STATUTE

REGULATING DISPUTE RESOLUTION PROVISIONS IN ADHESION CONTRACTS

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A number of recent Supreme Court decisions regarding the enforceability of forum selection and choice of law provisions have diluted the substantive rights of franchisees, employees, and consumers by precluding the litigation of their claims in the forum of their choice under laws designed to protect them. In this Statute, Professor Carrington proposes legislation to ensure that these claims are not diverted to inconvenient fora by judicial enforcement of dictated form contracts. The proposed Statute would limit the enforcement of forum selection and choice of law provisions to those contained in contracts conforming with standard contract and choice of law doctrine.

The problem addressed in this proposal stems from a series of Supreme Court decisions that interpret the Federal Arbitration Act of 1925 and other federal legislation bearing on contracts of adhesion made in interstate and international commerce.[1] In recent decades, the Court has disregarded principles of contract and conflicts law developed to protect weaker parties from predation at the hands of stronger parties positioned to dictate the terms of standard contracts.[2] Among the federal laws that have been materially weakened by the Court are the antitrust laws, employment discrimination laws, and laws protecting shippers and passengers. Among the state laws weakened or denied effect altogether are antitrust laws, franchise investment laws, and laws protecting consumers and workers. Legislation broadly restoring the enforceability of such rights is now needed.

The predatory strategy the Court has condoned depends on the use of standard contract provisions restricting either the choice of law determining the rights of vulnerable parties, or the choice of forum in which such rights can be asserted, or both. Such provisions share two features making them especially useful to

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[1] *See* Paul D. Carrington & Paul H. Haagan, *Contract and Jurisdiction*, 1996 SUP. CT. REV. 331.

[2] *See* G. Richard Shell, *Contracts in the Modern Supreme Court*, 81 CAL. L. REV. 431, 445 (1993).

predators. The first is that they can serve materially to diminish the value of the statutory rights of parties by increasing their enforcement costs and the risks of non-enforcement. The second is that the effects of such clauses are more visible and important to "repeat players" positioned to insist on standardized provisions than they are to the "one-shot players" with whom they contract, for the latter, unlike the former, seldom make contracts at all if the prospect of a future dispute is in their minds. In other words, *ex ante*, a favorable dispute resolution clause is more highly valued by the "repeat player" who knows that disputes will ensue than by the "one-shot player" who discounts the prospect of a dispute. Because dispute resolution clauses in standardized contracts are chronically undervalued by "one-shot players," they are a means by which "repeat players" enrich themselves at the expense of those with whom they contract by systematically, impairing the enforceability of the latters' statutory rights.

Ironically, in 1889, the Court recognized the problem of dictated form contracts.[3] On its authority and that of many other courts, it is now black letter law, expressed in Restatement (Second) of Contracts Section 211 that provisions in such dictated contracts must be "reasonable and just." It is also the law in most states that unconscionable contract provisions are not enforced, at least if they appear in adhesion contracts for the sale of goods.[4] For the reasons stated, provisions bearing on the resolution of future disputes, such as choice of law, forum selection, and arbitration clauses, are superior candidates for the application of these elementary principles. It is neither "reasonable and just" nor "conscionable" for employers to require workers, as a condition of their employment, to agree to disable themselves in asserting rights created for their protection from just such overbearing contracts. The same principles apply to small, local franchisees for whom a national or international franchise is increasingly a precondition to a successful local business. These principles also apply to consumers of goods and services who are provided with printed form contracts such as tickets, bills of lading, package inserts, receipts, and other instruments that they cannot realistically be expected to read and consider.

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[3] *See* Liverpool & Great Western Steam Co. v. Phenix Ins. Co., 129 U.S. 397 (1889).
[4] *See, e.g.*, U.C.C. § 2-302 (1996).

Similar doctrine is expressed in Section 187 of the Restatement (Third) of Conflict of Laws that parties to a contract may not by a choice of law clause bind themselves to forego rights created by a state to protect one party from the other. Choice of law provisions are valid only to the extent that they do not foreclose enforcement of applicable regulatory laws. Likewise, Section 80 of the same Restatement provides that forum selection clauses are not enforceable if the forum selected is unfairly or unreasonably inconvenient. That doctrine was recognized by the Court as recently as 1972, when it created an exception to validate choice of forum clauses made in international commerce between sophisticated businessmen who contracted for a forum that was mutually inconvenient but located in a country of which neither was a citizen.[5]

