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It is time to re-write the Federal Arbitration Act

Will plaintiffs get a fair shake in a revision of the Arbitration Act?

The Federal Arbitration Act ("FAA") was passed in 1925 to establish an alternative to the complications of litigation, and to expedite and facilitate settlement of disputes. As many courts have noted, the goal was to eliminate the expense and delay of extended court proceedings. As such, and as long has been stated, federal law favors arbitration and liberally interprets arbitration agreements in favor of arbitration. The policy became so popular that in 1984, the U.S. Supreme Court held that the FAA pre-empted state law. Since then, Supreme Court decisions have expanded the reach of the FAA and negated state's and individuals' rights. Further, the rulings have essentially disregarded the purpose of the FAA. The time has come for the FAA to be drastically revised, as leaving it to the courts has not worked.

In the 1920s, the drafters of the FAA felt that arbitration contracts needed to be enforced mainly because courts were congested and litigation was expensive. The drafters wanted businesses to be able to contract for arbitration but have courts enforce the agreements like any other contract. Previously, American courts were hostile towards arbitration agreements and were not enforcing the agreements. (See *Circuit City Stores, Inc. v. Adams* (2001) 532 U.S. 105.) For over 50 years, the FAA only applied in federal courts. Moreover, it was also seen as applying to only contract claims. Many commentators and scholars believe that this was the sole purpose of the FAA, to apply to contract claims between businesses that were involved in intrastate commerce.

In 1984, the U.S. Supreme Court held that the FAA pre-empted state law and applied not only in federal courts, but also in state cases. (*Southland Corp. v. Keating* (1984) 465 U.S. 1, 6.) The Court noted that although the legislative history had some ambiguities, there were "strong indications that Congress had in mind something more than making arbitration agreements enforceable only in the federal courts." (*Id.* at p. 6.) Justice O'Connor, writing for the dissent, pointed out that the legislative history made it abundantly clear that nobody thought the FAA was intended to apply to states. She thought it was clear that the Court was ignoring congressional intent to simply encourage arbitration because it was generally favored by federal courts. Justice Stevens, dissenting in part, also thought that the intent of Congress in enacting the FAA was being ignored.

In 1987, the U.S. Supreme Court again held that the FAA pre-empted a California statute, this time holding that Labor Code section 229, which permits wage lawsuits to be brought in court regardless of an arbitration agreement, was pre-empted by the FAA. (*Perry v. Thomas* (1987) 482 U.S. 483.) Justice Stevens, dissenting, pointed out that for 50 years, state law had not been pre-empted and that the Court was now re-writing the FAA (starting with *Southland* a few years earlier). He asserted that the States had the power to except certain categories of disputes from arbitration, unless Congress specifically decided otherwise, and Congress had made no such declaration. Justice O'Connor, dissenting, reiterated her position that the intent of the FAA was being ignored by the Court. She went on, stating that even if FAA applied to state court proceedings, California's policy choice to preclude

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waivers of a judicial forum for wage claims to protect the importantly public policy of protecting workers was entitled to respect and should not be disturbed by the Court.

In *Circuit City Stores, Inc. v. Adams* (2001) 532 U.S. 105, the Supreme Court went further in expanding the FAA. At issue, was whether the FAA applied to all employment contracts. The Ninth Circuit had held that the FAA specifically did not apply to employment contracts, while other Circuits had held that it applied to employment contracts other than those for transportation workers. The Supreme Court looked at the explicit language of the FAA, which states that it shall not apply to "contracts of employment of seamen, railroad employees or any other class of workers engaged in foreign or interstate commerce." The Supreme Court held that this meant that the exception applied to seamen, railroad employees, and other workers in the transportation industry. Justice Stevens, dissenting, pointed out that the FAA was intended to overcome the disfavor of arbitration by judges, but a number of the High Court's cases had pushed the pendulum far beyond a neutral attitude and endorsed a policy that strongly favored arbitration. In doing so, he asserted that there "is little doubt that the Court's interpretation of the Act [had] given it a scope far beyond the expectations of the Congress that enacted it." (*Id.* at p. 132.) He went on to state that "when the Court simply ignores the interest of the unrepresented employee, it skews its interpretation with its own policy preferences." (*Id.*at p.133.)

