# CONSUMER ARBITRATION OF STATUTORY CLAIMS: HAS PRE-DISPUTE [MANDATORY] ARBITRATION OUTLIVED ITS WELCOME?

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## I. INTRODUCTION

This essay explores whether pre-dispute arbitration, frequently called mandatory arbitration, has outlived its welcome. The phrase "mandatory arbitration" is misleading because it connotes arbitration that is compelled by law regardless of consent. Pre-dispute arbitration, on the other hand, means a written agreement, normally a term in a contract, to arbitrate future disputes. Under international conventions, the Federal Arbitration Act, and state arbitration law, courts will enforce pre-dispute arbitration agreements by a specific performance decree if the dispute between the parties is arbitrable.[1]

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1. *See* Article II of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 21 U.S.T. 2517 (1970), implemented by 9 U.S.C. §§ 201 - 208 (1994); Section Two of the Federal Arbitration Act, 9 U.S.C. § 2 (1994); Section One of the Uniform Arbitration Act (1955), *reprinted in* 7 UNIFORM LAWS ANNOTATED: BUSINESS & FINANCIAL LAWS 1 (1997).

Prior to the early 1920's, pre-dispute arbitration clauses were not enforceable by specific performance in the United States, although arbitral awards were final on the merits. This situation was rectified by the New York Arbitration Act in 1920 and the United States Arbitration Act ("FAA") in 1925, both of which validated the pre-dispute arbitration agreement. *See* IAN R. MACNEIL ET AL., FEDERAL ARBITRATION LAW: AGREEMENTS, AWARDS, AND REMEDIES UNDER THE FEDERAL ARBITRATION ACT §§ 4.3, 5.3, 5.4 (1994 & Supp. 1997).

Apart from concerns about ousting the jurisdiction of courts, opponents of pre-dispute arbitration argued that a rule of nonenforceability protected persons with inferior bargaining power from an unwitting loss of their day in court and the uncertainty of committing to an open agenda of potential dispute resolution. *Id.* § 4.3, at 20. Arguments of this sort were rejected by Congress in the rush to enact Section Two of the FAA in 1925. *See* IAN R. MACNEIL, AMERICAN ARBITRATION LAW: REFORMATION, NATIONALIZATION INTERNATIONALIZATION 83–121 (1992). *See also* Bruce L. Benson, *An Exploration of the Impact of Modern Arbitration Statutes on the Development of Arbitration in the United*

Generally, a dispute is arbitrable if four conditions are satisfied: (1) there is an agreement in writing to arbitrate some future dispute; (2) the dispute is within the scope of the written agreement to arbitrate; (3) the consent to arbitration is valid, that is, has not been induced by mistake, fraud, duress, or is not unconscionable; and (4) the claim asserted is suitable for arbitration, that is, has not been reserved by law for adjudication in the courts.[2] In short, if a dispute arising under a pre-dispute agreement satisfies the four requirements for arbitrability, a court will compel arbitration.[3]

Arbitration, then, is a method of dispute resolution that depends upon consent and occurs outside of the courts. The consent is to a private adjudication of a dispute submitted to arbitrators chosen by, and under procedures selected by, the parties. After a hearing, the arbitrators decide the dispute between the parties and enter a final award.[4] A confirmed award is enforceable in court as a judgment,[5] and, under traditional arbitration statutes, the award is not reviewable on the merits. Put differently, a court may not review the award for errors of law or fact.[6]

A basic assumption is that arbitration, controlled by the parties and managed by an experienced, impartial institution, is quicker, less formal, and less costly than adjudication in court. It is a confidential procedure that strives to achieve a fair, final outcome between the parties without setting a precedent, for future disputes.[7] Whether arbitration achieves these purposes is unclear for few

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*States*, 11 J. L. ECON. & ORG. 479 (1995) (arguing that non-legal pressures rather than arbitration legislation explain the growth of arbitration in the United States).

2. *See* MACNEIL ET AL., *supra* note 1, § 15.1. It has been suggested that arbitrability is an incoherent concept because it mixes disparate factors, such as claims arising out of the contract between the parties and duties imposed upon the parties by public law. Edward M. Morgan, *Contract Theory and the Sources of Rights: An Approach to the Arbitrability Question*, 60 S. CAL. L. REV. 1059 (1987).

3. By virtue of the "separability" doctrine recognized in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967), a court under the FAA determines questions of arbitrability, and the arbitrator may, depending upon the arbitration clause, decide disputes arising from the underlying contract, including whether that contract is enforceable. *See* MACNEIL ET AL., FEDERAL ARBITRATION, *supra* note 1, § 15.3. The parties may confer, by a clearly worded agreement, however, jurisdiction on the arbitrators to determine their own jurisdiction. *See* First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938 (1995).

4. As Judge Harry Edwards put it, an arbitrator "serves simply as a private judge...[y]et unlike a judge, an arbitrator is neither publicly chosen nor publicly accountable." Cole v. Burns Int'l Sec. Servs., 105 F.3d 1465, 1476 (D.C. Cir. 1997).

5. United States Arbitration Act, 9 U.S.C § 9 (1994).

6. *See* MACNEIL, ET AL., *supra* note 1, § 40.7.2.1. Although Section 10(a) of the FAA states the statutory grounds for vacating an arbitration award, the courts have developed some non-statutory grounds to vacate, such as "manifest disregard of the law." Although frequently mentioned in the cases, they are rarely invoked to vacate an award. *See* Kenneth R. Davis, *When Ignorance of the Law Is No Excuse: Judicial Review of Arbitration Awards*, 45 BUFF. L. REV. 49, 89–108 (1997).

7. In traditional commercial arbitration, the arbitrator may not be bound by any particular body of law. Moreover, there is no requirement that the arbitrator prepare a

comprehensive studies exist on this point.[8] But the process gives the parties an opportunity to achieve these purposes in whole or in part in each particular case. This opportunity, when voluntarily undertaken, is thought to justify a waiver of the special protections assured in court, such as the right to a jury trial, a more comprehensive due process hearing, and judicial review of the merits.

As the millennium approaches, it is clear that arbitration is highly favored by the courts: there is an "emphatic federal policy in favor of arbitral dispute resolution."[9] This policy rests upon two considerations: (1) the voluntary consent of the parties, usually commercial parties, to an established and respected model of dispute resolution; and (2) the prospect that the dispute, typically involving claims arising out of the underlying contract, will be finally resolved outside of the courts. In addition, the Supreme Court has asserted that the model of arbitration, envisioned in 1925 when the Federal Arbitration Act was enacted, is capable of handling any and all disputes submitted to it. Disputes arising under or relating to the underlying contract are simply transferred to a different forum[10] which is assumed to be capable of adjudicating all questions presented to it and to provide adequate remedies. But are these assumptions correct for all cases? More precisely, the question is whether pre-dispute arbitration, based upon the unitary model of arbitration assumed in the early arbitration legislation,[11] has outlived its usefulness. If so, in what contexts has this occurred, what corrections are justified, and how should change be implemented?

## II. COMMERCIAL ARBITRATION: FREEDOM TO CONTRACT

The starting point is the contract to arbitrate. Since arbitration is not prohibited and is rarely compelled, the process starts with consent, an agreement in writing to arbitrate. But freedom of contract has two sides, freedom to contract and freedom from contract. As I noted in another context,[12] how one views the pre-dispute arbitration question may depend upon which side of the consent coin is up, the "freedom to" or the "freedom from" side.

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written opinion or that an opinion actually prepared will be published. *See* MACNEIL ET AL., *supra* note 1, § 37.4.

8. For an interesting debate over some relevant but inconclusive studies, see Frank E. Sander et al., *Judicial (Mis)use of ADR? A Debate*, 27 U. TOL. L. REV. 885 (1996). For a more systematic account, see Thomas J. Stipanowich, *Rethinking American Arbitration*, 63 IND. L.J. 425, 441–62 (1988).

9. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 631 (1985). *See* First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 947 (1995) (noting a "strong arbitration-related policy").

10. *See* Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 26 (1991).

11. Ed Brunet calls this model "folklore" arbitration. Edward Brunet, *Toward Changing Models of Securities Arbitration*, 62 BROOK. L. REV. 1459, 1461–62 (1996).

12. Richard E. Speidel, *Contract Theory and Securities Arbitration: Whither Consent?*, 62 BROOK. L. REV. 1335, 1345–56 (1996).

