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# Introduction to the 1997 McGeorge Symposium on Contractual Arbitration

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## **Introduction To The 1997 McGeorge Symposium On Contractual Arbitration**

Kathleen M. Kelly\*

### **I. INTRODUCTION**

The purpose of this paper is to succinctly describe the context for presentations at the April 19, 1997, Symposium on Current Issues in the Use of Contractual Arbitration sponsored by McGeorge School of Law's Institute for Legislative Practice. At the time of the Symposium, Senate Bill No. 19, pending before the California Legislature, proposed adding the following grounds for vacating arbitration awards:

1286.5(a) In addition to any remedies and rights available under sections 1286.2 and 1286.4, a court shall vacate an arbitration award if it determines all of the following exists: (1) The award is the result of legal error by the arbitrator that has resulted in a miscarriage of justice. (2) The agreement or contract with the consumer party that contains a mandatory arbitration provision is in a standardized contract drafted by or on behalf of the non-consumer party. (3) The petition to vacate is filed by the consumer party.

Assessing the merits of this and other proposed legislation requires knowledge of current limits on the reach of state law and consideration of competing policy arguments bearing on either federal or state reform. This context paper will summarize the following topics addressed at the Symposium:

### **II. Importance of the Issues**

III. History and Federal Status Quo - Present federal authority greatly restricts the prerogatives left to state legislative action. An understanding of its basic contours is necessary before any proposals for state reform can be addressed.

IV. Contexts for Possible State Reform - Despite the preemptive effect of current federal law, some possible contexts for state reform can be identified that arguably do not run afoul of federal law.

### **V. Central Contentions Bearing on Possible Reforms**

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## II. IMPORTANCE OF THE ISSUES

Although no one may practice as a lawyer or medical doctor in any of the United States without satisfying extensive regulatory requirements, an arbitrator may offer him or herself for hire with no public showing of qualifications and may issue a binding determination of claims over malpractice, other personal injuries, significant property loss, violation of statutory rights, and other “high stakes” disputes with no explanation of the basis for the outcome. Up until the last ten to fifteen years, this state of affairs engendered little to no public clamor because arbitration flourished primarily in contexts where two equally powerful and informed parties chose arbitration as preferable to litigation. Market choice assured that only those arbitrators who served well continued to serve.<sup>1</sup>

In recent years, recurring defendants unhappy with jury verdicts have promoted arbitration in a boundless array of matters. Banks insert notices with monthly statements stating that further use of accounts will be deemed assent to arbitration for binding resolution of any consumer claims.<sup>2</sup> The multi-inch stack of papers signed upon buying a home will generally now include agreements to resolve all disputes with the seller, agent, or contractor through arbitration. It is not infrequent for doctors to present new patients not only with forms seeking medical history and insurance information, but also arbitration agreements. These typically incorporate rules of entities such as the American Arbitration Association (AAA), rules which neither the doctor nor the patient is likely to have seen. Courts concerned with docket pressure have largely upheld agreements signed in these and similar contexts.

Consumer advocates are crying foul. They urge that imposing arbitration against parties who are unwitting, or understand but perceive no choice, is eroding access to justice. They relate anecdotes of arbitration procedures that seem stacked against the consumer. For example, a home purchaser with a complaint about a construction deficiency found himself in arbitration, and on the day the arbitrator was scheduled to inspect, the insurance adjuster who had initially denied the claim instead arrived and related what he saw over the phone to the arbitrator in a friendly, jesting conversation.<sup>3</sup>

Industry spokespersons reply that current law is sufficient to address abuses conveyed by such anecdotes, and that ultimate good for all consumers ensues from the cost savings achieved when formal litigation expense is avoided.

Both sides are prone to make sweeping characterizations regarding the current state of affairs. The McGeorge Symposium is designed to gather speakers with expertise in law, empirical research that tests the law’s assumptions, and direct experience with arbitration as it is currently practiced in multiple industries. This

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1. See discussion *infra* Part III.B.

2. Ellie Winninghoff, *In Arbitration, Pitfalls for Consumers*, N.Y. TIMES, Oct. 22, 1994, at A3.

3. *Id.*

issue publishes the research and analysis of two key participants, and this paper notes areas for further empirical inquiry, the need for which was highlighted by Symposium discussion.

### III. HISTORY AND FEDERAL STATUS QUO

#### A. *The Reach of Current Federal Law*

Two recent Supreme Court decisions give the Federal Arbitration Act (first adopted in 1925) sweeping application to claims subject only to state court jurisdiction. In *Allied-Bruce Terminix Cos.*,<sup>4</sup> the Court considered the application of an Alabama statute invalidating pre-dispute arbitration agreements to a "Termite Protection Plan" with a consumer. The Court had previously held that the FAA creates substantive law applicable in state as well as federal court.<sup>5</sup> In *Allied-Bruce Terminix*, it held that the reach of that law extends to the limits of Congress' Commerce Clause power. The Alabama statute was determined to be preempted. Upon observing that the arbitration agreement in that case evidenced a transaction involving commerce, the Court noted both the multi-state nature of the corporate parties and the fact that materials used in performance of the contract came from outside Alabama. Since one of these conditions will be met in most all commercial or medical transactions, the reach of the FAA is great.

