Outsourcing Justice

Arbitration agreements represent an unjustified, expansive, and private system of justice that touches almost every aspect of American society and impacts the lives of millions.

By Imre Szalai

The Federal Arbitration Act is an old statute, enacted in 1925, and rather short. The heart of the Federal Arbitration Act is just one sentence, generally declaring that arbitration agreements are valid, irrevocable, and enforceable. This statute radically changed existing law when it was first enacted because prior to the 1920s, courts in America generally refused to enforce arbitration agreements. There was a strong view called the "ouster doctrine," which recognized that a private agreement between two parties could not oust the government of its judicial power to resolve disputes. As explained in more detail below, when it was enacted in 1925, the Federal Arbitration Act reversed the ouster doctrine and made arbitration agreements enforceable in connection with a very narrow subset of disputes.

I never learned of the Federal Arbitration Act when I was in law school. However, as soon as I entered practice, I saw this law being used all the time in a powerful manner. Several of my corporate clients had arbitration agreements in their transactions, and if a consumer or employee would sue my client, I would frequently respond by asking the court to enforce the arbitration agreement and stay or dismiss the case under the Federal Arbitration Act.

When a court ordered arbitration in connection with my cases, these cases would often just disappear, with the consumer or employee understandably not pursuing claims in the arbitral forum with very limited procedural rights. Entire class actions would often just evaporate when a court ordered arbitration. I became amazed at the power of the Federal Arbitration Act. Because so many cases disappeared after I obtained an order compelling arbitration, I saw how the statute was in effect used to suppress claims, and in the back of my mind, I sometimes wondered what was the original intent behind this 1925 law? Why didn't I learn about this law as a student? Did the drafters of the statute really intend it to suppress claims? But I continued to use the law in my practice because, as a young lawyer, I was able to clear my workload very quickly and make my clients content by easily ending a lawsuit through the invocation of this statute.

After a few years of using the statute, when my first child Ella was about to be born, I began to see the Federal Arbitration Act in a different light. The night my wife went into labor, I was a very anxious, soon-to-be first-time dad. Upon our arrival at the hospital, I was handed a stack of papers to sign at the front desk while my wife was taken away in a wheelchair to a delivery room. In the stack of papers, I found an arbitration agreement saying I promised never to sue the doctors, hospital, nurses, or insurance company in connection with the delivery of my child.

Because of my legal background, I was fully aware of what my requested signature on the arbitration agreement would mean, and I was shocked and remember

thinking how did such agreements become so widespread in American society. Realizing that I was about to become a father and a protective instinct arose in me, I did not want to sign the arbitration agreement. If someone committed medical malpractice and hurt my daughter or wife, I wanted to have all the full, procedural rights available in court, especially the right to a jury, broad discovery, and a public hearing with broad appellate rights, instead of a highly secretive arbitration hearing with virtually no rights. However, the hospital staff was demanding signatures on every page. So I sneaked out of the registration area and brought the paperwork to my wife who was in the middle of painful labor. Just in case something bad happened, I asked my wife to sign the arbitration agreement, thinking that no judge would ever enforce the agreement in light of her mental and physical state. Thankfully, my wife gave birth to our beautiful, healthy baby daughter, and no disputes arose regarding her delivery. Sadly, other parents have not been so fortunate, and there are reported decisions dismissing medical malpractice lawsuits in connection with the delivery of a baby because of an arbitration agreement.

At that moment in the hospital when I was about to become a father and I was asked to sign away the rights of my child and wife, I was furious. I believe most people would feel the same way in these circumstances if they understood the implications of signing an arbitration agreement. Arbitration agreements can have deep implications for the resolution of a dispute and deep implications on our justice system. At that moment in the hospital, I had a flashback to all the times in practice I successfully invoked the Federal Arbitration Act to end a lawsuit. I began to realize how could I be in favor of imposing on others what I would not be willing to impose on my own family.

I began noticing arbitration clauses appearing everywhere in society — in credit card agreements, cable television service contracts, cell phone agreements, banking agreements, employment agreements, on tickets to professional sporting events, on user agreements for various websites, the back of a box of Cheerios, and even a french fry carton. Partly because of a guilty conscience in having enforced so many arbitration agreements and partly because of a deep curiosity, I became fascinated with arbitration and how arbitration agreements spread throughout American society. I began studying anything I could find regarding the history of arbitration and arbitration laws in America. For example, I found that in my hometown of New Orleans, the New Orleans cotton exchange of the late 1800s was one of the earliest commodities exchanges in the country to institute a system of arbitration, and merchants in New York used arbitration since Revolutionary War days. (During the Revolutionary War, when the British occupied Manhattan, an arbitration system established by merchants became the primary functioning institution for resolving disputes during the occupation.) I found such uses of arbitration, between merchants of relatively co-equal status who knowingly agreed to submit a dispute to arbitration, to be more justified than the broad consumer and employment contexts I often see arbitration agreements used in today.

When I saw the history behind the Federal Arbitration Act and compared this history to the uses of arbitration, I saw in my law practice and my own private life, the juxtaposition was very jarring.

One name kept on appearing in my research regarding the history of American arbitration laws, Charles Bernheimer, a colorful merchant in New York City from the 1920s, and he was the main driving force in pushing for the enactment of arbitration laws in the 1920s in the United States. He was an interesting Indiana-Jones like character who went on expeditions to unexplored areas of the Southwest on behalf of the American Natural History Museum, and contemporaries described him as the Father of Commercial Arbitration in America. He was a lifelong devotee to the use of arbitration, and he helped with the founding of the American Arbitration Association. A few years ago, I tried to track down his relatives, and I discovered that his personal files were buried in the archives of my alma mater, Columbia University. No one had ever publicly written about his files.