AT&T v. Concepcion

In *AT&T v. Concepcion* (2011) 563 U.S. ___, 131 S.Ct. 1740**,** the Supreme Court again held that the FAA trumped California law. There, the Court looked at two California statutes and the application of those laws by the California Supreme Court. Under California law, courts may refuse to enforce any contract found "to have been unconscionable at the time it was made," or may "limit the application of any unconscionable clause." (Civ. Code, § 1670.5(a).) A finding of unconscionability requires a "procedural" and a "substantive" element. In *Discover Bank* v. *Superior Court* (2005) 36 Cal.4th 148, the California Supreme Court applied this framework to class-action waivers and held as follows:

> [W]hen 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 . . . 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.' Under these circumstances, such waivers are unconscionable under California law and should not be enforced.

At issue was a cellular telephone contract between the Concepcions and AT&T that provided for arbitration of all disputes, but did not permit classwide arbitration. After the Concepcions were charged sales tax on the retail value of phones provided free under their service contract, they sued AT&T in a California federal district court. Their suit was consolidated with a class action. The district court denied AT&T's motion to compel arbitration, holding that the *Discover Bank* Rule made the arbitration provision unconscionable because it disallowed classwide proceedings. The Ninth Circuit agreed and held that the FAA did not pre-empt its ruling.

The Supreme Court, examining its previous rulings, held that requiring the availability of classwide arbitration interferes with fundamental attributes of arbitration, and thus created a scheme inconsistent with the FAA. The dissent stated that the FAA specifically says that an arbitration agreement "shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract*." It then stated that California law set forth certain circumstances in which "class action waivers" in *any* contract are unenforceable. In other words, California's law was consistent with the FAA's language and primary objective.

The arbitration clause

It is obvious to those who practice law that the concept of arbitration today, and in 1925, is vastly different. Arbitration is often not quicker or cheaper; in fact, paying private arbitrators can often cost hundreds of thousands of dollars, money that a party would not otherwise have to spend if litigating in Court. There have also been studies showing that arbitrators are often biased towards large businesses, those who repeatedly use and pay for their services. Moreover, the law is clear that arbitrators are allowed to follow their own procedures and cannot be overturned even if they make a mistake in applying the law. i.e., there is no right to appeal. It is also obvious to those having read the countless interpretations of the FAA by appellate courts and the U.S. Supreme Court that there is a serious dispute among judges over the past 30 years about what Congress meant to do in enacting the FAA, with everyone agreeing there are serious ambiguities in the FAA.

In the past 30 years, courts have been inundated with fights over arbitration agreements. Since *Concepcion*, California courts have found numerous arbitration agreements unenforceable in the context of employment agreements. For example, *Wisdom v. AccentCare, Inc.* (2012) 202 Cal.App.4th 591, held that an arbitration agreement found in a pre-employment application was both procedurally and substantively unconscionable. The court held that the arbitration provision was procedurally unconscionable "because its language implied there was no opportunity to negotiate, because the rules of any arbitration were not spelled out in the agreement . . . and because plaintiffs did not understand they were waiving their right to a trial." It concluded the agreement was substantively unconscionable because it lacked mutuality. It concluded the agreement required the job applicant to agree to arbitrate any claims against the employer, but that

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there was no corresponding pledge by the employer to arbitrate potential claims against the applicant. As such, it was unconscionable.

Ajamian v. CantorCO2e (2012) 203 Cal.App.4th 771, held that an arbitration provision in an employment contract was both procedurally and substantively unconscionable and that the trial court did not abuse its discretion in finding it unconscionable. It also held the trial court properly found that the unconscionable provisions could not be severed where the agreement was part of a non-negotiated employment contract, the employee was unaware of the excessive costs of arbitration, and the agreement contained a one-sided and unlawful damages clause, and a one-sided attorneys' fees clause. More interesting, the Court held that the trial court, not an arbitrator, was correct in deciding the issue. The Court stated that the arbitration provision did not provide clear and unmistakable evidence that the parties intended to delegate authority to the arbitrator, rather than to the court, to decide the threshold issue of whether the arbitration provision itself was unconscionable.