In *Doctor's Assocs.*,<sup>6</sup> the Court held that a Montana statute requiring special notice that an agreement includes an arbitration clause was preempted. The statute specified that notice of an arbitration clause's inclusion must be typed in capital letters on the first page of any contract as the price for enforcement. The Court held that states may not invalidate arbitration agreements applicable to activities involving commerce under state laws applicable only to arbitration agreements.<sup>7</sup>

Because these precedents are so recent, reformers will not likely persuade the Supreme Court to alter its course any time soon. Congress and state legislatures are more promising arenas for those who seek reform. Since outstanding judicial precedent influences the politics of change even in the legislative arena, however, those who advocate for reforms at the federal level should be mindful of why federal precedent has evolved as it has. For the foreseeable future, those who advocate for

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4. 513 U.S. 265 (1995).

5. *Southland Corp. v. Keating*, 465 U.S. 1 (1984). This ruling has significant consequences since, although § 2 of the FAA providing for enforcement of arbitration agreements is broadly stated, § 4 only provides for federal actions to compel where the dispute would be subject to federal court jurisdiction in the absence of the agreement to arbitrate. Section 2 has not been construed as independently creating federal question jurisdiction.

6. 517 U.S. 581 (1996).

7. A 1996 inventory found that, at that time, four states excluded consumer contracts from some laws otherwise favoring arbitration, nine states precluded arbitration in insurance contracts, and two states in addition to Montana required special notice of an arbitration clause. Joseph T. McLaughlin, *Arbitrability: Current Trends in the United States*, 59 ALB. L. REV. 905, 924-25 (1996).

change at the state level must cast their efforts in a manner most likely to withstand federal preemption.

The remainder of Section III provides a brief synopsis of the federal history. Section IV summarizes issues surrounding avoidance of federal preemption highly important to those who advocate for state reform.

## *B. Synopsis of Relevant History*<sup>8</sup>

### *1. Early Success Stories*

In common law jurisdictions, the longest standing uses of binding arbitration without frequent complaints of injustice have been in two contexts: (1) international business disputes; and (2) labor disputes. As to the first, in England, the Crown wished to encourage participation of itinerant merchants in trade fairs.<sup>9</sup> As part of trade fairs chartered by the crown, therefore, peers redressed complaints among tradespeople using “a comprehensive body of norms created by the merchants and distinct from the common law.”<sup>10</sup> Although this early form of arbitration was only voluntary in that the King gave notice that participation at a trade fair would make a merchant subject to it, merchants embraced the system because:

- (1) it avoided problems about domestic exercise of jurisdiction over foreigners (which meant that civil courts were really not an option);
- (2) it was efficient because matters were decided by those with experience and knowledge about general mercantile expectations (the “Law Merchant”); and
- (3) its speed coupled with the King’s endorsement for enforcement enabled resolution before everyone dispersed and moved on to the next trade fair.

Although the “Law Merchant” was eventually absorbed into the common law, parties in international commercial transactions have continued to favor arbitration as a means to minimize fear about home-court advantage and to maximize efficiency through the use of specialists. This led to adoption of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards by the U.N. Economic and Social Council in 1958, and final accession thereto by the United States in 1970.<sup>11</sup>

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8. For a more thorough yet succinct summary of the relevant history, see IAN R. MACNEIL, *AMERICAN ARBITRATION LAW: REFORMATION, NATIONALIZATION, INTERNATIONALIZATION* (1992).

9. See, e.g., *LIBER ALBUS* 257 (1419) (declaring “[w]hereas the King doth will that no foreign merchants shall be delayed by a long series of pleadings, the King doth command that the Wardens and Sheriffs shall hear daily the pleas of such foreigners . . . and then speedy redress be given unto them”).

10. IAN R. MACNEIL ET AL., *FEDERAL ARBITRATION LAW: AGREEMENTS* § 4.2.1 (1995).

11. 9 U.S.C.A. §§ 201-08 (West 1970).

The second context in which arbitration has historically flourished is also one in which the civil court was initially not an option. Neither statutory nor common law has generally addressed the appropriate terms and conditions for employment of any individual (apart from the rather modern specification of minimums by both federal and state law). They have been fixed by action of the free market, including strikes and lockouts. Throughout modern legal history, however, there have been occasions where all parties have desired to avoid the economic damage these weapons can cause and have agreed to arbitration. In our own history, as early as 1786, the New York Chamber of Commerce organized arbitration for wages of seamen to keep commerce flowing.<sup>12</sup>

Once terms are established and reflected in an employment contract or collective bargaining agreement, court becomes at least theoretically possible as a forum for redressing claims of breach. As labor strength grew at the beginning of the century, however, unions did not favor this option in the view that pro-business politics were controlling judicial appointments. Unions sought contract clauses calling for arbitration over contract violations. Employers in industries with strong unions were prone to agree because experience taught that unions disinclined to go to court would lead work stoppages over contract grievances disrupting production. Arbitration was better than relying on injunctions and damage suits to combat work stoppages.

