Arbitration and the Contract Exchange

ESSAY

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I. INTRODUCTION

A contract exchange, defined as an organized marketplace for the creation or trading of specific contracts, provides benefits to its members as well as the public at large. But legal disputes can arise on contract

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exchanges, just as they do anywhere else, and those disputes can be litigated, mediated, arbitrated, or resolved in some other way. This Essay claims that arbitration, rather than litigation, is a particularly useful and appropriate means for resolving exchange-related disputes, and that this is true not only for traditional contract exchanges, like the Chicago Board of Trade (CBOT), but also for online "consumer contract exchanges," such as Priceline.com.

Arbitration is well suited to the task of deciding exchange-related disputes for several reasons. For one, arbitration is designed to be a low-cost imperfect substitute for litigation just as the contract exchange is designed to be a low-cost imperfect substitute for face-to-face contracting. Other reasons include the ability of exchange arbitrators to develop expertise in the specific contracts traded on the exchange, and the convenience of consolidating related claims in a single forum.

As evidence for the claim that arbitration is particularly valuable for contract exchange disputes, the Essay will show that the vast majority of disputes arising out of American commodities exchanges, are resolved through arbitration, not litigation. This is so both for disputes between members of an exchange, as well as for between members and their customers. Indeed, arbitration is so important to contract exchanges that the CBOT's official rules announce that a resort to litigation would be fundamentally "contrary to the objectives and policy of the Exchange."3

Traditional commodities exchanges like the CBOT are not the only type of contract exchange. In recent years, widespread access to the Internet has made it possible to organize a new type of "consumer contract exchange" with an unlimited number of seats, where consumers are expressly invited to participate.4 The few consumer contract exchanges that exist rely primarily on arbitration to resolve disputes arising on the exchange, just like their commodities exchange forebears.

The nature of arbitration requires that judicial review of an arbitrator's
decision be minimal, and it is under current law. But that does not mean that
the state plays no role in contract-exchange disputes. To the contrary, various
government departments, such as the Commodities Futures Trading
Commission (CFTC), regulate and oversee the structure and process of
exchange arbitration on an ongoing basis to ensure that the process is
sufficiently robust to be relied upon for just results.

This regulation of contract exchange arbitration has, inter alia, the
following salutary effect: It enhances the respect that courts will pay to the
regulated arbitration clause, process, and decisions. The foundation for this
enhanced respect is that the ex ante (regulatory) review acts as a substitute
for ex post (judicial) review of exchange-related arbitration.

In recent years, however, the Federal Arbitration Act (FAA) has been
read by the Supreme Court to mandate a high level of judicial respect for
arbitration and arbitration clauses regardless of whether there was ex ante
regulatory approval. Given the other significant costs of regulatory oversight,
especially for a nascent and growing industry like consumer contract
exchanges, it may be wise to rely solely on the FAA to protect exchange-
related arbitration.

This Essay proceeds as follows: Part I defines the concept of a contract
exchange, with a focus on consumer contract exchanges. Part II claims that
arbitration holds particular value for contract exchanges, and shows that real-
world contract exchanges in fact make extensive use of arbitration. Part III
examines regulation of contract exchange arbitration and the benefit it can
provide, namely enhanced judicial respect.

II. CONTRACT EXCHANGES

This Part provides background on contract exchanges and enumerates
some of the important private and social benefits they provide. This Part also
briefly describes traditional contract exchanges, as well as a new form, the

5 The Federal Arbitration Act empowers courts to vacate arbitration decisions only
in extreme situations, such as that the award was procured through bribery or the
arbitrators exceeded their powers. 9 U.S.C. § 10(a) (2014). See generally, e.g., Amy J.
Schmitz, Ending a Mud Bowl: Defining Arbitration's Finality Through Functional

6 See, e.g., Belom v. Nat'l Futures Ass'n, 284 F.3d 795, 798 (7th Cir. 2002)
("[C]ourts should accord considerable weight to an executive department's construction
of a statutory scheme that it has been entrusted to administer.").
A. Definition

A "contract exchange" can be defined as a centralized and organized marketplace for the origination or trading of specific contracts. A contract exchange is similar to any other marketplace in that it brings many buyers and sellers together in one place, except that traders buy and sell contracts for goods or services—not the goods or services themselves. One well-known type of contract exchange is a commodities exchange, like the CBOT, where parties make and trade contracts for the future delivery of corn, wheat, and other crops. Key features of contract exchanges include standardized forms and a set of trading rules promulgated by the exchange itself.

