seller might well cause sales as a whole to plummet.<sup>308</sup> Moreover, sellers may be reluctant to expend a significant portion of their advertising budget on subordinate terms when they could likely achieve greater inroads by focusing on terms more likely to influence consumer choice.<sup>309</sup> Furthermore, the free marketeers ignore the fact that in many industries barriers to entry have apparently discouraged new suppliers from joining the industry, and that all the suppliers in the industry may well employ essentially the same arbitration clause.<sup>310</sup>

In addition to the flaws of lack of information, transaction costs, and barriers to entry outlined above, the free market advocates must also confront a growing literature demonstrating that individuals may be quite far from the rational profit maximizers economists like to hypothesize. Professor Robert Ellickson, in particular, has recently done some pathbreaking work showing

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availability of low-cost insurance to protect those consumers who are knowledgeable about the risk of having to arbitrate may support the supplier's attempt to discriminate between knowledgeable and ignorant consumers.

306. See generally Hasen, *supra* note 297 (discussing effect of different individuals' preferences for or aversions to risk on structuring of legal rules).

307. Ronald Coase, *The Choice of the Institutional Framework: A Comment*, 17 J.L. & ECON. 493, 495 (1995) (asserting that a firm whose competitor lowers price by lowering quality has a strong incentive to advertise); Meyerson, *supra* note 230, at 601-02.

308. See Goldman, *supra* note 117, at 718-19; Meyerson, *supra* note 230, at 601-02. Rather, as Professor Eisenberg notes, an increase in advertising is likely to degrade the quality of form contracts in that advertisers will focus on the highly visible characteristics such as price that are most easily conveyed to consumers. Eisenberg, *supra* note 230, at 244.

309. See Goldman, *supra* note 117, at 718-19. In addition, the seller who seeks to advertise may face "free rider" problems, in the form of other competitors who would also benefit. Further, a very substantial amount of advertising might be needed to overcome consumer confusion. *Id.* at 719.

310. See Purcell, *supra* note 5, at 492-93 (arguing that even when a particular industry is generally competitive, the industry may well act uniformly as to certain contractual provisions such as arbitration clauses).

that policymakers must consider culture and human frailties, as well as self-interest, in developing legal rules and policies.<sup>311</sup> If consumers do not act rationally, one cannot assume that their actions will ensure efficient operation of the market.

In sum, because the market for most consumer goods differs substantially from the perfectly competitive, perfect information, zero transaction cost market envisioned by some economists, there is little or no reason to believe that market forces will prevent sellers from using arbitration clauses to take unfair advantage of consumers and other little guys. Rather, given the high cost of information and consumers' behavior with respect to risk, it appears that failing to regulate the market with respect to arbitration clauses is likely to lead to an inefficient result that benefits those who impose form arbitration agreements.<sup>312</sup>

*C. No Net Societal Gains Attributable to the Imposition of Binding Arbitration Justify Imposing Costs on Individual Consumers*

Some advocates of binding arbitration argue that even if such arbitration is not actually better for every party, it is better for most, better for society as a whole, and justifiable on that basis.<sup>313</sup> Such advocates contend that if more cases are resolved through binding arbitration, society as a whole will need to spend less money on judges, court staff, legal fees, and law schools.<sup>314</sup> The advocates of binding arbitration might also assert that arbitration improves social productivity by bettering long-term relationships between disputants, and by encouraging more cases to settle quickly and amicably.<sup>315</sup> Finally, they might argue that because arbitration is often cheaper than litigation, imposing binding arbitration would allow some persons to pursue a claim who could not otherwise afford to do so.<sup>316</sup>

There are several weaknesses in this societal benefit argument. First, once all of the relevant factors are considered, it is not clear that binding arbitration

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311. See ROBERT C. ELLICKSON, *ORDER WITHOUT LAW* (1991); Robert C. Ellickson, *Bringing Culture and Human Frailty to Rational Actors: A Critique of Classical Law and Economics*, 65 CHI.-KENT L. REV. 23 (1989).

312. See *supra* notes 271-311 and accompanying text.

313. In economic terms, the argument is that binding arbitration is efficient in the "Kaldor-Hicks" sense, in that the benefits secured by society as a whole outweigh the detriments imposed on particular individuals. The utility of society as a whole is therefore maximized. See POSNER, *supra* note 230, at 13-14.

314. See, e.g., *id.*; Golann, *supra* note 239; Goldman, *supra* note 117.

315. See, e.g., GOLDBERG ET AL., *supra* note 241.

316. E.g., McGinley, *supra* note 240 (arguing for arbitration in employment context).

is preferable for society as a whole. Second, even if binding arbitration were clearly better for society as a whole, it is not necessarily fair to force some persons to resolve their disputes in a less favorable forum in order to benefit other persons.<sup>317</sup>

*1. Mandatory Binding Arbitration Is Not Plainly Better for Society as a Whole*

To assess the comparative societal values of binding arbitration and litigation one must analyze both the costs and benefits of the two alternatives. From a cost standpoint, not everyone would agree that binding arbitration is cheaper and quicker than litigation. As arbitrations become more complex they become more like litigation and just as expensive.<sup>318</sup> Further, even to the extent one can show that resolving a case through arbitration is cheaper than resolving the case through trial, the fact is that most claims never make it to trial.<sup>319</sup> To the extent that parties choose to take a case to arbitration that either would not have been litigated or would have settled quickly had it been litigated, arbitration may actually increase societal costs.<sup>320</sup>

Nor is it necessarily true that there would be more widespread access to justice if all claims were resolved through binding arbitration rather than through litigation. On the contrary, the authors of arbitration agreements enter into binding arbitration agreements in order to pay out less money in arbitration than they would have paid out in litigation. As discussed earlier, suppliers are often able to control arbitration sufficiently to prevent many

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317. See generally JOHN RAWLS, A THEORY OF JUSTICE (1971) (arguing that individuals are entitled to certain minimum rights of which they cannot be deprived even to secure a greater advantage for others).

318. See generally Dayton, *supra* note 246, at 896 (assessing empirical studies as showing that ADR used in federal courts "has not resulted in speedier resolution of federal civil cases, has not reduced backlogs, and has not affected the incidence of civil trials"); Deborah R. Hensler, *Does ADR Really Save Money? The Jury's Still Out*, NAT'L LAW J., Apr. 11, 1994, at C2; Lyons, *supra* note 252; Carrie Menkel-Meadow, *Pursuing Settlement in an Adversary Culture: A Tale of Innovation Co-Opted or "The Law of ADR"*, 19 FLA. ST. L. REV. 1 (1991) (discussing increasingly adversarial and legal nature of ADR).

319. RICHARD L. MARCUS ET AL., CIVIL PROCEDURE: A MODERN APPROACH, 102-04 (2d ed. 1995) (observing that most legal claims are not litigated, and that only 3% of litigated claims are actually tried).