As reliance upon arbitration grew, arbitrators developed norms<sup>13</sup> controlling their decisions very akin to the "Law Merchant" that informally evolved to control the affairs of England's medieval merchants. This lent predictability to bargaining parties' affairs. At its best, continued use of arbitrators who are familiar with typical labor arbitration decisions facilitates common case-assessment (thus enabling settlements) and focuses presentations when cases must be heard. Thus, here, as in the case of international commercial disputes, arbitration has flourished with the assent of affected parties because:

- (1) court is not a realistic alternative;
- (2) specialized decision-makers are desirable; and
- (3) the desire to keep commerce flowing warrants putting a high premium on expedition.

## 2. *The Initial Stance of the Courts*

Many historians allege that English common law was initially inhospitable to arbitration because judges feared that they would lose fees by ouster of their juris-

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12. FRANCES KELLOR, *AMERICAN ARBITRATION: ITS HISTORY, FUNCTIONS AND ACHIEVEMENTS* (1948).

13. For a compilation of those norms after considerable evolution, see F. & E. ELKOURI, *HOW ARBITRATION WORKS* (1985).

diction.<sup>14</sup> While this rationale had no factual foundation in the United States, many early decisions of both state and federal courts displayed hostility toward arbitration:

The courts will scarcely permit any other body of men to even partially perform judicial work, and will never permit absorption of all the business growing out of disputes over a contract by any body of arbitrators, unless compelled to such action by statute.<sup>15</sup>

Although some courts voiced a more supportive view when asked to enforce an award, the courts generally did not compel parties to arbitrate if they resisted compliance with an arbitration agreement before submission. Seeking damages for breach of an arbitration agreement was ineffectual.<sup>16</sup>

Despite the unavailability of judicial enforcement, some domestic business interests became increasingly reliant upon voluntary compliance with arbitration agreements as the exclusive means for resolving disputes in the period leading to the first part of this century. The Chamber of Commerce of the State of New York was a leader in creating internal procedures encouraging adoption of and compliance with arbitration agreements.<sup>17</sup> Following the model of early international tradespeople, business interests were pleased to resolve their differences privately, quickly, and by reliance upon business norms, in order to keep commerce flowing, rather than public law. In close-knit environments, honor, fear of harming future relations, or the threat of exclusion from a trade association provided enough incentive to comply with arbitration agreements.

### 3. *Development of Modern Federal Law*

As business boomed and the range of deals expanded beyond local controls in the hey day at the beginning of the century, compliance issues arose. Those who could influence the legislative agenda of business still endorsed arbitration as the forum most effective for resolving differences with a minimum of interruption to commercial aims. The business lobby, therefore, first led statutory reform in New York, and then worked through the American Bar Association<sup>18</sup> on the successful drive ultimately resulting in adoption of the Federal Arbitration Act.<sup>19</sup>

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14. MACNEIL, ET AL., *supra* note 10, § 4.1.2 n. 4.

15. *United States Asphalt Refining Co. v. Trinidad Lake Petroleum Co.*, 222 F. 1006, 1010-11 (S.D.N.Y. 1915).

16. MACNEIL, *supra* note 8, at 20.

17. William Catron Jones, *Three Centuries of Commercial Arbitration in New York: A Brief Survey*, 1956 WASH. U. L.Q. 193, 211-18.

18. MACNEIL, *supra* note 8, at 84.

19. 9 U.S.C.A. §§ 1-16 (West 1998).

Present scholarship reflects a lively debate concerning whether the FAA's adopters intended for it to apply in state court with the full reach of Congress' Commerce Clause power.<sup>20</sup> Whatever the original intent may have been, a confluence of factors has caused the Supreme Court to increasingly favor contractual arbitration by coming to the aid of those who seek to enforce arbitration agreements or awards. Phenomena that arose shortly after adoption of the FAA are relevant. The New Deal increased exponentially the quantity of federal law and potential federal judicial work. Legislative initiatives included the Wagner Act,<sup>21</sup> which sought to encourage collective bargaining as the best means to minimize labor strife that could potentially disrupt the necessary flow of goods. Adoption of this strategy rejected prior efforts to fix fair wages by governmental action or stop strife with judicial injunctions. These more interventionist approaches were abandoned in favor of enforcing collective bargaining agreements.<sup>22</sup> The philosophy that labor-management disputants should be empowered to solve their own problems warranted development of precedent resolving all doubts in favor of arbitration. Initially, brakes were applied to this trend when important interests protected by other statutes appeared to be at stake. Ultimately, however, precedent developed in the labor-management setting provided a foundation for increasingly enthusiastic federal endorsement of arbitration over the later part of this century as a critical tool in avoiding court congestion.<sup>23</sup> The following summarizes key Supreme Court precedents in the evolution:

A pre-dispute arbitration agreement allegedly covering consumer claims for civil liability under Section 12 of the Securities Act of 1933 for misrepresentation in the sale of securities was void under Section 14 of the Act.<sup>24</sup>

A court must not deny a petition to compel arbitration because the claim seems patently frivolous. If the claim on its face is governed by the agreement, arbitration must be compelled.<sup>25</sup>

The rule of *United Steelworkers* applies even where the grievance does not rely upon any explicit clause within the collective bargaining agreement. The request to compel arbitration may only be denied if it may be said with "positive assurance" that the arbitration clause cannot be construed so as

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20. See, e.g., Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 WASH. U. L.Q. 637 (1996).

