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Arbitration Clauses in Contracts of Adhesion Trap “Sophisticated Parties” Too

Andrea Doneff

I. INTRODUCTION

When introduced as a method to control soil erosion, kudzu was hailed as an asset to agriculture, but it has become a creeping monster. Arbitration was innocuous when limited to negotiated commercial contracts, but it developed sinister characteristics when it became ubiquitous. Just before making the arbitration to kudzu analogy, the court said: “When two equally sophisticated parties bargain at arms length to submit disputes to arbitration, that agreement should be enforceable. Troubling questions arise when one party lacks the sophistication and bargaining power of the other. . . .” Courts often use the terms “sophistication” and “bargaining power” as complements, but in today’s business world, a party can be very sophisticated and still be taken advantage of in negotiating contracts with arbitration clauses because it has little or no bargaining power.

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Traditionally, courts and arbitration providers have provided more protection for individuals who enter into contracts that include clauses requiring arbitration and then realize they do not want to arbitrate than for commercial entities in the same predicament. A number of recent court decisions regarding contracts, and specifically regarding arbitration, have modified this analysis to distinguish between what the courts refer to as sophisticated and unsophisticated entities rather than corporations and individuals in their analysis of enforceability. Usually the distinction is made to justify a court’s enforcement of an arbitration clause against a business or an individual—because the party objecting to arbitration is “sophisticated,” the objection is easily dismissed.

In arbitration clause analysis, the argument is that sophisticated business-people, individually or on behalf of a commercial entity, can protect themselves from an onerous arbitration clause, while an unsophisticated person cannot. Often courts mix this sophisticated party distinction with a traditional unconscionability analysis of the difference in negotiating power without recognizing that they are not the same concepts. Courts avoid addressing the obviously negative effect their decisions have on parties who may be sophisticated entities entering commercial contracts but who have no real bargaining power or on unsophisticated (or significantly less sophisticated) small businesses or sole proprietors entering into contracts of adhesion.

Generally, where the court determines that the contracting party is “sophisticated,” the court upholds the arbitration clause. Because the courts have not explicitly set out a distinction that allows for any bright line rules or guiding principles, the approach allows powerful parties to reach results through arbitration that harm both the less powerful party that signed the contract and non-parties to the contract, especially consumers, affected by the decision. The Federal Arbitration Act (FAA) was passed to allow parties negotiating at arms’ length and with roughly equal negotiating power to contractually agree to resolve disputes quickly, efficiently, and with an expert decision maker. Congress did not intend to allow parties to contract away statutory protections so that powerful corporations can shield themselves from liability.

The Supreme Court heard or addressed a significant number of arbitration cases in the 2010 term. The decisions made it clear that the Supreme Court wanted to emphasize self-determination by the parties, enforcing contracts as parties wrote them. Arguably the Court left open the possibility of providing protection for consumers forced into arbitration against their will. In her dissent in Stolt-Nielsen S.A. v. AnimalFeeds Int’l Inc., discussed in detail in Section IV, Justice Ginsburg pointed out that Justice Alito, in his majority opinion, empha-

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sized the sophisticated nature of the bargaining parties, thus leaving room to make a distinction to protect consumers who enter into contracts that do not necessarily protect all of their rights. Yet the effect of even the decisions post-Stolt-Nielsen to date is to allow powerful corporations to force both corporations and individuals to accept contracts with arbitration clauses that protect the powerful corporation in ways not anticipated by Congress when it passed the FAA.

In American Express Co. v. Italian Colors Restaurant, decided shortly after Stolt-Nielsen, the Supreme Court ignored an opportunity to define the distinction between consumers and more sophisticated parties that it alluded to in Stolt-Nielsen. Instead it reversed without opinion a Second Circuit decision that had refused to enforce a class action waiver in agreements between small merchants and American Express on public policy grounds because the waiver left these sophisticated parties with no ability to protect rights Congress created if forced into arbitration without a class action option.

In both cases, important rights remained unguarded in arbitration because the Court held that our system provides no feasible way to pursue them. Because the Supreme Court has made it clear that its analysis emphasizes the parties' contract language and because these contracts are almost always drafted by the more powerful party, Congress must step in to protect society from weaker parties signing away the protections Congress built into our laws.

It makes little sense to protect the rights of consumers to bring class actions or to gain court review of unfair arbitration decisions and not to protect the rights of merchants caught in the same web by more powerful merchants. The merchants in Italian Colors will pass along to consumers the higher fees they wanted to protest, just like the costs the shippers allegedly overpaid in Stolt-Nielsen. The main difference is that in the cases that do not allow class actions in the commercial context, the costs of unprotected rights get spread throughout the consumer economy rather than directed at one specific consumer or employee, as in the individual cases.

Courts should recognize the effect their decisions have on both the obvious parties and those who are unnamed but not unaffected. They should take into account the fact that Congress set out protected rights not just for individuals, but to protect society—from anti-trust violators, from unethical fees, from companies trying to hide their wrongdoings from the public, and from companies trying to avoid creating precedent—the underlying basis for our legal system. Congress must help by clarifying the FAA and by returning to parties the protections provided by our judicial system but not necessarily available in arbitration. Courts should not hold that parties can contract away these protections. They do not belong just to the individual; they belong to society.

Searching for distinctions based on sophistication, commercial nature, or alleged arms-length negotiations does not provide protection. Instead, courts inter-

7. Id.
9. In re Am. Express Merchs. Litig., 554 F.3d at 320, rev'd, Am. Express Co., 130 S. Ct. 2401 (specifically pointing out that its decision is based on the need to protect statutory rights and the fact that the potential recovery is too small to be brought without a class action, not that the clause is unconscionable because the "small" merchants have no more right to protect themselves than do consumers).
ested in creating guidance for parties drafting, negotiating, signing, and enforcing arbitration clauses must consider that their guidance applies to all types of disputes and all types of parties. If courts or Congress want to return to arbitration as it was intended—a viable alternative to litigation because it offers a quicker, less expensive, final decision by a decision maker with expertise in the subject matter—the courts and Congress need to provide rules and specific guidance. That way parties can return to resolving disputes rather than fighting about how to resolve them.

Part II of this Article will provide a survey of the FAA, the cases that have enforced it since its passage in 1925, and the distinctions made by the drafters and the courts. Part III addresses a number of the common themes and limitations raised by cases applying the FAA, including the ability to protect statutory rights, the right to contract and have courts enforce contractual obligations, the need to protect consumers subject to mandatory arbitration clauses, and the need for finality in arbitration. Part IV reviews recent legislative and Supreme Court decisions considering issues regarding sophisticated and unsophisticated parties in arbitration. Part V offers approaches to arbitration suggested by these recent decisions and the need to ensure that arbitration remains a viable alternative to litigation but not a tool for avoiding liability or precedent.

II. HISTORY OF THE FAA AND CONGRESS’S SOPHISTICATED/COMMERCIAL PARTIES EMPHASIS

Arbitration has been around longer than any modern system of justice. It appears in Greek and Roman law. Modern arbitration finds its basis in medieval England and France, starting arguably as a form of mediation with friends or close colleagues trying to bring peace to a dispute, and slowly evolving into a process where the friends recommended an outcome and worked with the parties to accept the proposed solution. Unlike courts, friends and colleagues can bring their particular background, and often their expertise, to the problem, find an equitable solution, and send the disputing parties back to work in short order, with a workable solution, gained at little expense. Unfortunately, this practice was met with hostility in England as a court system developed, allegedly because the judges were paid according to how many disputes they heard. The publicly stated and arguably more sound reason for the hostility was that arbitration created an ouster of jurisdiction for the courts. In other words, judges knew that arbitration did not protect parties from bad arbitration decisions, especially given the lack of appeal, and the court system provided protections, so they encouraged parties to remain in the judicial system.

12. See Kulukundis Shipping Co. v. Amtorg Trading Corp., 126 F.2d 978, 983 & n.14 (2d Cir. 1942) ("Lord Campbell explained the English attitude as due to the desire of the judges, at a time when their salaries came largely from fees, to avoid loss of income.").
13. Id. at 983.
14. Id. at 984.
A. Congress Adopted Arbitration With Support From Businesses

American courts adopted this anti-arbitration policy, and, until the late 1800s, refused to enforce arbitration clauses if one party challenged them.\(^{15}\) As the United States became more industrialized, though, companies searched for an alternative to the court system for resolving their increasing numbers of disputes.\(^{16}\) In 1920, New York passed a statute allowing enforcement of arbitration clauses.\(^{17}\) This change of approach smoothed the way for the FAA,\(^ {18}\) passed by Congress in 1925, and then reenacted and codified in 1947 as Title 9 of the United States Code. Its purpose was to reverse the longstanding judicial hostility to arbitration agreements and to place arbitration agreements upon the same footing as other contracts.\(^ {19}\)

At the time it passed, it was generally understood that the FAA was intended to govern equally sophisticated business entities bargaining at arms’ length.\(^ {20}\)

In 1925, the economy looked substantially different than it looks today. There were very few transactions between large merchants and individual consumers that would have involved interstate commerce and thus fallen under the jurisdiction of the FAA. In fact, when one Senator raised a concern that arbitration contracts might be “offered on a take-it-or-leave-it basis to captive customers or employees,” the bill’s supporters reassured the Senator that they did not intend to cover such situations.\(^ {21}\)

When this concern was raised again in the hearings held shortly before Congress passed the FAA, the responding speaker, who had drafted the first draft of the proposed legislation, responded that Congress had passed other statutes to protect against the “take-it-or-leave-it” arbitration clause. The example he gave was of shippers being protected by the “Bill of Lading” Act and other federal statutes.\(^ {22}\) He pointed out that the real historical reason for not enforcing arbitration clauses was the legitimate concern that, “at the time this rule was made people were not able to take care of themselves in making contracts, and the stronger men would take advantage of the weaker, and the courts had to come in

\(^{15}\) Id.


\(^{17}\) N.Y. Civ. Prac. Law. § 7501 (1920).


\(^{21}\) Id. (internal citations omitted).

and protect them."23 Because Congress had since provided protections, he argued, this was no longer a concern. Unfortunately, his dismissal of that potential problem for the future proved shortsighted. With the passage of the FAA supported overwhelmingly by the American Bar Association, various chambers of commerce, and business interests,24 Congress passed it and it went into effect in 1925.

1. Arbitration Has Many Advantages

American businesses supported the FAA because they recognized that arbitration has many advantages. For example, used as Congress intended, arbitration can be quicker and less expensive than litigation. It allows parties to agree on when, where, and how the issues will be heard. Parties choose their decision maker(s), which can be extremely important in complex transactions where the decision maker needs specialized knowledge to understand and decide the dispute.25 And arbitration, at least prior to attempts to expand review, offers finality—the parties accept the decision of the arbitrator(s), comply with the requirements, and get back to business. Of course, in 1925, arbitration proceeded within three or four days of requesting it,26 not the years it often takes in modern arbitration, and, at least in New York, arbitrators in 1925 often "work[ed] for nothing, for the mere honor of the position . . . [or for] a small charge, if the matter is complicated and takes too much time."27 Not so now, when just the cost of paying arbitration fees can make it prohibitive.