320. See Hensler, *supra* note 318, at C2. Moreover, where an arbitration requires resolution of a dispute by a panel of private arbitrators, some parties have found that the scheduling difficulties that arise actually make it more costly and time consuming to resolve a matter through arbitration than it would have been before a judge. *Engalla v. Permanente Medical Group, Inc.*, 43 Cal. Rptr. 2d 621, 629 (Ct. App. 1995) (on average it takes 863 days to reach a hearing in a Kaiser arbitration); see also Hiltzik & Olmos, *supra* note 274, at 1 (discussing how HMO deliberately delays in selecting arbitrators in order to slow arbitration process).

persons from either bringing or winning arbitration claims.<sup>321</sup> At least absent regulation there seems to be no valid reason to assume that consumers as a whole will do better in arbitration than in litigation, and the seller's preference for arbitration suggests that the seller does better.

Even if binding arbitration were clearly cheaper than litigation, many would argue that the benefits society gains through avoiding litigation are not sufficiently great to justify the additional expense. Arbitration may not provide certain public goods that are provided by litigation.<sup>322</sup> For example, Professor Owen Fiss, Professor Judith Resnik, and Judge Harry Edwards argue that our existing system of justice serves a public purpose.<sup>323</sup> By closing off access to proceedings, eliminating judicial precedent, and allowing parties to write their own laws, we compromise society's role in setting the terms of justice.<sup>324</sup> Ironically, the privacy of arbitration results may actually make it less likely that other cases will settle.<sup>325</sup> The lack of publicity may be particularly detrimental in the context of consumer claims because one set of consumers will not be able to learn from the misfortunes of others.<sup>326</sup>

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321. See *supra* notes 251-80 and accompanying text.

322. See generally Guill & Slavin, *supra* note 252, at 8-9 ("[C]ertain forms of private judging dispense with many of the most cherished and carefully developed features of our public system: open proceedings, written decisions, appellate review, and the evolution of the common law."); Edward Brunet, *Questioning the Quality of Alternate Dispute Resolution*, 62 TUL. L. REV. 1, 8 (1987). But see Leo Kanowitz, *Alternative Dispute Resolution and the Public Interest: The Arbitration Experience*, 38 HASTINGS L.J. 239, 303 (1987) (asserting that arbitration is an effective method for addressing large public policy issues).

323. Harry T. Edwards, *Alternative Dispute Resolution: Panacea or Anathema?*, 99 HARV. L. REV. 669 (1986); Judith Resnik, *Many Doors? Closing Doors? Alternative Dispute Resolution and Adjudication*, 10 OHIO ST. J. ON DISP. RESOL. 211 (1995); Owen M. Fiss, Comment, *Against Settlement*, 93 YALE L.J. 1073 (1984).

324. See Budnitz, *supra* note 3, at 322-27 (arguing that arbitration will undercut social norms embodied in consumer protection statutes such as the Truth in Lending Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Community Reinvestment Act, the Home Mortgage Disclosure Act, the Women's Business Ownership Act, and state anti-usury provisions); Sterk, *supra* note 30, at 486 (arguing that agreements to arbitrate should not be enforced when the law at issue seeks justice in society as a whole, and not merely between the parties). But see Stempel, *supra* note 30 (opposing reliance on public policy exception).

325. Guill & Slavin, *supra* note 252, at 12 (asserting that where law is clearer and better known, more disputes will settle without either trial or arbitration). See generally Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950 (1979) (arguing that greater certainty in the law will encourage settlement).

326. Whereas the publicity generated by a lawsuit may warn other consumers of a problem, unpublished arbitration decisions can rarely have such an impact. Budnitz, *supra* note 3, at 313 (noting that arbitrators may not even be required to issue written decisions). Even in the rare situation where the consumer reports a victory to the press, the newspaper can report at most the amount of the award, and not any reasoning employed by the arbitrator. *Id.* (noting that arbitrators are not generally required to set out their reasoning).

Moreover, denying consumers adequate compensation may itself be a social cost. If one party is able to dominate the process of setting the terms for arbitration, that party may be able to secure an unfair advantage over its opponent.<sup>327</sup> Such inadequate recoveries may hurt not only the consumers themselves but also their families, thereby affecting overall social cohesiveness and productivity.<sup>328</sup> Persons who were not able to recover compensation against a seller of consumer goods might have to be supported by all of society.<sup>329</sup>

*2. Even If Binding Arbitration Were Better for Society as a Whole, It Would Not Necessarily Be Fair to Impose It on Certain Individuals to Secure a Gain for Society as a Whole*

Finally, assuming binding arbitration is preferable to litigation for society as a whole, having considered both the costs and benefits of the two systems, it is not necessarily fair or just to force a loss on certain individuals to bring about a benefit for society as a whole.<sup>330</sup> As first-year economics students learn, there is a difference between efficiency and equity.<sup>331</sup> It could be that society as a whole would be better off if a particular nasty individual were gagged, locked up, or even thrown off a cliff.<sup>332</sup> Still, most would argue that the individual's rights of free speech, liberty, and life make it wrong to harm the individual, even if society as a whole would gain. Applying this same reasoning, it may be wrong to force a detrimental system of justice on consumers merely to obtain a gain for society as a whole.<sup>333</sup> It is particularly egregious to allow this imposition where, as discussed above, the net social benefits of arbitration have not been proven.

More specifically, the Constitution provides all of us with the right to a

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327. See *supra* notes 251-80 and accompanying text.

328. See generally FRANCIS FUKUYAMA, *TRUST: SOCIAL VIRTUES AND THE CREATION OF PROSPERITY* (1995) (discussing relationship between economics, culture, and social welfare in a broad sense).

329. See Purcell, *supra* note 5, at 490.

330. For this same reason, it is problematic to cap individuals' recovery of damages.

331. See, e.g., POSNER, *supra* note 230, at 14.

332. Of course, many (myself included) would argue that such violence is detrimental to the society at large.

333. See generally Sturdevant & Golann, *supra* note 232, at 4 ("No system of resolving disputes can be considered fair if it exposes the parties to manifest injustice without their consent. Nor does a system of speedy, economical injustice solve the problem of court overcrowding in a socially acceptable way."); see also MACNEIL ET AL., *supra* note 9, ch. 3. (assessing advantages and limitations of arbitration). Indeed, our Bill of Rights and much of our law support the proposition that it is wrong to take from one person merely to secure a greater gain for others).

jury trial for claims “at common law” for an amount in excess of \$20.<sup>334</sup> While the Court has recognized that constitutional rights may voluntarily be waived,<sup>335</sup> waiver should not encompass forcing a consumer unknowingly to relinquish her right to pursue a claim through a fair jury trial solely to benefit other consumers.<sup>336</sup>

#### IV. FEDERALISM PRINCIPLES SUPPORT ALLOWING STATES TO REGULATE ARBITRATION

The Supreme Court’s use of the FAA to preempt state legislation is also inconsistent with the Court’s supposed commitment to federalism—a doctrine that has been called “the unique contribution of the Framers to political science and political theory.”<sup>337</sup> In *Gregory v. Ashcroft*<sup>338</sup> the Court explained:

Perhaps the principal benefit of the federalist system is a check on abuses of government power. “The ‘constitutionally mandated balance of power’ between the States and the Federal Government

334. U.S. CONST. amend. VII. See generally *Chauffeurs Local No. 391 v. Terry*, 494 U.S. 558 (1990) (discussing historical right to jury trial and analyzing when right is applicable to particular claims).

