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Fall 1999

The Pendulum Swings Again

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Recommended Citation

Richard C. Reuben, *The Pendulum Swings Again*, 6 *Dispute Resolution Magazine* 18 (1999).

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The Pendulum Swings Again

Badie, Wright decisions underscore importance of actual assent to arbitration

By Richard C. Reuben

Strange as it may seem, the U.S. Supreme Court and the California Supreme Court in the past year have actually agreed on something, and something important at that: That the relinquishment of legal rights through mandatory arbitration contract provisions must be knowing and voluntary.

The U.S. Supreme Court addressed the question in the context of the authority of a labor union to waive the rights of individual union members to bring statutory claims in public



courts by including a provision in the collective bargaining agreement that required claims arising under the agreement to be arbitrated rather than heard in a court of law.¹ In a decision by Justice Antonin Scalia, the court unanimously agreed in *Wright v. Universal Maritime*

Services Corp. that the waiver of statutory rights that an arbitration provision represents must be at least "clear and unmistakable."²

The high court's ruling came just weeks after the California Supreme Court affirmed an appellate court decision refusing to enforce a major bank's unilateral imposition of a mandatory and binding arbitration requirement on most business and personal checking and credit card accounts. The lower court had found the provision unconscionable under traditional California contract law, in *Badie v. Bank of America*.³

Taken together, these and other similar rulings suggest a new, and in my view proper, judicial reticence to enforce boilerplate, or "cram down," arbitration provisions.⁴ This new, more sober judicial mood may be seen as a settling of the judicial pendulum on mandatory arbitration that has been swinging for much of the last decade or so. Before the late 1980s, the general rule, carried over from medieval England to Colonial America, was that predispute agreements to arbitrate were not enforceable, essentially on the public policy ground that they improperly "oust" courts of their jurisdiction to decide cases arising under the law of the sovereign.

The pendulum of judicial attitudes swung to the other side of the arc in the late 1980s, when the U.S. Supreme Court formally overruled the "ouster doctrine," and in the early 1990s appeared to extend the judicial embrace of arbitration to include provisions compelling the mandatory arbitration of statutory discrimination claims in contracts of adhesion. For a time it seemed, the general rule was "anything goes."

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The Wrong Result

Ruling is cause of uncertainty in consumer arbitration

By Carroll E. Neesemann

In February, 1999, the Supreme Court of California refused to review the Court of Appeal's decision in *Badie v. Bank of America*, 67 Cal. App. 4th 779 (1998), passing up the chance to remove uncertainty created by the decision below. The Court of Appeal had refused to compel arbitration under an Alternative Dispute Resolution ("ADR") clause sent to customers by Bank of America, with monthly account statements, to be added to existing

customer agreements. The decision has created uncertainty in that: (1) The appellate court looked at only some of the claims asserted, and affirmed for defendant on others, making the scope of the decision unclear. (2) The decision was grounded on several factual aspects



of Bank of America's underlying agreements and forms of notice, making it hard for other financial institutions to decide whether their existing agreements could be used to comply and what additional contract language might be needed. (3) Although the decision was purportedly grounded on general contract principles, it exhibited a hostility toward arbitration that made it unclear if even contractual provisions meeting all of the apparent requirements of the decision would be upheld in California.

The matter is further complicated by a new Delaware statute (S.B. 57) governing banks and other financial institutions chartered in Delaware.

Factual background

In 1992 Bank of America began to send "bill stuffers" to its customers containing an ADR clause that stated in pertinent part (*Badie*, 67 Cal. App. 4th at 785):

Dispute Resolution — If you or we request, any controversy with us will be decided either by arbitration or reference. Controversies involving one account, or two or more accounts with at least one common owner, will be decided by arbitration under the Commercial Arbitration Rules of the American Arbitration Association. All other controversies will be decided by a reference under California Code of Civil Procedure Section 638 and related sections. A referee who is an active attorney or retired judge will be appointed by the

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Cases like *Badie* and *Wright* suggest the pendulum has finally begun to settle at a more reasonable, principled and intuitive judicial position: That pre-dispute agreements to arbitrate will be upheld if they are "clearly and unmistakably" the result of actual assent by the parties.

But wait, you say. Such reasoning would undue the law of standard form contracts of adhesion. After all, the common law decided long ago that the needs of a large and complex society include the ability to permit private parties to standardize contracts for classes of transactions. And didn't the U.S. Supreme Court also tell us that arbitration provisions are not to be treated differently than other contractual provisions, even by state legislatures?⁵ This was essentially the position argued by the banking industry in *Badie*, a position that plainly has been accepted by at least one federal circuit court,⁶ and is reiterated in these pages by a distinguished attorney, Carroll Neeseman.