2. Arbitration Has Disadvantages, Too

Even in 1925, however, courts and businesses recognized a number of drawbacks to arbitration, but believed that merchants could understand and weigh the advantages and disadvantages to reach an informed choice.28 Some of the disadvantages of arbitration are as obvious as giving up a right to a jury trial and judicial consideration of the law as it applies to the facts and that it is held in a non-public forum, with limited review, and does not create precedent. Some of the less obvious disadvantages include limited discovery as a trade-off for quicker resolution, sometimes limited remedies,29 the cost of paying the arbitrator(s), and often an administrative fee. A party also faces the possibility that the party drafting the arbitration clause will require arbitration in order to avoid publicity, will

23. Id. (pointing out that the U.S. was now in a stronger trade position with countries like England, and that Congress had passed protective litigation).
24. Id. at 19-24.
25. For example, it makes little sense to ask a jury to decide whether one company's technology infringes another's patent when the jury cannot even understand the technology, let alone the nuances of patent rights. For construction disputes, a jury or even a judge can hardly be expected to determine which of the contractors caused the structural problems with a building or place blame for delays where each contractor's work builds from the last, even with experts trying to explain the intricate facts and relationships.
27. Id. at 27.
29. See discussion of limiting remedies, infra notes 70-75.
choose an arbitrator likely to rule in its favor (due to history and likelihood of rehire by repeat players), or try to avoid litigation’s protections for the weaker party, such as class actions. These latter disadvantages have become much clearer in the past thirty years, as the courts have become much more lenient in enforcing arbitration clauses.\(^\text{30}\)

**B. The Supreme Court Went Cautiously Into the Arbitration Age**

As the Supreme Court recognized in *Wilko v. Swan*,\(^\text{31}\) arbitration offers “prompt, economical and adequate solution of controversies,” but at the cost of “less certainty of legally correct adjustment.”\(^\text{32}\) Likely based on the concern that this trade off might harm individuals more than commercial entities, the Supreme Court initially did not simply enforce all arbitration clauses signed prior to a dispute arising (pre-dispute arbitration clauses). In *Wilko*, the Supreme Court did not enforce a pre-dispute arbitration clause against a securities buyer trying to enforce his rights under the Securities Act.\(^\text{33}\) The Court distinguished between commercial entities and individuals, and reasoned that the judicial forum provided by the Act was an important protection for individuals that could not be waived prior to the dispute.\(^\text{34}\) “Recognizing the advantages that prior agreements for arbitration may provide for the solution of commercial controversies, we decide that the intention of Congress concerning the sale of securities is better carried out by holding invalid such an agreement for arbitration of issues arising under the Act.”\(^\text{35}\)

The Supreme Court followed this cautious application of the FAA in *Bernhardt v. Polygraphic Co. of Am.*,\(^\text{36}\) where the Court refused to enforce an arbitration clause in an employment agreement because the employment did not involve interstate commerce. The Court said “[t]here is no showing that petitioner while performing his duties under the employment contract was working ‘in’ commerce, was producing goods for commerce, or was engaging in activity that affected commerce, within the meaning of our decisions.”\(^\text{37}\)

Similarly, in several early labor arbitration cases, including *Alexander v. Gardner-Denver*, the Supreme Court refused to require individuals to arbitrate statutory claims, distinguishing between labor arbitration on the one hand, which handled issues germane to the collective bargaining agreement, a “majoritarian” agreement based on the union’s agreement not to strike, and individual claims under Title VII on the other, which are designed to protect individual statutory rights.\(^\text{38}\) The Supreme Court held that, “[w]hile courts should defer to an arbitral

\(^{30}\) See section II.C. below.

\(^{31}\) *Wilko*, 346 U.S. at 436-37 (1953) (citations omitted).

\(^{32}\) Id. at 438.

\(^{33}\) Id.

\(^{34}\) Id. at 435, 438.

\(^{35}\) Id. at 438.


\(^{37}\) Bernhardt, 350 U.S. at 200-01.

decision where the employee’s claim is based on rights arising out of the collective-bargaining agreement, different considerations apply where the employee’s claim is based on rights arising out of a statute designed to provide minimum substantive guarantees to individual workers.”

The Court reasoned that “a standard that adequately ensured effectuation of Title VII rights in the arbitral forum would tend to make arbitration a procedurally complex, expensive, and time-consuming process. And judicial enforcement of such a standard would almost require courts to make de novo determinations of the employees’ claims.”

The Court’s fears were both well-stated and well-founded. Those fears came to pass once the Supreme Court changed its mind and started enforcing arbitration clauses forced on consumers, employees, and others, resulting in great difficulty for those trying to protect their rights.

In Wilko, Alexander v. Gardner-Denver, and Bernhardt, the Supreme Court addressed individual claims and recognized that arbitration was not the appropriate forum to pursue these claims.

C. The Federal Arbitration Act’s Expansive Application

As the Supreme Court started interpreting the Commerce Clause broadly, the Court also opened the door to broad interpretation of the FAA and broad enforcement of arbitration clauses. This expansion started in the late 1960s, and expanded most rapidly in the 1980s and ‘90s. From Prima Paint forward, the Court declared a federal policy favoring arbitration over litigation. In Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp., the Supreme Court stated “Courts of Appeals have since Prima Paint . . . consistently concluded that questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration. We agree.”

The Court held that ambiguous arbitration clauses should be construed in favor of arbitrating disputes.

In Southland Corp. v. Keating, the Supreme Court significantly expanded the reach of the FAA. In Keating, the Court held that the FAA “withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting party agreed to resolve by arbitration.” In other words, states could no longer pass laws to exempt certain types of claims from arbitration, provide for additional review, or otherwise limit enforcement of arbitration clauses if the agreement was covered by the FAA. The states’ inability to pass laws specifi-

employees to bring minimum wage claim under FLSA even though they had unsuccessfully submitted wage claim based on same underlying facts to joint labor/management grievance committee). For a more thorough discussion of the labor cases and the policies the Court applied, see Sternlight, supra note 21, at 653-54.

42. See Sternlight, supra note 21, at 647 n.10 (providing a list of Supreme Court cases in the 1980s and ‘90s enforcing arbitration clauses based on the “Congressional preference”).
44. Id. at 24.
45. Id. at 24-25.
47. Id. at 10.
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Cally limiting the enforceability of arbitration clauses eased concerns about inconsistent decisions for businesses and individuals. In subsequent decisions, the Court also held that state laws that required parties drafting arbitration clauses to place them on the front page or otherwise make them apparent are not enforceable. And of course, there are numerous Supreme Court cases limiting the ability of courts to review arbitration decisions.

1. Courts Enforced Arbitration Clauses Because Congress Did Not Exempt Statutory Rights Claims From Arbitration

From Southland in the early 1980s and for the next decade or more, courts became very “hands off” in enforcing arbitration agreements, especially between merchants. As long as the agreement allowed the parties to pursue their statutorily protected rights or to enforce the contract the parties signed, arbitration clauses were enforced. The Supreme Court used two theories for this expansion. First was the preference for arbitration over litigation, discussed above. For example, in Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., the Supreme Court upheld an arbitration clause requiring arbitration of statutory rights under United States antitrust laws in Japan by Japanese arbitration rules because the FAA and the antitrust laws did not limit or prohibit arbitration of antitrust claims. The Supreme Court said:

By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum. It trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration. We must assume that if Congress intended the substantive protection afforded by a given statute to include protection against waiver of the right to a judicial forum, that intention will be deductible from text or legislative history.

2. Courts Also Enforced Arbitration Clauses Based on the Theory That the Contract Evidenced the Parties’ Intent

The Supreme Court’s second basis for upholding arbitration clauses was the basic contract principle of enforcing the agreement the parties signed. The Supreme Court in Stolt-Nielsen spent a good deal of energy reviewing its past decisions based on this principle. This discussion started with Volt v. Board of Trustees of Leland Stanford Junior University, in which the Court stated “that the FAA’s central purpose is to ensure that ‘private agreements to arbitrate are en-

51. Id. at 628 (citations omitted).
forced according to their terms."\(^53\) The \textit{Stolt-Nielsen} Court went on to quote \textit{Volt} for the proposition that courts and arbitrators construing or enforcing arbitration clauses must "give effect to the contractual rights and expectations of the parties."\(^54\) The Court equated arbitration clauses to any other contract, stating "as with any other contract, the parties' intentions control."\(^55\)

Much more recently in the collective bargaining setting, the Supreme Court has also expanded the role of arbitration. In \textit{14 Penn Plaza LLC v. Pyett},\(^56\) the Court enforced an arbitration clause for age discrimination in employment claims where the collective bargaining agreement clearly and unmistakably required union members to arbitrate Age Discrimination in Employment Act (ADEA) claims, severely limiting \textit{Gardner-Denver}.\(^57\)

3. Businesses Used This Opportunity to Insert All-Encompassing Arbitration Clauses in Commercial, Consumer, and Employment Contracts

As courts moved from hostility to arbitration to a more "hands off" approach, businesses began inserting arbitration clauses in various types of agreements, including employment and consumer agreements. Over time, the Supreme Court stopped making a clear distinction in enforceability between commercial and individual arbitration. For example, in \textit{Gilmer v. Interstate-Johnson Lane} in 1991, the Supreme Court held that employees could be required to arbitrate their statutorily protected rights under the ADEA, almost directly contradicting its holding in \textit{Bernhardt}.\(^58\)

The Court in \textit{Gilmer} specifically rejected the argument that arbitration clauses relating to ADEA claims should not be enforced because there is often unequal bargaining power between employers and employees (an argument applicable to many employment and consumer agreements). "Mere inequality in bargaining power, however, is not a sufficient reason to hold that arbitration agreements are never enforceable in the employment context."\(^59\) Instead, the Court held that courts should "remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that

\(^{54}\) \textit{Stolt-Nielsen}, 130 S. Ct. at 1773.
\(^{55}\) \textit{Id.} (quoting \textit{Mitsubishi Motors}, 473 U.S. at 626). The Court in \textit{Stolt-Nielsen} cited these cases to preclude the argument that arbitrators cannot apply their own policy reasons to read in procedural protections not specified in the parties' arbitration agreement; i.e., arbitrators cannot allow class actions where the parties' contract does not authorize them. \textit{Id.} at 1776-77 (quoting \textit{Steelworkers v. Warrior & Gulf Nav. Co.}, 363 U.S. 574, 581 (1960)) ("[A]n arbitrator 'has no general charter to administer justice for a community which transcends the parties' but rather is 'part of a system of self-government created by and confined to the parties'.")
\(^{59}\) \textit{Gilmer}, 500 U.S. at 32-33.
would provide grounds for the revocation of any contract." The Court failed to address the reality that a contract of adhesion, coupled with a process that provides less protection than the judicial system, creates inherent problems for parties who likely will never have bargaining power to protect themselves.