In commercial contexts where the parties have the power and opportunity to bargain over arbitration, the "freedom to" side is up.[13] Consent to arbitration is usually informed and voluntary, and the intended objective—efficient and fair dispute settlement outside of court—is consistent with social policy. The parties have the opportunity to determine what disputes are to be arbitrated, to choose the arbitrators and the situs of the arbitration, to select the arbitration institution and the governing arbitration rules, to limit discovery or not, and to choose the applicable law.[14] Recent decisions suggest that the parties also have the power to vary the applicable legal framework by agreeing, for example, that a court shall have power to review the final award for errors in law.[15]

This does not mean that commercial arbitration is without problems.[16] Recurring and, perhaps, increasing litigation has been brought by those who regret the decision to arbitrate or who challenge the final award. Much of this litigation is under the FAA and taps into the Supreme Court's rigid enforcement of the "federal" contract to arbitrate created under Section Two. The reported cases reveal that relatively few petitions to compel arbitration or to stay litigation are denied because the dispute was not arbitrable, and even fewer awards have been vacated under the FAA's statutory grounds or the judicially created exceptions. This protective legal shield leaves the parties to cope as best they can within an arbitral process to which they have consented and that is favored by the law.

## III. CONSUMER ARBITRATION: FREEDOM FROM CONTRACT?

### *A. The Consumerization of Arbitration*

Arbitration, however, is not limited to commercial parties. Increasingly, arbitration clauses appear in contracts between brokers and their customers, employers and employees, franchiser and franchisees, HMOs and subscribers, businesses, such as banks, and their customers, insurers and their insured, and law partnerships and associates.[17] In short, arbitration has become "consumerized."[18]

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13. Under the FAA, the freedom to contract side is exemplified by *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), which, with some limitations, states that private agreements to arbitrate are to be enforced according to their terms. For a discussion of the scope of freedom to contract in arbitration, see Speidel, *supra* note 12, at 1345–49.

14. For a discussion of the elements of and ideal conditions for commercial arbitration, see MACNEIL ET AL., *supra* note 1, § 3.2.

15. Lapine Tech. Corp. v. Kyocera Corp., 130 F.3d 884, 888–90 (9th Cir. 1997).

16. For an evaluation of problems in contemporary commercial arbitration, see Stephen Hayford & Ralph Peeples, *Commercial Arbitration in Evolution: An Assessment and Call for Dialogue*, 10 OHIO ST. J. DISP. RESOL. 343, 383–407 (1995), and Thomas J. Stipanowich, *Beyond Arbitration: Innovation and Evolution in the United States Construction Industry*, 31 WAKE FOREST L. REV. 65 (1996).

17. *See* Barry Meier, *In Fine Print, Customers Lose Ability to Sue*, N.Y. TIMES, Mar. 10, 1997, at A1. *See also* Anne Brafford, *Arbitration Clauses in Consumer Contracts of Adhesion: Fair Play or Trap for the Weak and Unwary?*, 21 J. CORP. L. 331 (1996);

Unlike the commercial arbitration model, the contract to arbitrate is between an individual and an organization, and the agreement to arbitrate is in a standard form prepared by the organization and offered on a take-it-or-leave-it basis.[19] Moreover, the arbitration agreement attempts to cover claims "relating to" as well as those "arising from," the contract, which could include federal and state statutory claims created to benefit or protect the individual. In some cases, the arbitration may proceed before an arbitration institution administered by, and under rules drafted by, one party to the contract to arbitrate.[20] This consumerization of private arbitration, coupled with the Court's strong support of the federal contract to arbitrate, has prompted critics to contend that regulated industries, by invoking pre-dispute arbitration clauses, can deregulate themselves by compelling arbitration in a forum that cannot provide adequate legal remedies and whose decisions are not subject to judicial review.[21] Others question the constitutionality of the arbitration process itself.[22]

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Mark E. Budnitz, *Arbitration of Disputes Between Customers and Financial Institutions: A Serious Threat to Consumer Protection*, 10 OHIO ST. J. DISP. RESOL. 267 (1995).

18. *See* Thomas J. Stipanowich, *Punitive Damages and the Consumerization of Arbitration*, 92 NW. U. L. REV. 1, 1–3 (1997) (identifying the problem and exploring the proper role of punitive damages in securities arbitration).

19. The classic contract of "adhesion" just described is not per se objectionable, especially if parties asked to adhere have adequate information and choice. An informed party can decide to "leave it" and look elsewhere. Assuming adequate information, economist support governmental intervention through doctrines like unconscionability only when there is a market failure and the government can do a better job than the market to supply an alternative. *See* Richard Craswell, *Property Rules and Liability Rules in Unconscionability and Related Doctrines*, 60 U. CHI. L. REV. 1, 34–51 (1993).

20. For an extreme example, see *Engalla v. Permanente Medical Group, Inc.*, 938 P.2d 903, 922–24 (Cal. 1997), finding a possible waiver of the right to arbitrate due to delays in processing claims by the party in control of its self-administered arbitration process. Securities arbitration is a less extreme example, because the Self Regulatory Organizations ("SRO"), such as the National Association of Securities Dealers ("NASD"), are beyond the control of any one broker-dealer and the entire process is regulated by the Securities Exchange Commission ("SEC"). *See* Stephen J. Ware, *Employment Arbitration and Voluntary Consent*, 25 HOFSTRA L. REV. 83, 145–55 (1996); Deborah Masucci, *Securities Arbitration—A Success Story: What Does the Future Hold?*, 31 WAKE FOREST L. REV. 183 (1996). *But see* Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 995 F. Supp. 190 (D. Mass. 1998) (holding that the New York Stock Exchange arbitration forum was inadequate to vindicate an employee's statutory rights under the Age Discrimination in Employment Act). This article will not address securities arbitration, for dicussion of those issues, see Speidel, *supra* note 12, at 1356–63.

21. *See* David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33, 132 (arguing that the diminished prospects for damage recovery in arbitration makes "compelled arbitration a prospective waiver of substantive rights"). In 1989 I wrote:

> These developments create an incentive for organizations subject to federal and state regulation to use arbitration as a device to blunt or break social legislation, especially where the agreement to arbitrate is contained in a standard form prepared by the regulated party. Even if the arbitral practices and procedures are neutral, the limited capacity of

Do these pre-dispute agreements between individuals and organizations—consumer arbitration—justify flipping the consent coin from "freedom to" to "freedom from" contract? If so, what does such a flip mean for pre-dispute arbitration clauses?

### *B. Employment Contracts: An Example*

To illustrate what is at stake in one controversial context, consider the employment contract in which an employer requires an employee to agree to arbitrate statutory claims as a condition to employment.[23] Assume that there is no collective bargaining agreement. An individual signs an employment contract with a corporation containing a form arbitration clause, in which both parties agree to arbitrate all disputes "arising under or relating" to this contract under the rules of the American Arbitration Association ("AAA") and to use the AAA as the administering institution.[24] In some situations, the employer may not adequately disclose the form agreement to arbitrate. Here the employee did not read the form, and it was not called to his or her attention. In other cases, the employer may disclose the broad arbitration clause but provide no explanation of what arbitration means or that statutory rights might be involved. Both of these situations create the risk of unfair surprise and undermine the concept of voluntary consent. Other contracts may provide full disclosure of what arbitration involves but give no opportunity for choice to the employee: unless the employee agrees to arbitration, the job is not available. Assume further that, in addition to the various applicable federal statutes protecting against racial, age, and disability discrimination in employment,[25] applicable state law requires arbitration agreements to be in conspicuous type, creates a statutory right for employees to sue employers for sexual harassment, and declares that the state-created statutory right must be resolved in a court not in arbitration.

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> arbitration in disputes over statutory rights coupled with the finality of the award could water down the protection provided for the other party, if not undermine the public policies underlying the regulatory legislation.

Richard E. Speidel, *Arbitration of Statutory Rights Under the Federal Arbitration Act: The Case for Reform*, 4 OHIO ST. J. ON DISP. RESOL. 157, 206 (1989).

22. *See* Jean R. Sternlight, *Rethinking the Constitutionality of the Supreme Court's Preference for Binding Arbitration: A Fresh Assessment of Jury Trial, Separation of Powers, and Due Process Concerns*, 72 TUL. L. REV. 1 (1997).

23. There is a burgeoning body of literature on this problem. *See, e.g.*, Samuel Estreicher, *Predispute Agreements to Arbitrate Statutory Employment Claims*, 72 N.Y.U. L. REV. 1344 (1997). *See also* MACNEIL ET. AL., *supra* note 1, § 16.5.

24. The AAA is selected to remove from the discussion any claim that the arbitration institution selected is inexperienced, incapable of administering complex cases or neither independent nor impartial.

25. *See, e.g.*, Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000; Civil Rights Act of 1866, 42. U.S.C. § 1981 (1994); Age Discrimination in Employment Act ("ADEA") or Equal Pay Act, 29 U.S.C. § 206(d) (1994); Americans with Disabilities Act ("ADA"), 42 U.S.C. §§ 12101–12213 (1994).

Suppose that after three years on the job, the employer terminates the employee's employment. The employee then files suit in a federal district court[26] against the corporation claiming (1) the termination was a breach of contract; (2) discrimination under Title VII; and (3) sexual harassment under the state statute. The employer, in turn, files a motion to stay the lawsuit pending arbitration and a motion to compel arbitration as agreed.[27] The employee wants to have both motions dismissed and to proceed with the lawsuit. Where does he or she stand?