While such assertions are unquestionably true, they paint only half the picture. The U.S. Supreme Court began painting the other half in the years after *Gilmer*, as it began to push the pendulum back toward the center. In a series of cases, the U.S. high court repeatedly reaffirmed the principle that agreements to arbitrate must meet the threshold requirement of contractual validity before they may be enforced.⁷ In so doing, the court has particularly stressed that state courts may well void mandatory arbitration clauses on the grounds of unconscionability.⁸ *Badie* merely accepted that invitation.

In my view, state courts should simply follow the U.S. Supreme Court's clear guidance, and reassert the primacy of their state laws of contract generally by applying their traditional doctrines of contract formation to contractual arbitration provisions. In the adhesion contract context at issue in *Badie* case, I believe the rule of law that should emerge would generally hold that arbitration clauses slipped into the boilerplate of standard form contracts are presumptively unenforceable on unconscionability grounds, absent some evidence of actual assent.

A famous California Supreme Court

decision, *Graham v. Scissor-Tail*,⁹ provides a familiar framework for explaining the analysis, although I do account for some variation among the states. The case arose from a dispute between rocker Leon Russell and the legendary Bay area concert promoter Bill Graham. In setting up a concert tour, the two used the American Federation of Musicians' standard form contract, which called for mandatory and binding arbitration of disputes by a panel composed of AF of M members.

In refusing to enforce the provision on unconscionability grounds, the *Graham* court synthesized prior California contract law into a two-part test. First, the contract must be one of adhesion – that is, one not subject to bargaining and offered on a take-it-or-leave-it basis. Second, the enforcement of the provision must not frustrate the "reasonable expectations of the weaker or 'adhering' party" or be "unduly oppressive or 'unconscionable.' "

Assent to waive one's right to a public forum by accepting an arbitration clause in a standard form contract can be established through a check-off provision, just like the refueling and insurance options in car rental agreements.

Applying that standard, the *Graham* court ruled the mandatory arbitration provision unenforceable because it frustrated the reasonable expectations of the weaker party to a hearing before a neutral tribunal. Remarkably, the court chose to issue its ruling per curiam, as if to underscore the ease, solemnity and importance of its decision

The law has long recognized that permitting the drafting party to draft non-negotiable terms has the benefit of efficiency, but also runs the risk of abuse. Unilateral mandatory arbitration provisions constitute just such an abuse. They oppress weaker parties by unilaterally stripping consumers of their right to the accurate and public application of the law to disputes that may arise. They also frustrate a consumer's reasonable expectations of the terms of the deal. Consumers reasonably expect that when they decide to purchase a consumer item – such as a computer or house or medical services – they are simply making a decision on the

item to be purchased and the essential terms of the transaction (such as price and quantity), not that they are also making a decision on how related disputes will be handled. To the contrary, to the extent a dispute arises under the contract, most consumers would expect a day in court, even if it is small claims court, if they so choose.

If you believe in the rule of law, the rights waived in arbitration are substantial, and often include specific and hard-fought statutory rights granted to consumers through the legislative political process. An agreement to arbitrate essentially waives those rights in favor of a less formal, but more arbitrary forum. There is nothing wrong with such a waiver, in my view, as long as it is a knowing and voluntary decision that has been made "clearly and unmistakably."

But, you say again, how can such notions of individual assent possibly square with the concept of a standard form

contract?

Let me simply suggest that the waiver *qua* arbitration clause may surely be valid if it is negotiated at the time of the transaction, as is commonly done in other areas. When one rents a car today, for example, there is almost always a negotiation over insurance and refueling options, consummated by either the addition of coverage and refueling to the contract, or the customer's initialing of the rejection of those options. Arbitration provisions waiving important legal rights can be subject to a similar check-off procedure. Why should the waiver of one's legal rights require less proof of assent than the purchase of a tank of gas?

Mandatory arbitration provisions in contracts of adhesion expose the difficult tension between individual contractual rights and collective contractual needs. The question is where we draw the line. The law of adhesion contracts has traditionally used the doctrine of unconscionability to draw that line, and cases like

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Graham v Scissor-Tail more precisely instruct us to draw it at the reasonable expectations of the parties. By presumptively refusing to enforce cram-down arbitration provisions for consumer claims, absent evidence of knowing and voluntary waiver, we will restore those reasonable expectations, and, in the words of the case law, ensure minimum levels of integrity to the arbitration of consumer disputes.

Endnotes

1. *Wright v. Universal Maritime Svcs. Corp.*, 525 U.S. 70 (1998).