The Supreme Court's 1995 decision in Allied-Bruce Terminix Co. v. Dobson brought arbitration even farther from its roots, as the Court held that arbitration agreements in consumer contracts were enforceable. In Terminix, the Supreme Court was asked to interpret the meaning of the FAA's provision that courts must enforce arbitration provisions in contracts "involving commerce." The Court found that the legislative history of the FAA revealed Congress' intent that "control over interstate commerce reaches not only the actual physical interstate shipment of goods but also contracts relating to interstate commerce." Terminix held that the FAA applied to the full extent of the Commerce Clause, not just to contracts involving actual interstate transactions. The decision in Terminix did not address the unequal bargaining power of the parties; it did not need to—Gilmer set out the standard of enforcing arbitration agreements against parties with unequal bargaining power except in limited circumstances.

During the 1980s and 1990s few cases voided arbitration agreements due to unequal bargaining power. Instead, the courts acknowledged that, while perhaps it is procedurally unconscionable to require someone to agree to arbitration who has little or no bargaining power, if arbitration provided the same basic protections as litigation, requiring parties to arbitrate is not substantively unconscionable.

III. COURTS BEGAN TO RECOGNIZE THE NEED TO PROTECT CONSUMERS AND LESS POWERFUL COMMERCIAL ENTITIES

With this change from arbitration agreements agreed upon by merchants negotiating at arms' length to less powerful merchants, consumers, and employees being informed that they could "take-it-or-leave-it," i.e., agree to arbitration or not get the job, the credit card, the loan, the business, etc.; courts faced new challenges. In addition, long-standing arbitration clauses in business-to-business contracts sometimes left one party without an effective means of redress where the contracting parties could not foresee that, many years down the road, some of the

60. Id. at 33 (quoting Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 627 (1985)).
62. Id. at 268.
63. Id. at 268-74; see also 9 U.S.C. § 2.
64. Allied-Bruce Terminix Co., 513 U.S. at 274 (quoting 65 CONG. REC. 1931 (1924) (remarks of Rep. Graham)).
65. Id. at 281.
67. This note does not address the issue of whether the courts did or should have severed the unenforceable clause, rejected the entire arbitration agreement based on the unenforceable clause, or treated the claims as not arbitrable. For full treatment on this issue, see David S. Schwartz, Understanding Remedy-Stripping Arbitration Clauses: Validity, Arbitrability, and Preclusion Principles, 38 U.S.F. L. REV. 49, 50 (2003); Kathleen M. Scanlon, Class Arbitration Waivers: The "Severability Doctrine and Its Consequences, 62 DISP. RESOL. J. 40, 41-43 (2007).
problems faced by parties in arbitration would differ from those originally anticipated by the contracting parties.  

Section 2 of the FAA allows courts to invalidate arbitration clauses “upon such grounds as exist at law or in equity for the revocation of any contract.” 69 Frequently, when courts refuse to enforce arbitration clauses, they base their decisions on the state law contract concept of “unconscionability.”  The Supreme Court in 1889 defined an unconscionable contract as “one that ‘no man in his senses, not under delusion, would make, on the one hand, and which no fair and honest man would accept on the other.’” 70 That definition has changed over time because it does not address today's unconscionable contracts, where individuals and even companies have little choice but to accept what they would not, in their “senses,” otherwise accept because they will not be able to conduct the business, get the loan or credit card or, especially in today's economy, the job, unless they agree to it. Yet powerful corporations today freely draft contracts that “no honest man would accept.” More importantly, as will be discussed later, our Supreme Court has encouraged this practice by enforcing arbitration clauses that anyone in 1889 would have deemed unconscionable on both grounds.

California and several other courts have invalidated arbitration clauses they found unconscionable under state law on a variety of bases. The analysis often starts by determining that the contract is one of adhesion, which usually requires a showing that the drafter has significantly more bargaining power than the signee and that the contract was offered on a take-it-or-leave-it basis. If the contract is one of adhesion, courts look for one or more further indicia of unconscionability, such as limiting remedies by contract, despite statutory provisions allowing for such damages. 73 In determining whether such a limitation is unconscionable, problems faced by parties in arbitration would differ from those originally anticipated by the contracting parties. 68

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courts do not require exactly the same remedies—just sufficient remedies to effectuate the purpose of the statute.74 Courts also refuse to enforce arbitration clauses (or portions of them) based on policy grounds—generally that the statutory protections provided by the law under which the claimant is suing cannot be protected if the provision is enforced. For example, the D.C. Circuit held that arbitration agreements including fee-shifting clauses—meaning the claimant pays some or all the arbitration costs, including the arbitrator’s fees—are per se unenforceable because they would prevent individuals from being able to pursue claims, particularly because they could pursue the same claims in court without paying anything but filing fees.75 Courts also stepped in to void or refuse to enforce arbitration clauses drafted by companies using arbitration to: limit liability,76 prohibit discovery,77 make clauses overly one-sided or make bringing a claim too much trouble,78 and require one party to go to arbitration, while the other could still pursue claims in court.79

California has taken the lead in trying to protect consumers, at least, from onerous arbitration provisions, and courts in other states have stepped in when large companies clearly crossed the line. One of the issues California addressed was forum selection clauses, or choice of law provisions, in arbitration clauses. In


74. Roby v. Corporation of Lloyd's, 996 F.2d 1353, 1365 (2d Cir. 1993) (affirming arbitration after concluding that foreign arbitral forum's different remedies met statutory purposes of deterrence because "the available remedies are adequate and the potential recoveries substantial"); see also Martens v. Smith Barney, 181 F.R.D. 243, 256 (S.D.N.Y. 1998) (refusing to sign off on a class action settlement that would result in individual arbitrations unless the arbitrations provided sufficient remedial safeguards) ("No statutes require arbitrations to mimic all the procedural formalities of federal courts, but under Title VII, arbitrations cannot disallow remedies central to the Title VII scheme. Arbitration agreements prospectively waiving such central remedies are unenforceable.").


76. Lhotka v. Geograpic Expeditions, Inc., 104 Cal. Rptr. 3d 844, 853 (Cal. Ct. App. 2010) (finding that a contract clause limiting damages to the cost of the trip purchased from defendant, requiring plaintiff to indemnify defendant for attorneys fees, and setting the forum in California when plaintiff lived in Colorado, was unenforceable. The court also held that the entire arbitration agreement was unenforceable because it showed that the defendant "designed its arbitration clause 'not simply as an alternative to litigation, but as an inferior forum' that would give it an advantage." \( \text{Id.} \) (quoting Armendariz v. Foundation Health Psychcare Servs., Inc., 6 P.3d 669, 697 (2000)).

77. \( \text{See, e.g.,} \) Armendariz, 6 P.3d at 682 (holding that agreements to arbitrate at least public policy disputes must provide for discovery). \( \text{But see} \) Burton v. Bush, 614 F.2d 389, 390 (4th Cir. 1980) (holding that parties to an arbitration have no right to pre-trial discovery, although the arbitrators may subpoena documents and witnesses for the hearing); \( \text{see also} \) Gilmer, 501 U.S. at 31 (holding that limited discovery did not void arbitration clauses).

78. \( \text{See, e.g.,} \) Morrison v. Amway Corp., 517 F.3d 248, 257 (5th Cir. 2008) (asserting that the drafter of an arbitration clause has the discretion to establish and unilaterally change the arbitration rules); Swain v. Auto Servs., Inc., 128 S.W.3d 103, 108 (Mo. Ct. App. 2003); Comb v. Paypal, Inc., 218 F. Supp. 2d 1165, 1177 (determining that arbitration can be held in a state different from where the parties reside). For a more complete discussion of unconscionable arbitration clauses, see Brief for Professional Arbitrators and Arbitration Scholars as Amicus Curiae in Support of Respondent, Rent-a-Center, West, Inc. v. Jackson, 130 S. Ct. 2772 (2010) (No. 09-494), 2010 WL 1393445.

79. Cordova v. World Fin. Corp., 208 P.3d 901, 908-09 (N.M. 2009) (lender required borrower to arbitrate all claims, but left itself the choice of going to court); Tyson Foods, Inc. v. Archer, 147 S.W.3d 681, 687 (Ark. 2004) (holding that arbitration cannot be used to shield one party from litigation while allowing the other to pursue judicial remedies).
America Online, Inc. v. Superior Court of Alameda County, the California Supreme Court invalidated a clause that required the arbitrators to apply Virginia law to an arbitration in California, undoubtedly chosen because Virginia law prohibited class actions. The court reasoned that the forum selection clause would substantially diminish the rights of California residents in a way that would violate the state's public policy. Choosing a forum or applying law that prohibits class actions in essence exempted AOL from liability for overcharging customers small amounts because, without the possibility of a class action, few, if any, customers would bring claims for recovery.

In addition, some perhaps unexpected problems arose after arbitration had been in use for a number of years. These problems include unfair bias toward repeat customers by arbitrators, exorbitant costs that preclude small merchants and individuals from pursuing claims, and delay or other tactics by wealthy or powerful parties designed to make it too costly (both time-wise and monetarily) for individuals and small companies to pursue arbitration.

The difficult question the courts began to address was how to protect lawless consumers from companies seeking to limit liability, avoid creating precedent, and hide wrongdoing in private arbitration. The courts are just starting to address the next issue—whether and how to protect sophisticated individuals and businesses from waiving judicial protections or statutorily protected rights by signing contracts of adhesion containing arbitration clauses.

Still, the Supreme Court, at least, has acted cautiously—continuing to enforce arbitration agreements unless the complaining party made a strong and specific showing of unconscionability. For example, in Green Tree Financial Corp.-Alabama v. Randolph, the Supreme Court stated that a party that could show it could not afford the costs of pursuing claims in arbitration might convince a court not to enforce an arbitration clause, but it set the burden high. The Court held that "where, as here, a party seeks to invalidate an arbitration agreement on the ground

81. Id. at 708.
82. Id. at 711-12.
83. See Brief of the National Association of Consumer Advocates as Amicus Curiae in Support of Respondents, in Pacificare Health Sys., 538 U.S. 401 (2003) (No. 02-215), 2003 WL 133135 (reviewing several studies that show significantly different outcomes in arbitrations of consumer claims against HMOs in arbitration than in litigation (e.g., the brief discusses a study by an HMO showing that arbitrators are twenty times more likely to grant summary judgment in favor of the corporation than is a court, and another study of National Arbitration Forum shortly before its demise showing that at least one bank reported prevailing in over 19,000 cases while the consumer prevailed in only eighty seven, a 99.6% success rate)). But see Searle Civil Justice Institute, Consumer Arbitration Before the American Arbitration Association—Preliminary Report (2009), available at http://www.law.northwestern.edu/searlecenter/uploads/Consumer%20Arbitration%20full_report.pdf (discussing an independent study of cases handled by the American Arbitration Association (AAA), that asserts that, when following AAA procedures, consumers prevail about half the time and finding no repeat-player prejudice).
85. See, e.g., Todd Shipyards, Corp. v. Cunard Line Ltd., 735 F.Supp. 1463, 1468 (N.D. Cal. 1989) (upholding arbitrator’s award of attorneys fees against Cunard where it filed numerous motions in different federal courts and refused to attend the arbitration proceedings); see also Lhotka, 104 Cal. Rptr. 3d at 851-52.
that arbitration would be prohibitively expensive, that party bears the burden of showing the likelihood of incurring such costs.” The Court refused to invalidate the clause because Randolph, who raised and argued the claims, failed to provide proof of such prohibitive costs.  