When I started reading through his files, I felt like I had found the Holy Grail regarding the history of the Federal Arbitration Act. In meticulous detail, I saw an almost week-by-week account of an intensive, well-orchestrated lobbying campaign for the Federal Arbitration Act and similar state statutes enacted during the 1920s. In these archives, I saw personal, behind-the-scenes meetings with Congressmen (including an invitation to one of Hollywood's first celebrity, exclusive hangouts, which became a brothel). Bernheimer was a German immigrant, and I learned that German law inspired his ideas for the Federal Arbitration Act and similar state statutes, but because of the First World War and the hatred of all things German, the lobbying campaign kept this background a secret. In his letters, I saw the broader historical context in which arbitration laws came about, and I learned how Prohibition and the Progressive Era influenced the enactment of arbitration laws. An amazing, stranger-than-fiction history of the Federal Arbitration Act began to come to life, letter-by-letter in these archival materials and other overlooked sources.

When I saw the history behind the Federal Arbitration Act and compared this history to the uses of arbitration, I saw in my law practice and my own private life, the juxtaposition was very jarring. Also, in light of this history, I began to see tremendous flaws in fairly recent

Supreme Court decisions purporting to interpret the Federal Arbitration Act. For example, in 1984, the Supreme Court held in a case called Southland v. Keating that section two of the Federal Arbitration Act, which declared that arbitration agreements are binding, applied in state court and powerfully preempts any state law standing in its way (despite the fact that the rest of the statute clearly and exclusively refers to federal district court, not state courts.) The drafters in the 1920s intended the law to apply solely in federal court. Based on the history and campaigning for the statute, the drafters created a unified, comprehensive statutory scheme. In light of this history, it is ludicrous to conclude, as the Supreme Court in effect did in Southland in 1984, that the drafters created section 2 to stand apart and broadly apply in both state court and federal court, while the rest of the statute would be limited just to federal court.

Also, beginning in the 1980s, the Supreme Court began to hold in a series of cases that the Federal Arbitration Act covers complex statutory claims. In the 1985 case of Mitsubishi Motors Corp. v. Soler-Chrysler-Plymouth, the Supreme Court held that complex antitrust claims were subject to the Federal Arbitration Act. However, the history I uncovered shows that the statute was drafted by merchants for merchants, for routine, simple contract disputes, not important statutory claims that belong more appropriately before a public court.

Also, in the 1991 case of Gilmer v. Interstate/Johnson Lane Corp and more explicitly in the 2001 case of Circuit City v. Adams, the Supreme Court held that the Federal Arbitration Act covers employment disputes. These cases are fundamentally flawed. In my research, I found exchanges of letters from the 1920s showing that the drafters eventually added language to the statute to clarify that the statute was never intended to cover employment disputes. These old letters from the drafters were not publicly known prior to the publication of my research a few months ago; when the Supreme Court was deciding the important issue of the law's applicability to employment relationships back in 1991 and 2001, no one was aware of these archival materials.

Over the past few decades, arbitration agreements have proliferated like cancer throughout American society. Such agreements appear in virtually all types of consumer transactions, and millions of American workers are bound by arbitration agreements in their employment relationships. These agreements threaten the enforcement of critical statutory rights embodied in civil rights and wage and hour legislation and in consumer protection laws. The rights and obligations created by such important legislation are meaningless if employees and consumers can no longer access the judicial system and are relegated to a private system of arbitration governed by increasingly one-sided arbitration provisions. America has become an "arbitration nation," with an increasing number of disputes taken away from the traditional, open court system with the right to a jury and relegated into a private, secretive system of justice.

Turning to the judiciary, a majority of Supreme Court Justices are continuing an aggressive expansion of the scope of the Federal Arbitration Act and holding that it preempts virtually any law that stands in its way, especially in recent cases like AT&T Mobility LLC v. Concepcion in 2011 and American Express Co. v. Italian Colors Restaurant in 2013. In these cases, the Supreme Court held that under the Federal Arbitration Act, class action waivers are enforceable, and these rulings can have a horrible impact on the availability of class actions. An individual with an arbitration agreement containing a class action waiver will find it very difficult to bring a class action. However, the reach of these recent Supreme Court decisions goes far beyond the class action context. These Supreme Court rulings can also undermine the fairness of individual arbitration proceedings. In these decisions, the Supreme Court set forth a very broad, and in my opinion vague, interpretation of the preemptive powers of the Federal Arbitration Act. Post-Concepcion and post-American Express, lower courts are holding that the Federal Arbitration Act preempts any defense that specifically targets arbitration. In the past, prior to these decisions, courts would sometimes use the unconscionability doctrine to strike down one-sided arbitration clauses, such as arbitration clauses with very severe limits on discovery. However, some courts today, in the wake of Concepcion and American Express, are finding that the Federal Arbitration Act preempts such uses of the unconscionability defense because such defenses are improperly targeting fundamental attributes of arbitration. See, e.g., Lucas v. Hertz Corp., 875 F. Supp. 2d. 991 (N.D. Cal. 2012). ("Prior to the Supreme Court's ruling in Concepcion, numerous courts, at both the state and federal level, found arbitration agreements substantively unconscionable where the rules of the arbitral forum allowed for only minimal discovery or where the affect [sic] of the discovery rules operated solely to one side's benefit," but after Concepcion, "limitations on arbitral discovery no longer support a finding of substantive unconscionability."). In effect, judicial review of arbitration agreements for fundamental fairness has become more circumscribed than in the past, and courts are moving closer to a model of almost rubber-stamping orders enforcing arbitration agreements, no matter how one-sided such agreements may be. ■

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