*1. Which Arbitration Law Controls?*

Where the employee stands depends upon which arbitration law governs this arbitrability dispute, the FAA or state arbitration law.[28] In all probability, the FAA rather than state arbitration law governs this dispute. Under Section Two of the FAA, the employment contract must evidence a "transaction involving commerce," and the Supreme Court has interpreted this phrase to extend to the limits of Congress's power to regulate commerce.[29] Although the substance of federal and state arbitration law does not usually vary, application of the FAA means that the federal contract to arbitrate is protected against state arbitration law that is inconsistent with or discriminates against the FAA.[30]

One nagging problem remains. Is this a contract of employment within the exception in Section One of the FAA that nothing in the FAA "shall apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce?" The answer is important because if the FAA does not apply the arbitrability question is decided under either state arbitration law or, perhaps, under Section 301 of the Labor Management Relations Act, which is more protective of an employee with federal statutory claims.[31] For example, in the so-called "labor arbitration" cases,[32] the Supreme

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26. For purposes of this discussion, I will assume diversity jurisdiction. Even though an arbitration dispute is within the scope of the FAA, the FAA does not confer independent jurisdiction on the courts. *See* MACNEIL ET AL., *supra* note 1, § 9.2.1. To simplify matters, I will also keep the dispute in the federal courts even though the FAA applies to disputes within its scope that are litigated in state courts. *See id.* § 10.6.

27. These motions are authorized under FAA, 9 U.S.C. §§ 3–4 (1994).

28. Section 301 of the Labor Management Relations Act, 29 U.S.C. § 185(a) (1994), governs where the arbitration clause is contained in a collective bargaining agreement. *See* MACNEIL ET AL., *supra* note 1, § 11.3 (tracing development).

29. Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265 (1995) (holding that the FAA extends to the limits of Congress's power to regulate commerce). *See* MACNEIL ET AL., *supra* note 1, § 9.5.

30. *See supra* text accompanying note 47. For a striking illustration of federal preemption, see *Great Western Mortgage Corp. v. Peacock*, 110 F.3d 222 (3d Cir. 1997) (enforcing agreement under FAA to arbitrate state statutory rights against sexual harassment in employment).

31. For example, if state arbitration law rather than the FAA applies, the arbitration agreement would be subject to any state law requiring conspicuous type for arbitration clauses or withdrawing particular claims from arbitration. If the arbitration clause was in a collective bargaining agreement, and arbitration law arose under § 301 of the Labor Management Relations Act, the FAA would probably not apply, see, for example,

Court denied preclusive effect to arbitral awards that purported to decide federal statutory claims on the grounds that they were either beyond the scope of the agreement to arbitrate under the collective bargaining agreement or that arbitration of those claims would create an unacceptable tension between individual rights under the statutes and the union's responsibility to the collective welfare of its members in conducting the arbitration.[33]

The Supreme Court has not given a final answer on the scope of the exclusion in Section One of the FAA. The Court, in *Gilmer v. Interstate/Johnson Lane Corp.*,[34] avoided the exclusion question and distinguished the "labor arbitration" cases, while enforcing an employee's agreement to arbitrate federal age discrimination claims under the FAA. However, a virtually unanimous body of caselaw exists in the lower federal courts holding that non-unionized employees in transactions evidencing commerce are not excluded unless the "employment contracts of workers engaged in the transportation of goods in commerce" are involved.[35] Until the Court rules otherwise, therefore, the FAA governs most disputes between non-unionized employees and their employers.[36]

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*Asplundh Tree Expert Co. v. Bates*, 71 F.3d 592, 601 (6th Cir. 1995), and the employee would have the benefit of three decisions of the Supreme Court (the so-called "labor arbitration" cases) that deny preclusive effect to certain federal statutory rights in labor arbitration. *See* Alexander v. Gardner-Denver Co., 415 U.S. 36 (1974) (Title VII); McDonald v. City of West Branch, 466 U.S. 284 (1984) (claims under 42 U.S.C. § 1983); Barrentine v. Arkansas-Best Freight Sys., Inc., 450 U.S. 728 (1981) (Fair Labor Standards Act).

32. *See supra* note 31.

33. *See* Brisentine v. Stone & Webster Eng'g Corp., 117 F.3d 519 (11th Cir. 1997) (distinguishing *Gilmer* and holding that an ADA claim was not subject to mandatory arbitration under a collective bargaining agreement).

34. 500 U.S. 20, 25, n.2 (1991) (holding that the arbitration agreement at issue was not part of a contract of employment). *Gilmer* did not overrule the so-called "labor arbitration" cases. *See supra* note 31. Livadas v. Bradshaw, 512 U.S. 107, 127, n.21 (1994). Rather, the cases were distinguished on three grounds: (1) the "labor cases" involved the preclusive effect of an arbitrator's decision on the statutory claims, not the arbitrability of those claims in the first instance; (2) in labor arbitration, an individual's interest may not be fully represented by collective interests in the bargaining agreement, but an individual employee outside of the collective bargaining agreement can represent herself; and (3) the arbitrability of the ADEA claim in *Gilmer* was subject to the FAA with its liberal policy favoring arbitration, not to Section 301 of the Labor Management Relations Act. *See also* Dalton v. Jefferson Smurfit Corp., 979 F. Supp. 1187, 1194–95 (S.D. Ohio 1997) (articulating these distinctions). In *Pryner v. Tractor Supply Co.*, 109 F.3d 354, 359–64 (7th Cir. 1997), *cert. denied* 118 S. Ct. 294 (1997), however, the court held that even though the FAA might apply to some aspects of an arbitration dispute under a collective bargaining agreement, employees under that agreement were not required to arbitrate statutory claims.

35. A leading case is Cole v. Burns Int'l Sec. Servs., 105 F.3d 1465, 1472 (D.C. Cir. 1997). *See* Estreicher, *supra* note 23, at 1363–73 (discussing the cases and predicting that the Court will not adopt a broad exclusion of employment contracts). *See also* MACNEIL ET. AL., *supra* note 1, §§ 11.4, 11.5.

Does the FAA apply to arbitrability disputes if the employees are not excluded under Section One of the FAA but are governed by a collective bargaining agreement? In

*2. Was the Dispute Arbitrable?*

In response to the employer's motions to stay and to compel, the employee can try to persuade the court that the dispute is not arbitrable in the answer, in a declaratory judgment motion or in a motion to enjoin arbitration. The arbitrability decision is for the court, not the arbitrator.[37] Under the FAA, however, the courts, with one or two exceptions, have enforced the agreement to arbitrate.

a. Was There a "Written" Agreement to Arbitrate?

A threshold question is whether the employee agreed in writing to arbitrate anything. Suppose the employee signed a writing either containing or incorporating by reference an arbitration agreement.[38] Does this satisfy Section Two of the FAA that there must be a "written provision in...a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction?" Under the objective test applied by most state courts, the answer is yes, even though employee was not aware of and did not read the clause.[39]

The point where concerns about unfair surprise erode the legal effect of objective assent is difficult to discern. Is a consumer always responsible for the contents of a writing to which she agreed? When should a reasonable person expect to find an arbitration clause in an employment contract, a margin account agreement, or a deposit agreement with the bank? For example, in a recent case of note, a consumer buyer ordered a computer from the manufacturer and paid for it by credit card before the goods were delivered. The seller did not disclose a written

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*Pryner*, the court first held that Section Sixteen of the FAA, dealing with interlocutory appeals, applied to jurisdictional questions. Assuming that the court had appellate jurisdiction, however, the court held that the FAA did not apply to the question whether an employee subject to a collective bargaining agreement had voluntarily agreed to arbitrate statutory claims. Influenced in part by the "labor arbitration" cases, the court concluded that the employees had not voluntarily agreed to arbitrate statutory claims and could not be compelled to arbitrate.

36. In a minor revolt from the majority rule, which the Supreme Court has agreed to review, the Court of Appeals for the Fourth Circuit held that an employee's Title VII and ADA statutory claims are arbitrable if within the scope of an arbitration term in a collective bargaining agreement. Austin v. Owens-Brockway Glass Container, Inc., 78 F.3d 875 (4th Cir. 1996). Subsequently, the court, following *Austin*, held that an ADA claim asserted by a unionized employee was within the scope of a broad arbitration clause in a collective bargaining agreement and, thus, arbitrable. Wright v. Universal Maritime Service Corp., 121 F.3d 702, No. 96–2850, 1997 WL 422869 (4th Cir. July 29, 1997) (unpublished table decision), *cert. granted* 118 S. Ct. 1162 (1997).

37. Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967).

38. Although Section Two of the FAA requires a "written" agreement to arbitrate, it does not require that the writing be signed. *See* MACNEIL ET AL., *supra* note 1, § 17.3.