A. Courts Distinguish Between Sophisticated and Unsophisticated Parties, but Don’t Offer Sufficient Guidance

Various courts, including the Supreme Court, have looked at levels of sophistication, equality of bargaining power, and the voluntariness with which parties entered into arbitration clauses in considering whether to enforce the clauses. The courts use these terms almost interchangeably and rarely provide a sufficient explanation as to what they mean so that other courts can follow their reasoning.

1. The Supreme Court did not Expand the Protections it Believed Congress Provided in the FAA

In response to an argument that Congress intended that section 1 of the FAA be read to exclude all employment contracts, the Supreme Court instead read the exemption narrowly. In Prima Paint Corp. v. Flood & Conklin Mfg. Co, the Court pointed out that the FAA specifically exempts employment contracts for “seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce,” but the Court interpreted that language narrowly to exempt just workers with jobs involving commerce, such as transportation jobs. In making this finding the Supreme Court “note[d] that categories of contracts otherwise within the Arbitration Act but in which one of the parties characteristically has little bargaining power are expressly excluded from the reach of the Act.” In other words, the majority of the Supreme Court Justices believed in 1967 that the FAA’s specific but narrowly defined exemptions showed that Congress thought about the unequal bargaining power concern and addressed it by making very limited specific exemptions. Justice Black dissented, quoting extensively from the legislative history to support his argument that the FAA’s exceptions should be interpreted broadly. Specifically, he discussed Senator Walsh’s expressed concerns about insurance contracts, employment agreements, construction, and shipping agreements, where the arbitration agreement was typically offered on a take-it-or-leave-it basis, and really was not entered into voluntarily. Apparently the

87. Id. at 92.
88. See Miller, supra note 5, at 501-18 (where the author reviewed contract cases (not necessarily with arbitration clauses) and found a significant increase in the number of cases that make this distinction). Taking the same search in Westlaw’s “allcases” database and adding “arbitration /10” of “contract” or “agreement” retrieved ninety-eight cases, two from the 1970s, eight from the 1980s, twenty-one from the 1990s and sixty-seven in the last ten years.
89. 9 U.S.C. § 1.
91. Id. at 409-10 (contending that the majority’s broad interpretation of the language included in the exemption for employment contracts of workers “engaged in commerce” in the Arbitration Act is inaccurate).
92. Id. at 413-14 (quoting Arbitration of Interstate Commercial Disputes, Joint Hearings on S. 1005 and H.R. 646 Before the Subcommittees of the Committees on the Judiciary, 68th Cong., 1st Sess., 15
Senator was assured by the bill’s drafters that the FAA was not intended to cover those types of disputes. 93 The Court ignored this history, and did not address all of the other individuals or corporations with which Senator Walsh was concerned, each of whom had similarly little bargaining power compared with seamen, railroad workers, and other workers involved in interstate commerce who were specifically exempted.

The Court in Gilmer reiterated the refusal to narrow the application of the FAA, holding specifically that “[m]ere inequality in bargaining power, however, is not a sufficient reason to hold that arbitration agreements are never enforceable in the employment context.” 94 The Court emphasized that contract law grounds could be used to invalidate contracts signed under fraudulent or coercive circumstances, but pointed out that there was no evidence that Mr. Gilmer, “a sophisticated businessman,” was coerced or defrauded into signing the arbitration clause. 95 In other words, the Supreme Court was not at all concerned with the adhesive nature of arbitration agreements, despite the fact that, unlike adhesive contracts enforced or rejected by courts, parties in arbitration have limited discovery, no jury, virtually no appeal, and no right to class actions. Arguably, the Supreme Court could have avoided a lot of the problems that some Senators foresaw in the employment context by interpreting the FAA to exempt all employment contracts rather than interpreting it to apply broadly to employment contracts as it did in Circuit City Stores v. Adam. 96

Of course, had the Supreme Court broadly applied the assurances Senator Walsh sought, arbitration would be very different than it is today. It would not apply in construction contracts, where most likely the building owner (at least in a commercial setting) has vastly more power than the general contractor, who has dramatically more power than the subcontractors. Yet the construction industry was one of the first to adopt arbitration as a means for resolving disputes and allowing them to get on with their work. 97 And the parties in Stolt-Nielsen did not appear to be arguing that the charter parties (shipping contracts) that had required arbitration for the last fifty or more years should not be enforced. Instead, they simply sought a venue for protecting rights no one foresaw being enforced through arbitration. Insurance companies, also addressed by Senator Walsh, presently engage in significant amounts of arbitration with customers despite Justice Black and Senator Walsh’s concerns about whether arbitration should be allowed in such “take-it-or-leave-it” cases. Used as intended, arbitration offers a quick and efficient way to determine claims, a big advantage for companies that often find themselves involved in legal disputes.

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93. Id. at 411 n.2.
95. Id.
96. Circuit City Stores Inc., 532 U.S. at 115-16 (2001); see also Gilmer, 500 U.S. at 25 (alluding to the answer provided in Circuit City, but refusing to address the issue directly).
97. JOHN C. CAMERON, PRACITIONER’S GUIDE TO CONSTRUCTION LAW, p. 19-1 & n.3 (2000).
2. Lower Courts Remain "Hands off" with Respect to Arbitration Agreements Signed by "Sophisticated Parties"

A federal district court in Texas may have expressed the reason for the hands off approach to arbitration contracts between sophisticated parties most simply:

It is difficult for the Court to understand why sophisticated business entities—or anyone for that matter—would contract away their right to resolve their disputes in the courts in favor of having them resolved by persons not bound by the hallmarks of the judicial process, such as the rules of evidence and the right to appeal. Nonetheless, in this case, we have two sophisticated business entities that obviously knew or should have known what they were doing. Having expressly agreed to arbitration in its contract for insurance, [plaintiff] must now reap what it has sown and submit its claims in that forum.98

This blanket enforcement indicates a lack of appreciation for the difference in bargaining power between these parties. Yes, a company can negotiate some terms with its insurer, such as coverage, but arbitration has become a standard, non-negotiable term. Courts often look to what we as companies and as individuals have come to expect to determine whether to enforce arbitration clauses.99 We certainly have come to expect that insurance companies and others have standard form arbitration clauses in all their contracts.100 That expectation simply shows resignation, not intent to agree, as the Court looked for in Stolt-Nielsen. It would be surprising if any but the most sophisticated (meaning biggest dollar) of sophisticated clients have any ability to negotiate around arbitration clauses. And those clients probably do not need to.

In the case quoted at the beginning of this note, In re Knepp, the court found that an adhesive arbitration clause requiring a consumer to pay part of the filing fees and arbitration costs was unconscionable given a potentially better free system provided by the court system.101 The court lamented that the Supreme Court had expanded arbitration to include consumer cases rather than simply cases Congress originally intended to cover—contracts between equally sophisticated parties who did not have to give up their constitutional rights in order to enter the marketplace.102 In Knepp, the court was not faced with sophisticated parties who were forced to give up their rights in order to enter the marketplace.

100. Id.
102. Id.
B. Courts Apply the “Sophisticated Party” Distinction to Individuals as Well as Corporations

The Florida district court in *In Re Managed Care Litigation*,103 addressed head-on many of the arguments regarding enforcing arbitration agreements or specific provisions of arbitration agreements in the context of sophisticated parties, but did not provide much guidance for future cases. In that case, several groups of physicians sued a number of insurance providers, asserting that the providers systematically deny, delay, and minimize payment of patient health care charges that should be covered by insurance.104 The physicians tried to bring the action in court rather than in arbitration, as required by their insurance contracts. The court pointed out that it can invalidate arbitration agreements (just as it can invalidate any contract) if the arbitration provisions are unconscionable, but refused to find the arbitration clause unconscionable.105

Some of the factors the physicians argued weighed against enforceability were:
- the contract or clause was offered on a “take-it-or-leave-it” basis,
- the clause was on a pre-printed form or boilerplate in a contract drawn by the party in the strongest economic position,
- the clause was hidden on the back of the contract,
- there was an inequality of bargaining power between the parties,
- the arbitrator had no discretion to award arbitration expenses to the prevailing party, and
- the clause precluded certain types of damages.106

In other words, the physicians made the same arguments that consumers and employees regularly make successfully.

The court in *In re Managed Care* rejected these arguments, explaining that courts distinguish between an average consumer and more sophisticated parties when determining whether to enforce an arbitration agreement.107 In this case, the court said, it must “initially view the Plaintiffs’ claims with some skepticism . . .” due to the complaining parties’ sophistication, and “absent clear and convincing evidence that the agreements are unconscionable . . . we are compelled to enforce” the arbitration clause.108 In other words, the court set a very high standard for unconscionability of contracts signed by sophisticated parties. Unfortunately, it did not define “sophisticated.”

The court then went on to analyze both procedural and substantive unconscionability. Under procedural unconscionability, the court determined that the fact that the contract was one of adhesion, offered on a “take-it-or-leave-it” basis,

103. *In re Managed Care Litig.*, 2009 WL 855963.
104. Id. at *1.
105. Id. (citing Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer, 515 U.S. 528, 555-56 (1995) (“[A]n arbitration clause may be invalid . . . if, for example, it is procured through fraud or forgery; there is a mutual mistake or impossibility; the provision is unconscionable . . .”).
106. *In re Managed Care Litig.*, 2009 WL 855963, at *4 (relying on Whitney v. Alltel Commc’ns Inc., 173 S.W.3d 300, 310 (Mo. Ct. App. 2005) (invalidating consumer contract based on similar concerns)).
107. *In re Managed Care Litig.*, 2009 WL 855963, at *4.
108. Id. (emphasis added).
was relevant only if the parties entered into the contract without knowingly and voluntarily consenting to all of its terms. Because the clause was in bold and all caps above the signature line and because the “Plaintiffs—as sophisticated practicing physicians—have undoubtedly dealt with numerous contracts that contain binding arbitration agreements,” the court found the physicians’ agreement knowingly and voluntary.

Second, the court found that refusing to enforce boiler-plate provisions would “slow commerce to a crawl,” and that the average person would “expect that disputes arising out of an agreement like this might have to be resolved in arbitration.” The court made short shrift of the unequal bargaining power argument:

In order for a court to rescind an agreement based on a claim of unconscionability due to an inequality of bargaining power, the moving party must demonstrate that, due to its diminished bargaining power, it had no choice but to sign the agreement (i.e. that they were unable to contract with other health insurance companies).

It also did not address the fact that physicians, like the rest of us, have little bargaining power over whether their insurance agreements contain arbitration clauses. The physician can choose not to accept various insurance plans, but refusing to do business with insurance companies that deny or delay payments would simply put physicians out of business.

When explaining substantive unconscionability as it differs from consumers to sophisticated parties, the court gave no weight to the argument that making the physicians pay for part of the arbitration costs should invalidate the agreement. And unlike the courts that have held that consumers should not be prohibited from statutorily mandated damages, the court in *In re Managed Care* enforced the contract as the providers wrote it—waiving damages, rights, and all.