335. See Edward L. Rubin, *Toward a General Theory of Waiver*, 28 UCLA L. REV. 478 (1981); Sternlight, *supra* note 11.

336. As Professor Rubin observes, the Court has applied different theories of waiver in different contexts, distinguishing particularly between civil and criminal law. Rubin, *supra* note 335, at 478-79. Yet where a person does not act willingly or knowingly, and where the act is against the person’s own interest, it is hard to see how a person can be said to have waived, rather than been robbed of, her rights. See generally Sternlight, *supra* note 11 (arguing that the Supreme Court’s decisions in *Fuentes v. Shevin*, 407 U.S. 67 (1972) and *D.H. Overmyer Co. v. Frick Co.*, 405 U.S. 174 (1972), require courts to assess the legitimacy of arbitral waivers in terms of the visibility and clarity of the waiver, the relative knowledge and economic power of the parties, the voluntariness of the purported agreement, and the substantive fairness of the agreement).

Significantly, the Court has been more permissive of waiver in the arbitration context, where a party’s constitutional rights to a jury trial, to an Article III judge, and to procedural due process are at stake, than even in the context of forum selection clauses, where no such rights are involved. A forum selection clause is valid only if it survives contractual attack and if it is “reasonable.” *Carnival Cruise Lines v. Shute*, 499 U.S. 585, 591-95 (1991). By contrast, in interpreting arbitration clauses the Court has held that courts should be mindful of the preference for arbitration and has imposed no requirement that arbitration clauses must even be “reasonable.” See generally Sternlight, *supra* note 11.

337. *United States v. Lopez*, 115 S. Ct. 1624, 1634 (1995) (Kennedy & O’Connor, JJ., concurring) (citing Henry Friendly, *Federalism: A Forward*, 86 YALE L.J. 1019 (1977); GORDON S. WOOD, *THE CREATION OF THE AMERICAN REPUBLIC, 1776-1787*, at 524-32, 564 (1969)). See generally Larry Kramer, *Understanding Federalism*, 47 VAND. L. REV. 1485 (1994); Deborah Jones Merritt, *Three Faces of Federalism: Finding a Formula for the Future*, 47 VAND. L. REV. 1563 (1994).

338. 501 U.S. 452 (1991).

was adopted by the Framers to ensure the protection of 'our fundamental liberties.'<sup>339</sup>

Concluding that states have a core interest in being able to regulate their own judiciary,<sup>340</sup> the Court found that the federal Age Discrimination in Employment Act ("ADEA")<sup>341</sup> should not be interpreted to prevent states from requiring their judges to retire at a particular age. The Court explained that while "Congress may legislate in areas traditionally regulated by the States . . . [i]t is a power that we must assume Congress does not exercise lightly."<sup>342</sup> Therefore, because Congress had not made "clear and manifest" an intention to restrict states' selection of their own judges, the federal statute should be interpreted narrowly to allow states autonomy in this key area.<sup>343</sup>

The Court has recently applied federalist principles in other contexts as well. In *New York v. United States*<sup>344</sup> the Court held that Congress lacked the power to force the state of New York into federal service by giving it a choice of either accepting ownership of certain hazardous waste or regulating the waste according to Congress' instructions.<sup>345</sup> Finally, in *United States v. Lopez*<sup>346</sup> the Court struck down Congress' attempt to regulate the use of handguns on local school premises as not legitimate under the Commerce Clause.<sup>347</sup> The Court emphasized that the Court had a duty to ensure that the Commerce Clause was not so stretched as to deprive states of their crucial role in the federalist scheme of government.<sup>348</sup>

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339. *Id.* at 457-58 (quoting *Atascadero State Hosp. v. Scanlon*, 473 U.S. 234, 242 (1985) (quoting *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528, 572 (1985) (Powell, J., dissenting))); *see also* *New York v. United States*, 505 U.S. 144, 181 (1992) ("[T]he Constitution divides authority between federal and state governments for the protection of individuals.").

340. *Gregory*, 501 U.S. at 459-60.

341. 29 U.S.C. §§ 621-634 (1994).

342. *Gregory*, 501 U.S. at 460.

343. *Id.* at 470.

344. 505 U.S. 144 (1992).

345. *Id.* at 174-77. The Court found the "commandeer[ing]" of state government unconstitutional because it would allow federal government officials to engage in actions without it being clear to the electorate that they had done so. *Id.* *See generally* James F. Blumstein, *Federalism and Civil Rights: Complementary and Competing Paradigms*, 47 VAND. L. REV. 1251, 1287-94 (discussing the Court's decisions in *Gregory* and *New York*).

346. 115 S. Ct. 1624 (1995).

347. *Id.* at 1633-34; *see* U.S. CONST. art. I, § 8, cl.8; *see also* *Seminole Tribe of Fla. v. Florida*, 116 S. Ct. 1114, 1122 (1996) (emphasizing that "each state is a sovereign entity in our federal system," and holding that the Eleventh Amendment precluded Congress from using the Indian Commerce Clause of the Constitution to subject states to lawsuits by Indian tribes without their consent); *Lopez*, 115 S. Ct. at 1633-34.

348. Two concurring Justices stressed the familiar theme that federalism allows states to "perform their role as laboratories for experimentation to devise various solutions where the best solution is far

Several Justices have suggested that the Court should also interpret the FAA narrowly to allow states maximum authority over their own judicial system. Writing for the majority in *Volt*, Chief Justice Rehnquist observed that “[t]he FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration.”<sup>349</sup> Thus, although the FAA preempts state legislation that “actually conflicts with federal law,”<sup>350</sup> the Court found that states should be permitted to enact arbitration legislation that is consistent with the purpose of the FAA.<sup>351</sup> As Justice Stevens wrote, concurring in part and dissenting in part in *Southland*:

[I]t must surely be true that given the lack of a “clear mandate from Congress as to the extent to which state statutes and decisions are to be superseded, we must be cautious in construing the [A]ct lest we excessively encroach on the powers which Congressional policy, if not the Constitution, would reserve to the states.”<sup>352</sup>

Justices O'Connor and Rehnquist, dissenting in *Southland*, found that state courts and legislatures ought to be allowed “to develop their own methods for enforcing the new federal rights.”<sup>353</sup> Eleven years later, dissenting in *Terminix*, Justices Thomas and Scalia also spoke out strongly for federalism, concluding:

Even if the interstate commerce requirement raises uncertainty about the original meaning of the statute, we should resolve the uncertainty in light of core principles of federalism. While

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from clear.” *Id.* at 1641 (Kennedy & O'Connor, JJ., concurring).

349. *Volt Info. Sciences Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 477 (1989). However, Chief Justice Rehnquist joined the majority in *Doctor's Associates* that struck down Montana's notice requirement in arbitration contracts. *Doctor's Assocs., Inc. v. Casarotto*, 116 S. Ct. 1652 (1996).

350. *Volt*, 489 U.S. at 479.

