Gateway Widens Doorway to Imposing Unfair Binding Arbitration on Consumers

Jean R. Sternlight
University of Nevada, Las Vegas – William S. Boyd School of Law

Follow this and additional works at: https://scholars.law.unlv.edu/facpub

Part of the Constitutional Law Commons, Contracts Commons, and the Dispute Resolution and Arbitration Commons

Recommended Citation
https://scholars.law.unlv.edu/facpub/255

This Article is brought to you by the Scholarly Commons @ UNLV Boyd Law, an institutional repository administered by the Wiener-Rogers Law Library at the William S. Boyd School of Law. For more information, please contact youngwoo.ban@unlv.edu.
Gateway Widens Doorway to Imposing Unfair Binding Arbitration on Consumers

by Jean R. Sternlight

When Rich and Enza Hill opened the boxes to their new Gateway 10th Anniversary computer system, they had no idea they were trading their right to a jury trial for binding arbitration. Nonetheless, the Seventh Circuit Court of Appeals has held that because the boxes contained a “Standard Terms and Conditions Agreement” including an arbitration clause, the Hills waived their right to sue Gateway in court when they failed to return the computer within 30 days. Instead, the Hills could only file a claim against Gateway in arbitration, and pay fees totaling at least $2,000 to get there.

Hill v. Gateway, is but the most extreme example of a series of court decisions that allow large companies to impose potentially unfair binding arbitration agreements on unwitting consumers. When a California bank sent its customers an envelope stuffer announcing that all future claims against the bank must be arbitrated rather than litigated, Florida’s Fifth District Court of Appeal held that consumers who purchased pest extermination services were required to arbitrate not only contractual disputes but also personal injury claims that allegedly resulted from the extermination, where they signed an arbitration clause as part of the contract. In the health care context, the Utah Supreme Court, in Sosa v. Paulos, found that a doctor could require a patient to arbitrate any future medical malpractice complaint before a panel of specialists in the doctor’s own field because the patient signed an arbitration clause among a number of other documents just a few minutes before she went into surgery.

The Gateway decision is more striking than these and many other pro-arbitration cases because the Hills literally had no chance to escape the arbitration clause other than by making the heroic effort of returning their new computer. Realistically, they had no chance to even learn of the existence of the arbitration clause before the computer was ordered, paid for, and delivered. While the Seventh Circuit implied potential buyers might learn about Gateway’s arbitration program through advertisements, the Gateway web page, or conversations with Gateway personnel, these options are illusory. Neither the advertisements nor the web page made any mention of arbitration. Further, even had the Hills somehow had the prescience to ask a salesperson about arbitration, it is not at all clear they could have obtained a copy of the clause. Even once the computer was delivered it is by no means clear that a typical consumer would have noticed or understood the arbitration clause contained on page 3, paragraph 10 of the statement of terms document, which was packed together with the computer, monitor, keyboard, lots of software, and multiple sets of instructions.

States’ statutory attempts to protect their consumers from unfair arbitration clauses have been largely unsuccessful because courts have found that state laws that single out arbitration contracts for more hostile treatment than other contracts are preempted by the Federal Arbitration Act, as long as the contract involves interstate commerce. For example, the Supreme Court held preempted a Montana statute requiring adequate notice of an arbitration provision contained in a contract, as well as an Alabama statute entirely prohibiting pre-dispute arbi-
First, the Magnuson-Moss Act, passed in 1974 "to improve the adequacy of information available to consumers, [and] prevent deception," provides that consumers cannot, prior to their assertion of a claim, be deprived of their right to sue merchants in court. While the Act allows merchants to establish informal dispute settlement procedures, the Act and the accompanying regulations and legislative history imply that these procedures must be non-binding. In comments issued together with the regulations the FTC explicitly rebutted claims of some industry representatives that warrants ought, in advance of a dispute, be allowed to require consumers to resort to binding arbitration. It stated:

The Rule does not allow for this for two reasons. First, Congressional intent was that Section 110 Mechanisms not be legally binding. Second, even if binding Mechanisms were contemplated by Section 110 of the Act, the Commission is not prepared, at this point in time, to develop guidelines for a system in which consumers would commit themselves, at the time of product purchase, to resolve any difficulties in a binding, but nonjudicial proceeding. The Commission is not now convinced that any guidelines which it set out could ensure sufficient protection for consumers against warrantors, even if the Congressional report had not made clear, as it did, that it wished for such mechanisms to not be binding.