The Court has disregarded these wise principles embedded in black letter law, and sometimes also expressed in applicable federal legislation. The Court has held that cruise line passengers were bound by the fine print in their ticket to assert a claim for personal injury across the continent from where the ticket was purchased or the alleged injury occurred.[6] It has held that a shipper of fruit from Morocco to Massachusetts is bound by a bill of lading to arbitrate a claim for spoilage in Tokyo.[7] It has held that an automobile dealer in Puerto Rico is bound by a clause in his franchise agreement to arbitrate in Tokyo a claim for alleged violation by the manufacturer-supplier of the antitrust laws of the United States.[8] It has held that a local franchisee asserting a state law antitrust claim against the franchisor is precluded by his franchise agreement from using the state's courts to enforce his state-created rights.[9]

It has held that a local franchisee in Montana, despite contrary state law, is bound by contract to pursue a claim against the franchisor in Connecticut.[10] It has held that a consumer of termite removal services is bound, by the standard form termite removal contract, to arbitrate a claim against the removal contractor.[11] This forum could have charged for its services about

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[5] *See* M/S Bremen v. Zapata Off-Shore Co., 407 U.S. 1 (1972).
[6] *See* Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585 (1991).
[7] *See* Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer, 515 U.S. 528 (1995).
[8] *See* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985).
[9] *See* Southland Corp. v. Keating, 465 U.S. 1 (1984).
[10] *See* Doctor's Associates, Inc. v. Casarotto, 116 S. Ct. 1652 (1996).
[11] *See* Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265 (1995).

as much as the termite contractor had charged to remove the termites.[12] The Court also held that an employee of a securities brokerage firm is bound by his submission to the governance of a securities exchange to arbitrate an age discrimination claim in a forum provided by the exchange.[13] The latter holding has led lower courts[14] to assume that the Court was questioning an earlier decision holding that race and gender discrimination claims cannot be subjected to binding arbitration.[15]

Employers, franchisors, and providers of goods and services who seek to deny others their rights may only recently have fully realized what the Court has done. It has hence become increasingly common for them to include in contracts provisions that virtually disable employees, franchisees, and consumers from enforcing rights, not only those rights created in the contract, but also those rights created by law to prevent the very predatory conduct shielded by dispute resolution provisions. In some places, for example, it is almost impossible to secure employment or health care without agreeing to waive or seriously impair one's rights in relation to the employer or health care provider.[16]

The securities industry has been especially aggressive in exploiting the invitation extended by the Court to impair the rights of its employees. The Court had earlier held that small investors are not bound by clauses in brokerage agreements to arbitrate statutory fraud claims in a forum provided by the securities industry.[17] That decision has been overruled,[18] the Court relying on the power conferred by Congress on securities exchanges to enforce the investment fraud laws. It is, however, unclear how the authority of the exchanges to self-regulate with respect to fraud can be extended to employment relations or other matters outside the compass of securities regulation laws.

The Statute proposed here seeks to correct these unjust outcomes by restoring the vigor of the Restatement provisions quoted above. It is narrowly drafted to avoid any adverse effects on legitimate arbitration practice. Thus, it would not impair freedom of contract among those engaged in interstate or interna-

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[12] *See* Carrington & Haagan, *supra* note 1, at 385.

[13] *See* Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991).

[14] *See, e.g.*, Austin v. Owens-Brockway Glass Container, Inc., 78 F.3d 875 (4th Cir. 1996); Nghiem v. NEC Electronics, 25 F.3d 1437, 1441 (9th Cir. 1994).

[15] *See* Alexander v. Gardner-Denver Co., 415 U.S. 36 (1974).

[16] *See* Olia Silea, *Arbitration for 21st Century*, Rec. N.N.J., June 20, 1997, at B1.

[17] *See* Wilko v. Swan, 346 U.S. 427 (1953).

[18] *See* Rodriguez de Quijas v. Shearson/American Express, 490 U.S. 477 (1989).

tional commerce to resolve disputes among businesspersons or others who are themselves sophisticated readers of contracts or likely to be well-advised by counsel and who have sufficient economic power to withstand predation.

Nor does it apply to collective bargaining agreements, or to agreements regarding the resolution of existing disputes, or to claims asserting rights explicitly created in the contract containing the dispute resolution provision, such as claims for breach of express warranties. Thus, the Statute's only effect is to prevent the use of dispute resolution clauses to diminish the value of statutory rights devised to protect "one-shot players" from economic predation by "repeat players." Indeed, the proposed Statute would permit enforcement of adhesive arbitration agreements to bar lawsuits enforcing state or federal law protecting employers, consumers, or franchisees if the agreement contains provisions assuring that the arbitral tribunal will impose no added costs on the parties and will be required to obey the substantive law applicable to disputes.