351. *Id.*

352. *Southland v. Keating*, 465 U.S. 1, 19 (1984) (Stevens, J., concurring and dissenting) (quoting *Metro Indus. Painting Corp. v. Terminal Constr. Co.*, 287 F.2d 382, 386 (2d. Cir.) (Lumbard, C.J., concurring), *cert. denied*, 368 U.S. 817 (1961)). Justice Stevens concluded that although the FAA should be applied in state as well as federal courts, states should be allowed to regulate arbitration in ways not inconsistent with the FAA. He specified that “[g]iven the importance to the State of franchise relationships, the relative disparity in the bargaining positions between the franchisor and the franchisee, and the remedial purposes of the California Act, I believe this declaration of state policy [prohibiting a claim under the California Franchise Act from being arbitrated] is entitled to respect.” *Southland*, 465 U.S. at 20.

353. *Southland*, 465 U.S. at 31; *see also* *Perry v. Thomas*, 482 U.S. 483, 493-94 (1987) (Stevens, J., dissenting) (arguing that states' power to exempt certain matters from arbitration should be preserved); *id.* at 494-95 (O'Connor, J., dissenting) (same).



"Congress may legislate in areas traditionally regulated by the States" as long as it "is acting within the powers granted it under the Constitution," we assume that "Congress does not exercise [this power] lightly." To the extent that federal statutes are ambiguous, we do not read them to displace state law. Rather, we must be "absolutely certain" that Congress intended such displacement before we give preemptive effect to a federal statute.<sup>354</sup>

Justice O'Connor, while concurring rather than dissenting in *Terminix*, made it quite clear that she was uncomfortable with the broad preemption being announced by the Court. She observed, for example, that the Court's interpretation of the FAA would "displace many state statutes carefully calibrated to protect consumers,"<sup>355</sup> including "state procedural requirements aimed at ensuring knowing and voluntary consent."<sup>356</sup>

Notwithstanding the Court's purported commitment to federalism, its recent 8-1 decision in *Doctor's Associates*<sup>357</sup> sharply impinges upon states' right to regulate in an area of traditional state concern.<sup>358</sup> Although Congress, in the FAA, did not expressly provide that certain state legislation should be preempted, the Court nonetheless interpreted the preemptive scope of the FAA to invalidate a state's attempt to require that consumers, employees, and franchisees receive adequate notice that they were signing away their right to trial by accepting an arbitration clause.<sup>359</sup> While Justice Thomas, dissenting, implicitly raised the federalism concerns he had previously expressed in *Terminix*, this time he was not even joined by Justice Scalia.<sup>360</sup> Rather, Justice Scalia and the other seven members of the Court issued a decision that was so

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354. *Allied-Bruce Terminix Cos. v. Dobson*, 115 S. Ct. 834, 848 (1995) (Thomas & Scalia, JJ., dissenting) (quoting *Gregory v. Ashcroft*, 501 U.S. 452, 460, 464 (1991)). Justices Scalia and Thomas therefore concluded that *Southland* ought to be overturned and that the FAA should be held not to apply to proceedings brought in state courts. *Id.* at 849-50.

355. *Terminix*, 115 S. Ct. at 843 (O'Connor, J., concurring).

356. *Id.* (citation omitted). Justice O'Connor essentially stated that although she continued to disagree with the Court's decision in *Southland*, and that although she believed that "over the past decade, the Court has abandoned all pretense of ascertaining congressional intent with respect to the Federal Arbitration Act, building instead, case by case, an edifice of its own creation," she would follow *Southland* on grounds of stare decisis. 115 S. Ct. at 844 (citing *Perry*, 482 U.S. at 493 (Stevens, J., dissenting)). Justice O'Connor called upon Congress to correct the Court's faulty interpretation of the FAA "if it wishes to preserve state autonomy in state courts." *Id.*

357. *Doctor's Assocs., Inc. v. Casarotto*, 116 S. Ct. 1652 (1996).

358. Few areas are more fundamentally local than the regulation of basic contracts.

359. *Doctor's Assocs.*, 116 S. Ct. at 1656.

360. *Id.* at 1657.

brief as to imply that no reasonable person could question the Court's ruling.<sup>361</sup>

#### V. REASSESSING THE PREFERENCE

It is time for the Supreme Court to reassess its extreme preference for mandatory binding arbitration over litigation, and to replace its current *preference* with the more limited *acceptance* of binding arbitration initially intended by Congress when it enacted the FAA. Rather than numbly repeat the mantra that arbitration is to be favored *over* litigation, the Court should instead look upon arbitration with favor in appropriate circumstances. Specifically, it should distinguish between those arbitration agreements entered voluntarily and knowingly by two or more parties of comparable strength, and those imposed by a stronger party on a weaker party that is ignorant of the clause's terms and implications. Further, the Court should not permit its assessment to be controlled by the interests of court administrators in hiring fewer judges and building fewer courthouses.<sup>362</sup> To the extent that the Supreme Court refuses to recognize that unregulated mandatory binding arbitration agreements can be detrimental to consumers, employees, and other little guys, Congress should step in to protect their interests.

Like many of arbitration's strongest advocates, I believe that binding arbitration can be quicker, cheaper, more harmonious, and fairer than litigation. However, whereas some believe binding arbitration is necessarily

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361. *See id.*

362. Judge Trieweller, specially concurring in *Casarotto v. Lombardi*, 886 P.2d 939 (Mont. 1994), has expressed this same point very forcefully and candidly. Addressing his remarks "[t]o those federal judges who consider forced arbitration as the panacea for their 'heavy case loads' and who consider the reluctance of state courts to buy into the arbitration program as a sign of intellectual inadequacy," 886 P.2d at 939, Judge Trieweller states:

What I would like the people in the federal judiciary, especially at the appellate level, to understand is that due to their misinterpretation of Congressional intent when it enacted the Federal Arbitration Act, and due to their naive assumption that arbitration provisions and choice of law provisions are knowingly bargained for, all of these procedural safeguards and substantive laws [provided in courts] are easily avoided by any party with enough leverage to stick a choice of law and an arbitration provision in its pre-printed contract and require the party with inferior bargaining power to sign it. [Such opinions] illustrate an all too frequent preoccupation on the part of federal judges with their own case load and a total lack of consideration for the rights of individuals. . . . Furthermore, if the Federal Arbitration Act is to be interpreted as broadly as some of the decisions from our federal courts would suggest, then [Congress] . . . has written state and federal courts out of business as far as these corporations are concerned. . . . These insidious erosions of state authority and the judicial process threaten to undermine the rule of law as we know it.

*Id.* at 940.

superior to litigation, I believe only that arbitration *can be* superior to litigation, depending on the circumstances. Two or more merchants, with roughly equal bargaining power, should be permitted to select binding arbitration over litigation if they believe that selection serves their best interests. Consumers and employees, as well, should be permitted to opt for binding arbitration if they believe binding arbitration is preferable. However, companies should not be permitted to mandate that consumers or other little guys unknowingly waive their jury trial, due process, and Article III rights in favor of a possibly unfair arbitration process.<sup>363</sup> The Court should interpret the FAA to allow both state legislatures and lower courts to protect consumers from injustice.