While the agency commentary accompanying the Magnuson-Moss Warranty Act regulations observes that a warrantor may offer consumers the option of binding arbitration, once a dispute has arisen, the regulations prohibit warrantors from mandating binding arbitration prior to the occurrence of the dispute.

Gateway is also questionable as a matter of contract law. While it is clear that buyers and seller entered a contract regarding purchase and sale of the computer, that contract did not necessarily include an arbitration provision. Judge Easterbrook, writing for the majority, essentially concluded that a contract for arbitration was formed because the buyers accepted delivery of the computer and then failed to return it within 30 days. Yet, pursuant to the more traditional contract analysis offered by the buyers, the contract was formed when, by accepting payment, fixing a confirmation, and shipping the computer, Gateway accepted the purchase offer made by the Hills over the phone. Buyers argue that because their offer did not contain an arbitration clause, the supplemental terms contained in the box were simply a proposal for additional or modifying terms which the buyers did not accept. Uniform Commercial Code §2-207 provides that if a party accepts a contract but also states different or additional terms than were offered, those terms are regarded as mere "proposals for addition" and not modifications to the contract. Here, because the contract was entered between consumers and merchant prior to the shipment of the computer, it would seem that the Hills should not be bound by the proposal for an arbitration clause.

Third, although courts have generally rejected attempts to challenge private arbitration agreements on constitutional grounds, finding a lack of state action and/or waiver of such claims, commentators are increasingly raising the possibility of such an argument. The state often throws its weight behind private arbitration by interpreting asserted agreements broadly to favor arbitration over litigation. Where courts "prefer" on such a preference in their interpretation of an arbitration agreement the court arguably engages in state action that calls to play constitutional protections. Given the existence of state action, enforcing an unfair mandatory binding arbitration agreement that was not knowingly and voluntarily accepted by the consumer will often violate the Seventh Amendment right to a jury trial for claims brought at common law in federal court. If a state participates in enforcing such a waiver, it also potentially acts unconstitutionally in violation of the Fourteenth Amendment's guarantee of due process and Article III's guarantee of the right to present a claim to a federal court judge.

Finally, Gateway is unwise as a matter of policy. Judge Easterbrook base his conclusion that "practical considerations support allowing vendors to enclose the full legal terms with their products," on a "straw man," asserting that requiring cashiers to read such terms over the phone would simply "anesthetize" or anger potential customers. This analysis is flawed because it fails to consider alternative
West Group will make your law firm home page

You'll have an attractive, persuasive home page. West Group's home page marketing consultants and designers will help you create a home page that looks great, works efficiently, and is filled with persuasive information.

West's Legal Directory directs traffic to your home page. When we host your home page, you get FREE Professional Profile listings in West's Legal Directory (WLD) for every attorney in your firm, as well as a FREE Firm Profile. When searchers "hit" any of your WLD listings, they find a link to your home page. To help you track traffic on your home page, you get a detailed monthly report of who's using your home page, and how.

Your home page will be available when people need it. We'll host your home page in a secure mainframe, maintained 24-hours per day by experts and accessible by incoming lines that can handle 200,000 calls per second! Our financial stability ensures we'll be around a long time to maintain your home page.

Call for a FREE consultation. Lawyers have trusted West Group companies for more than a century. Now, trust us to help ensure that your home page investment will be a glowing success. To discuss a home page for your firm, please call 1-800-455-4565, ext. 52003. For more information and a demonstration of FirmSites we've created, please visit us on Internet at www.wld.com/demo.htm.
ways to regulate dealer conduct and because it ignores the potential significance of allowing companies to require consumers to trade their litigation rights for arbitration. Companies can use such clauses not only to take away a consumer-friendly jury but also to force consumers to bring claims in a distant and thus expensive forum, to impose high extra arbitration costs, to deny consumers needed discovery, to deprive consumers of recovery for punitive damages, and to prevent consumers from using the economical class action procedures that would be available in court. The Gateway provision itself was unfair in some of these ways. It required that the dispute would be heard under International Chamber of Commerce rules which demand the filing party to pay at least $2,000 for the services of the ICC and its arbitrator. What kind of sense would it make for a consumer with a dispute over a $4,000 computer to pay half that amount in arbitration fees alone? The clause also required all claims to be brought in Chicago, which would certainly be quite expensive for those customers who, unlike the Hills, did not live in Chicago. Finally, the ICC rules make no provision for discovery, which could well prove crucial to a consumer’s claim of fraud or defect.