In analyzing substantive unconscionability, the court did not address a distinction between sophisticated and unsophisticated parties. The court simply enforced the arbitration agreement. The court ignored the fact that doctors, while they may choose not to participate in insurance plans, have little bargaining power

109. Id. at *5.
110. Id.
111. Id. at *5 n.6.
112. Id. (quoting *Swain v. Auto Servs., Inc.*, 128 S.W.3d 103, 107-08 (Mo. Ct. App. 2003)).
113. *In re Managed Care Litig.*, 2009 WL 855963, at *6.
114. Id. (relying on *Green Tree Fin. Corp-Ala. v. Randolph*, 178 F.3d 1149, 1158 (11th Cir. 1999), aff’d in part and rev’d in part, 531 U.S. 79 (2000) (holding that potentially high arbitration costs invalidated the arbitration clause, and distinguishing other cases that rejected the same argument on the basis that those cases involved commercial entities, not small consumer transactions or employment contracts). The Supreme Court reversed, finding that, while high costs could invalidate an arbitration clause, Randolph had not demonstrated them. Justice Ginsburg, concurring in part and dissenting in part, suggested that the case simply required remand to allow Randolph to show the high costs, and pointed out that *Gilmer*, which the court relied on in enforcing the arbitration clause, involved a program where the employer paid all the costs and Justice Ginsburg questioned whether the Court’s decision would or should have been the same given the consumer/employee, take-it-or-leave-it clause presented in *Gilmer*. 531 U.S. at 94.
115. *In re Managed Care Litig.*, 2009 WL 855963, at *7 (quoting *Davis v. Prudential Secs., Inc.*, 59 F.3d 1186, 1193 n.6 (11th Cir. 1995) (“[P]arties wishing to avoid the imposition of punitive damages in arbitration may simply expressly exclude punitive damages in the arbitration agreement.”)).
over the policies chosen by their patients. Even a large group of doctors has difficulty negotiating with Blue Cross/Blue Shield (BCBS), and refusing to participate in a BCBS insurance plan would almost certainly ensure that the physicians’ practice would suffer irreparably. As always, of course, the patients suffer most—if their doctors refuse to take certain insurance plans, patients must find new doctors. If the doctors continue to accept the plans that continue to refuse to pay or delay payment, patients end up paying the difference and for any increased cost of doing business. Some doctors refuse to file insurance for patients, requiring patients to pay up front and file their own claims for repayment. As always, the consumers end up harmed by the insurance companies’ power. This decision simply allows the harm to continue unchecked.

One recent example of a court establishing a bright line rule but not addressing how that line works is the case of Dime Bank v. Merrill Lynch.116 In Dime Bank, the Connecticut Superior Court expressed little patience with banks trying to get out of clearly written arbitration agreements, despite the fact that the agreements were written by securities brokers who allegedly encouraged the banks to buy risky securities knowing that the market was tanking. The court applied prior state supreme court precedent holding that “a presumption that the language used is definitive arises when . . . the contract at issue is between sophisticated parties and is commercial in nature.”117 The court also looked at federal and state court cases applying the FAA and discussed the strong presumption in favor of arbitration at both levels.118 Despite the arguably overbroad wording of the arbitration agreement the parties signed, the court held:

[I]t is what these sophisticated corporate parties agreed to at the time. In the absence of fraud in the making of a contract, or a showing of bad faith in obtaining the assent of a party to its terms, the courts, as noted earlier, cannot unmake bargains that in hindsight turn out to be unwisely made from the perspective of one of the sophisticated parties to that bargain.119

The interesting question left by this case, which has no subsequent history, and was not published by the court, is what the court would have done differently if individuals or unsophisticated parties challenged such an agreement. If one unsophisticated party (consumer, employee) unquestionably and not under duress agreed to a contract with clear terms that later turned out to be a bad deal, would the court refuse to enforce the bargain? On what grounds? If not, why make the distinction?

Arguably, of course, in the case before the court, both sophisticated parties understood the terms and agreed to them. In reality, most likely, one party wrote the onerous clause and the other agreed to it, knowing that it met societal expecta-

118. Id. at *8.
119. Id.
tions and that a court would enforce it, even if it meant that the company could not pursue claims that might affect unwitting consumers. Courts should not place the burden on the bankers to negotiate to avoid arbitration where arbitration is being used to hide allegations of bad acts from the public. We have too strong a public interest in letting consumers and businesses know whether and which stockbrokers are acting in bad faith, i.e., taking money that ultimately belongs to consumers, to put the onus on the negotiating party to protect that interest.

C. Courts Even Apply The “Sophisticated Parties” Distinction to Employment Disputes

To confuse the argument even further, the Nevada Supreme Court enforced an arbitration clause in an employment agreement because it found that the plaintiff, a “financial relationship manager” for Bank of America and Bank of America Investment Services was a “sophisticated party” who voluntarily signed her employment agreement and failed to prove that she could not negotiate the agreement or have counsel review it. Despite the court’s assumption of sophistication in those who hold Series 7 (General Securities) licenses, the court provided no guidance on the weight it gave to this plaintiff’s sophistication or how to determine in the future whether it would treat differently sophisticated and unsophisticated parties who protest arbitration clauses. Is it simply whether they were allowed to negotiate them? If so, the level of sophistication has little to do with it. If the bank allowed an employee to negotiate, knowing that the bank’s lawyers could negotiate circles around the office cleaners, administrative staff, and possibly even the CEO, the employees would still sign contracts that insufficiently protect both their own and the public interest. Should there be a distinction between staff and executives? Skilled jobs and unskilled? This decision provides no guidance.

The Bank of America case is like State ex rel. Wells v. Matis, in which the West Virginia Supreme Court enforced an arbitration agreement against a television anchor because he was “sophisticated,” but really because he was allowed to negotiate his contract. The same court distinguished Wells soon thereafter in a case where the “unsophisticated” employee had only a tenth-grade education. Although the court found it important to point out the employee’s lack of education, it appears that the real factor the court relied on was the employee’s inability to negotiate. Unlike Wells, the plaintiff in the second case was given the form contract on a take-it-or-leave-it basis. The court described the plaintiff’s lack of education and assertion that she had little understanding of the law and arbitr-
tion,\textsuperscript{124} then refused to enforce the arbitration clause, finding the bargaining power “grossly unequal.”\textsuperscript{125} The court did not explain how a more educated employee would have more bargaining power over a contract proffered on a take-it-or-leave-it basis. Is this court’s rule that really big companies cannot require low level—undefined—employees to sign arbitration agreements but they can require higher level employees to? If the drafter was a smaller corporation and the signee was a low level employee with a college degree, would the court hold any differently?

In its present formulation, this “sophisticated party” distinction provides an unworkable solution, as demonstrated by a district court in Indiana that tried to reconcile two “sophisticated party” cases and apply them to a third, which apparently fell right in between. In Abbott v. Lexford Apartment Services, Inc.\textsuperscript{126} the court distinguished between several cases involving arbitration clauses in employment agreements based in part on the type of jobs the employees performed, even though one decision did not even specify the job. In the first case, in which the court refused to enforce the clause, the employee was a restaurant server—a “fungible commodity.”\textsuperscript{127} In Abbott, the employee was a maintenance worker at an apartment complex, “a position presumably requiring . . . skill,” so he was not fungible.\textsuperscript{128} And in the third case, in which the earlier court had upheld the arbitration clause, the court did not even say what kind of job the employee held.\textsuperscript{129} Of course, in Abbott, as in the other cases, the court threw in the sophistication analysis as part of its overall justification for enforcing the agreement against the maintenance worker but not the restaurant server.

In Abbott, the court was comfortable with the employer’s choice of arbitration provider (American Arbitration Association), where both parties got a say in choosing the arbitrator, and with the length and availability of the arbitration clause for review prior to signing. The court found no “gross inequality” in bargaining power, drawing upon earlier decisions to note that “[a] party does not need to be a sophisticated business-person or have an advanced education to be bound by an arbitration agreement.”\textsuperscript{130} The court correctly pointed out that, “[i]f we were to find that no low-level employee can be held to an arbitration agreement due to a supposed disparity in bargaining power between the employer and employee, then most arbitration agreements to resolve employment disputes would be rendered ineffective,” which would be contrary to the Supreme Court’s decision in Circuit City that the benefits of the arbitration process apply in the employment context.\textsuperscript{131}

The court did not address the fact that a maintenance worker’s sophistication presumably applies to fixing things rather than understanding legal documents or that he would not have gotten the job if he did not sign the agreement. In other

\textsuperscript{124} Of course, lack of knowledge of the law is no defense, but knowingly giving up rights because you have no power to negotiate otherwise results in the same inability to protect rights as unknowingly giving up rights.

\textsuperscript{125} Saylor, 613 S.E.2d at 922-23.

\textsuperscript{126} 2002 WL 1800320 (S.D. Ind. 2002).

\textsuperscript{127} Id. at *5 (citing Geiger v. Ryan’s Family Steak Houses, Inc., 134 F.Supp. 2d 985, 998 (S.D. Ind. 2001)).

\textsuperscript{128} Id.

\textsuperscript{129} Id. (citing Flynn v. Aerehem, Inc., 102 F.Supp. 2d 1055, 1058 (S.D. Ind. 2000)).

\textsuperscript{130} Id. n.2 (quoting Kreimer v. Delta Faucet Co., 2000 WL 962817, at *5 (S.D. Ind. 2000)).

\textsuperscript{131} Id. (quoting Weaver v. Am. Oil Co., 276 N.E. 144 (Ind. 1971)).
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words, the court did not provide guidance to the administrative assistant, the retail manager, or the many other employees who, while skilled, educated, and intelligent, may not be sophisticated in understanding that they are waiving their right to have a jury hear their discrimination claims. And even if they were so sophisticated, they could do nothing about it, just as merchants have no power to tell American Express that they will take its charge cards but not its one-sided agreement.

IV. Recent Attempts to Leave Arbitration to Sophisticated Parties Bargaining at Arms’ Length Have Not Succeeded

From its inception, arbitration has offered important advantages for companies and for individuals searching for alternative ways to resolve their disputes. The search now remains for ways to return arbitration to its original intent—a voluntary process that addresses definable disputes without forcing every dispute through the court system or through preliminary motions with the arbitrator just to get the dispute heard.

A. Congress Has Started to Address Some of the Issues Surrounding Protecting Rights in Arbitration

Congress has tried to take a broad perspective on addressing this problem, but has ended up making progress only in a few specific areas. Most recently, it passed the Dodd-Frank Wall Street Reform and Consumer Protection Act,\textsuperscript{132} amending the 1934 Securities Exchange Act,\textsuperscript{133} in part to provide protections for whistleblowers on financial mismanagement.\textsuperscript{134} The whistleblower provisions state that “no predispute arbitration agreement shall be valid or enforceable, if the agreement requires arbitration of a dispute arising under this section.”\textsuperscript{135} This law goes directly to the issue of allowing big companies to hide their wrongdoing in arbitration. Finally, Congress has recognized that we all have an interest in ensuring public and judicial handling of matters such as those that caused our recent economic crisis.