The Court's prior decisions offer a great deal of support for this Article's arguments. First, prior to 1983 the Court's opinions were consistent with the idea that the FAA was intended to require acceptance of, rather than preference for, arbitration.<sup>364</sup> In 1967 in *Prima Paint*, the Court declared: "As the 'saving clause' in § 2 indicates, the purpose of Congress in 1925 was to make arbitration agreements as enforceable as other contracts, but not more so."<sup>365</sup> Second, the Court's past and even its current decisions support the proposition that arbitration is beneficial only to the extent it is adopted voluntarily by the parties. As discussed earlier, the *Volt*, *Mastrobuono* and *First Options* decisions all emphasize that arbitration is meant to be a consensual process.<sup>366</sup> Third, as discussed in Section IV, this Article's thesis is consistent with the Court's recent focus on federalism principles.<sup>367</sup> Fourth, both the Court and Justice Stevens in particular have at times focused on the difference emphasized in this Article between contracts negotiated between equal parties and those imposed by a stronger party upon a weaker party.

*Fuentes v. Shevin*,<sup>368</sup> a 1972 decision, discussed the extent to which a consumer signatory to a form contract could be held to have waived a constitutional right. The Court observed that "a waiver of constitutional rights

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363. The Equal Employment Opportunity Commission has already recognized this distinction, having taken the position that employers may not force employees to arbitrate rather than litigate disputes as a condition of their employment. Margaret A. Jacobs, *Firms with Policies Requiring Arbitration are Facing Obstacles*, WALL ST. J., Oct. 16, 1995, at B5.

364. See *supra* notes 31-125 and accompanying text.

365. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 403, 405 n.12 (1967).

366. See *First Options of Chicago v. Kaplan*, 115 S. Ct. 1920 (1995); *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212 (1995); *Volt Info. Sciences v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468 (1989); see also *supra* notes 137-44 and accompanying text.

367. It is not, however, consistent with the Court's ignoring of federalism and other policy concerns in *Doctor's Associates*. See *supra* notes 168-76 and accompanying text.

368. 407 U.S. 67 (1972).

in any context must, at the very *least*, be clear.”<sup>369</sup> Observing that the sellers of a stove and stereo to a consumer “made no showing whatever that the appellants were actually aware of or made aware of the significance of the fine print now relied upon as a waiver of constitutional rights,”<sup>370</sup> the Court held that by signing the form contract the consumer did not waive her right to procedural due process prior to replevin of her stove.<sup>371</sup> The Court should apply this important insight to hold that consumers and other weaker parties do not waive their right to a jury trial by having a form arbitration clause forced upon them.<sup>372</sup>

In *Terminix*, the Court briefly considered the argument, presented by amicus curiae, that binding arbitration agreements may be detrimental to consumer interests.<sup>373</sup> While the Court blithely concluded that the speed and inexpensiveness of arbitration would benefit consumers as well as more powerful parties,<sup>374</sup> the Court did not entirely reject the idea that consumer and other form contracts must be treated differently than those contracts entered into by two businesses negotiating at arm’s length. Rather, the Court found that states could use general common law principles to protect consumer interests.<sup>375</sup>

Justice Stevens has repeatedly urged that arbitration agreements entered into between equals must be distinguished from those imposed by a stronger party upon a weaker party. For example, dissenting in *Mitsubishi Motors*, he urged that a car dealer should not be forced to resolve its claim against a large automobile manufacturer through arbitration.<sup>376</sup> Similarly in *Gilmer*, Justice

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369. *Id.* at 95 (emphasis added).

370. *Id.*

371. *Id.*; see also *D.H. Overmyer Co. v. Frick Co.*, 405 U.S. 174 (1972) (upholding confession-of-judgment provision, which waived the right to a day in court where it was accepted knowingly in return for consideration by a sizable company).

372. See Sternlight, *supra* note 11 (arguing that courts should assess clarity, voluntariness, disparate power and fairness in determining validity of arbitral waiver of constitutional rights).

373. *Allied-Bruce Terminix Cos. v. Dobson*, 115 S. Ct. 834, 842 (1995). See generally Brief of Amicus Curiae of the Southern Poverty Law Center in Support of Respondents 33, *Terminix* (No. 93-1001) (arguing that broad application of FAA would “devastate consumer interests” in that “[a]n arbitration clause inserted by the superior party into a form contract, or other in circumstances in which there is a marked imbalance of sophistication, knowledge, and financial resources, functions essentially as an uninformed waiver of the right to trial by jury”).

374. *Terminix*, 115 S. Ct. at 842. The Court presented no real evidence to support its assumption that all parties would benefit equally from such savings and did not seem to worry much about whether the more powerful parties might also use the arbitration agreement to gain advantage over the weaker. *Id.* Instead, the Court simply cited some general statements urging the value of arbitration and noted that many small claims are heard by arbitrators. *Id.*

375. *Id.* at 843.

376. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 665 (1985)

Stevens, again dissenting, urged that the FAA was intended to allow merchants with roughly equal bargaining power to agree to arbitration, but should not be applied to allow employers to impose arbitration upon their workers.<sup>377</sup> Finally, writing for the majority in *Mastrobuono*, Justice Stevens emphasized that the consumers likely had no "idea that by signing a standard-form agreement to arbitrate disputes they might be giving up an important substantive right."<sup>378</sup> He interpreted the agreement in favor of the consumer, to allow punitive damages, and against the brokerage house that drafted the agreement.<sup>379</sup>

Given these broad principles and their support in prior law and Supreme Court decisions, the Court and the lower courts should change their approach to binding arbitration in four key areas of arbitration doctrine.

*A. Interpret Contracts Evenhandedly, Rather Than with a Preference for Arbitration*

The Court should reject the view that ambiguities in arbitration agreements should always be interpreted as broadly as possible to favor arbitration. The practice of interpreting ambiguities to favor arbitration, which the Court first enunciated in *Moses H. Cone* in 1983,<sup>380</sup> is nothing less than a means of spreading binding arbitration by Supreme Court fiat. Some courts have used this interpretive power boldly to require consumers, employees and others who likely had no idea arbitration would be relevant to a given issue to submit the problem to arbitration.<sup>381</sup> However, no policy supports the Court's practice of interpreting an ambiguous arbitration agreement any differently

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(Stevens, J., dissenting) (arguing that "it is particularly improper to require a party to resolve a statutory antitrust claim through arbitration where there has been no genuine bargaining over the terms of the submission, and the arbitration remedy provided has not even the most elementary guarantees of due process").

377. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 36-43 (1991) (Stevens, J., dissenting).

378. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212, 1219 (1995).

379. *Id.*

380. *Moses H. Cone Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983).

381. For example, the Tenth Circuit recently held that a highly ambiguous contract between an insurance company and several of its sales agents should be interpreted to require arbitration of the employees' claims of employment discrimination in violation of federal law. "Notwithstanding the ambiguity of the February 1992 version of the Code (or perhaps more correctly, because of such ambiguity), we conclude that the most appropriate construction of the February 1992 Code is to apply its arbitration provisions to employment disputes involving these Plaintiffs." *Armijo v. Prudential Ins. Co.*, 72 F.3d 793, 798 (10th Cir. 1995); *see also* *Gregory v. Electro-Mechanical Corp.*, 83 F.3d 382 (11th Cir. 1996) (interpreting arbitration provision broadly to cover tort, fraud, and deceit as well as claims for breach of contract).

from any other ambiguous contract.