Assuming that the imposition of an arbitration clause may have a significant impact on consumers, Gateway unreasonably shifts to consumers both the search costs of ascertaining the existence of such a clause and the return cost of avoiding such a clause. While it might not make sense to require cashiers to read extensive terms to customers, surely it would not be unreasonable to require the company to alert customers to the existence of such an important clause. Gateway might easily have done so in any number of ways: by noting the existence of the arbitration clause in its advertisements where it already mentioned the limited warranty; by requiring its cashiers to mention the arbitration clause and then offering to read it or send it upon the customer’s request; or by at least including mention of the clause on the written confirmation that the company sent to its customers prior to shipment of the computer. While none of these methods would guarantee that consumers were not unfairly and unwittingly deprived of their right to litigate disputes in court, such methods would at least decrease the likelihood of such an outcome. It is simply wrong to rest waiver of a constitutional right on the assumption that a consumer would both read in detail all of the documents enclosed with a new computer and then take the dramatic and expensive step of returning the brand new-computer to its shipper. Moreover, given the realities of consumer behavior, it would be preferable to flatly prohibit merchants from requiring consumers to waive their litigation rights in favor of binding arbitration. At a minimum merchants should be barred from imposing arbitration clauses that are unfair.

The Gateway arbitration clause was not as bad for consumers as it might have been. At least the clause did not, as some clauses do, require disputes to be heard by biased decision makers and limit the consumers’ rights to punitive damages. However, Gateway gives companies virtually free rein to develop their own unfair clauses and impose them after the fact on unwitting consumers. Either courts or the Congress should take steps quickly to make consumers. Either courts or the Congress should take steps quickly to protect consumers from such practices. We should not allow foxes to design the cages. Finally, the ICC rules make no provision to requiring the company to alert consumers from using the economical class action procedures that would be available in court.

1. Hill v. Gateway, 105 F.3d 1147 (7th Cir. 1997) (rehearing denied). The arbitration clause was on page 3, paragraph 10 of the standard terms document, and the clause was not highlighted nor displayed in large print. (Clause on file with author).

2. The arbitration clause provided that arbitration would be governed by the International Chamber of Commerce Rules of Arbitration. These rules, normally applied to large transactions between companies located in different countries, require the party filing a dispute for up to $50,000 to pay administrative expenses of $2,000. The rules further provide that the arbitrator’s fee in such cases shall be at least $2,000 up to a maximum of 15 percent of the value of the claim. While these fees can apparently be split between the parties, they do not include additional costs a party must generally pay such as for an attorney or for travel.

3. Although the advertisement did mention a limited warranty, the purchasers had no reason to believe that the warranty would be so abused as to deprive them of the protection that was provided to them with protections should the product turn out to be defective.

4. Of course, even if the web page had mentioned such a clause many computer customers might well not have a computer that would allow them to peruse the web page in the first place.

5. In all likelihood, few customers would have been focusing on the presence or absence of an arbitration clause. Rather, they would probably have been thinking about the $4,000 they were spending on the computer system, the “pleasure and time savings.” How much they would save with their new computer, and perhaps about the potential difficulties they would face in setting up the new system.

6. This author’s persistent attempts to procure a copy of the arbitration provision from Gateway’s sales and customer representatives did not prove productive. Gateway’s failure to provide this information promptly would seem to violate the Magnuson-Moss Warranty-Federal Trade Commission Improvement Act. 15 U.S.C. §§701-720; 16 C.F.R. §§701.3, 702.3, 703.3 (written warranty shall include information about any informal dispute resolution pro-
procedure and shall promptly be made available to any consumer upon request).