B. Benefits

Contract exchanges are beneficial organizations that serve the interests of their participants and the public at large.

Contract exchanges benefit participants by facilitating efficient, anonymous transactions among strangers. By providing competitive, liquid markets for standardized contracts, contract exchanges help parties obtain a legitimate market price. Furthermore, exchange-traded contracts can be used for a variety of business purposes, most notably to hedge risk. Contract exchanges also reduce transaction costs in a variety of ways, including by standardizing contracts and gathering buyers and sellers together in one place.

Contract exchanges also confer benefits on the broad public, including nonparticipants. They help reduce the incidence of scarcity and glut by providing insight into expected future market conditions. And by quickly

7 See generally, Schwartz, supra note 1, at 317–46.
8 Id., at 324.
9 Contract exchanges also provide a lawful and "legitimate outlet for speculative capital" by providing a market able to absorb even very large transactions with little effect on prices. Jonathan Lurie, The Chicago Board of Trade 1859-1905, 22–23 (1979). And for traders on exchanges that employ clearinghouses or margin requirements, counterparty risk is greatly reduced. Contract exchanges have been shown to stabilize prices and reduce credit needs, time delays, and risk.
10 This is particularly important with respect to agricultural commodities, as scarcity could lead to famine.
and efficiently conveying useful information to markets, contract exchanges are vitally important to overall economic growth. There are some drawbacks to contract exchanges. For instance, they deny contracting parties the ability to negotiate their agreements, making it impossible for all parties to precisely meet to their needs. These caveats aside, contract exchanges clearly are privately and socially beneficial institutions. Indeed, Congress has encouraged or mandated their use in a variety of settings, from derivatives and swaps to the home mortgage market.¹¹

C. Traditional Contract Exchanges

Contract exchanges have traditionally been located in large "exchange halls" in major cities.¹² Only members of an exchange can trade on the floor. Because space is limited in even the largest halls, only a relatively small group of people can become members. Full membership is called a "seat," and it can be prohibitively expensive.¹³ The result is that wealthy and sophisticated parties have long reaped the many benefits of participating in contract exchanges, but ordinary consumers have not.

The most familiar exchange today is probably the commodities futures


¹² See Bd. of Trade of City of Chi. v. Christie Grain & Stock Co., 198 U.S. 236, 245 (1905) (The "main feature" of the CBOT is that "it maintains an exchange hall for the exclusive use of its members, which now has become one of the great grain and provision markets of the world. Three separated portions of this hall are known respectively as the wheat pit, the corn pit, and the provision pit.").

markets based in Chicago.14 Until recently, the three futures exchanges in Chicago were the CBOT, the Chicago Mercantile Exchange, and the MidAmerica Commodity Exchange.15 In 2007, the CBOT merged with the Chicago Mercantile Exchange, forming CME Group, Inc. ("CME Group").16

Traders are able to efficiently buy and sell futures through the open outcry system and through electronic trading systems because they can rely on the standardized terms in the contracts. For example, the butter futures contract traded on the CME is for 40,000 pounds of USDA Grade AA frozen butter, delivered to an approved warehouse "on any business day of the contract month except that delivery may not be made prior to the third business day following the first Friday of the contract month."17 Every butter contract on the CME has identical terms, and no trader is permitted to alter them in any way. And this standardization has the important effect of making futures contracts into fungible commodities that can easily be priced and traded on a liquid market.18

D. Consumer Contract Exchanges

Contract exchanges have traditionally been located in large exchange halls in major cities, as just discussed. In recent years, however, inexpensive and widespread access to the Internet has rendered physical constraints irrelevant for many purposes. A contract exchange no longer needs to have a physical location to bring traders together in one place. A web-based contract exchange can be just as centralized and organized as a physical one. And this has made possible a new form of contract exchange—one without seats or members—that welcomes the public (consumers) to directly participate,

14 Other futures exchanges are located in Minneapolis and New York.

15 KENNETH M. MORRIS & VIRGINIA B. MORRIS, THE WALL STREET JOURNAL GUIDE TO UNDERSTANDING MONEY & INVESTING 128 (Sophie Forrester et al. eds., 1999) (the CBOT specialized in "grains, Treasury bonds and notes, precious metals and financial indexes [sic]"; the Chicago Mercantile Exchange specialized in "meat ... livestock, [and] currency"; the MidAmerica Commodity Exchange specialized in "financial futures, currency, livestock, grain, and precious metals").