Mayers v. Volt Management Corp (2012) 203 Cal.App.4th 1194, held that an arbitration agreement was unconscionable. There, plaintiff filed a lawsuit against his former employer alleging several claims under the California Fair Employment and Housing Act ("FEHA"). The defendant filed a motion to compel arbitration based on plaintiff's agreement to submit employment-related claims to final and binding arbitration, as evidenced by his signed employment application, employment agreement, and acknowledgment of receipt of the employee handbook. The trial court denied the motion. The defendant appealed, arguing the trial court erred because the arbitration provisions were enforceable and did not contain any unconscionable elements. The defendant argued that, in any event, the trial court should have severed any offending provisions and ordered arbitration. The appellate court disagreed and affirmed the ruling. The court held that the arbitration provisions contained in the employment application, employment agreement, and employee handbook each required that plaintiff submit employment-related claims to arbitration pursuant to the "applicable rules of the American Arbitration Association in the state" where plaintiff was employed or was last employed by the defendant. Plaintiff was not provided with a copy of the controlling AAA rules or advised as to how he could find or review them. The provisions also failed to identify which set of rules promulgated by the AAA would apply. The Court further stated that the "arbitrator shall be entitled to award reasonable attorney's fees and costs to the prevailing party." This would have exposed the employee to greater liability to defendant for attorneys' fees than he would have been had he pursued his FEHA claims in court. For these and other reasons, the arbitration clause was ruled unconscionable and not enforced.

In January 2012, the National Relations Labor Board ("NLRB") faced the question of whether an employer violates the National Labor Relations Act ("NLRA") when it requires employees covered by the NLRA, as a condition of their employment, to sign an agreement that precludes them from filing joint, class, or collective claims addressing their wages, hours, or other working conditions against the employer in any forum, whether arbitral or judicial. The NLRB found that such a condition was illegal and found no conflict with the FAA and its policies. Many found this to show disagreement with the ruling in *Concepcion.*

Had the FAA not been so ambiguously drafted, and had the Supreme Court not expanded the purpose of the FAA so drastically, many of these court battles would not be necessary. The Supreme Court has gone so far that arbitration is not on "equal footing." It has become so popular that employees and consumers are being forced into impossible and unfair situations, leaving big businesses to take advantage of them. Permitting large corporations to be able to ban class-wide arbitration and require each individual consumer to initiate private and costly arbitration is an invitation to break the law and take advantage of customers and consumers.

The AFA

Currently, the Arbitration Fairness Act of 2011 ("AFA") is before Congress; it had previously failed in a 2009 version. The AFA amends the FAA and holds that any pre-dispute arbitration agreement requiring arbitration of an employment, consumer, or civil rights dispute is unenforceable. The amendment states that 1) the FAA was intended to apply to disputes between commercial entities of generally similar sophistication and bargaining power; 2) that a series of decisions by the Supreme Court have changed the meaning of the Act so that it now extends to consumer disputes and employment disputes; 3) most consumers and employees have little or no meaningful choice whether to submit their claims to arbitration. Often, consumers and employees are not even aware that they have given up their rights; 4) mandatory arbitration undermines the development of public law because there is inadequate transparency and inadequate judicial review of arbitrators' decisions; and 5) arbitration can be an acceptable alternative when consent to the arbitration is truly voluntary, and occurs after the dispute arises.

The 2011 AFA must be passed, at least in some form. Consumers and employees can no longer be held hostage to unfair agreements that clearly put them at a disadvantage while inviting companies to break the law. The FAA was enacted so that businesses that have disputes can hire someone to efficiently arbitrate a dispute that otherwise may take too long in court and so courts would enforce those commercial agreements. The FAA was not, and should not, have been enacted to force every consumer to be forced into arbitrations when they agree to waive constitutional rights by signing some arbitration provision hidden in some consumer contract they never read. Similarly, an employee who wants to keep his job, or an applicant who wants to get a job, should not be forced to give up constitutional and

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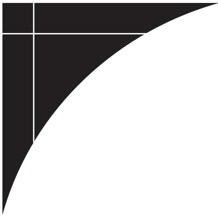

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statutory rights. Neither group should be stuck in a position where they lose rights to discovery, right to a jury, right to the law being applied properly, the right to an appeal, and the right to not have to spend hundreds of thousands of dollars. Simply put, the Supreme Court should not be so quick to allow its consumers and workforce to be forced to waive key rights and thus, Congress must act.

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