13 9 U.S.C. §1 et seq.

14 Although states’ protective legislation would apply in the absence of interstate commerce, the Supreme Court has defined the term broadly to cover the full range of Congress’ authority to regulate all “commerce in fact.” Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265 (1995).


18 The statute at issue was Fla. Stat. §517.122, which provides that where securities brokers require their customers to arbitrate claims they must provide the customers “the option of having arbitration before and pursuant to the rules of the American Arbitration Association or other independent non-industry forum as well as any industry forum.”

19 Plaintiffs apparently did not present to the court the Magnuson-Moss or constitutional arguments discussed in this article, and also did not make all of the contract law arguments set out here.


23 The statute provides that the informal dispute resolution procedure must comply with regulations adopted by the Federal Trade Commission, 16 U.S.C. §2310(a)(2), and that the consumer may pursue a legal remedy only after resorting to the appropriate internal procedure. 15 U.S.C. §2310(e). The FTC rules explicitly state that “decisions of the [informal dispute] mechanism shall not be legally binding on any person.” 16 C.F.R. §703.5(j). See also 16 C.F.R. §703.5(g) (consumer who is dissatisfied with informal decision may pursue legal remedies). The legislative history of the statute is clear that the informal dispute procedures were envisioned as a prerequisite rather than a substitute for court remedies. Remarks of Congressman Moss, 119 Cong. Rec. 972 (Jan. 12, 1973); H.R. Rep. 93-1107, 93d Cong., 2d Sess. 41 reprinted in 1974 U.S.C.C.A.N. 7702, 7723. See generally Wilson v. Waverlee Homes, Inc., 954 F. Supp. 1530 (M.D. Ala. 1997) (given restrictions of Magnuson-Moss, mobile home manufacturer may not compel consumer to arbitrate claims against manufacturer based on arbitration agreement between consumer and retailer).

24 40 Fed. Reg. 60168, 60210 (1975). See also id. at 60211 (“reference within the written warranty to any binding, non-judicial remedy is prohibited by the Rule and the Act”).


26 16 C.F.R. §703.5(i). Even assuming for the sake of argument the validity of a predispute agreement to binding arbitration of a consumer claim, the FTC rules prohibit companies from using ADR mechanisms that are unfair in certain ways. Companies cannot charge consumers any fee for use of the mechanism, 16 C.F.R. §703.3(a), nor have the disputes decided by persons who are employed by the company for any purpose other than to resolve disputes. 16 C.F.R. §703.4(a)(1). The company is also supposed to ensure that the decision maker is sufficiently “insulated” from the warrantor, for example in terms of personnel decisions, that the decision will not be biased. 16 C.F.R. §703.3(b). The clause at issue in Gateway is impermissible because the ICC rules require consumers to share the arbitration fees and costs.

27 While the court is not explicit as to how the contract was formed, it implies that the vendor was the offeror and the buyer the offeree. 105 F.3d at 1148-49. The analysis drew from the Seventh Circuit’s earlier decision in ProCD, Inc. v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996), holding that a software purchaser was bound by a license agreement where the box mentioned that the software was governed by a license and where the license was provided in the manual and appeared on a user’s screen every time the program was run. Gateway is a more extreme case than ProCD in at least two respects. First, the Gateway customers received no notification at all, prior to delivery, that they would be subject to an arbitration clause. Second, an arbitration clause is a waiver of constitutional rights, as supposed
THE MOST POWERFUL
THE MOST ECONOMICAL
PUBLIC RECORDS

Access to DBT ONLINE is restricted to Law Enforcement, Fraud Investigators, the Insurance Industry and Attorneys

THE SYSTEM:
Average Search Less than $1*

Average Report That Sweeps Hundreds of Data Sources is Less than $10**

- FREE Fully Functional Demo
- FREE Training
- NO MINIMUM
- NO SERVICE CHARGE

® DBT ONLINE
THE PREMIER INFORMATION RESEARCH SYSTEM®
Instant Access to Billions of Records

ACCESS SYSTEM
IN THE NATION

THE FEATURES:
Assets, Financial & Corporation
Relatives & Associates
Historical Addresses & Associates
Person Locates/Backgrounds - 50 States
Business Locates/Backgrounds - 50 States
Secretary of State Data - 43 States
Real Property - 38 States (650 Counties)
Bankruptcies - 50 States
Liens / Judgments - 33 States
Vehicles - 32 States
Drivers' Licenses - 22 States
And More. Much More.