Courts should no more interpret a contract to prefer arbitration than they should interpret an ambiguous contract to favor banks or insurance companies. If parties want pink elephants to proliferate, they may so contract, but the court should interpret ambiguous contracts either evenhandedly or against the interest of the drafting party.<sup>382</sup> Congress never authorized the Court to put its thumb on the scale to favor arbitration in the commercial or consumer context,<sup>383</sup> and such bias also lacks support as a matter of policy.<sup>384</sup>

*B. Allow States to Regulate Arbitration So Long As the Regulations Are Consistent with the Purposes of the FAA*

Congress should amend the FAA to clarify and narrow its preemptive scope. Specifically, Congress should revise the statute to allow states to regulate arbitration both to ensure that persons enter arbitration agreements knowingly and to ensure that the arbitration process is fair.<sup>385</sup> If Congress is going to allow parties to waive their constitutional rights to a jury trial and a fair process in favor of the more informal arbitration process Congress should also ensure that parties receive the functional equivalent of those constitutional rights—specifically, notice and a fair hearing.<sup>386</sup>

Many states currently have laws on the books that purport to regulate the nature of arbitration agreements to ensure that persons who agree to

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382. In *Mastrobuono*, 115 S. Ct. 1212, although the Court repeated its stock phrase that “due regard must be given to the federal policy favoring arbitration,” *id.* at 1218, the Court also relied on the common-law rule that ambiguous contractual language should be construed against the drafter, holding that the arbitrator should be allowed to award punitive damages in the contract at issue in the case. *Id.* at 1219.

383. As discussed earlier, commercial and consumer arbitration must be distinguished from arbitration used to resolve disputes between management and organized labor. In the organized labor context Congress has expressed a preference for resolving labor disputes through arbitration rather than through strikes or shutdowns. See *supra* notes 24-25 and accompanying text. But, as discussed earlier, it is entirely inappropriate to apply Congress’ preference for labor arbitration over strikes to support a preference for consumer arbitration over litigation. *Id.*

384. See *supra* Section III.

385. I do not urge Congress to reverse the Court’s recent decisions in *Southland* or *Terminix* that the FAA applies in state courts to all transactions subject to regulation under the Commerce Clause. While these decisions are somewhat suspect, on both historical and policy grounds, I share Justice Stevens’ view that although Congress did not originally intend for the FAA to apply in state courts, “intervening developments in the law compel the conclusion that the Court . . . reached [in *Southland*].” *Southland v. Keating*, 465 U.S. 1, 17 (1984) (Stevens, J., concurring in part and dissenting in part). Given the development of the *Erie* doctrine, it seems virtually inevitable that Congress’ substantive regulation with respect to arbitration should apply equally to state as well as federal fora.

386. Rubin, *supra* note 335, at 536-41.

arbitration do so knowingly and willingly. Some states, for example, require that arbitration provisions appear in a particular point size,<sup>387</sup> be accompanied by a written acknowledgment,<sup>388</sup> be prominently displayed,<sup>389</sup> or that the arbitration form be approved in advance by the state.<sup>390</sup> However, the Court's recent decision in *Doctor's Associates* places all of these state laws in jeopardy.<sup>391</sup> The decision confirms the validity of lower court decisions that have concluded that the FAA preempts all state laws that would in any way prevent an arbitration from occurring. Such decisions had held preempted not only state laws barring all pre-dispute arbitration agreements or prohibiting all claims under a particular statute from being arbitrated,<sup>392</sup> but also state laws requiring that contracts provide adequate notice as to an arbitration clause,<sup>393</sup> as well as state laws regulating the fairness of a particular arbitration process.<sup>394</sup> Now, under *Doctor's Associates*, all such state laws are invalid,

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387. See, e.g., CAL. CIV. PROC. CODE §§ 1295, 1298 (West 1994); MO. REV. STAT. § 435.460 (1989).

388. See, e.g., VT. STAT. ANN. tit. 12, § 5652 (1994).

389. See, e.g., ALASKA STAT. § 09.55.535 (1994); COLO. REV. STAT. ANN. § 13-64-403 (West 1994); MO. REV. STAT. § 435.460 (1994); MONT. CODE ANN. § 27-5-114 (1993) (must appear on first page).

390. See, e.g., ALASKA STAT. § 09.55.535 (1994).

391. Cf. *Allied-Bruce Terminix Cos. v. Dobson*, 115 S. Ct. 834, 843 (1995) (O'Connor, J., concurring) (noting that the Court's broad reading of preemptive scope of the FAA "will displace many state statutes carefully calibrated to protect consumers").

392. See, e.g., *Saturn Distrib. Corp. v. Williams*, 905 F.2d 719, 721 (4th Cir.) (holding that a Virginia statute forbidding nonnegotiable arbitration provisions in auto franchise agreements was preempted by the FAA), *cert. denied*, 498 U.S. 983 (1990); *Seymour v. Gloria Jean's Coffee Bean Franchising Corp.*, 732 F. Supp. 988 (D. Minn. 1990) (holding that a Minnesota law prohibiting franchisors from forcing franchisees to arbitrate disputes as a condition of becoming franchisees was preempted); *Johnson v. Piper Jaffray, Inc.*, 530 N.W.2d 790 (Minn. 1995) (holding that the FAA preempts Minnesota Human Rights Act to the extent the MHRA purports to void agreements that require waiver of judicial forum with respect to such claims).

393. See, e.g., *David L. Threlkeld & Co. v. Metallgesellschaft Ltd.*, 923 F.2d 245, 249 (2d Cir.) (preempting Vermont law requiring that "any agreement to arbitrate must be displayed prominently in the contract or contract confirmation and must be signed by the parties"), *cert. dismissed*, 501 U.S. 1267 (1991); *Securities Indus. Ass'n v. Connolly*, 883 F.2d 1114, 1117 (1st Cir. 1989) (preempting Massachusetts securities regulations that ordered arbitration clause to be placed "conspicuously" and further demanded "full written disclosure of the legal effect of the pre-dispute arbitration contract or clause"), *cert. denied*, 495 U.S. 956 (1990); *Webb v. R. Rowland & Co.*, 800 F.2d 803, 805-06 (8th Cir. 1986) (preempting Missouri statute requiring that "arbitration clauses be introduced by a notice, in 10 point capital letters, that the contract contains a binding arbitration clause"); *Mr. Mudd, Inc. v. Petra Tech.*, 892 S.W.2d 389 (Mo. Ct. App. 1995) (holding that a state statute requiring notice of arbitration clause to be specially stated in the contract was preempted by the FAA); *Woermann Constr. Co. v. Southwestern Bell Tel. Co.*, 846 S.W.2d 790 (Mo. Ct. App. 1993) (striking down state law requirement that notice of binding enforceable arbitration appear in 10 point type).

394. See, e.g., *Olde Discount Corp. v. Tupman*, 805 F. Supp. 1130 (D. Del.) (preempting state regulation allowing Securities Commission to impose remedy of rescission for alleged securities trading violations because remedy would interfere with parties' right to arbitrate claims), *aff'd*, 1 F.3d 202 (2d

except as applied to purely local transactions, to the extent a state may justify the law as part of a broader regulatory effort, or perhaps to the extent the parties have agreed to be regulated by state rather than federal arbitration law.<sup>395</sup>

The position taken by the Montana Supreme Court in *Doctor's Associates* with respect to preemption under the FAA was correct, and it ought to have been affirmed by the Supreme Court. Now that the Court has taken the extreme position of voiding all protective state legislation, Congress should amend the FAA to effectively reverse the Court's ruling, protect weaker parties, and ensure the constitutionality of the FAA. Specifically, while states should not be permitted to prohibit pre-dispute arbitration agreements altogether, they should be allowed to enact legislation designed to ensure that arbitration agreements are entered knowingly and voluntarily.