Also, on May 19, 2010, the Department of Defense issued an Interim Rule implementing defense appropriation legislation prohibiting the use of funds made available by the legislation for any contract in excess of $1 million unless the defense contractor agrees not to require arbitration of Title VII or tort claims arising out of sexual harassment or assault as a condition of employment.\textsuperscript{136} This rule emanates from the “Franken Amendment” to the defense appropriation bill, written to provide judicial redress for future claims after an employee of a Halliburton subsidiary alleged that she was raped by co-employees while working for the company in Iraq. Although the Fifth Circuit affirmed the District Court’s decision

\textsuperscript{132} Pub. L. No. 111-203 (July 10, 2010).
\textsuperscript{134} Pub. L. No. 111-203, § 922 (2)(c)(2).
\textsuperscript{135} Id.
\textsuperscript{136} Defense Federal Acquisition Regulation Supplement; Restrictions on the Use of Mandatory Arbitration Agreements, 48 C.F.R. § 222.7401 (2010).
not to require her to arbitrate her assault claims, though she still had to arbitrate her discrimination claims, the possibility that a crime as serious as rape could be hidden by Halliburton in its confidential arbitration program provided the impetus Congress needed to provide this piecemeal protection.

1. Congress Considered Protections for Consumers and Employees

Before this legislation, though, Congress had made little progress on providing guidance on important arbitration issues such as how to protect consumers and employees from over-reaching companies. In 2002, nine bills were introduced to address arbitration of employment agreements, consumer contracts, franchise agreements, and motor vehicle purchases. Only the Motor Vehicle Franchise Contract Arbitration Fairness Act, first introduced in 1998, passed, exempting motor vehicle dealers from mandatory arbitration with automobile manufacturers. But the Automobile Arbitration Fairness Act of 2008, designed to exempt consumers from mandatory arbitration of contract disputes with car dealers, did not pass. The Fair Contracts for Growers Act, requiring consent to arbitration after a dispute arises, also did not. The Consumer and Employee Arbitration Bill of Rights gave way to the Arbitration Fairness Act of 2002, followed by the Arbitration Fairness Act of 2007, which was re-written as the Arbitration Fairness Act of 2009. None passed in 2009 despite a Democratic House, Senate, and President. The Franken Amendment came from the Arbitration Fairness Act, showing that Congress has taken at least a small, specific step.

The Alcohol Franchise Contract Arbitration Fairness Act of 2008, which would require a post-dispute agreement to arbitrate even if the parties signed a pre-dispute contract, did not pass. The Nursing Home Arbitration Act was submitted to the House in February of 2009, submitted to the Judiciary Committee for mark-up in June 2010, and was not passed.

In his support for the 2002 Arbitration Fairness Act, Senator Sessions discussed the fact that arbitration works well for many disputes and that keeping arbitration as an alternative is important because of skyrocketing legal costs. Rather than exempting employment or consumer claims from arbitration, the 2002 legislation proposed alleged safeguards: notice—a large print statement so a con-

137. Jones v. Halliburton, 583 F.3d 228, 242 (5th Cir. 2009).
138. Jon O. Shimabukuro, The Federal Arbitration Act: Background and Recent Developments, CRS Report for Congress, CRS-7-8 (2002), http://www.policyarchive.org/handle/10207/bitstreams/1191.pdf (pointing out that a version of a bill to provide judicial redress for discrimination claims has been introduced in every Congress since the 103rd (1993-1995)).
tracting party cannot miss the provision; the right for the non-drafter to choose the law the state would apply; the right to representation: and a convenient forum, etc. None of these provisions dealt with the class action problem that has become much more prevalent in the past decade. None of them dealt with the reality that parties still would not have actual negotiating power, so even if they now know they have waived their constitutional right to a jury, they still cannot do anything about it.

On the other hand, the Arbitration Fairness Act of 2009, currently before Congress, goes much further than the 2002 version. It exempts civil rights claims, consumers, employees, and franchisees from mandatory pre-dispute arbitration clauses. The Senate version of the bill also makes the determination of arbitrability a question for the court, not the arbitrator, regardless of what the contract says, overturning in part the decision in First Options of Chicago v. Kaplan. This bill would go a long way toward ensuring that individuals can avail themselves of the judicial process with its protections such as discovery, jury trials, and appeals. And it leaves arbitration as an option, as long as the parties agree to arbitrate after the dispute arises. The proposed amended statute states that Congress finds the following, which is consistent with the legislative history:

The Federal Arbitration Act . . . was intended to apply to disputes between commercial entities of generally similar sophistication and bargaining power . . . . A series of United States Supreme Court decisions have changed the meaning of the Act so it now extends to disputes between parties of greatly disparate economic power, such as consumer disputes and employment disputes.

The proposed Act also includes franchisees, but does not specify why the sponsors included franchisees in the exemptions, since franchisees arguably could be sophisticated commercial entities. Once again, Congress made a distinction on the basis of sophistication, then smudged the edges. It seems that the sponsors' reasoning is the same as the reasoning behind the passage of the Motor Vehicle Franchise Contract Arbitration Fairness Act: the unequal bargaining power be-

150. Proposed section 9(b)(1), S. 931 (introduced April 29, 2009) & H.R. 1020, 111th Cong. (introduced Feb. 12, 2009). The American Bar Association issued a resolution opposing the Act, in significant part because it believes it will have a negative effect on international arbitration, which allows arbitrators to make initial decisions. The Report accompanying the resolution argues that taking review back to the courts slows the process, making American arbitration an undesirable option for international players. Edna Sussman, Report accompanying Resolution on Arbitration Fairness Act, (Aug. 25, 2009), http://businessconflictmanagement.com/blog/2009/08/aba-resolution-on-fairness-in-arbitration-act/; See Edna Sussman, The Unintended Consequences of the Proposed Arbitration Fairness Act, 56 Fed. Lawyer 48, 49 (2009) (noting that the revised Act addresses most of her concerns). The report is careful to say that it only addresses concerns with the effect on international arbitration. Id. at 48; see also, Thomas J. Stipanowich, Arbitration: The New Litigation, 2010 U. Ill. L. Rev. 1, 47 (2010) (calling the proposal “draconian” and referring to the 2007 bill’s inclusion of exemptions for contracts between parties of unequal bargaining power as having a potentially serious effect on business-to-business arbitration, a provision not in the current proposal).
151. First Options of Chi., Inc. v. Kaplan, 514 U.S. 938, 944 (1995) (allowing parties to contract to have the arbitrator decide issues of arbitrability if the language is “clear and unmistakable”).
between the motor vehicle manufacturer and the franchisee. If so, it should not be so limited—any person or entity signing a contract of adhesion should not be forced to give up statutorily protected rights because he or it agreed to arbitration.

A significant concern remains, however, that if the Arbitration Fairness Act passes, small disputes, which may be easily and quickly handled in arbitration, will end up with no forum. Even with attorneys' fees provisions, lawyers will not pursue small, individual claims through litigation. Parties may also decide that the costs of pursuing their claims—Experts, time, court costs—are simply too high, especially for claims that vindicate a right but for which recovery would be very small.

Also, if this Act passes, employers will no longer need to offer to pay for arbitration processes to make them fair, since parties will be able to choose not to arbitrate. Companies that designed programs to ensure as unbiased arbitrators as possible offer an important service—the small claims court-like efficiency of hearing many small claims on settlement days or with a minimum of administration. It is unclear whether those programs will survive if so many parties can opt out of arbitration.

It is also unclear whether businesses, faced with the choice after the dispute arises of going through arbitration or forcing a consumer or employee into court, will choose to force the party into court in the hopes that the potential plaintiff will find the litigation process too overwhelming and drop the claim.

2. Congress has not Really Addressed Business-to-Business Arbitration Clauses Other than Franchisees

The authors of the Arbitration Fairness Act address unequal bargaining power for franchisees but not for small merchants, such as the ones in Amex v. Italian Colors, and the doctors trying to get paid for taking care of consumers in In Re Managed Care (or even large merchants who have no bargaining power). The merchants and businesses have the same issues and same concerns as the consumer or employee—no right to bargain, suing a large, repeat customer with limited choices of arbitrators, no judicial review, no class actions despite small damages and a likelihood that no attorney will bring an individual claim for such small damages.

One of the problems in addressing these concerns is that these "sophisticated" entities are not clamoring for protection from all arbitration agreements. They recognize the importance of the speed, efficiency, and expert decision-making to their ability to run their business. What they are clamoring for is protection from what the Supreme Court's recent decisions allow—large, powerful corporations drafting one-sided contracts and presenting them to suppliers, merchants, franchi-

153. 148 CONG. REC. S54526-01 (May 17, 2002), available at 2002 WL 1004477 (comments of Senator Tom Daschle) ("It is wrong for one party to take advantage of its raw negotiating power to limit the legal rights of another party.").

154. DAVID W. EWING, JUSTICE ON THE JOB: RESOLVING GRIEVANCES IN THE NONUNION WORKPLACE 291 (1989) (quoting corporate director of industrial relations at Northrop explaining why Northrop pays arbitrators' fees: "We bear the cost of the arbitration for the very practical reason that most of the employees who seek arbitration of their grievances simply couldn't afford it if we did not.").
sees, consumers, and employees on a take-it-or-leave-it basis. Just like consumers and employees, businesses are trying to avoid allowing the big companies to use those contracts to do whatever they want and get away with it.

The real problem, though, is that, despite Senator Sessions’ admonishment against piecemeal legislation while proposing the Arbitration Fairness Act of 2002, the Arbitration Fairness Act of 2009 is still that. Senator Feingold specifically stated that it is designed not to change business-to-business arbitration. 155 So it does not address the unequal bargaining power, the need to protect statutory rights, the lack of precedent, or the long term effect that unfair limitations set out in arbitration agreements’ place on businesses such as the merchants in *Italian Colors*, except with regard to franchisees. It does not solve the problem of arbitration being used by companies trying to “get away with” something.

The sponsors’ intent is admirable: “to “strengthen the arbitration system by returning arbitration to a more equitable design that reflects the intent of the original arbitration legislation, the Federal Arbitration Act.” 156 To accomplish that goal, though, Congress or the courts must do more than exempt a few categories from arbitration. It must remove from arbitration those rights that simply cannot always be protected in arbitration—statutory claims, especially where, for example, only a class action can provide sufficient protection.

Another way Congress can protect rights is to ensure that the decision is not made at the expense of public knowledge of corporate wrongdoing. If the parties want to choose arbitration after a court has certified a class action, they should be allowed to, but, just as in court, parties should not be allowed to agree to keep arbitration issues and outcomes confidential where the outcome affects others who are not parties to the arbitration. Examples include antitrust claims, discrimination, and financial wrongdoing by companies.

**B. The Supreme Court Must Stop Enforcing Arbitration Clauses That Allow Powerful Corporations to Control the Justice Process**

The Supreme Court has heard a significant number of arbitration cases in the past few years, most of which are discussed throughout this article. In these recent decisions, the Supreme Court has taken a very “hands off” approach to arbitration agreements. As discussed below, the effect of leaving so much to arbitration based on the contract is that it allows the party that drafted the agreement to effect substantive limitations by what appear to be procedural means.