Too Many Data Sources - Too Small a Page

*Costs based upon $1.50 per minute rate, user data entry time of 10 seconds, an average response time of 3 seconds. Cost of less than $1.00 does not include report or browse time.
**Average of 2.33 minutes per report that accesses hundreds of data sources. Most multi-data source reports range from 2 to 6 minutes of online time, but may run more.

For the MOST information
Call 800-279-7710


The Gateway court observed that U.C.C. §2-207 is irrelevant where there is only one form, and not a "battle of the forms" between the two parties, 105 F.2d at 1150, but did not expressly state whether or how the provision applied to the computer sale. However, by its terms the section does seem to apply to this situation where the shipper accepted the buyer's offer and then submitted additional terms. Further, even if U.C.C. §2-207 is in fact irrelevant it would seem that the buyers never accepted the arbitration clause. It has long been established that mere silence is not sufficient to accept a contract. Restatement (Second) of Contracts §69 provides, in relevant part, that silence does not constitute acceptance except "[w]here the offeror has stated or given the offeree reason to understand that assent may be manifested by silence or inaction, and the offeree in remaining silent and inaction intends to accept the offer . . . [w]here the offeror provides, in writing, a notice of acceptance, even against merchants. E.g., Diskin v. J.P. Stevens & Co., 836 F.2d 47, 50-51 (1st Cir. 1987). The new terms also do not modify a contract between merchants if the offer expressly limited acceptance to the terms of the offer or if notification of objection to new terms was previously given or is given within a reasonable time after notice of them is received. U.C.C. §2-207.

The "Standard Terms and Conditions" agreement enclosed with the computer did include a statement that by keeping the computer the customers agreed to be bound by the terms. However, pursuant to the U.C.C. and standard contract law this preliminary statement itself should not have been binding on the Hills.

E.g., Terminix International Co. v. Ponio, 693 So. 2d 104, 108 (Fla. 5th D.C.A. 1997) ("The short answer to these [constitutional] arguments is that the plaintiffs waived these rights by consenting to arbitrate disputes arising out of . . . the agreement."). See also FDIC v. U.S. Fire, 922 F.2d 833, 833 (9th Cir. 1986) (rejecting challenge to constitutionality of arbitration based on lack of state action).


E.g., Moses H. Cone Memorial Hospital v. Mercury Constr., 460 U.S. 1, 24-25 (1983) ("Questions 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 lack of arbitrability.").

See generally Jean R. Sternlight, Rethinking the Constitutionality of the Supreme Court's Preference for Binding Arbitration: Toward a State Action Theory of ADR, 51 Admin. L. Rev. 655, 661 (1999) (arguing that companies can use binding arbitration to secure assumption of consumer rationality).

In theory, both the FAA, 9 U.S.C. §10(a)(2) and the Magnuson-Moss Act regulations, 15 C.F.R. §§703.3 & 703.4, prohibit the use of biased arbitrators. However, in practice courts have often refused to credit consumers' claims of bias. E.g., Sosa v. Paulus, 924 F.2d 537 (Utah 1996) (refusing to strike arbitration clause on ground that alleged medical malpractice victim was required to present claim to doctors in defendant's specialty area).

Courts have sometimes struck such clauses as in violation of an underlying federal statute. E.g., Graham Oil Co. v. ARCO Prods. Co., 43 F.3d 1244 (9th Cir. 1994) (arbitration clause which, inter alia, precluded recovery of punitive damages held void under federal Petroleum Management Protection Act).

Jean R. Sternlight is an associate professor of law at Florida State University College of Law and director of education and research of the Florida Dispute Resolution Center. She received her J.D., cum laude, from Harvard Law School in 1983 and her B.A., with high honors, from Swarthmore College in 1979.


Because most consumers will believe it is statistically unlikely they would need to sue Gateway, they will tend to undervalue the cost imposed by the arbitration clause and will not likely return the computer they have so eagerly awaited.