21. 29 U.S.C.A. § 151 (West 1935).

22. Collective bargaining agreements were apt to include arbitration clauses, as discussed *supra*, Part III.B.1.

23. See Sternlight, *supra* note 20, at 660 n.126 (noting a 1982 address by Chief Justice Burger as a harbinger of this trend).

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

25. *United Steelworkers of America v. American Mfg. Co.*, 363 U.S. 564 (1960).



to embrace the dispute. All doubts must be resolved in favor of coverage, given the national policy favoring arbitration as a substitute for industrial strife.<sup>26</sup>

Courts should not review the merits of an arbitration award after its issuance, and arbitrators have no obligation to give their reasons for an award.<sup>27</sup>

*Wilko v. Swan* should not be followed in a case between international disputants involving claimed violations of Section 10(b) of the Securities Exchange Act of 1934. In this setting, arbitration agreements protect parties fearful of hostile forums and afford predictability. Failure of enforcement would undermine the orderliness needed for international business transactions.<sup>28</sup>

An employee who arbitrated his discharge under a collective bargaining agreement's grievance procedure did not thereby forego his ability to sue under Title VII claiming discrimination because the contractual rights at issue before the arbitrator were distinct from the plaintiff's statutory rights.<sup>29</sup>

The reasoning of *Alexander v. Gardner-Denver* applies to claims under the Fair Labor Standards Act (specifying minimum wages and conditions).<sup>30</sup>

A federal district court should not stay a petition to compel arbitration where the issue of arbitrability is pending before a state court. It should promptly decide the issue of arbitrability because of Congress' intent to "move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible."<sup>31</sup>

Section 2 of the FAA (declaring that arbitration agreements in contracts arising from transactions that "involve commerce" are enforceable on the same basis as all other contracts) creates substantive law applicable in both federal and state courts.<sup>32</sup> Thus, there is a federal policy against disfavoring

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26. *United Steelworkers of America v. Warrior & Gulf Navigation Co.*, 363 U.S. 574 (1960).

27. *United Steelworkers of America v. Enterprise Wheel and Car Corp.*, 363 U.S. 593 (1960).

28. *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974).

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

30. *Barrentine v. Arkansas-Best Freight Sys., Inc.*, 450 U.S. 728 (1981).

31. *Moses H. Cone Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 22 (1983).

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

arbitration agreements applicable in both federal and state court whenever commerce is involved.

Antitrust claims of a Puerto Rico corporation against a joint venture between Japanese and Swiss corporations are subject to an arbitration clause in the distribution and sales agreements even though they contained no express reference to statutory claims and the specified forum was arbitration by the Japan Commercial Arbitration Association. Addressing the capacity of the courts to assure accomplishment of the public purposes served by federal antitrust laws, the Court observed that despite the deference required after issuance of an award, a court could assure itself that the tribunal “took cognizance of the antitrust claims and actually decided them.”<sup>33</sup>

Section 2 of the FAA preempts California Labor Code section 229 providing that actions for the collection of wages may be maintained “without regard to the existence of any private agreement to arbitrate” where the “involving commerce” requirement of the FAA is met.<sup>34</sup> Section 229 is contrary to the federal policy favoring enforcement of arbitration awards.

Customer agreements providing for arbitration of any controversy relating to their accounts apply to alleged violations of the antifraud provisions in Section 10(b) of the Securities Exchange Act of 1934. Section 29(a) of the Exchange Act only prohibits waiver of the Act’s substantive obligations. Any view that the federal judicial forum is a substantive protection is based on an out-moded mistrust of arbitration. RICO claims were also found arbitrable.<sup>35</sup>

*Wilko v. Swan* is overruled. A pre-dispute agreement to arbitrate claims under the Securities Act of 1933 is enforceable.<sup>36</sup>

A former securities representative’s claims under the Age Discrimination in Employment Act of 1967 (ADEA) are subject to an arbitration clause in the registration agreement he signed. *Alexander v. Gardner-Denver* is limited to the collective bargaining context. “[T]he burden is on Gilmer to

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33. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 638 (1985).

34. *Perry v. Thomas*, 482 U.S. 483 (1987).

35. *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

36. *Rodriguez de Quijas v. Shearson/American Express*, 490 U.S. 477 (1989).

show that Congress intended to preclude waiver of a judicial forum for ADEA claims.”<sup>37</sup>

The interstate commerce language in section 2 of the FAA should be read broadly to encompass the furthest reach of Congress’ Commerce Clause power. Thus, a state (here, Alabama) may not apply a statute making pre-dispute arbitration agreements invalid and unenforceable to a contract between a multi-state company (using materials coming from outside Alabama) and a consumer for termite protection.<sup>38</sup>

An award containing punitive damages should be enforced even though the arbitration agreement’s choice-of-law clause pointed to New York, where under state law, only courts may issue punitive damages. The choice-of-law clause did not unequivocally exclude punitive damages.<sup>39</sup>

The FAA preempts a state statute requiring “notice that a contract is subject to arbitration” to be “typed in underlined capital letters on the first page of the contract.”<sup>40</sup> Such a restriction cannot be applied solely to contracts requiring arbitration. In contracts involving commerce, states may only decline enforcement of arbitration agreements on the grounds of “*generally applicable contract defenses* such as fraud, duress or unconscionability.”<sup>41</sup>

Given the recency and vehemence of current federal authority seeking to preserve judicial resources through favoring enforcement of arbitration agreements, reform at the federal level is improbable in the foreseeable future. “Congress has committed to the SEC the task of ensuring that the federal rights established by the Securities Act are not compromised by inadequate arbitration procedures” through oversight of the NYSE and NASD.<sup>42</sup> Any organized consumer group seeking to lobby for exclusion of any other federal statutory right from arbitration enforcement would have to fight the perception, fostered by the above summarized Supreme Court cases, that the *status quo* helps guard against an absolute necessity to fund an expanded federal judiciary.