2. It should be noted that using this waiver analysis allowed the court to duck, at least explicitly, the question presented of whether its landmark decision in *Gilmer v. Interstate/Johnson Lane*, 500 U.S. 20 (1991), overturned its venerable holding that unions may not waive the statutory rights of the rank and file in collective bargaining agreements. *Alexander v. Gardner-Denver Co.*, 415 U.S., 36 (1976). That question, which has badly fractured the lower court, remains open, and, for the foreseeable future, unlikely to be resolved by the court as currently constituted.

3. *Badie v. Bank of America*, 67 Cal.App.4th 779 (Nov. 3, 1998), *rev. denied* (Feb. 1999).

4. *See, e.g.*, *Duffield v. Robertson Stephens & Co.*, 144 F.3d 1182 (1998); *Engalla v. Permanente Medical Group, Inc.*, 15 Cal.4th 951 (1997) (HMO may be subject to civil liability for fraud based on public assurances that mandatory arbitration program is faster, less expensive than public litigation). For courts moving in an opposite direction, *see, e.g.*, *McWilliams v. Losicon, Inc.*, 143 F.3d 593 (10th Cir. 1998) and *Koveleski v. SBC Capital Markets, Inc.*, 167 F.3d 361 (7th Cir. 1999).

5. *See Moses H. Cone Mem'l Hosp. v. Mercury Constr., Corp.*, 460 U.S. 1 (1983). For a discussion and criticism, *see generally* Jean R. Sternlight, *Rethinking the Constitutionality of the Supreme Court's Preference for Binding Arbitration: A Fresh Assessment of Jury Trial, Separation of Powers, and Due Process Concerns*, 72 *TUL. L. REV.* 1 (1997).

6. *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (1997) (Easterbrook, J.) ("A competent adults are bound by such documents, read or unread.")

7. *See, e.g.*, *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995); *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995) *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468 (1989); *Perry v. Thomas*, 482 U.S. 483 (1987)

8. *First Options of Chicago v. Kaplan*, 514 U.S. 938 (1995).

9. 28 Cal.3d 807 (1981).

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Relevance and admissibility of evidence are also critical issues. Judges are used to being in charge and making decisions according to set rules and established precedent. By contrast, mediators need to be good listeners and to be open to a broad range of possible solutions, with a view to helping the parties to arrive at an acceptable, custom-made settlement of their case.

Of course there are different types of mediation; evaluative mediation, focusing more closely on the rights of the parties, is closer to judging. But whatever

It may be that the adjudication and mediation tracks are so different that the functions should be separated entirely, leaving judges to judge cases and mediators to mediate them.

the appropriate role of evaluation in mediation — and there is much debate about that question — good mediators should begin by exploring the respective interests of the parties, with a view to "creating value" (or enlarging the pie) before dividing the pie. Often issues that at first appear to be purely distributive turn out to be good candidates for value creation. And value creation requires training and experience different from that which judges usually have. The skills required of judges and mediators are sufficiently different that we cannot assume that even first-rate judges will turn out to be first-rate mediators. Some judges, of course, do turn out to be good mediators, but that is surely not the norm.

But, it will be said, "don't many judges engage in settlement activities all the time?" Yes, but settlement is not the same as mediation. Settlement work by judges is usually evaluative, rights-based and often coercive. That may be more appropriate for purely distributive types of cases, but it is not for more complex cases involving continuing relationships, where the forward-looking focus of mediation operates quite differently from the

backward-looking focus of adjudication or judicial settlement.

That brings me to a fourth and related point. Even if a judge is not mediating a case that she will later try, and even if that judge has had an adequate amount of high-quality mediation training (at least 30 hours),² there may be an *appearance* of impropriety. Suppose a newspaper reports that a judge met separately with one side as part of his attempt to settle the case. Does this comport with the public expectation of judges as neutral, disinterested decision makers? Or suppose a judge expends considerable effort to mediate a complex case but in the end does not succeed because he believes that one of the parties is being unreasonable, and

so asserts. Even if the judge won't try *this* case, could this episode be seen by the intractable party and his lawyer as foreshadowing possible bias by the judge against them in future cases?

Finally there's the problem of perceived leakage in a small clubby court. Even if the case is unsuccessfully mediated by Judge A, the parties may find it hard to believe that none of the information disclosed at the mediation will become known to Judge B who is to try the case.

Maybe the two tracks — mediation and adjudication — are so distinct that it is not desirable to align them. Perhaps courts should have publicly paid, well-trained, full-time mediators functioning separately but alongside the judges, all as part of a broad-range Comprehensive Justice Center. That, in effect, is now the common pattern with respect to appellate mediation programs. Why not do the same at the trial level?

Of course not all trial mediation would be done by court mediators. There would still be referral to private mediators, as there is now. And perhaps the court

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