39. *See* Ludwig v. Equitable Life Assurance. Soc. of U.S., 978 F. Supp. 1379, 1381–82 (D. Kan. 1997) (U–4 agreement). The more remote the written arbitration terms are from the writing signed by the employee, the greater the chance that they were not incorporated by reference. *See* MACNEIL ET AL., *supra* note 1, § 17.3.2.

arbitration term before payment was made. Inside the box containing the computer the buyer found for the first time standard terms, including an arbitration clause, and a statement that if the buyer did not agree to the standard terms he could return the goods and get a refund. The arbitration clause was not in conspicuous type and, although the buyer noticed the standard terms, he did not read them. The buyer then used the computer for thirty days until alleged defects were discovered. The buyer filed a law suit, the seller filed a motion to compel arbitration under Section Four of the FAA, and the motion was granted. The court held that even though the standard terms were not disclosed at the time of payment, the buyer had an opportunity to review them when the box arrived and was given a choice to approve the terms or return the computer for a refund. There was no unfair surprise here, even though the buyer had not read the terms and appeared to assent to them by using the computer rather than returning the goods for a refund. In short, where arbitration clauses are proposed in standard forms, consumers are expected to read and understand those standard terms and exercise choice to accept or return the goods, even though the arbitration term is first disclosed after payment in the box containing the goods.[40]

b. Were the Claims Asserted Within the Scope of the Written Agreement to Arbitrate?

If the employee agreed in writing to arbitrate something, what is the scope of that agreement? Since the employee agreed to a "broad" arbitration clause, all claims "arising out of or related to" the contract are within the scope of the agreement to arbitrate. The Supreme Court has held that statutory claims "relate" to the contract and are included within a broad arbitration clause even though the intent to include statutory claims is not specifically disclosed.[41] The assumption is that contracting parties understand what "related to" means and can bargain to exclude statutory or other claims from the scope of arbitration.[42] Whether they have done so, however, may be difficult to establish.[43]

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40. Hill v. Gateway 2000, Inc., 105 F.3d 1147 (7th Cir. 1997), *cert denied* 118 S. Ct. 47 (1997). The court, speaking through Judge Easterbrook, appeared to balance the cost to sellers of requiring pre-payment disclosure against the cost to buyers of reviewing the form and making an informed choice. The result of the balance favored the seller.

41. Mitsubishi Motors v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985) (antitrust claims related to an international franchise agreement).

42. In Oldroyd v. Elmira Savings Bank, 134 F.3d 72 (2d Cir. 1998), the court rejected the argument that a claim for retaliatory discharge, protected under the "whistle blower" protection provision of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 12 U.S.C. § 1811 (1994), was beyond the scope of a "broad" arbitration clause. The court stated that "the existence of a broad agreement to arbitrate creates a presumption of arbitrability which is only overcome if it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that [it] covers the asserted dispute," *Oldroyd*, 134 F.3d at 76 (citing World Crisa Corp. v. Armstrong , 129 F.3d 71, 74 (2d Cir. 1997), and held that the presumption had not been rebutted on the facts.

43. For a successful attempt to exclude a Title VII claim, see *Palladino v. Avnet Computer Technologies, Inc.*, 134 F.3d 1054 (11th Cir. 1998), where the court interpreted a

Where Title VII claims are involved, however, the Ninth Circuit has required that the employee must "knowingly" agree to submit the statutory claims to arbitration. According to the court, this requirement is "apparent from the text and legislative history of Title VII" and reflects "our public policy of protecting victims of sexual discrimination and harassment through the provisions of Title VII and analogous state statutes...a policy that is at least as strong as our public policy in favor of arbitration."[44] This reading of Title VII has been rejected by other courts[45] and has not been confirmed by the Supreme Court. Furthermore, the requirement of "knowing" agreement has not been found by any court from the text or legislative history of other federal statutes protecting employees against discrimination.

c. Was the Arbitration Clause Unenforceable "Upon Such Grounds as Exist at Law or in Equity for the Revocation of Any Contract?"

Section Two of the FAA conditions the enforceability of a written pre-dispute clause upon the absence of grounds that "exist at law or in equity for the revocation of any contract." Those grounds, whether fraud, duress, mistake or unconscionability, however, must exist under applicable state law,[46] and therein lies a curious problem of federalism.

First, the Supreme Court has held that the FAA preempts state contract law that discriminates against the federal contract to arbitrate, that is, treats the federal contract to arbitrate differently than other contracts. Thus, a state statute

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broad arbitration clause that precluded the arbitrator from awarding damages other than for breach of contract to exclude the statutory claim. The concurring opinion disagreed with the interpretation approach, preferring to rest the decision on the ground that the exclusion deprived the employee of "any prospect for meaningful relief." *Id.* at 1060. Judge Cox stated:

> Arbitration ordinarily brings hardships for litigants along with potential efficiency. Arbitral litigants often lack discovery, evidentiary rules, a jury, and any meaningful right to further review. In light of a strong federal policy favoring arbitration, these inherent weaknesses should not make an arbitration clause unenforceable.... But a clause such as this one that deprives an employee of any hope of meaningful relief, while imposing high costs on the employee, undermines the policies that support Title VII. It is not enforceable.

*Id.* at 1062.

44. Prudential Ins. Co. of Am. v. Lai, 42 F.3d 1299, 1304–05 (9th Cir. 1994). *Accord* Renteria v. Prudential Ins. Co. of Am., 113 F.3d 1104 (9th Cir. 1997) (Title VII); Nelson v. Cyprus Bagdad Copper Corp., 119 F.3d 756 (9th Cir. 1997) (holding that employee did not knowingly agree to arbitrate ADA claims by signing a form acknowledgment receipt of a revised employee handbook). In *Borg-Warner Protective Services Corp. v. Gottlieb*, 116 F.3d 1485, No. 95–56153, 1997 WL 349043 (9th Cir. June 25, 1997) (unpublished table decision), however, the court found a voluntary agreement under a clearly worded arbitration clause.

45. *See* Patterson v. Tenet Healthcare, Inc., 113 F.3d 832 (8th Cir. 1997) (reviewing decisions and enforcing agreement to arbitrate a Title VII claim).

46. *See* Speidel, *supra* note 12, at 1342, n.31 (summarizing cases).

requiring conspicuous type for arbitration clauses but not other contracts is preempted because it discriminates against the federal contract to arbitrate.[47]

Second, it has proven difficult if not impossible to prove under applicable, non-discriminatory state law that an arbitration clause was induced by fraud, mistake, or duress or that the clause was unconscionable. Those grounds are simply not present in most cases.[48]

What about the unconscionability defense? The most appealing grounds for unconscionability exist where a party assenting to a standard form is unfairly surprised by a term hidden in the fine print that materially varies the normal default rules to the advantage of the drafter. For example, the term may attempt to disclaim implied warranties or exclude liability for consequential damages. In arbitrability disputes, however, the assenting party usually has an opportunity to review the standard form and the arbitration clause that, on the face of it, applies to both parties with the prospect of benefitting both.[49] Moreover, any claim of unfairness is further reduced because arbitration is favored by the law, and the arbitration is to be administered by an independent agency under arbitration rules that are balanced and fair. The argument for unconscionability is further diminished if the arbitration clause is fully disclosed and offered to the employee on a take-it-or-leave-it basis. Where is the oppression in that? If you "take it" you get employment where both parties are bound to arbitrate, and if you "leave it" you can search for work where arbitration is not required. Although this analysis might not fit every transaction, it reflects the view of the courts in all but the most egregious situation.[50] Objective assent to a standard term that is a favorite in the law and binds both parties is not unconscionable, unless the party seeking relief can demonstrate that the other party is substantially advantaged by a one-sided clause or that the arbitration procedures are controlled by and favor the other party. These cases are few and far between.

d. Was the Arbitration of These Statutory Claims Against Public Policy?

A final objection to arbitrability is that the dispute is not suitable or appropriate for arbitration, and, therefore, submitting it to arbitration would be against public policy. There are two aspects to this public policy objection. The

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47. *See* Doctor's Assocs.., Inc. v. Casarotto, 517 U.S. 1652 (1996) (state statute singling out contract to arbitrate for higher standards of disclosure preempted).

48. *See* MACNEIL ET AL., *supra* note 1, § 19.2.

49. Occasionally a court will find that the employee's promise to arbitrate was not supported by consideration from the employer. *See* Gibson v. Neighborhood Health Clinics, Inc., 121 F.3d 1126 (7th Cir. 1997).