Those who favor reform, therefore, must necessarily consider what possibilities the preemptive effect of the FAA leaves open at the state level.

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

38. *Allied Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995).

39. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995).

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

41. *Id.* at 1656 (emphasis added).

42. *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 286 (9th Cir. 1988). For a recent discussion of those efforts, commenting on the 1996 NASD Taskforce Report on Securities Arbitration Reform, see Joel Seligman, *The Quiet Revolution: Securities Arbitration Confronts the Hard Questions*, 33 HOUS. L. REV. 327 (1996).

## IV. CONTEXTS FOR POSSIBLE STATE REFORM

Government regulation may affect arbitration: (1) when one party resists compliance with an arbitration agreement and the other seeks to enforce use of arbitration; or (2) the party aggrieved by an award seeks judicial relief from it. The discussion which follows will outline critical authorities bearing upon the viability of possible state reforms at either juncture and highlight issues addressed by Symposium participants.

A. *Enforcement of Arbitration Agreements*

*Doctor's Assocs., Inc. v. Casarotta* unequivocally affirms that, "generally applicable contract defenses, such as fraud, duress or unconscionability, may be applied to invalidate arbitration agreements without contravening section 2 [of the FAA]."<sup>43</sup> Seemingly, this allows states full leeway to develop, by court decision or statute, doctrines of adhesion and unconscionability so as to afford greater protection for consumers unwittingly entering into arbitration agreements. The central caveat is that doctrines developed must apply generally and not disfavor arbitration commitments as contrasted with other contractual obligations. The Montana notice requirement, which fell to preemption in *Doctor's Associates*, was deemed flawed because it imposed an extra hurdle before enforcement of an arbitration agreement that was not applicable to contracts generally.

The leading California case expounding upon the doctrines of adhesion and unconscionability as they apply to arbitration agreements is *Graham v. Scissor-Tail, Inc.*<sup>44</sup> The court defined an adhesion contract as one imposed by a party with superior bargaining strength when the other party had no effective opportunity to reject it.<sup>45</sup> It noted that characterizing a contract as "adhesive" is not necessarily pejorative since efficiency dictates the use of many form agreements. The adhesive contract warrants scrutiny, however, to avoid "oppression and overreaching."<sup>46</sup> The contract at issue in the case was found adhesive even though the complaining party was a sophisticated promoter because the other party was constrained by membership in the American Federation of Musicians to view certain clauses as non-negotiable.

After finding the contract adhesive, the court identified two judicially imposed limitations on enforcement: (1) Is the contract outside the reasonable expectations of the weaker or "adhering party?" and (2) Pursuant to "a principle of equity applicable to all contracts generally,"<sup>47</sup> is the contract unduly oppressive or "uncon-

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43. 116 S. Ct. 1652, 1656 (1996).

44. 28 Cal. 3d 807, 623 P.2d 165, 171 Cal. Rptr. 604 (1981).

45. *Id.* at 817, 623 P.2d at 171, 171 Cal. Rptr. at 613.

46. *Id.* at 818, 623 P.2d at 171, 171 Cal. Rptr. at 614.

47. *Id.* at 820, 623 P.2d at 173, 171 Cal. Rptr. at 616.

scionable?" A "yes" to either question forecloses enforcement. The court observed that both notice provisions and "the extent to which the contract in question may be said to be one affecting the public interest"<sup>48</sup> should influence the assessment of "reasonable expectations." Upon discussing the unconscionability analysis, the court reiterated that "[c]ontracts having a demonstrable public service aspect . . . may be deemed unconscionable on broad grounds of public policy."<sup>49</sup> After alluding to "minimum levels of integrity" and "the common law right of fair procedure," the court held that a petition to compel arbitration should be denied where the clear effect of the contractual procedure will be "to deny the resisting party a fair opportunity to present his position."<sup>50</sup> On the facts of the case, a process in which the American Federation of Musicians decided disputes was found unconscionable.

In recent applications of *Graham v. Scissor-Tail*, California courts have held that: (1) a one-sided trial *de novo* right in an arbitration agreement applicable to medical malpractice claims rendered it unconscionable;<sup>51</sup> and (2) an employment agreement in which the employee's statutory remedies were greatly curtailed while the employer's were embellished was unconscionable.<sup>52</sup> These arbitration agreements evidenced transactions "involving commerce" as defined in current federal precedents.

