



The Federal Arbitration Act: The end of consumer rights as we know them?

By Ryan E. Hodge

Late Friday afternoon a new client walks into your office. He has a complaint about his mobile home. You listen to his claim. It sounds like he has really been taken advantage of, and he has the documentation to prove it. He then hands you his contract. You casually flip through the standard boilerplate provisions prohibiting the recovery of consequential damages and providing limited express warranties only to stumble upon the following language that makes you swallow hard.

By entering into this contract you agree to submit to binding arbitration on any and all claims arising out of or related to this transaction including but not limited to claims of warranty breach, consumer protection claims, negligence, and breach of contract. Arbitration will be binding on both parties except that seller or its assignees may proceed to court on any collection matter relating to nonpayment under the terms of this contract. By submitting to binding arbitration you waive all claims to participate in a jury trial individually or through a class



Ryan E. Hodge is a managing partner at the firm of Ray Hodge & Associates, Wichita. He has been in practice since 1994, practicing in the areas of criminal, domes-

tic, bankruptcy and civil litigation. His current emphasis is on personal injury litigation. Ryan received his J.D. from the University of Kansas and an M.B.A. from Eastern College in Philadelphia, PA. He serves as "Consumer Law" editor on KTLA's board of editors.

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action initiated by yourself or anyone on your behalf.

Arbitration will take place in Minneapolis, Minnesota and will be conducted by an arbitrator of our choosing. You agree to pay any fees to initiate such arbitration not to exceed \$1000 and further agree to pay in advance half the cost of the arbitrator in an amount not to exceed \$2500. In the event that you do not prevail on your claim you agree to pay all of seller's attorney fees and costs for participating in such arbitration. Prevailing on a claim is defined as recovering at least 75% of what you request in arbitration.

Shiver me timbers you say as you read the provision. Can this really be binding? If it is, what chance does this person have? Welcome to an old but recently discovered tool of the tort reform era.

In 1925 the United States Congress passed the Federal Arbitration Act (FAA). It was drafted and sponsored by lawyers from the American Bar Association who represented businesses that were whining about how the courts simply did not understand business. Interestingly enough, state legislatures apparently understood business all too well as numerous states had laws that imposed special burdens on arbitration provisions in contracts. This was primarily because of how overreaching and oppressive many of the arbitration provisions had been. Because the FAA is federal law, it is preemptive of any state law to the contrary. In substance the FAA requires arbitration agreements to be enforceable just as any other provision in a contract. The key language is as follows:

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction... shall be valid, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Early on, the Supreme Court narrowly construed this Act and continued to protect citizens from denial of their right to a trial by jury. For example, the Court found in *Wilkov v. Swan*, 346 U.S. 427 (1953), that the FAA did not control in a brokerage contract because the Securities Act was more specific legislation and thus controlling. Likewise, the Court found in *Alexander v. Garner-Denver Co.*, 415 U.S. 36 (1954), that an arbitration act

could not allow a prospective waiver of rights under Title VII.

Unfortunately, in 1985 the Supreme Court changed its position on the FAA. The Court's position on the FAA went from the belief that arbitration should be confined to "determination of the quality of a commodity or the amount of money due under a contract," *Wilkov* at 435, to the FAA-established "emphatic federal policy in favor of arbitral dispute resolution." *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.* 473 U.S. 614, 631 (1985).

The Court in its rampage to "favor" arbitration has run roughshod over the rights of consumers in order to enforce overreaching adhesion contracts. *Allied-Bruce Terminix Co v. Dobson*, 513 U.S. 265 (1995). The Court also had ignored its prior precedent and decided that this federal arbitration preemption is controlling even on statutory rights that were totally separate from the contract. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991) (holding that a plaintiff's claim for age discrimination in employment was subject to arbitration).

This preemption of statutory rights is most dangerous for consumers in the context of state consumer protection laws, which are preempted by the FAA. See for example, *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987) (binding arbitration provision prohibited a consumer from bringing RICO and Securities Exchange Act violation claims); *Mitsubishi Motors Corp. v. Soler-Chrysler Plymouth, Inc.*, 473 U.S. 614 (1985) (antitrust actions are subject to arbitration agreements); *Value Car Sales, Inc. v. Bouton*, 608 So. 2d 860 (Fla. 1992) (consumer protection claims are subject to arbitration clauses); *Jack B. Anglin Co. v. Tipps*, 842 S.W.2d 226 (Tex. Ct. App. 1992) (provisions of consumer protection statutes making the statute not subject to contractual waiver are preempted by the FAA requiring consumer to submit consumer protection claims to binding arbitration); *Doctor's Associates, Inc. v. Casarotto*, 116 S. Ct. 1652 (1996) (state statutes regulating format of binding arbitration are preempted).

In addition to the loss of statutorily granted consumer rights, the manners in which these arbitration provisions

are obtained are irrelevant to whether they are enforced. See for example, *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (7th Cir.) (arbitration provisions binding even if the consumer does not see them. Arbitration agreement that arrived in package with product that was ordered over the phone was valid and enforceable); *Prima Pain Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967) (contracts entered into by fraudulent inducement are subject to arbitration); *Gammara v. Thorp Consumer Discount Co.*, 828 F. Supp. 673 (D. Minn. 1993) (prohibition against participating in class action litigation and forced submittal to binding arbitration enforceable).