**1. Recent Supreme Court Cases Do Not Clarify the Distinction Between Sophisticated and Unsophisticated Parties**

In the 2009/2010 term, the Supreme Court hinted at a distinction in enforcing arbitration clauses against less sophisticated parties, but did not clarify it. Nor did it apply the distinction when given an opportunity. In *Stolt-Nielsen v. Animal-Feeds International Corp.*, 157 the Supreme Court refused to enforce a decision by

155. See supra note 149.
156. Id.
arbitrators to allow a class action where the arbitration agreement was silent regarding class actions. The Court reasoned that the silent arbitration agreement did not authorize class actions and therefore the parties’ intentions could not be interpreted otherwise.\(^{158}\)

The Supreme Court’s decision contravenes public policy and legislative history, both under the FAA and under other statutory rights. AnimalFeeds provides animal food components such as fish oil to animal food producers around the world.\(^{159}\) It contracts with shippers to send its products to the producers.\(^{160}\) International shipping generally is controlled by use of “charter parties” or pre-written form, highly standardized, contracts, chosen by the sender.\(^{161}\) The one at issue in *Stolt-Nielsen* had been in use since 1950.\(^{162}\)

In 2003, a Justice Department criminal investigation determined that Stolt-Nielsen, the shipper in this case, had engaged in illegal price-fixing activities.\(^{163}\) That indictment was dismissed by the district court and the Justice Department did not appeal.\(^{164}\) Several shippers filed lawsuits, which were consolidated and sent to arbitration.\(^{165}\) AnimalFeeds then filed a demand for class arbitration in New York.\(^{166}\) The parties chose a panel of arbitrators to determine whether class arbitration was appropriate, stipulating that the arbitration agreement was silent as to class actions.\(^{167}\) When the arbitrators certified a class action, Stolt-Nielsen appealed, and the Supreme Court held that the silent arbitration clause could not be read to allow class actions.\(^{168}\)

The result: each plaintiff can bring an individual action for small damages. The reality: few, if any, affected companies will fund such actions. Even if the statute allows for attorneys’ fees, the damages are too small to warrant the time and expense of investigating and pursuing the claim. The effect: consumers pay more because of the excessive costs charged, large corporations get away with antitrust violations, and the public at large remains unaware of the problem. In other words, because of the Supreme Court ruling, big business controls the methods, the costs, and the outcomes.

Here the Court relied on its longstanding approach of looking to the intent of the parties as set out in the contract.\(^{169}\) But in this case there was no intent to al-

\(^{158}\) *Id.* at 1776.

\(^{159}\) *Id.* at 1764.

\(^{160}\) *Id.*

\(^{161}\) *Id.*

\(^{162}\) *Stolt-Nielsen*, 130 S. Ct. at 1765.

\(^{163}\) *Id.*


\(^{166}\) *Stolt-Nielsen*, 130 S. Ct. at 1765.

\(^{167}\) *Id.* at 1766.

\(^{168}\) *Id.* at 1776. Likely there will be many articles written about the death of class action arbitrations following *Stolt-Nielsen*. This article merely acknowledges the effect as part of how contracting parties, courts, and Congress must consider arbitration going forward. The Court has moved from hostility to being too permissive to the current approach that favors large businesses. Hopefully Congress and the courts soon will move toward a middle ground where parties negotiating at arms’ length can agree to hire arbitrators to decide specific claims, as the FAA and its supporters intended.

\(^{169}\) *Id.* at 1770.
low class arbitrations evidenced because there had not been a history of class actions in international shipping and the charter party was written before the federal rule allowing class actions existed.\textsuperscript{170} The Court held that, without intent, a class action was not authorized.\textsuperscript{171} The Court was very careful to say that it did not rule out the possibility of class actions where the contract does not specify them if, from the agreement, the intent can be found.\textsuperscript{172} But what the Supreme Court created, without saying so, is a requirement of an affirmative showing of intent to allow class actions. The Court did not address whether courts can apply state law or public policy to hold class action waivers unconscionable. It appears clear that arbitrators cannot apply policy. The Court will take up the issue of state unconscionability claims in \textit{AT&T Mobility v. Concepcion}, discussed below.

One aside in \textit{Stolt-Nielsen}, that Justice Ginsburg latched onto in dissent, is Justice Alito’s observation that “the parties [here] are sophisticated business entities,” and “that it is customary for the shipper to choose the charter party that is used for a particular shipment.”\textsuperscript{173} Justice Ginsburg in dissent noted, “the Court apparently spares from its affirmative-authorization requirement contracts of adhesion presented on a take-it-or-leave-it basis.”\textsuperscript{174} Neither Justice Alito in his majority opinion nor Justice Ginsburg in her dissent distinguished between sophistication and bargaining power. Nor did either provide any guidance as to how the Court might answer the issue of class action waivers in contracts of adhesion presented on a take-it-or-leave-it basis. And Justice Ginsburg ignored the fact that courts long have required more than a contract of adhesion presented on a take-it-or-leave-it basis to void an arbitration clause.\textsuperscript{175}

In its first decision post-\textit{Stolt-Nielsen}, though, the Court did not reinforce Justice Ginsburg’s hopeful reading of Justice Alito’s opinion. In \textit{In re American Express Merchants’ Litigation},\textsuperscript{176} the Second Circuit refused to enforce a class action waiver in an antitrust claim between small merchants (less than $10 million annually in American Express charges) and American Express where the cost of bringing an individual action effectively would prohibit it. The claim centered on fees charged by American Express for credit cards that were higher than fees charged by comparable credit card companies. In order to accept American Express’ charge cards, which were profitable for the merchants, American Express’ standard contract required them to also accept the credit cards, and to pay the same higher fees that they paid for the charge cards. The standard contract also contained a provision that waived both class and collective actions and required the merchants to try all claims in arbitration.

In that case, the claimants demonstrated that the fees for experts necessary to prove the violation and the small damages per merchant would prohibit bringing individual actions. The Second Circuit reasoned that the waiver “violate[d] the firm principle of antitrust law to the effect that an agreement which in practice acts as a waiver of future liability under the federal antitrust statutes is void as a

\textsuperscript{170} Id. at 1769 n.6.
\textsuperscript{171} Id. at 1776.
\textsuperscript{172} Id. at 1776 n.10.
\textsuperscript{173} Id. at 1775 (quoting \textit{Stolt-Nielsen}, 130 S. Ct. at 1783 (Ginsburg, J., dissenting)).
\textsuperscript{174} Id. at 1783.
\textsuperscript{175} See, e.g., \textit{Armendariz}, 6 P.3d at 690-91.
\textsuperscript{176} 554 F.3d 300 (2d Cir. 2009), vacated, 130 S. Ct. 2401 (2010).
matter of public policy.\textsuperscript{177} The Second Circuit looked at the many cases that refused to enforce class action waivers in consumer contracts based on unconscionability and specifically rejected the unconscionability theory in favor of the argument that public policy mandated a forum to protect statutory rights. Because the class action waiver effectively prevented them from protecting their rights, the Second Circuit held, it was not enforceable.\textsuperscript{178}

The Supreme Court subsequently vacated the Second Circuit's decision without opinion and remanded it in light of its decision in \textit{Stolt-Nielsen}.\textsuperscript{179} The Supreme Court's lack of guidance to the Second Circuit is puzzling. It appears the Court simply invalidated all case law for the past twenty or more years finding class action waivers invalid as well as those allowing class actions where the arbitration clauses were silent. If so, the Supreme Court has treated all powerless parties equally—leaving all the power in the hands of the companies that draft arbitration clauses and proffer them on a take-it-or-leave-it basis. Justice Ginsburg did not dissent or challenge the decision. Her desire to protect the less sophisticated party or the one with unequal bargaining power was not raised in this decision. Perhaps the distinction she seeks is between consumer and commercial arbitration rather than bargaining power.

Just as in the many cases in which the California courts have refused to enforce class action waivers by consumers, discussed below, the losers in the \textit{American Express} litigation are likely the consumers—merchants will simply pass along to customers the costs associated with complying with the contract. And in cases like \textit{Stolt-Nielsen}, if no one brings the antitrust claims, the large companies learn that they can get away with their actions, so long as they continue to have arbitration agreements. The consumers pay the higher prices, not the large companies and ultimately not the shipping companies. In each case, requiring arbitration ensures that the consumer's rights go unprotected. By enforcing arbitration provisions for claims that can only be brought as class actions, then requiring authorization of class or even collective actions in arbitration, the Supreme Court has stepped further from the original intent of the FAA.

The merchants' sophistication in the \textit{American Express} litigation provided them no power to negotiate with American Express when it required them to accept a less desirable credit card if they wanted to accept the elite card or required them to sign a standard form contract that waived all rights to bring a class action. In effect, the Supreme Court's decision handed American Express even more power, because the decision in essence held that it is okay for American Express to hide its alleged antitrust activities behind arbitration.

\begin{enumerate}
\item \textbf{The Supreme Court Will Decide Whether to Allow Courts to Invalidate Class Action Waivers Based on Varying State Law Interpretations of Unconscionability}
\end{enumerate}

Over time, courts around the country have ruled differently on whether class action waivers should be enforced in consumer and employment cases. In \textit{Laster

\textsuperscript{177} Id. at 319.
\textsuperscript{178} Id. at 320.
\textsuperscript{179} \textit{Am. Exp. Co.}, 130 S. Ct. 2401 (2010) (mem.).
v. AT&T Mobility LLC,\textsuperscript{180} to be heard in the Supreme Court's 2010/2011 term, as AT&T v. Concepcion, the Ninth Circuit once again found a class action waiver unconscionable and refused to enforce it. The Ninth Circuit followed the California Supreme Court's decision in Discover Bank v. Super. Ct. of L.A.,\textsuperscript{181} and held that exculpatory clauses in arbitration contracts are substantively unconscionable.\textsuperscript{182} In Discover Bank, the California Supreme Court looked to California's Civil Code, which states that all contracts that attempt to exempt anyone from responsibility for his own fraud or willful injury to another are not enforceable as a matter of public policy.\textsuperscript{183} It held that not all class action waivers are unenforceable, but

when the waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money, then, at least to the extent the obligation at issue is governed by California law, the waiver becomes in practice the exemption of the party "from responsibility for [its] own fraud, or willful injury to the person or property of another." (Civ.Code, § 1668.) Under these circumstances, such waivers are unconscionable under California law and should not be enforced.\textsuperscript{184}

This holding explained twenty years of California courts either invalidating arbitration clauses that waived class actions or allowing class actions in arbitration, despite class action waivers or silent arbitration clauses.\textsuperscript{185}

The Supreme Court will hear the appeal of this decision in the 2010/2011 term, and either uphold states' rights to apply their own law in making decisions on whether it is unconscionable to require a party to an arbitration agreement to waive its right to class actions or decide in line with Stolt-Nielsen that it is the contract that matters. The Court must determine whether the intent of the contract was to authorize a class action. If the contract does not authorize class actions, according to Stolt-Nielsen, the parties have no right to a class action.