To what extent do these precedents square with *Doctor's Associates* and to what extent do they point out possible turf for further clarity and consumer protection through statutory reform? One Symposium participant has argued that the Montana result found invalid in *Doctor's Associates* could not be achieved through reliance upon unconscionability law rather than a statute specifically requiring notice of an arbitration clause because nothing in the FAA justifies a distinction between common law and statutory law.<sup>53</sup> However, *Doctor's Associates* declared that Montana's sin was singling out arbitration for treatment different from all other commitments which might be scrutinized as unconscionable. If singling out arbitration for unique treatment is the mortal sin, then may a state (with application to disputes covered by the FAA's broad reach):

Provide by statute that all forum selection clauses (or as in the case above, jury waivers) must be in bold face at the front of a contract?<sup>54</sup>

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48. *Id.* at 820 n.18, 623 P.2d at 173, 171 Cal. Rptr. at 616.

49. *Id.* at 821, n.20, 623 P.2d at 173, 171 Cal. Rptr. at 617.

50. *Id.* at 824-26, 623 P.2d at 175-76, 171 Cal. Rptr. at 619-20.

51. *Saika v. Gold*, 49 Cal. App. 4th 1074, 56 Cal. Rptr. 2d at 138. Either side could seek trial *de novo* if the award exceeded \$25,000. The court found that this would rarely serve patients well but always gave doctors the ability to escape unfavorable awards.

52. *Stirlen v. Supercuts, Inc.*, 51 Cal. App. 4th 1519, 60 Cal. Rptr. 2d 138.

53. Stephen J. Ware, *Arbitration and Unconscionability After Doctor's Associates, Inc. v. Casarotto*, 31 WAKE FOREST L. REV. 1001, 1015 (1996).

54. Symposium participants differed regarding the practical utility of such warnings and this is a front for possible empirical work.

Specify by statute baseline procedures which must be in place in order to afford the "common law right of fair procedure" alluded to in *Graham v. Scissor-Tail* as necessary before any forum selection clause will be enforced?<sup>55</sup>

Literally, such possible measures do not single out arbitration, although concededly, arbitration would be the primary forum affected.

### B. Review of Awards

Given the preemptive effect of the FAA, a state may not adopt any conflicting general review standard for arbitration awards and apply it to arbitrations within the FAA's broad reach. The FAA allows denial of enforcement only in cases of: (1) corruption or fraud; (2) evident partiality; (3) arbitrator misconduct, such as improper refusal to postpone a hearing or receive evidence; or (4) an award exceeding the powers conferred by the parties' definition of the dispute submitted.<sup>56</sup> Consistent with the trend of federal deference to arbitration summarized above, these grounds have been narrowly construed.<sup>57</sup>

However, the Supreme Court has not treated the FAA, standing alone, as dispositive of review standards where the matters arbitrated include statutorily created rights protecting public as well as private interests. In such an instance, the recent decisions of the Court have proceeded on the basis that the FAA creates a strong policy favoring arbitrability of disputes. It has also left open the possibility of Congress "trumping" the FAA with expression of explicit and specific intent in another statute limiting the ability of parties to contractually waive court enforcement of its protections. It has posed the issue as whether "Congress intended to preclude a waiver of judicial remedies for the statutory rights at issue," which might be established by an "inherent conflict between arbitration and the statutes's underlying purposes."<sup>58</sup> In the present federal wave of enthusiasm for arbitration, the

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55. A Commission on the Future of Worker-Management Relations appointed by the U.S. Secretary of Labor issued a Report and Recommendations in 1994 calling for a core of protections in arbitration of employment disputes. They included: (1) a neutral arbitrator who knows the applicable law; (2) a simple method for the employee to secure information essential to present his/her claim; (3) a fair method of cost-sharing; (4) the right to independent representation; (5) remedies comparable to those afforded by litigation; (6) a written opinion; and (7) sufficient judicial review to assure a result consonant with governing law. At present, industry compliance upon drafting arbitration agreements is the only device for achieving these goals.

56. 9 U.S.C.A. § 10 (West 1970). California's general statutory grounds for vacation of an arbitration award are comparable, although phrased and ordered somewhat differently. CAL. CODE OF CIV. PROC. § 1286.2 (West Supp. 1997).

57. Such narrow construction of statutory grounds for review of arbitration awards is also the current approach of the California Supreme Court. *Advanced Micro Devices, Inc. v. Intel Corp.*, 9 Cal. 4th 362, 885 P.2d 994, 36 Cal. Rptr. 2d 581 (1994) (holding that an award should be upheld so long as it was "even arguably" based on the contract).

58. *Shearson/American Express, Inc.*, 482 U.S. at 227.

Supreme Court has not found such intent in any federal statute. At least one lower federal court, however, has found that Title VII of the Civil Rights Act of 1964 affords employees a nonwaivable right of reasonable access to a neutral forum, rendering it essential that an employer compelling arbitration pay the arbitrator's fees.<sup>59</sup>

Do state legislatures have the same capacity to countermand the FAA regarding enforcement mechanisms for particular statutorily created rights? Only one week after its discussion of federal statutory intent potentially overriding the FAA in *McMahon*, the Supreme Court seems to have said "no" in *Perry v. Thomas*.<sup>60</sup> Upon ruling that the FAA preempted California Labor Code Section 229, the Court recalled words from *Southland Corp. v. Keating* to the effect that, "in enacting Section 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration."<sup>61</sup> Arguably, this precedent creates an anomaly: In the face of the FAA, Congress may still deem judicial enforcement essential to accomplish the purposes of a statutory right it creates, yet the states do not have the same prerogative regarding statutory rights they create. Anomalous or not, the precedent is only ten years old and hence would be challenging to reverse. Congressional recognition that the states creating new statutory rights ought to have the prerogative to control forum of enforcement might be a sufficiently narrow amendment of the FAA as interpreted to overcome political hurdles.