17 CHI. MERCANTILE EXCH. RULEBOOK § § 51S00, 51S03.B, 51S04.C [hereinafter CME RULEBOOK].

18 See Schwartz, supra note 1, at 319–23.
which this author has called a "consumer contract exchange."\textsuperscript{19}

One form of consumer contract exchange is consumer-to-business. A second form of consumer contract exchange is consumer-to-consumer. Each will be considered in turn.

1. \textit{Consumer-to-Business Contract Exchanges}

The Internet has allowed contract exchanges for consumer-to-business transactions to thrive. In general, consumer-to-business contract exchanges enable consumers to make requests for a good or service and receive a number of offers from businesses competing to fulfill the request. The result is that consumers obtain attractive prices and rates.

Perhaps some of the most easily recognizable consumer-to-business exchanges are travel service websites that provide a marketplace for fungible travel services, such as a rental car or an airline ticket. Among the better known are Priceline, where consumers "name their own price" (bid) for travel services, and Hotwire, where travel providers make bids to consumers. On Hotwire, a consumer enters basic information about the service requested, and businesses present offers for the consumer to accept or reject.\textsuperscript{20} The consumer does not know the name of the company making each offer. The consumer only learns the company's identity upon accepting its offer.\textsuperscript{21} Priceline reverses the offer and acceptance process: consumers make the offer to an anonymous group of vendors by entering the price the consumer is willing to pay.\textsuperscript{22} If a vendor accepts the price, the identity is revealed.

In contrast to Priceline and Hotwire, travel services websites such as Expedia, Orbitz, or Kayak lack anonymity. Consumers accept offers knowing the identity of the company behind each offer. Consumers may pay

\textsuperscript{19} Id. at 334–35.


\textsuperscript{21} \textit{10 Tips to a Great Hotel Rate}, \textsc{Consumer Reports}, http://www.consumerreports.org/cro/magazine-archive/2010/june/shopping/hotels/10-tips-to-a-great-rate/index.htm (last updated Jun. 2010) (noting that on Priceline or Hotwire, "the identity of your hotel doesn't become known until after you complete a nonrefundable transaction").

\textsuperscript{22} Terms \& Conditions, \textsc{Priceline}, http://www.priceline.com/privacypolicy/terms_en.html (last visited Apr. 10, 2014).
more based on perceived brand value. This difference separates a contract exchange (like Hotwire) from an ordinary marketplace (like Kayak).

By keeping the brand opaque, Hotwire requires consumers to treat the car rental like a generic commodity and compare offers purely on the basis of price. Although there are small differences between the contracts (one hotel room will likely differ slightly from another), the important consideration is that the consumer, in deciding purely on price, treats them as if they were identical. And for a consumer that prefers to deal with a specific company, they can do so directly off the exchange, although almost certainly for a higher price.

Priceline and Hotwire are not alone. Other consumer-to-business contract exchanges exist today, such as MoneyAisle, a contract exchange for generic consumer financial products, such as FDIC-insured certificates of deposit.

2. Consumer-to-Consumer Contract Exchanges

On a consumer-to-consumer contract exchange, consumers make contracts with one another or trade those contracts. This type of exchange is available to consumers on the Internet and has thus only appeared in the past few years, coinciding with the widespread adoption of high-speed Internet.

There are few real-life examples of consumer-to-consumer contract

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23 See Susan Simpson & Jennifer Palmer, Proposal Greeted with Excitement, Worry in Tulsa, OKLAHOMAN, Apr. 27, 2010, at 1B (reporting on the differing brand identities of car rental companies); see generally HAL R. VARIAN, INTERMEDIATE ECONOMICS 448–53 (5th ed. 1999) (noting that many firms "invest heavily in creating a distinctive brand identity" so that they can obtain higher prices for their goods or services than is available for commodified equivalents).