In its present form, the Statute is drafted for consideration by the Congress of the United States. In slightly varied form, it might also be suitable for enactment by a state legislature. As state legislation, it affords an alternative to efforts to revise state arbitration laws to avoid the effects of some of the Court's decisions interpreting the Federal Arbitration Act. The National Commissioners on Uniform State Laws is presently reconsidering its Uniform Arbitration Act in light of these developments.[19] A proposal is also presently under consideration by the California legislature.[20] These efforts seem unlikely to overcome the preemptive effects of the Court's decisions.

This Statute is drafted in recognition that states cannot modify the federal law and policy favoring arbitration. The states, however, retain the power to legislate in the field of contracts so long as they make arbitration clauses subject to no special restraints.[21] State legislatures are therefore well advised to leave their arbitration laws alone and direct their attention to adhesion contracts containing provisions impairing the rights of "one-shot players,"

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[19] Timothy J. Heinsz, *The Uniform Arbitration Act: Changes in the Wind?*, 4 DISP. RESOL. MAG. 18 (Fall, 1997).

[20] *See* S.B. 19, 1997-1998 Reg. Sess. (Cal. 1996).

[21] *See Allied-Bruce*, 513 U.S. at 281.

for such laws are not yet preempted. The following Statute is written with that caution in mind.

APPENDIX

AN ACT PROVIDING FOR THE ENFORCEMENT OF STATE AND FEDERAL LAWS PROTECTING EMPLOYEES, LOCAL FRANCHISEES, AND CONSUMERS

Whereas, contracts of employers with employees, franchisors with local franchisees, and providers of goods or services with consumers, do not necessarily express the mutual and voluntary assent of both parties; and

Whereas such contracts are used with increasing frequency in interstate and international commerce by employers, franchisors, and providers of goods and services to impair the enforcement of rights conferred by state or federal law to protect employees, local franchisees, and consumers; and

Whereas the use of standard contracts thus to deny or impair protective rights is unjust and unconscionable;

Now, therefore, it is enacted that:

1. This Act shall be known as the Employee, Local Franchisee, and Consumer Rights Enforcement Act of 1998.

2. For the purposes of this Act,

(a) *commerce* includes all transactions or employments arising out of interstate or international commerce;

(b) an *employee* is a worker not subject to a collective bargaining agreement who is not an executive officer of a corporation, an attorney, a licensed investment broker, a medical doctor, a professional athlete, or an artistic performer;

(c) a *local franchisee* is a person engaged in retailing goods or services at not more than three locations in a single county or parish of a state who is authorized by contract to use the trade name or trademark of a franchisor engaged in commerce;

(d) a *consumer* is any person purchasing goods or services delivered for personal use in the United States, and includes passengers and shippers of goods on common carriers in commerce; and

(e) *the state* is the state of the principal place of employment of the employee, or the principal place of business of a

local franchisee, or the place of delivery of goods or services to a consumer.

3. Subject to the provisions of Section 4 of this Act, a contract between an employer and employee, or between a franchisor and franchisee, or between a consumer and a provider of goods or services is invalid to the extent that it:

(a) purports to preclude the application of federal law or law of the state enacted to protect the employee, local franchisee, or consumer; or

(b) purports to deny the employee, local franchisee or consumer access to courts located in the state that are otherwise available to the employee, local franchisee or consumer to enforce state or federal laws enacted to protect that employee, local franchisee, or consumer.

4. Notwithstanding the provisions of the foregoing Section 3 of this Act, this law shall not preclude:

(a) application of an otherwise valid choice of law, forum selection, or arbitration clause to proceedings brought to enforce rights created by the contract in which the clause appears; or

(b) enforcement of an arbitration agreement between an investor and an investment broker pursuant to regulation by a Self-Regulating Organization as authorized by Section 78(s) of Title 15; or

(c) enforcement of an arbitration agreement made with respect to a dispute existing between the parties at the time the agreement is made; or

(d) enforcement of an otherwise valid arbitration agreement if:

(i) the place of arbitration is located in the state;

(ii) the employee, local franchisee or consumer is required to pay no fees in excess of those required by courts in the state;

(iii) the arbitral tribunal is required by contract to enforce statutory rights; and

(iv) the arbitral award is subject to judicial review by courts in the state to assure that there are no errors of law or clear errors of fact resulting in non-enforcement of state or federal laws enacted to protect employees, franchisees, or consumers.