50. The cases where unconscionability and related defenses are rejected predominate. *See* Doctor's Assocs., Inc. v. Stuart, 85 F.3d 975, 980–81 (2d Cir. 1996) (claim rejected); Great Western Mortgage Corp. v. Peacock, 110 F.3d 222, 227–30 (3d Cir. 1997) (claim of coercion and involuntary agreement rejected); Engalla v. Permanente Med. Group, 938 P.2d 903, 924–25 (Cal. 1997) (unconscionability defense rejected). *But see* Stirlen v. Supercuts, Inc., 60 Cal. Rptr. 2d 138 (Cal. Ct. App. 1997) (arbitration agreement unconscionable on unique facts). *See also* MACNEIL ET AL., *supra* note 1, §19.3; Stephen J. Ware, *Arbitration and Unconscionability After Doctor's Associates, Inc. v. Casarotto*, 31 WAKE FOREST L. REV. 1001 (1996).

first is that a statutory claim, because of the third party and public interests involved, is not suitable for arbitration and should be decided by a court rather than an arbitrator. These statutory rights cannot easily be vindicated in arbitration, a process that is confidential and where a written opinion is normally not prepared by the arbitrator. The second aspect is that the arbitration process is not capable of resolving these disputes in accordance with the law or protecting the interests of the employee. Thus, if the employee's claim is based upon a statute designed to protect the employee and to regulate the employer, giving an employer power through an adhesion contract to shift disputes over statutory claims from the courts to an arbitration tribunal is against public policy.

Under the current state of Supreme Court jurisprudence, however, both of these arguments have been rejected under the FAA. Accepting that the parties have agreed to arbitrate statutory claims under a broad arbitration clause, the Court has held that (1) state law withdrawing state-created statutory claims from arbitration agreements under the FAA is preempted,[51] and that (2) federally created statutory claims are arbitrable unless Congress has clearly withdrawn them from arbitration.[52] In the absence of a clear congressional decision that the statutory claim is not suitable for arbitration, the Court has stated that the nature of the claim is irrelevant because adjudication is simply shifted from a court to an arbitral forum that is capable of deciding the claim. Moreover, arbitrators are capable of deciding statutory claims. The parties do not forego substantive rights,[53] they simply submit them for resolution in a different forum. Thus, the employer can—through the standard arbitration provision—block access to courts and to judicial review of both state and federal statutory claims,[54] including Title VII,[55] unless Congress has clearly stated otherwise, or the employer, by requiring the employee to give up

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51. Southland Corp. v. Keating, 465 U.S. 1 (1984) (FAA creates a substantive rule applicable in state and federal courts and forecloses state legislative attempts to undercut the enforceability of federal contracts to arbitrate by withdrawing from arbitration a claim included in the agreement to arbitrate). *See also* Perry v. Thomas, 482 U.S. 483 (1987) (holding the FAA preempts state legislation permitting wage collection action to be maintained in court without regard to existence of private agreement to arbitrate). The preemption, however, is limited to "issues as are essential to defining the nature of the forum in which a dispute will be decided." *Great Western Mortgage*, 110 F.3d at 230.

52. *See* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 226–27 (1987) (holding that the party seeking to avoid arbitration has the burden of showing that Congress intended to preclude a waiver of a judicial forum for the federal claims at issue). *See* MACNEIL ET AL., *supra* note 1, § 16.2 (discussing decline and fall of public policy defense in securities arbitration).

53. *See* Graham Oil v. Arco Prods. Co., 43 F.3d 1244, 1248–49 (9th Cir. 1994) (holding that an arbitration clause waiving federal statutory remedies and attempting to shorten the statute of limitations was unenforceable).

54. *See* Oldroyd v. Elmira Sav. Bank, 134 F.3d 72 (2d Cir. 1998) (Congress did not intend to withdraw claims under FIRREA's whistle blower protection provision from arbitration).

55. *See, e.g.*, Patterson v. Tenet Healthcare, Inc., 113 F.3d 832 (8th Cir. 1997) (Title VII); Miller v. Public Storage Management, Inc., 121 F.3d 215 (5th Cir. 1997) (ADA).

protected rights or submit to a biased forum, undermines the rights and protections provided by law.[56]

Although the Court's decisions in this area have been sharply criticized by the commentators,[57] they have been followed by the lower federal courts.[58]

### *C. Scope of Judicial Review*

An important part of the problem, as yet unresolved by the Court or Congress, is the scope of judicial review of arbitration awards where statutory claims have been submitted to and decided by the arbitrators. Can either party get judicial review of the merits? The answer to this question depends on the context and the controlling arbitration law.

In labor arbitration, where federal claims such as Title VII are involved, the answer to date is yes. These claims are probably not arbitrable in the first instance,[59] and, in any event, a court is not precluded by an arbitrator's award from reviewing the decision on the merits. Again, the reasoning of the "labor arbitration" cases seems to be that individual employees have not voluntarily agreed to arbitrate these claims and that their rights under the statutes may not be adequately represented or protected by unions under collective bargaining agreements.

Under Section Ten of the FAA, the answer is no, the parties cannot get judicial review of the merits of an arbitration award. The courts can review for bias in the process, partiality by the arbitrators, the fairness of the hearing and whether the arbitrators exceeded their powers,[60] but not for errors in applying the law or

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56. *See* Cole v. Burns Int'l Sec. Servs., 105 F.3d 1465 (D.C. Cir. 1997).

57. *See* Paul D. Carrington & Paul H. Haagen, *Contract and Jurisdiction*, 1996 SUP. CT. REV. 331 (1997); Stephen L. Hayford, *Commercial Arbitration in the Supreme Court 1983–1995: A Sea Change*, 31 WAKE FOREST L. REV. 1 (1996); Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 WASH. U. L.Q. 637 (1996).

58. The FAA, which does not create federal jurisdiction, is applicable in state courts when other grounds for federal jurisdiction are not invoked. Thus, a state court is required to enforce a federal contract to arbitrate even though applicable state law states that arbitration of a state-created statutory claim is against public policy. MACNEIL, ET AL., *supra* note 1, § 10.6.

59. The issue is subject to doubt. In *Pryner v. Tractor Supply Co.*, 109 F.3d 354 (7th Cir. 1997), *cert. denied* 118 S. Ct. 294 (1997), the court held that the statutory rights of workers subject to a collective bargaining agreement were not arbitrable on the facts but suggested that they might be arbitrable if the worker consents to have them arbitrated: "If the worker brings suit, the employer suggests that their dispute be arbitrated, the worker agrees, and the collective bargaining agreement does not preclude such side agreements, there is nothing to prevent a binding arbitration." *Id.* at 362. On the other hand, cases in the Fourth Circuit have held that statutory claims are arbitrable even though a collective bargaining agreement is involved. The issue is headed to the Supreme Court for review. *See supra* note 36.

60. FAA, 9 U.S.C. § 10 (1994), provides:

finding the facts. In any event, review of the merits in the typical commercial arbitration might be difficult if it is not clear what law was to be applied or if the arbitrators did not prepare a written opinion. How do you review such an award for errors of law or fact if the source of law to be applied is not clear and no written opinion exists?

Despite the traditional FAA answer, there is growing evidence that even if statutory claims, such as Title VII, are arbitrable in the first instance some courts will find a way to subject their adjudication by arbitrators to judicial review on the merits. Recently, the Ninth Circuit enforced an agreement by the parties that questions of law decided by arbitrators may be reviewed in court for errors of fact or law.[61] Other courts have shown a greater willingness to embrace the "manifest disregard" of law standard for review[62] or to state that a pre-dispute agreement to arbitrate public law claims may not be enforceable unless there is an opportunity for a "meaningful" judicial review of the arbitration award.[63] And where statutory claims are involved, many commentators agree that judicial review of the merits should be permitted.[64] Although dicta of the Supreme Court are consistent with the need for broader judicial review,[65] the Court has not had an opportunity to rule on the question.

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(a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—
(1) Where the award was procured by corruption, fraud, or undue means.
(2) Where there was evident partiality or corruption in the arbitrators, or either of them.
(3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.
(4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made....

61. Lapine Tech. Corp. v. Kyocera Corp., 130 F.3d 884, 888–90 (9th Cir. 1997).

62. For example, see *Montes v. Shearson Lehman Bros., Inc.*, 128 F.3d 1456 (11th Cir. 1997), where the court vacated an award on evidence that the arbitrators were told to disregard the Fair Labor Standards Law and on the absence of evidence "to refute the suggestion that the law was disregarded." *Id.* at 1462. The court, however, distinguished between disregarding a law that clearly applied and an erroneous interpretation of that law. The latter was not subject to judicial review under the FAA.

63. Cole v. Burns Int'l Sec. Servs., 105 F.3d 1465, 1486–87 (D.C. Cir. 1997).

64. A recent example is Stephen A. Hochman, *Judicial Review to Correct Arbitral Error—an Option to Consider*, 13 OHIO ST. J. DISP. RESOL. 103 (1997). *See also* Davis, *supra* note 6, at 125–26 (implied agreement to submit to judicial review when parties choose law to be applied by arbitrator); Michael A. Scodro, Note, *Arbitrating Novel Legal Questions: A Recommendation for Reform*, 105 YALE L.J. 1927 (1996) (arbitrator can certify novel legal questions to court for decision).

65. *See, e.g.*, First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 942 (1995) (manifest disregard of the law). For an analysis of the dicta and other matters, see Davis, *supra* note 6, at 89–108.