Of course, states may be less deferential to arbitration where statutory rights are involved if the agreement does not evidence a transaction "involving commerce" as defined by current federal precedent without running afoul of *Perry*. Given the reach of "involving commerce," however, any such approach will affect very few cases. The California Supreme Court has followed the logic of *McMahon* without discussing *Perry* or the application of its relevant discussion to cases "involving commerce" within the meaning of the FAA. In *Moncharsh v. Heily & Blase*,<sup>62</sup> the leading California case on the standard of arbitration award review, the court rejected language in prior decisions suggesting that an "error of law apparent on the face of the award" provides grounds for review and specified that the grounds delineated in California Code of Civil Procedure Section 1286.2 are exclusive.<sup>63</sup> Upon so holding, however, it stated the following:

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59. See *Cole v. Burns Int'l Sec. Servs.*, 105 F.3d 1465 (D.C. Cir. 1997) (including a lengthy opinion by Judge Edwards, who has written extensively concerning the suitability of arbitration for statutory claims).

60. 482 U.S. 483 (1987).

61. *Id.* at 489.

62. 3 Cal. 4th 1, 832 P.2d 899, 10 Cal. Rptr. 2d 183 (1992). This case involved a lawyer and a law firm. Although the issue was not raised, it is highly likely that the business of the firm would have met *Allied-Bruce's* test for "involving commerce."

63. *Id.* at 33, 832 P.2d at 919, 10 Cal. Rptr. at 203.

We recognize that there may be some limited and exceptional circumstances justifying judicial review of an arbitrator's decision when a party claims illegality affects only a portion of the underlying contract. *Such cases would include those in which granting finality to an arbitrator's decision would be inconsistent with the protection of a party's statutory rights.*<sup>64</sup>

Consistent with this view, in *Board of Education v. Round Valley Teachers' Ass'n*,<sup>65</sup> the court found that an arbitrator's award was inconsistent with exclusive statutory specifications regarding the causes and procedures applicable to reelection of probationary teachers and was, therefore, subject to judicial review.

Can *Moncharsh* be squared with *Perry*? If so, could the legislature adopt a general statute providing for a higher standard of review over state law statutory claims resolved by arbitrators than the general standard in California Code of Civil Procedure Section 1286.2? Seemingly, this would simply do in a single place what *Moncharsh* says could be done in each individual state statute creating substantive rights. If the federal impediment to this approach is insurmountable, could the legislature create incentives for private parties to contractually agree in their arbitration agreements to a higher standard of judicial scrutiny when state statutory claims are resolved?<sup>66</sup>

## V. CENTRAL CONTENTIONS BEARING ON POSSIBLE REFORMS

There is ample conflicting opinion regarding the need for reform of any sort (beyond concern over capacity to survive preemption). What follows summarizes some of the key arguments elaborated upon in the debate by Symposium participants.

### A. Key Arguments of Arbitration Proponents Who Disfavor Reform

(1) Parties may secure a more prompt resolution via arbitration because individual arbitrator availability controls scheduling rather than court congestion.

Rejoinder: This is fine in theory, but if a chosen arbitrator delays significantly in issuing a decision, parties who have failed to build time

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64. *Id.* at 32 (emphasis added) (citing *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987)).

65. 13 Cal. 4th 269, 914 P.2d 193, 52 Cal. Rptr. 115 (1996).

66. One court has upheld and honored a contractual clause providing for *de novo* review of "errors of law," *Gateway Tech., Inc. v. MCI Telecomm. Corp.*, 64 F.3d 993 (5th Cir. 1995), and another has declined to follow such a clause on the ground that it is "offensive to the public policy which supports arbitration," *Lapine Tech. Corp. v. Kyocera Corp.*, 909 F. Supp. 697, 706 (N.D. Ca. 1995). California Code of Civil Procedure § 1296 currently states that "[i]f the agreement so provides," courts will review for errors of law in awards growing out of construction contracts with public agencies.



limits into their arbitration agreement have no remedy.<sup>67</sup> Even when resolution is faster, faster is not always better.<sup>68</sup>

(2) The informality of arbitration makes it more accessible for complainants because there is less litigation expense.<sup>69</sup> They may contemplate pursuing a claim without a lawyer even if the stakes are not high enough to attract a contingency fee lawyer or warrant paying hourly fees.

Rejoinder: That supports making it available as an option after disputes arise, but not mandating pre-dispute agreements on this exclusive process.

Informality is a two-edged sword. It may make participation easier, but it may make access to the information needed to effectively present one's case harder. Without formal discovery, a complainant may not be able to make his or her case.

Comeback: In California, all arbitrators may issue subpoenas (including *duces tecum*) and make arrangement for inspection of documents prior to hearing. A substantial number of agreements incorporate standard rules, such as the National Rules for the Resolution of Employment Disputes, promulgated by the AAA (June 1, 1996) specifying even broader authority on the part of the arbitrator to order discovery (AAA Employment Rule 7).