The Court could find that the facts of Laster argue even more strongly than Stolt-Nielsen in favor of strict contract interpretation. In Stolt-Nielsen, the contract was silent. Here it is specific. Obviously a contract that specifically waives the right to a class action does not authorize class actions. The Court has already held that contracts of adhesion are unenforceable unless they are unconscionable. The other ground for invalidating contracts of adhesion is that they do not allow

\begin{itemize}
\item \textsuperscript{180} 584 F.3d 849, (9th Cir. 2009), cert. granted, AT&T Mobility LLC v. Concepcion, 130 S. Ct. 3322 (2010).
\item \textsuperscript{181} 113 P.3d 1100, 1109 (Cal. 2005).
\item \textsuperscript{182} Laster, 584 F.3d at 857.
\item \textsuperscript{183} Discover Bank, 113 P.3d at 1108.
\item \textsuperscript{184} Id. at 1110.
\item \textsuperscript{185} Discover Bank, 113 P.3d at 1100, and cases discussed therein. But see Puleo v. Chase Bank USA, N.A., 605 F.3d 172 (3d Cir. 2010) (decided after Stolt, and upholding a District Court decision not to allow a class action in the face of the form contract's clear statement of the parties' intent not to allow class actions).
\end{itemize}
parties to pursue their statutory rights. But in *In re American Express Litigation* the Supreme Court apparently upheld a class action waiver by corporations where the court found enforcing it would not allow parties to pursue statutorily protected rights. One way to affirm the Ninth Circuit decision without running into the *American Express* decision is for the Supreme Court to rely on the sophisticated/unsophisticated distinction to uphold the unconscionability decision. It would have to find that a state may decide that a contract of adhesion, presented on a take-it-or-leave-it basis to a party with less business savvy, and/or grossly unequal bargaining power, which waives statutory rights that Congress intended to protect, is unconscionable.

Although perhaps legally and ethically correct, and far more in line with the intended purpose of the FAA, such a decision would fly in the face of the Court's recent emphasis on contract language. It might also create more litigation by businesses that would (correctly) argue that they, too, should be able to avoid arbitration or have the courts modify their arbitration agreements at least to allow class actions in order to protect their rights.

If the Court upholds the California decision, the simplest way for it to justify its holding would be to say that states have the right to determine unconscionability standards. Such a decision, of course, would leave us with extreme conflicts between states, no guidance, and increasing litigation in state courts. For the vast majority of businesses that today operate nationally or even internationally, the inconsistency needs to be corrected. The Supreme Court should use the opportunity to provide specific guidance and to provide protections from over-reaching corporations.

California has been the most vocal opponent of class action waivers in arbitration. Other courts have also held that class action waivers are not enforceable in arbitration based on the public policy that statutory rights must have a forum. But most courts have upheld class action waivers. One distinction courts appear to make is whether the statute the individual seeks to enforce provides attorneys' fees to a prevailing party; in other words, whether parties are likely to find someone to bring the case for them.

For example, the Eleventh Circuit has upheld class action waivers, but in one case refused to uphold the waiver because the statute under which the individual sued did not provide for attorneys' fees. Interestingly, applying the Eleventh Circuit decision shortly thereafter, the district court for the Northern District of Georgia upheld a class action waiver for essentially the same claim against the same party, Comcast. The distinction—the choice of statute under which the parties chose to sue: the Cable Act, which the plaintiff in the Eleventh Circuit case sued under, does not provide for attorneys' fees to the prevailing party, but the

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186. See, e.g., Snowden v. CheckPoint Check Cashing, 290 F.3d 631, 638-39 (4th Cir. 2002) (where attorney's fees are recoverable under the statute, a claimant is able to recover fully in arbitration and class action waiver is unenforceable). For a thorough overview of cases upholding versus invalidating class action waivers, see Bryon Allyn Rice, Comment, *Class Action Waivers in Mandatory Arbitration Clauses and the Need for a Judicial Standard*, 45 HOUS. L. REV. 215 (2008), and specifically cases discussed at 45 HOUS. L. REV. 226 n.68.
188. Dale v. Comcast Corp., 498 F.3d 1216, 1221 (11th Cir. 2007) (distinguishing *Jenkins* and refusing to enforce a class action waiver where the claimant could not recover attorneys' fees under the statute).
Georgia Fair Business Practices Act, under which the second plaintiff sued, does. The district court case appears not to have been appealed, but makes it clear that the court intended to limit the exception to only cases in which attorneys’ fees could not be recovered.

These cases provide one more example of the burden created on both courts and parties by leaving these decisions to the courts to make in each individual case. The lack of predictability makes drafting arbitration clauses nearly impossible and litigation inevitable. The Supreme Court and Congress both have the opportunity to end this problem. Of course, if the Supreme Court chooses to end the problem by simply enforcing the contracts, parties will have predictability but no avenue for redress.

3. The Supreme Court Also Reads the Contract Strictly in Other Types of Claims

In Rent-a-Center West, Inc. v. Jackson, also decided in the 2009/2010 term, the Supreme Court, with the same 5-4 majority (Scalia drafting, Alito, Thomas, Roberts, and Kennedy joining) as Stolt-Nielsen, sent the issue of whether an arbitration clause was unconscionable to the arbitrator because the parties’ contract “clearly and unmistakably” referred issues of enforceability to the arbitrator. The Court reasoned that Jackson challenged the entire arbitration agreement rather than the delegation clause (the part of the arbitration agreement that states the arbitrator will decide the issues), so his challenge was to the validity of the contract as a whole, a question for the arbitrator.

Justice Stevens’ strong dissent, joined by the other three justices, pointed out that the agreement at issue was an arbitration agreement; it just happened to be a separate contract rather than part of Jackson’s employment contract. Thus, Stevens argued, a challenge to the arbitration agreement fell under the first category of challenges—challenges only to the validity of the arbitration clause—not the second—challenges to the entire contract.

This decision only peripherally addressed sophistication or unequal bargaining power, as Justice Stevens asserted that Jackson’s argument, that the arbitration agreement was unconscionable, raised the issue of whether the agreement “clearly and unmistakably” evinced the parties’ intent to submit questions of arbitrability to the arbitrator; which must have been answered in the negative. Instead, Justice Stevens asserted that the validity of the arbitration clause must have been decided separately from the validity of the other claims—in this case employment discrimination—which would have made it a question for the court. Stevens quoted the Restatement (Second) of Contracts, Section 208, Comment d (1979) for the proposition that “gross inequality of bargaining power, together with terms unreasonably favorable to the stronger party, may . . . show that the weaker

190. 130 S. Ct. 2772 (2010).
191. Id. at 2778-79 (asserting that it was following Prima Paint, 388 U.S. at 403-04 & Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 442 (2006).
192. Jackson, 130 S. Ct. at 2782 (Stevens J., dissenting).
193. Id. at 2784.
party had no meaningful choice, no real alternative, or did not in fact assent or appear to assent to the unfair terms."

In other words, if the contract is unconscionable, a court can determine that the party did not in fact agree to the terms of the contract. In Jackson, if the Court were to find that the arbitration agreement was unconscionable, then Jackson would still be able to pursue his discrimination claims, not in arbitration, but in court. Justice Stevens' argument was consistent with the FAA—letting people who want to arbitrate pursue arbitration, while not forcing those who do not want to arbitrate to give up their rights to judicial determination. It would also be consistent with Justice Alito's reasoning in Stolt-Nielsen—the parties must authorize the arbitrator to decide. When presented with an unconscionable agreement, an issue is raised as to whether the parties intended to agree to it or agreed because they had no real choice. Unfortunately, the Court chose the path that leaves the more powerful corporation with the stronger position—the corporation can now argue to the arbitrator, who is often paid by the corporation, that the arbitrator should hear a claim he or she will be paid to hear.

V. CONGRESS AND THE COURTS MUST PROVIDE GUIDANCE SO THAT ARBITRATION CAN CONTINUE TO ACHIEVE ITS GOALS AND THAT PROTECTED RIGHTS REMAIN PROTECTED

Parties voluntarily choose arbitration to create a fair, quick, affordable means for resolving disputes. Unfortunately, some powerful companies have used a good process to create one-sided protections for themselves. The Supreme Court's decisions during the 2009/2010 term not only allow these companies to get away with potentially illegal or unethical behavior, they encourage it.

A blanket rule that parties with less bargaining power, or who are significantly less sophisticated than the drafting party, should be able to get out of their contracts, disregards most state contract law and simply does not solve the problem of how to return arbitration to its negotiated, quick, and efficient start.

One option, of course, is for parties to start refusing to sign pre-dispute clauses or to be more deliberate in drafting them. Rather than blanket clauses that include all potential claims and exclude class actions, parties can and should consider taking the time to draft a well thought out clause. Parties should address class actions, whether to arbitrate or to litigate statutorily protected rights, and should choose different approaches for different types of disputes (e.g. mediation for disputes within an ongoing relationship, litigation for issues of precedential value, and arbitration for commercial business disputes). Of course, this proposal requires that all parties have sufficient bargaining power to effect change, a scenario that seems unlikely even in many business-to-business negotiations.

Because most parties who sign pre-dispute clauses have insufficient bargaining power to protect their rights, specific protections need to be built into the law.

194. Id.
195. See Stipanowich, supra note 151, at 50-59; see also Thomas J. Stipanowich, Symposium Keynote Presentation, Arbitration and Choice: Taking Charge of the "New Litigation," 7 DePaul Bus. & Com. L. J. 383, 387 (2009) (discussing a proposed business protocol for arbitration because lawyers rarely have the time or expertise to address all of the client's potential future issues in drafting pre-dispute arbitration clauses).
The FAA needs to be modified to clarify that class actions are allowed, regardless of whether arbitration clauses allow them or are silent. The Federal Rules of Civil Procedure can be revised to state that courts have sole jurisdiction over determining whether claims should be pursued as class actions. If a court certifies a class, the whole claim should be sent to court for adjudication, unless the parties then agree to hold the entire action in arbitration. Both parties would have to agree to arbitration. That way, claims are not tried in a piecemeal fashion, another problem that is created when only some claims are sent to arbitration.

Claims that really need to be determined by juries and heard by courts—discrimination, civil rights, antitrust cases that could create important precedent—should not go to arbitration. Blanket arbitration clauses must be re-examined post-dispute to ensure that the rights of all parties, and society’s concerns, can be met in arbitration. It is an issue that should be decided by a court up front rather than on appeal.

Companies should not be able to hide their wrongdoings by forcing claims against them into arbitration. And courts, especially the United States Supreme Court, should not continue to let them. Arbitration hearings should be open to the public unless all parties agree or the arbitrator orders that they be private. Decisions should be published, as the AAA has started publishing its employment decisions. Although the decisions will not provide binding precedent, they can create guidance for future decisions, arbitration awards, and perhaps even courts.

VI. CONCLUSION

It is time to revise the FAA. The United States is no longer a nation where businesses sue only similarly situated businesses. It is no longer a nation where most claims affect only one party. Many of our actions have national and even global effects. Congress must consider that the concerns it expressed back in 1924 and 1925 of businesses requiring arbitration on a take-it-or-leave-it basis have come to pass. Arbitration is being required in take-it-or-leave-it contracts by companies with disproportionate bargaining power against other companies with significantly less bargaining power, as well as against individuals with little or no bargaining power. In each instance, society suffers. Important protections provided by Congress cannot be pursued. Arbitration has become too expensive and too limiting. Congress and the courts must re-examine arbitration and make sure it returns to its intended use—arms-length negotiated agreements designed to allow quick, efficient, and effective resolution of claims, not contracts of adhesion that make it difficult or impossible for parties to protect themselves or pursue their claims.