## IV. A STATUTORY SOLUTION?

### *A. Arbitration and Public Justice*

Arbitration, along with mediation, negotiated settlements and other agreed methods to resolve disputes, is a private alternative to adjudication in courts. Nevertheless, Richard C. Reuben argues that alternative dispute resolution ("ADR") in general has "become part of the judicial process and no longer stands apart from it," and in the case of arbitration "court-related and contractually compelled [arbitration] can be state action for constitutional purposes." Even if arbitration is not state action,[66] Reuben's conclusion that ADR, including arbitration, "should be recognized as an expansion of public justice, rather than the establishment of a private alternative to public justice,"[67] is compelling. This suggests that in certain contexts, at least, a public interest model of arbitration may be needed.[68] For many, that need is illustrated by contracts to arbitrate between customers and broker-dealers in the securities industry,[69] non-unionized employees and their employers, and consumers and corporate suppliers of goods and services.

In the employment context, when all of the case and statute parsing and contract interpretation is done, the need for some protection against arbitration (freedom from contract) is revealed when employers try to compel the arbitration of federal and state statutory claims under broad, standard form arbitration clauses governed by the FAA. If a collective bargaining agreement is involved, the statutory claim is probably not arbitrable, and if decided by an arbitrator the claim is subject to full judicial review. The core reason is that the employee probably has not voluntarily agreed to arbitrate the statutory claim and, in any event, works in a

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66. If judicial enforcement of the employer's demand that the employee submit all claims to arbitration were state action, the condition that the employee give up her Fifth Amendment right to due process, her Seventh Amendment right to a jury trial, and her right to an Article III judicial forum would be unconstitutional. *See* Duffield v. Robertson Stephens & Co., 144 F.3d 1182, 1200–02 (9th Cir. 1998) (stating effect of state action and holding that securities dealer's use of pre-dispute arbitration clause was not state action).

67. Richard C. Reuben, *Public Justice: Toward a State Action Theory of Alternative Dispute Resolution*, 85 CAL. L. REV. 577, 594–608, 641 (1997).

68. The model could vary from context to context. In securities arbitration, for example, the contract to arbitrate is drafted by broker-dealers and is typically offered to customers on a take-it-or-leave-it basis, the arbitration process is administered by various SROs, such as NASD, and regulatory supervision is provided by the SEC. Given SEC oversight and the continuing efforts of the SROs to improve the quality and impartiality of the arbitration process, a pre-dispute clause with disclosure might be sufficient where in another context lacking regulatory oversight it would be suspect. *See* SECURITIES ARBITRATION REFORM, REPORT OF THE ARBITRATION POLICY TASK FORCE, 17–21 (1996), recommending this approach for NASD securities arbitration [hereinafter TASK FORCE REPORT]. *See also* David S. Ruder, *Securities Arbitration in the Public Interest: The Role of Punitive Damages*, 92 NW. U. L. REV. 69 (1997); Speidel, *supra* note 12, at 1365–63.

69. *See* Stipanowich, *supra* note 18.

setting where his or her individual rights may not be adequately represented by the union.[70]

On the other hand, if a collective bargaining agreement is not involved, and if the employees are not excluded under Section One of the FAA for being in the transportation industry, the FAA applies, and the same statutory claims are arbitrable under broad arbitration clauses unless Congress has clearly excluded them from arbitration. Moreover, the FAA does not authorize judicial review of the merits, and the non-statutory power of courts to review the merits has not been clearly delineated by the Supreme Court. The individual, then, must fend for herself in a contracting process where information is sparse and choice is limited to "take-it-or-leave-it." Problems at the threshold are exacerbated by the fact that the statutory rights and remedies may not be fully vindicated in the arbitration process,[71] and an award on the merits is probably not subject to judicial review. Employees, of course, have a strong advocate in the over-worked Equal Employment Opportunity Commission ("EEOC"),[72] but assistance from the EEOC

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70. *See* Albert Y. Kim, Comment, *Arbitrating Statutory Rights in the Union Setting: Breaking the Collective Bargaining Interest Without Damaging Labor Relations*, 65 U. CHI. L. REV. 225 (1998) (recommending a two-track settlement mechanism in which individual members possess greater control over the grievance process for statutory discrimination claims). *See also* H. David Kelly, Jr., *An Argument for Retaining the Well Established Distinction Between Contractual and Statutory Claims in Labor Arbitration*, 75 U. DET. MERCY L. REV. 1 (1997); David E. Feller, *Fender Bender or Train Wreck?: The Collision Between Statutory Protection of Individual Employee Rights and the Judicial Revision of the Federal Arbitration Act*, 41 ST. LOUIS U. L.J. 561 (1997).

71. One advocate for employees argues that because there is a fundamental inequality of bargaining power between employee and employer, the "contract" for mandatory arbitration always involves a waiver of employee rights, most notably the right to a jury trial and discovery necessary to prove the case. Joseph D. Garrison, *Pro: The Employee's Perspective: Mandatory Binding Arbitration Constitutes Little More Than a Waiver of a Worker's Rights*, 52 DISP. RESOL. J., Fall 1997, at 15.

72. The EEOC's position, stated in an internal directive, is that mandatory arbitration systems imposed as a condition of employment are fundamentally inconsistent with the civil rights law. *See* EEOC Notice Number 915.002 (July 10, 1997). According to Ellen J. Vargyas:

> The use of unilaterally imposed agreements mandating binding arbitration of employment discrimination disputes as a condition of employment harms both the individual civil rights claimant and the public interest in eradicating discrimination. Those whom the law seeks to regulate should not be permitted to exempt themselves from federal enforcement of civil rights laws. Nor should they be permitted to deprive civil rights claimants of the choice to vindicate their statutory rights in courts—an avenue of redress determined by Congress to be essential to enforcement.

Ellen J. Vargyas, *EEOC Explains Its Decision: Verdict on Mandatory Binding Arbitration in Employment*, 52 DISP. RESOL. J., Fall 1997, at 8, 14. A critic of the EEOC, however, asserts that the EEOC is unable to keep up with the employment discrimination complaints filed—over 90,000 in 1994—and argues that mandatory arbitration is, from the employer's standpoint, a better alternative to litigation in congested courts where discrimination claims amount to 20% of all litigation pending in federal and state courts and where in 1996

in a particular case may be limited or even foreclosed if the employer's conduct under scrutiny is subject to an enforceable arbitration clause.[73] To compound the indignity, the FAA may preempt state or local efforts both to protect employees against involuntary arbitration agreements and to withdraw state-created statutory claims from arbitration. Thus, a strong case can be made that pre-dispute arbitration as interpreted by the Court under the FAA has outworn its welcome in employment disputes and, perhaps, in other adhesion contracts to arbitrate between consumers and corporations where statutory claims are involved.

### *B. Some Alternatives*

What are the best solutions to these vexing problems of arbitration practice and law that, because of the public interests involved, are on the "freedom from" side of the consent coin?[74]

#### *1. Power to Settle Statutory Claims by Agreement*

The starting point is to recognize that most statutory claims, like claims for breach of contract, are capable of final settlement by private agreement without administrative approval or judicial review of the merits.[75] The settlement might be upset for fraud or duress, but not because an employee has no power to waive or compromise a statutory claim for value. It follows that if the parties have power to settle, an amendment of the FAA to bar all statutory claims from arbitration is not an appropriate solution. The decision to withhold a statutory claim from arbitration should be made by Congress at the time the right is created,[76] not by an amendment to the FAA. As a practical matter, a statutory claim submitted to the arbitration process might be settled by agreement, through mediation,[77] or decided by the

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employees filed over 23,000 discrimination law suits in federal courts. Martin J. Oppenheimer & Cameron Johnstone, *A Management Perspective: Mandatory Arbitration Agreements Are an Effective Alternative to Employment Litigation*, 52 DISP. RESOL. J. 19, 22–23 (1997).

73. *See* E.E.O.C v. Kidder, Peabody & Co., 979 F. Supp. 245 (S.D.N.Y. 1997).

74. Many commentators have tried to answer this question. Although some prefer to minimize government intervention and maximize private efforts to reform and others argue for greater legalization of the arbitration process where statutory claims are involved, all seek to achieve an acceptable balance between arbitral efficiency and process fairness. Most focus upon three critical areas: (1) consent to arbitration; (2) arbitration process and procedures; and (3) judicial review. For a thorough and balanced assessment. *See* Note, *Mandatory Arbitration of Statutory Employment Disputes*, 109 HARV. L. REV. 1670 (1996).

75. *See* Estreicher, *supra* note 23, at 1346 (recognizing that statutory discrimination claims can be settled for value or submitted by agreement to a "post-dispute adjudicative process").

76. *See* Duffield v. Robertson Stephens & Co., 144 F.3d 1182 (9th Cir. 1998) (holding that Congress, in enacting the Civil Rights Act of 1991, intended to bar employers from compelling employees through the use of pre-dispute arbitration clauses from waiving Title VII rights to a judicial forum).