To fully understand just how dangerous this Act is, consider for example the following as if it were a provision in a contract.

By entering into this hospital and accepting care and treatment you agree to submit any claims of negligence on the part of the hospital or the Doctor to binding arbitration. The arbitrators will be of our choosing. You must notify us within one year of the alleged act of negligence that you intend to exercise this right.

Now let's take this one step further. Suppose a person requests arbitration and is told that to participate they must come up with a \$1,000 filing fee and fees to pay the arbitrator payable in advance with a 20-hour minimum at the rate of \$250 per hour. Of course, there is no discovery for the injured victim, and if the defendant has deep pockets and uses a single arbitrator for its arbitration, it could backlog the process to the point that nothing happens for several years. If the arbitrator makes an erroneous interpretation of the legal issues surrounding the consumer's claim, there is no appeal forum.

The Act provides that any arbitration provision "shall be valid, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." In other words, arbitration clauses can be avoided under state law but only on grounds that would generally apply to any contract provision. *Doctor's Associates, Inc. v. Casarotto*, 116 S. Ct. 1652

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(1996). Examples of such voiding powers would include theories of unconscionability, duress, undue influence, incapacity, impossibility, frustration of purpose, breach of covenant of good faith and fair dealing, fraud in the factum, and mistake.

Given Kansas' courts posture on contract voiding, it is unlikely any consumer could hope for protection from any of these traditional contract-voiding theories. Kansas' key case on unconscionability is *Wille v. Southwestern Bell*, 219 Kan. 755 (1976). This is an early case testing the issue of unconscionability under the Uniform Commercial Code. The court set out a number of factors to be considered to determine whether a contract was unconscionable. Although the factors seem reasonable, Kansas courts have been consistently unable to find facts sufficient to rise to this level. See for example, *Gonzales v. Associates Financial Services Co. of Kansas, Inc.*, 266 Kan 141 (1998).

A few courts have taken a more liberal approach to issues of unconscionability. For example, the Utah Supreme Court found unconscionable an arbitration provision that the con-

sumer pay the other side's attorney's fees and costs if the consumer does not recover at least half of the damages sought in the arbitration. *Sosa v. Paulos*, 924 P.2d 357 (Utah 1996). Similarly, a California court found an arbitration provision unconscionable when it was in an adhesion contract, required the parties to appear for arbitration in Minneapolis and required the payment of a large fee. *Patterson v. ITT Consumer Financial Corp.*, 14 Cal. App. 4th, 1659 (1993), cert. denied, 510 U.S. 1175 (1994).

It seems that little can be done except hope that businesses remain ignorant of this law and its oppressive powers. However, should you come across such a provision and it seems to be particularly harsh, here are some pointers to challenge the contract.

■ Remember that any state-based theory for voiding a contract can be applied to an arbitration clause. Look closely at whether any such remedies could be applied.

■ If you are going to attack such a provision in a boilerplate adhesion contract, go class action seeking per-

manent injunctive relief. At least that way there is some chance of getting enough in attorney fees to make it worth you while.

■ Try to use discovery to go beyond the provisions of the arbitration agreement to show that the process itself is, in fact, unfair.

■ Does the arbitrator work for the defendant on a regular basis? Has the arbitrator ever made a finding against the defendant? Are the arbitrator's awards inordinately low? Remember, even if the arbitration clause appears to be relatively benign, the way in which the clause is enforced may be quite draconian.

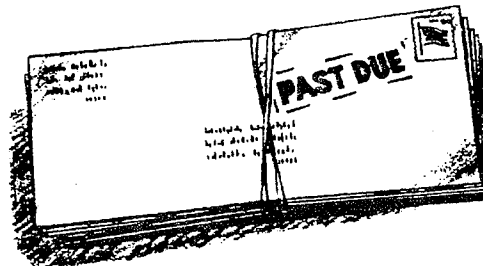
■ Remember that Kansas has unconscionability provisions in several statutes, including the Uniform Commercial Code, the Kansas Consumer Protection Act, and the Uniform Consumer Credit Code. Kansas courts have never held that the standard for finding unconscionability is different in a contract involving consumers. Such a legal conclusion is critical and is explicitly stated in the

text of the UCCC. Argue that the Consumer Protection Act implicitly requires such a finding and that the standard used in *Southwestern Bell v. Willie* (factors for finding unconscionability under the UCC) is not proper in the context of transactions involving consumers.

■ Make sure you have a really, really egregious claim. If the provisions of the arbitration clause are not so repulsive as to shock the conscience, bringing such a challenge may do nothing more than create bad law.

Judicial tort reform is as rampant as legislative tort reform. From requiring parties to submit to binding arbitration to denying plaintiff's attorneys fees on claims that allow for them in order to discourage the bringing of such claims, the courts are tort-reforming the consumer right out of the courtroom. Only by bringing the most egregious cases can we hope to begin to turn the tide. This shouldn't be difficult; it will just take some digging. After all, when the law is lax, treachery and deceit rage. ♦

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