In addition, Congress should amend the FAA to allow states to regulate the substance of arbitration proceedings themselves in ways that are consistent with the initial purposes of the FAA.<sup>396</sup> Although a strong argument can be made that states should not be permitted to interfere with arbitration agreements entered into by two knowledgeable parties of roughly equal strength,<sup>397</sup> states should be permitted to enact laws to protect weaker or

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Cir. 1992), *cert. denied*, 510 U.S. 1065 (1994); *Securities Indus. Ass'n v. Lewis*, 751 F. Supp. 205, 206-08 (S.D. Fla. 1990) (preempting Florida securities statute requiring that parties be afforded option of arbitration before an independent non-industry panel, such as the American Arbitration Association, and not forced to arbitrate in an industry forum); *Coco Concrete Constr. v. J.T. Schrimsher Constr. Co.*, 792 F. Supp. 109 (N.D. Ga. 1992) (preempting state arbitration law which prohibited arbitration awards from including attorney fees). *But see* *Frank Fiore Enter. v. Francis*, No. 86 Civ. 7241 (WCC), 1987 WL 9429 (S.D.N.Y. Apr. 8, 1987) (holding that the FAA does not preempt state statute prohibiting arbitration of controversy involving an incompetent person absent a prior court order); *Fouquette v. First Nat'l Sec.*, 464 N.W.2d 760 (Minn. Ct. App. 1991) (holding that the FAA does not preempt Minnesota law providing that court rather than arbitrators should review claim of fraud in the inducement of the entire contract).

395. *Volt* states that parties may elect to be governed by state rather than federal arbitration law, so long as the state law does not "undermine the goals and policies of the FAA." *Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 477-78 (1989). While the party opposing a state restriction would likely argue that the restriction violates the FAA, citing *Doctor's Associates*, the proponent could cite *Volt's* acceptance of a state law that effectively denied arbitration by allowing litigation to proceed first. In any event, drafters of future arbitration clauses who do not want to be bound by state law will probably state a clear choice for the FAA.

396. Dispute resolution organizations themselves can effectively regulate arbitration by refusing to handle arbitrations that do not meet minimal fairness criteria. For example, JAMS/Endispute will only take employment cases where "an employee retains the same avenues as in court, including the right to . . . punitive damages . . . prehearing discovery and representation by counsel." Jacobs, *supra* note 363.

397. I recognize that there may be factual disputes as to whether certain categories of participants are sufficiently unevenly matched as to warrant state protection. However, I believe that courts are capable of resolving such disputes. Existing state protective language seems to focus primarily on unequal contractual relationships which, for the reasons discussed earlier, are least likely to produce



less knowledgeable parties, so long as the legislation does not forbid arbitration altogether. For example, in order to protect a weaker party, states ought to be permitted to enact legislation requiring that arbitrators be impartial, requiring that a party be permitted to retain an attorney in arbitration, precluding unfair forum selection clauses, and ensuring that parties are allowed adequate discovery.<sup>398</sup>

Legislation that requires arbitrations to be consensual and fair is consistent with the purpose of the FAA, which was not to impose arbitration at any cost, but rather to assist parties in entering mutually beneficial arbitration agreements. Because of the various market characteristics discussed in Section III, allowing stronger parties to impose form arbitration agreements on weaker parties may greatly harm the weaker parties, individually and as a group.<sup>399</sup> Nor are mere notice provisions likely to be adequate to protect consumer interests. Even if provided with notice, many consumers still will not read or understand the arbitration agreement a merchant is seeking to apply. Given the inadequacy of notice provisions, states should be permitted to step in with their own regulations to correct market imperfections and protect the weaker party.

The FAA explicitly recognized that states should be allowed to protect consumers using common-law contractual doctrines such as fraud or duress.<sup>400</sup> States should be able to use their own statutes to achieve similar ends and to avoid total dependence on the interpretational whims of individual judges.<sup>401</sup> Such measures as notice provisions can easily be seen as

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efficient results without state regulation. For example, states often focus on consumer contracts, franchisor/franchisee contracts, employment contracts, and medical contracts.

398. This is just a small set of examples of ways in which states might choose to regulate the arbitration process. For other examples of due process constraints, see *supra* note 30. Some may argue that I am destroying the beauty of the arbitration process, and that over-legalizing arbitration will take away its advantages of speed and economy. I have two responses. First, I do not advocate *requiring* any regulations whatsoever. Rather, I simply advocate allowing individual states to determine what, if any, regulation is appropriate. Second, as discussed earlier, it has not been shown that arbitration is necessarily better than litigation for individual consumers, or even for society as a whole. See *supra* notes 238-336 and accompanying text.

399. Other groups requiring protection might include employees and franchisees. Not surprisingly, it is just such groups that states have already sought to protect through their legislation. See, e.g., MICH. COMP. LAWS ANN. § 445.1527 (West 1989); OR. REV. STAT. § 650.165 (1995); S.D. CODIFIED LAWS § 32-6B-49.1 (Supp. 1994); TEX. REV. CIV. STAT. ANN. art. 4413(36) § 5.02(18) (West Supp. 1996).

400. 9 U.S.C. § 2 (1994).

401. Congress could prevent states from voiding arbitration agreements altogether by expressly stating such a prohibition, as well as by allowing states to regulate arbitration only to protect parties in a substantially unequal bargaining positions. Further, current attitudes toward arbitration are quite favorable, so that it is unlikely many states would seek to prohibit binding arbitration altogether.

a legislative method of avoiding fraud or duress. Further, there is no valid reason to restrict states' regulation of arbitration, so long as they do not prohibit arbitration altogether. Rather, a state should be able to regulate more closely a contract that requires a person to waive a constitutional right than it might regulate the typical commercial agreement.<sup>402</sup>

*C. Encourage Lower State and Federal Courts to Be More Willing to Reject Arbitration Agreements on Grounds of Fraud and Duress*

Consistent with a policy of accepting but not preferring arbitration, the Court and lower state and federal courts should be more open to rejecting arbitration agreements on grounds such as coercion and duress. The FAA explicitly provides that arbitration agreements may be voided on "such grounds as exist at law or in equity for the revocation of any contract."<sup>403</sup> This language has widely been interpreted to allow courts to void arbitration agreements on grounds of fraud, duress, and unconscionability,<sup>404</sup> and the Court itself has recognized that the common law doctrines may be used to protect consumer interests.<sup>405</sup> Nonetheless, citing the Court's policy of favoritism toward arbitration, many courts have proved reluctant to void any arbitration agreement on these common law grounds.<sup>406</sup> For example, in *Rodriguez de Quijas v. Shearson/American Express, Inc.* the Court found that while consumers might theoretically raise a defense of fraud or overwhelming economic power, the consumers had failed to produce a sufficient factual showing to support the defense.<sup>407</sup> Yet, according to Petitioners' brief, the consumers were first-time investors including minors, retirees, and persons who did not even speak English.<sup>408</sup> Plaintiffs also accused the broker's agent

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402. The Court has already recognized that "state law *whether of legislative or judicial origin*, is applicable if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987) (emphasis added). Thus, the Court has already accepted that states may use statutes as well as common laws to protect their citizens from inappropriate arbitration agreements.