77. *See* TASK FORCE REPORT, *supra* note 68, at 47–64 (recommending mediation and early neutral evaluation as first steps in securities arbitration).

arbitrators in a way that satisfies both parties and is consistent with public interests. Thus, a preferred long-range solution would be to improve the arbitration process rather than to arbitrarily exclude statutory and other claims arising from or relating to the contract. Nevertheless, some amendments to the FAA may still be needed.

*2. Informed and Voluntary Agreement*

The first step toward reform is to determine the degree of consent to arbitration that should be required. Should it be sufficient simply to increase information about arbitration made available or to give the individual both information and a choice to take arbitration or leave it without losing the job or other opportunity? Assuming that employers or other corporations who insist on arbitration as a condition of doing business are not likely to take the initiative to insure either objective, the best route is an amendment of the FAA that withholds enforcement of apparent consumer agreements to arbitrate statutory claims unless stipulated standards of disclosure and choice are met. But how much information and choice should be required?

One approach is to insist that the individual's choice to take arbitration or leave it be informed. The employer can still condition its willingness to contract on the individual's agreement to arbitration but must conspicuously disclose what arbitration is and that statutory claims might be involved.[78] Without the required disclosure the pre-dispute agreement to arbitrate will not be enforced. With the required disclosure, the consumer can assent to arbitration or look for another contract without an arbitration clause. To support this approach, one must assume that the market will provide an alternative employment opportunity without the arbitration condition. This is the solution recommended to the NASD by the Arbitration Policy Task Force.[79]

The other approach is to require increased disclosure about what arbitration is—and that statutory claims may be involved—and to provide a choice to take arbitration or leave it without the risk of losing the job or other contract opportunity. In short, the corporation can refuse to negotiate over the terms of the arbitration clause but if the individual rejects arbitration the corporation may not reject the individual for that reason alone. This is true "voluntary" arbitration, where the individual has both adequate information and increased choice.

Will requiring voluntary arbitration deprive corporations of the value of arbitration or provide disincentives to establish programs well-designed for the benefit of all parties? Professor Samuel Estreicher opposes voluntary arbitration in

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78. According to the Ninth Circuit, this is the essence of the voluntary agreement required to arbitrate Title VII claims. Borg-Warner Protective Servs. Corp. v. Gottlieb, 116 F.3d 1485, No. 95-56153, 1997 WL 349043, *1 (9th Cir. June 25, 1997) (unpublished table decision).

79. Task Force, *supra* note 68, at 47–64. *See* Ruder, *supra* note 68, at 81–87 (describing recommendations). The assumption that alternative choices exist in securities arbitration, especially in margin accounts, however, has been questioned. *See* Richard E. Speidel, *Punitive Damages and the Public Interest Model of Securities Arbitration: A Response to Professor Stipanowich*, 92 NW. U. L. REV. 99, 105–08 (1997).

the employment context, arguing that the usual test for voluntariness is too vague for certain administration and that voluntariness "detracts from the desired uniformity of internal dispute resolution programs if predispute agreements will be upheld for some employees but not others who are similarly situated in a particular workforce."[80] In short, the value of protecting individual choice is outweighed by the importance of a system established by the employer to resolve employment disputes, including discrimination claims, outside of the courts.

Professor Richard Shell, however, predicts that even with an informed choice to "leave it," many individuals will choose arbitration without any objection. He suggests that negotiation theory predicts that many individuals defer to the authoritative legality of printed forms, especially when no immediate economic consequences exist, and rely upon the collective action of others established by the forms to decide proper behavior for themselves. Thus, since corporations tend to leverage these negotiation advantages, giving the individual an informed choice to say no without losing the economic opportunity is necessary to legitimize the process.[81] This choice also validates the "knowing" waiver required to contract out of the guarantees the judicial process offers, such as the right to a jury trial. But if many consumers, despite the choice to opt out, will probably agree to arbitration,[82] one should still be concerned about the quality of the arbitration process to which they have agreed.

*3. Process and Procedure*

If voluntary arbitration is needed in consumer contracts where statutory rights are at stake, the FAA should be revised to deny the enforcement of agreements between individuals and corporations to arbitrate statutory claims related to the contract, unless the individual has an informed choice to arbitrate or

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80. Estreicher, *supra* note 23, at 1358–59. He argues:

> A dispute resolution system, like a pension plan, is what economists call a "collective" or a "public" good. It is efficiently provided, if at all, on a collective basis. "This is because the costs of such a program..., even when justified by the collective benefits to the affected employees, typically exceed the benefits to individual employees. Piecemeal application of a dispute resolution program could threaten to unravel the program for all other similarly situated employees."

*Id.*

81. G. Richard Shell, *Fair Play, Consent and Securities Arbitration: A Comment on Speidel*, 62 BROOK. L. REV. 1365 (1996).

82. Three alternatives to this solution might be considered.

First, the pre-dispute arbitration agreement is replaced by a clause that after a dispute arises that cannot be settled by agreement the parties may agree to submit the existing dispute to arbitration. Failing such agreement, either party can resort to the courts.

Second, the pre-dispute arbitration agreement is replaced by a clause requiring mandatory mediation if a dispute cannot be settled by agreement. If mediation does not work, the parties can either agree to arbitration or resort to the courts.

Third, the pre-dispute arbitration is not replaced. Rather, it is presumptively unenforceable unless the party insisting upon it establishes that the arbitration process to which the dispute must be submitted is fair, balanced and impartial.

not without losing the contract opportunity for that reason. With this flip of the consent coin to freedom to contract, what changes, if any, should be made in the arbitration process itself ?[83]

It would be reassuring to believe that with a legislative requirement of voluntary consent as a condition to enforcing the pre-dispute arbitration agreement, other problems in the arbitration process will resolve themselves without direct government intervention. Pressure, moral and otherwise, applied on corporations and private dispute resolution institutions by groups such as the so-called Dunlop Commission on the Future of Worker-Management Relations[84] and the AAA's National Consumer Disputes Advisory Committee,[85] could provide an incentive for voluntary action. If the value of arbitration to corporations is high and if individuals are given a choice not to arbitrate without losing the contract opportunity, an economist might predict that the market and other forces will provide an incentive for improvement.[86] This is particularly true if the opportunity given up, the right to litigate in court, is truly less effective and more costly than arbitration.

Perhaps. However, can the danger of clauses selecting an unreasonable situs for the arbitration or selecting law not reasonably related to the transaction be

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83. Although Professor Estreicher favors informed but not voluntary arbitration, he insists that the arbitration process itself be "properly designed." "But if properly designed, private arbitration can complement public enforcement and, at the same time, satisfy the public interest objectives of the various statutes governing the employment relationship." Estreicher, *supra* note 23, at 1349.

84. UNITED STATES DEP'T OF COMMERCE AND LABOR, COMM'N ON THE FUTURE OF WORKER-MANAGEMENT RELATIONS (1994). As reported by Professor Estreicher, *supra* note 23, at 1349–50, the essential safeguards recommended by the Dunlop Commission for employment disputes resolution include: (1) no restriction on the right to file charges with the appropriate administrative agency; (2) a reasonable place for the holding of the arbitration; (3) a competent arbitrator who knows the laws in question; (4) a fair and simple method for exchange of information; (5) a fair method of cost sharing to ensure affordable access to the system for all employees; (6) the right to independent representation if sought by the employee; (7) a range of remedies equal to those available through litigation; (8) a written award explaining the arbitrator's rationale for the result; and (9) limited judicial review sufficient to ensure that the result is consistent with applicable law. *See* Dennis C. Donnelly, *The Dunlop Report: A Summary Review in Perspective*, 40 ST. LOUIS U. L.J. 139 (1996).

85. *See* AMERICAN ARBITRATION ASSOCIATION, CONSUMER DUE PROCESS PROTOCOL: A DUE PROCESS PROTOCOL FOR MEDIATION AND ARBITRATION OF CONSUMER DISPUTES, May, 1998. The principles follow but are broader than the those recommended by the AAA's Task Force on Alternative Dispute Resolution in *Employment, A Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of the Employment Relationship*, (1995).

86. It is reported that Kaiser Permanente, the largest health maintenance organization in the United States, will implement in California nearly all of the recommendations of an outside panel of federal and local officials for improvements in its internal dispute settlement process. Revision of this process, which was criticized by the California Supreme Court in *Engalla v. Permanente Medical Group, Inc.*, 938 P.2d 903 (Cal. 1997), was necessary to restore consumer confidence. NAT'L L.J., Jan. 19, 1998, at B2.

controlled under existing law and practice? Can courts can be counted on to invalidate clauses that agree to arbitrate statutory claims but attempt to reduce the substantive rights and remedies otherwise available in court? Can corporations be persuaded to select independent, experienced institutions to administer the arbitration and balanced rules to govern the arbitration? Can adequate pools of arbitrators, capable of conducting fundamentally fair hearings and deciding disputes over statutory claims, be developed for selection without amending the FAA? An optimist might predict that all of these possibilities will come to pass over time without further amendment of the FAA—that these objectives can be achieved without direct legal intervention.