"The short answer to these [constitutional] arguments is that the plaintiffs waived these rights by consenting to arbitrate disputes arising out of . . . the article III judge. See generally Sternlight, Rethinking, supra note 35, at 53-82.

Many state constitutions provide similar rights for claims brought in state court. However, courts might find that the FAA preempts such state constitutional provisions.

Sternlight, Rethinking, supra note 35, at 96-118. Although not all binding arbitration clauses would likely be found to violate due process, those that were unfair or biased would do so.

Id. at 93-96. The Article III claim could be raised only by those litigants who would have had a right to sue in federal court.

105 F.3d at 1149.

"See generally Jean R. Sternlight, Panacea or Corporate Tool: Debunking the Supreme Court's Preference for Binding Arbitration, 74 Wash. U.L.Q. 637, 674-679 (1996) (arguing that companies can use binding arbitration to secure strategic advantages over consumers, employees, and franchisees).

The arbitration fee is over and above any attorneys' fees and travel costs the customer must also pay. At least in litigation the judge is free.

By contrast, had the consumers been able to bring a lawsuit they would have been permitted to bring it in any jurisdiction where they could secure personal jurisdiction over Gateway.

TULANE L. REV. (Nov. 1997) (arguing that reliance on state preference for arbitration over litigation gives rise to state action, and that unknowing waivers do not meet constitutional standards).
Program Update Featuring:

- **Office Depot Business Services Division** offers savings from 40% to 80% off products listed in the program catalog. In addition, a list of 150 of the most commonly used "commodity office products" has been assembled and items included are offered to Florida Bar members at an even lower price. Add up to fifty items suited to the unique needs of your practice to this list and receive the same negotiated percentage savings on your own customized products list. Free next day delivery is included. For unanticipated and/or after hour purchases, an in-store purchasing card is provided.

To take advantage of these savings, complete the Office Depot application provided as an insert in the November 1 issue of The Florida Bar News and fax to Carole Thompson, Office Depot, 1-800-816-3139. Upon approval of your account, you will be contacted by an Office Depot account executive to complete the set up process and familiarize you with this exciting new program for Florida Bar members.

- **WorldCom Long Distance Telephone Service** provides members a cost-effective telecommunications service for home and/or businesses of all sizes. For information on home service, call 1-888-876-9869. The business service number to call is 1-800-539-2000.

- **Other Programs Available to Members**

<table>
<thead>
<tr>
<th>Program</th>
<th>Contact Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Association Insurance Programs</td>
<td>Business Planning Concepts, Inc. 800-282-8626</td>
</tr>
<tr>
<td>Court and Surety Bonds</td>
<td>JurisCo 800-274-2663</td>
</tr>
<tr>
<td>Professional Liability Insurance</td>
<td>FLMIC 800-633-6458</td>
</tr>
<tr>
<td>Car Rentals</td>
<td>Alamo #93718 800-354-2322</td>
</tr>
<tr>
<td></td>
<td>Avis #A421600 800-331-1212</td>
</tr>
<tr>
<td></td>
<td>Hertz #152030 800-654-2200</td>
</tr>
<tr>
<td></td>
<td>National #5650262 800-227-7368</td>
</tr>
<tr>
<td>Computerized Legal Research</td>
<td>Lexis -Nexis Advantage 800-356-6548</td>
</tr>
<tr>
<td>Credit Card Program</td>
<td>MBNA 800-457-3714</td>
</tr>
<tr>
<td>Document Assembly System</td>
<td>Automated Leg Sys &quot;ProDoc&quot; 800-759-5418</td>
</tr>
<tr>
<td>Express Shipping</td>
<td>Airborne Express #N82 800-443-5228</td>
</tr>
<tr>
<td>Eyecare</td>
<td>Lens Express #FLBAR 800-666-5367</td>
</tr>
<tr>
<td>Magazine Subscriptions</td>
<td>Subscription Services 800-289-6247</td>
</tr>
<tr>
<td>Wireless Communications Products</td>
<td>Cellular Works 800-235-5967</td>
</tr>
</tbody>
</table>

---

Member Benefits, The Florida Bar, 650 Apalachee Parkway, Tallahassee, Florida, 32399-2300