(3) Those with expertise in the field of dispute may be selected as arbitrators affording efficiency for presentation and a better informed decision. For example, a dispute about construction defects can be presented more readily to an arbitrator with background knowledge about usual construction methods than to a generalist judge or jury.

Rejoinder: That's fine for parties that have the information necessary to evaluate the experience and neutrality of possible arbitrators. When a single

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67. In *Engalla v. Permanente Med. Group, Inc.*, 51 Cal. App. 4th 134, 152 (1995) (declining to bar enforcement on grounds of fraud in the inducement or unconscionability), the court noted that, on average, it takes 863 days to reach a hearing in a Kaiser arbitration. This statistic did not account for any additional time necessary to reach a decision.

68. See *supra* Part III.B1, 2, & 3.

69. For eighteen years, Michigan experimented with a statutory structure intended to promote arbitration of medical malpractice claims and yet build in protections for consumers as a means to reduce malpractice insurance premiums. Under that statute, cases were more quickly resolved than in court (an average of 19 months as opposed to 35 months), but average litigation expenses were almost identical (\$17,509 for arbitration vs. \$17,798 for court cases). John P. Desmond, Comment, *Michigan's Medical Malpractice Reform Revisited—Tighter Damage Caps and Arbitration Provisions*, 11 T. M. COOLEY L. REV. 159, 183 n.124 (1994).

consumer has a complaint against a recurring respondent, however, any prospective arbitrator with relevant experience is likely to have had past dealings with the respondent but will have had none with the complainant. Moreover, no public information is available. The desire for future dealings with respondent may also imperil objectivity.<sup>70</sup>

Comeback: Lawyers who specialize in complainant cases for any given field can help balance the equation and gain, over time, knowledge about qualifications of prospective arbitrators.

(4) Freedom to contract should be preserved. Professor Ware argues that consumers receive some *quid pro quo* for signing arbitration agreements.

Rejoinder: There is a need to define some means of empirically testing whether consumers are actually enjoying any increased services or saved costs in industries where arbitration has become prevalent. Symposium participants gave differing perspectives.

#### B. Some Leading Arguments of Arbitration Detractors Favoring Reform

(1) Where respondents are repeat players and complainants typically are not, arbitrators have a built-in motive to prefer respondents because they desire to cultivate future business.<sup>71</sup> Professor Bingham's article summarizes her research on the "repeat player" effect in non-union employment cases.

Rejoinder: Arguably, Professor Bingham's Table 4 (when compared to Table 2) shows that the limiting effects of employment handbooks (specifying available claims and remedies) has had more influence on results than an employer's "repeat player" status.

(2) Arbitration of statutory claims does not adequately protect individual rights because qualifications of arbitrators vary considerably,<sup>72</sup> and there is no public scrutiny as in the case of judicial appointments. The extreme deference to arbit-

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70. See *supra* Part III.B.1.

71. See Carole Gould, *Securities ADR: Is it Fair to Investors?*, 10 ALTERNATIVES TO THE HIGH COST OF COURT 165, 167-68 (1992) (describing an investor disgruntled to learn that her arbitrator had another case pending with the same defendant whose lack of confidence in the process was confirmed by an award in her favor for much less than the proven damages).

72. Judge Edwards reported an empirical study in 1976 indicating that 16% of labor arbitrators have never read a judicial opinion involving Title VII, 40% do not keep abreast of current developments under Title VII, and yet 50% of those in these groups deem themselves fit to hear employment discrimination cases. Harry T. Edwards, *Arbitration of Employment Discrimination Cases: An Empirical Study*, in PROC. OF THE 28TH ANN. MEETING OF THE NAT'L ACAD. OF ARB. 59, 71-72 (1976).

ration decisions under prevailing law forecloses this from constituting an adequate safeguard.

Rejoinder: The vast majority of individual cases do not raise complex issues of law, but rather call for application of established law to facts. Arbitrators are as expert in this function as trial judges and more expert than juries.

(3) Arbitration of statutory claims does not adequately protect public rights because the privacy of arbitration: (1) eliminates harm to public image as one incentive for compliance with statutory goals; (2) makes it harder to demonstrate a pattern or practice of violations warranting harsher penalties; and (3) deprives the public of useful precedents that could guide other entities subject to statutory regulation.

Rejoinder: "[T]he parties to an arbitral agreement knowingly take the risks of error of fact or law committed by the arbitrators and . . . this is a worthy 'trade-off' in order to obtain speedy decisions by experts in the field whose practical experience and worldly reasoning will be accepted as correct by other experts."<sup>73</sup>

Comeback: The rejoinder assumes voluntary choice, which simply is all too often not the case when a patient, bank customer, or other consumer is presented with an arbitration agreement routinely used by all service providers in an industry.

The work of Professors Ware and Bingham appearing in this issue elaborates upon several of the key issues noted above.

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73. Joseph C. Sweeney, *Judicial Review of Arbitral Proceedings*, 5 FORDHAM INT'L L. J. 253, 254 (1981-82), cited and relied upon in *Moncharsh*, *supra* note 44, at 12.