Accepting this prediction for now, voluntary consent to and increased "due process" in arbitration do not necessarily mean that arbitrators will follow the applicable law on statutory claims and properly apply it to the issues of liability and remedy that are involved. Should anything be done to insure that the actual implementation of these rights in arbitration approximates the remedies that the individual would otherwise get in court?

If the traditional model of arbitration with its emphasis on finality is still accepted in this context, the answer may be yes to changes in the form and content of the arbitrator's award and no to expanding the scope of judicial review. This approach accepts the risk of additional expense and formality in arbitrating statutory claims but avoids the perverse incentives created when both parties can appeal adverse decisions to the courts for review of the merits. Thus, under Principle Fifteen of the AAA's Consumer Due Process Protocol, the arbitrator is expected to identify and apply pertinent contract terms and legal precedents and, if requested, to provide a brief explanation of the basis of the award which is subject to review only in "accordance with applicable statutes governing arbitration awards."[87] The Dunlop Commission, on the other hand, took a different approach for the arbitration of statutory claims in employment contracts. In essence, the Commission agreed that in disputes over statutory claims the employee should have the range of remedies equal to those available through litigation, and the arbitrator should prepare a written award explaining the rationale for the result, but it recommended that both parties should have the right to a limited judicial review to ensure that the result is consistent with applicable law.[88]

This consensus on all but the right to judicial review of the merits of the award suggests that if a legislative solution is required, the FAA should be amended to require the arbitrators to conduct a fundamentally fair hearing on the statutory claims involved, to apply the law applicable to those claims, and to prepare a written opinion explaining the decision on the merits. If this requirement is not satisfied, the district court should have the power to vacate an award without examining the merits and either to remand the matter to the arbitrators for further consideration or to decide the question de novo.[89]

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87. CONSUMER DUE PROCESS PROTOCOL, *supra* note 85, Principle 15.

88. *See supra* note 84.

89. This approach is consistent with the UNCITRAL Model Law on International Commercial Arbitration, UNITED NATIONS COMMISSION ON INTERNATIONAL

*4. Judicial Review*

Assuming a requirement of voluntary consent to the enforcement of pre-dispute agreements to arbitrate statutory claims, improved due process in the adjudication of those claims, and a requirement that the arbitrator prepare a written opinion with a rationale for the decision, should the FAA also be amended to permit either party to seek judicial review of the merits of the award? For example, the court might be given power to review the decision de novo for errors of law and fact and, if errors are found, to resolve finally that aspect of the dispute.[90]

The answer depends upon whether the traditional model of arbitration, with its emphasis on finality, has, like pre-dispute arbitration, also outlived its welcome in these contexts. Has the case been made for expanded judicial review? On the one hand, knowledgeable people might agree that the answer is no in consumer cases where statutory claims are not involved and in securities arbitration where, in theory at least, direct regulation by the SEC exists. On the other hand, interested parties might disagree with the Dunlop Commission about expanding the scope of judicial review in employment contracts or, at the very least, disagree that any expanded review for federally created discrimination claims should be extended to other statutory claims in consumer arbitration. Given the complexity of the problem and the absence of systematic empirical studies, the risk is that increased judicial review of arbitral awards will undermine the value of finality in many arbitrations.

At this point in the evolution of consumer arbitration, the sensible solution is to leave the scope of non-statutory judicial review under the FAA to the Supreme Court. Although we must wait for the right case to come along, the Court, in prior opinions, has signaled its interest in this problem and hinted that awards on claims "related to" the contract are not necessarily final.[91] Although a literal application of the so-called "manifest disregard" of the law test might be unsatisfactory, it is a short leap to the conclusion that "disregard" also includes the improper application of existing statutory law.

## V. CONCLUSION

Ultimately, the future of pre-dispute arbitration should be in the hands of those who use it, even the corporations that insist upon arbitration in dealings with customers, clients and franchisees. The FAA, however, should be revised to

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TRADE LAW: MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION, A/40/17, Annex I (1985). *See* Articles 28(1) & (2) and 31(2). The parties may vary these rules by agreement.

90. Most commentators, including Professor Estreicher, agree. Estreicher appears to support recommendations of the Dunlop Commission that an employee in arbitration should be entitled to a range of remedies equal to those available through litigation, a written award explaining the arbitrator's rationale for the result, and limited judicial review sufficient to ensure that the result is consistent with applicable law. Estreicher, *supra* note 23, at 1349–51.

91. *See* Davis, *supra* note 6, at 89–108 (tracing the judicial development of non-statutory grounds for review and concluding that revision of Section Ten of the FAA is not required).

provide incentives for improvement in transactions between individuals and corporations, first by denying enforcement of agreements to arbitrate unless they were voluntary, and second, by requiring arbitrators to prepare written opinions providing the rationale for decisions on statutory claims.[92] The first requirement simply reaffirms a basic requirement that agreements to arbitrate be voluntary and the second responds to the reality that arbitration is being used in regulated settings not contemplated when the FAA was enacted in 1925. At a minimum, the fundamentally fair hearing where statutory claims are involved requires that all of the usual remedies are available to the consumer and that the arbitrator's written award contain a rationale for the decision. Even if the FAA is not revised to permit judicial review on the merits, the written award will facilitate what judicial review the courts are willing to give under the evolving non-statutory exceptions.

As transactional contexts change and develop, and as the legal system regulates in new and different ways, a unitary model of arbitration enforced by mandatory order in consumer arbitrations has outlived its welcome. It is time for a change in the legal framework surrounding the process in the interest of protecting freedom from arbitration and of promoting integrity in the process and sound legal outcomes in the decision of statutory claims.

92. *See* APPENDIX, *infra*, for a proposed statutory revision.

## APPENDIX

### DRAFT: FEDERAL CONSUMER ARBITRATION ACT[93]

§ 1. For purposes of this Act:

(a) *commerce* includes all transactions or employments arising out of interstate or international commerce;

(b) a *consumer* is any individual purchasing goods, property or services in interstate commerce, including a franchisee, if the seller or supplier knows or has reason to know that the purchaser will consume the goods, property or services in the United States;

(c) an *employee* is a worker or other provider of services who is not subject to a collective bargaining agreement and is not an executive officer of a corporation;

(d) an *adhesion contract* is a contract or transaction between a consumer and its supplier or between an employee and its employer in a form proposed by the supplier or employer and not resulting from a process of bargaining between the parties advised by counsel of their choice; and

(e) *statutory rights* are rights and remedies created by federal and state legislation for the benefit of consumers and employees.

§ 2. A written term in an adhesion contract between a consumer and a supplier or an employee and employer agreeing to arbitrate a controversy thereafter arising out of the contract or agreeing to arbitrate an existing controversy arising out of the contract is not enforceable unless the written term conspicuously:

(a) discloses the agreement to arbitrate, explains the nature and effect of arbitration, and states that statutory rights maybe included in the agreement to arbitrate; and

(b) offers the consumer or employee a choice to accept or to reject the arbitration term without losing the opportunity to purchase the goods, property, or services offered or to enter into the employment relationship.

§ 3. Even though the requirements of §2 have been satisfied, terms in an adhesion contract to arbitrate shall be enforced only if they are just and reasonable. In particular:

(a) a term purporting to preclude the application of statutory rights is invalid unless the jurisdiction whose law is made applicable by the contract has a materially greater interest in regulating the contract than does the United States or the state whose law would otherwise apply; and

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93. This proposal draws upon, but is less drastic than, legislation proposed by Professor Paul Carrington. *See* Paul Carrington, *Regulating Dispute Resolution Provisions in Adhesion Contracts*, 35 HARV. J. ON LEGIS. 225 (1998).

(b) a term having the effect of precluding the assertion in a convenient forum of statutory rights is invalid, provided, however, that a contract may require a consumer or employee to assert claims in a jurisdiction other than that in which the consumer or employee resides if the jurisdiction selected has a materially greater interest in regulating the contract than does the state of residence.

§ 4. If statutory rights are within the scope of an enforceable contract to arbitrate under this Act, the arbitrator(s) shall:

(a) afford the parties a hearing, including discovery, that is appropriate for the nature and complexity of the statutory rights involved;

(b) apply the law that is applicable to the resolution of the statutory rights, including the granting of all remedies that would be available in a judicial proceeding; and

(c) prepare a written opinion that gives the rationale for a decision on the statutory rights.

§ 5. Upon appeal by either party from an award involving statutory rights, the district court shall:

(a) review the award for compliance with § 4 and, if the award does not comply, remand the case to the arbitrator(s) for appropriate action;

[(b) if the award complies with § 4, review the award for errors of law or clear errors of fact that have the effect of denying or impairing statutory rights and, if errors of law or clear errors of fact are found, decide the case on the merits.]