403. 9 U.S.C. § 2 (1994).

404. *Allied-Bruce Terminix Cos. v. Dobson*, 115 S. Ct. 834, 843 (1995); *Perry*, 482 U.S. at 492 n.9; *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 627 (1985).

405. *Terminix*, 115 S. Ct. at 843.

406. Jeffrey W. Stempel, *A Better Approach to Arbitrability*, 65 TUL. L. REV. 1377, 1397-414 (1991) (discussing great difficulty in prevailing on common-law defenses such as fraud, illegality, impossibility, waiver, coercion, failure of consideration, unconscionability, or contract of adhesion); MACNEIL ET AL., *supra* note 9, § 19.2.1 (noting that challengers to arbitration clauses on contract grounds face an "uphill battle" and that such arguments will "hardly ever" prevail).

407. 490 U.S. 477, 483-84 (1989).

408. Brief for Petitioners at 2, *Rodriguez de Quijas* (No. 88-385).

of having intentionally misled them.<sup>409</sup> Lower courts, similarly, have been extremely unsympathetic to consumers' claims of fraud and duress, holding that consumers should have been aware of arbitration clauses even if they were buried deep in contracts or conveyed in stressful or even dishonest ways.<sup>410</sup> The courts, in rejecting consumers' contractual defenses, repeatedly cite the supposed federal policy favoring arbitration and observe that any doubts as to the legitimacy of the agreement should be resolved in favor of arbitration.<sup>411</sup> These decisions are inconsistent with both the history and text of the FAA and also lack any valid policy support.

*D. Encourage Lower Courts to Scrutinize Arbitration Appeals More Closely*

Finally, the Court should allow and encourage lower courts to take a closer appellate look at arbitration decisions. The FAA provides that arbitration decisions should be reversed only for certain very limited reasons, and this Article does not seek to undermine that provision. However, relying on the supposed policy of preference for arbitration over litigation, some courts have virtually refused to conduct any appellate review of arbitration decisions whatsoever. For example, in *Advanced Micro Devices, Inc. v. Intel Corp.*,<sup>412</sup> the California Supreme Court refused to reverse an arbitral award that all agreed far exceeded the award that a court might have ordered had the case been litigated. The arbitrator effectively awarded plaintiff a royalty-free licensed use of an Intel product that was not at issue in the pending arbitration.<sup>413</sup> The majority justified the award on the ground that "the remedy an arbitrator fashions does not exceed his or her powers if it bears a rational relationship to the underlying contract as interpreted. . . ."<sup>414</sup> Three of the

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409. *Id.*; see also *Shell*, *supra* note 190, at 459-60.

410. See, e.g., *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 287-88 (9th Cir. 1988) ("We see no unfairness in expecting parties to read contracts before they sign them. . . . We are unable to understand how any person possessing a basic education and fluent in the English language could fail to grasp the meaning of that [arbitration] provision."); *Benoay v. E.F. Hutton & Co.*, 699 F. Supp. 1523, 1529 (S.D. Fla. 1988) (requiring arbitration even though broker had represented to consumer that form was a "mere formality" because "[a] party who signs an instrument is presumed to know its contents").

411. See, e.g., *David L. Threlkeld & Co. v. Metallgesellschaft Ltd.*, 923 F.2d 245, 248 (2d Cir.), *cert. denied*, 501 U.S. 1267 (1991); *Cohen*, 841 F.2d at 285; *Benoay*, 699 F. Supp. at 1526.

412. 885 P.2d 994 (Cal. 1994). Although the *Advanced Micro* decision is based on California law rather than the FAA, the effect of the preference for arbitration is similar. See *supra* note 18.

413. *Advanced Micro*, 885 P.2d at 998; see Margaret A. Jacobs, *Intel-Advanced Micro Case Stirs Debate Over Arbitrator's Powers*, WALL ST. J., Feb. 10, 1995, at B6.

414. *Advanced Micro*, 885 P.2d at 996. The court explained that because "[t]he decision to

seven Justices dissented sharply, noting that "under the majority's test it is theoretically possible for an arbitrator to order the losing party to be placed in the stocks or the pillory or to direct that the contractual relationship be repaired by ordering the marriage of the parties' first-born children."<sup>415</sup>

*Advanced Micro Devices* involved two large companies that had bargained for the arbitration clause by which they were governed. As applied to them, the majority's rationale makes some sense. If the parties want more extensive appeal or less liberal remedies, they can provide for that in their agreement. However, as applied to consumers and other weaker parties, *Advanced Micro Devices* and other similar decisions threaten basic justice. By limiting their review of arbitrators' decisions courts are simply furthering the policy of sacrificing consumer interests to achieve judicial economy. The FAA was written to limit, not eliminate, appeal. Although courts should refuse to conduct *de novo* review on many arbitration decisions, they should not be reluctant to set aside arbitral awards that are clearly unfounded and inconsistent with applicable law.<sup>416</sup>

## VI. CONCLUSION

In case after case since the *Moses H. Cone* decision in 1983,<sup>417</sup> the Supreme Court has reiterated that arbitration should be preferred over litigation.<sup>418</sup> However, when the parties have not knowingly and voluntarily agreed to arbitration, this preference has no justification as a matter of legislative history, nor can it be defended as a matter of policy. Instead, such an arbitral preference simply allows stronger parties to take advantage of weaker parties.

The Court should abandon its unjustified preference for arbitration and replace it with a policy of acceptance of arbitration voluntarily agreed to by contracting parties.<sup>419</sup> Such an approach is consistent with the legislative history of the FAA and with policies of protecting individual self-

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arbitrate disputes is motivated in part by the desire to avoid the delay and cost of judicial trials and appeals," judicial review should be minimized. *Id.* at 1000.

415. *Id.* at 1014 n.2.

416. *Cf. Engalla v. Permanente Med. Group, Inc.*, 43 Cal. Rptr. 2d 621 (Cal. Ct. App. 1995) (reversing lower court's refusal to compel arbitration, despite allegations Kaiser had behaved fraudulently in connection with arbitration process); Carbonneau, *supra* note 20, at 268-72 (arguing for more thorough appellate review of arbitral decisions and noting that other countries' laws call for more review than employed by U.S. courts).

417. *Moses H. Cone Hosp. v. Mercury Constr. Corp.*, 465 U.S. 1 (1983).

418. *See supra* note 10.

419. *See supra* Section V.

determination, fairness, and state autonomy. If the Court does not restore the balance between arbitration and litigation, Congress should step in to protect weaker parties from improper and unfair arbitration agreements. Congress need not enact its own laws directly regulating arbitration; rather, it should simply restore to state legislatures and courts their power to protect consumers and other little guys from agreements to which they were never truly a party. In sum, if the Supreme Court will not change its course, Congress must act quickly to prevent companies from using arbitration as a tool of oppression, rather than to achieve justice.