24 See 10 Tips to a Great Hotel Rate, supra note 21. Because contract exchanges have efficiency advantages over other methods of contracting, we should expect that consumers that use Priceline or Hotwire will obtain lower prices than are available elsewhere. This is indeed borne out in practice: Consumer Reports has found that prices obtained by consumers on Priceline and Hotwire are the most attractive anywhere, online or off. WILLIAM J. McGEE, CONSUMER REPORTS WEBWATCH, BOOKING AND BIDDING IN THE BLIND: AN IN-DEPTH EXAMINATION OF OPAQUE TRAVEL WEB SITES (2008), available at http://www.consumerwebwatch.org/dynamic/travel-report-booking-bidding.cfm.

25 Aaron Smith, Home Broadband 2010, PEW RESEARCH INTERNET PROJECT, 6 (Aug. 11, 2010), http://www.pewinternet.org~/media/Files/Reports/2010/Home%20broadband%20202010.pdf (reporting that the percentage of Americans with broadband Internet access grew from 16% in 2003 to 66% in 2010, based on survey data).
exchanges. Of those, "Prosper" and "Lending Club" are among the most economically significant.26 Founded in 2006, Prosper is "the largest peer-to-peer lending marketplace" in the world.27 Consumers pool their money online to make small, unsecured loans to one another.28 Prosper is open to anyone who wishes to lend and borrowers with an adequate credit score.29 To date, more than one million consumers have joined Prosper, lending and borrowing more than $200 million.30 Prosper charges borrowers and lenders servicing fees, but the fees are generally lower than those charged by traditional banks.31

Prosper sets the interest rates based on the borrower's financial status and credit history.32 Lenders can put as little as $25 into a loan and, if enough of them invest to meet the full amount sought by the borrower, then the loan will fund and the borrower will make payments to each of the lenders over the life of the loan.33 Apart from the amount and interest rate, all contractual terms—term of loan, choice of law, acceleration clause, and the like—are

26 This discussion will focus on Prosper, but Lending Club is a similar business of similar size.


29 Borrowers must meet the minimum credit score requirement of 640. Prosper's SEC Registration Declared Effective, BUSINESS WIRE (Jul. 14, 2009), http://www.businesswire.com/news/home/20090714005330/en/Prosper%E2%80%99s-SEC-Registration-Declared-Effective. Nationally, credit scores range from 300–850, with a median of 723. Kenneth R. Harney, New Mortgages Worry Regulators, WASH. POST, June 10, 2006, at F3. Thus, a score of 640 indicates a borrower whose creditworthiness is well below average but far from the worst.

30 Supra note 28.

31 Prosper charges borrowers a 3% servicing fee and lenders a 1% servicing fee, but this approximately 1% or 2% transaction cost is likely a tighter spread than is usual for traditional banks, which might pay depositors 1% and lend to them at 6%.

32 See Prosper Reports 17% Increase in Loans, LOAN SAFE (DEC. 20, 2010), http://www.loansafe.org/prosper-reports-17-increase-in-loans (announcing change).

33 Just like at the CBOT, there are actually two contracts, one between the lender and Prosper, and another between Prosper and the borrower. But they function effectively as a single contract; that is, if the borrower defaults, the lender suffers the loss.
fixed in a standard form promissory note drafted by Prosper.\textsuperscript{34} Prosper operates both a primary market and a secondary market for promissory notes, the latter in an apparent joint venture. It does not employ a clearinghouse or margin, which makes sense in the context of a lending market.

Prosper delivers significant benefits to the consumers who choose to participate: independent reports indicate that borrowers on Prosper receive better interest rates than are available from a bank or other financial institution,\textsuperscript{35} and that lenders receive a relatively attractive rate of return on their investments.

3. Quasi-Contract Exchanges

There are number of websites that host marketplaces where consumers make contracts with one another, yet do not strictly fit the definition of a contract exchange given in Part II.A. Even so, it is worth noting these marketplaces because they are closely related to true consumer contract exchanges and may have lessons to teach. This Subsection will briefly describe two such quasi-contract exchanges, eBay and Sittercity.

eBay is a giant online marketplace where consumers sell goods to one another, often in an auction format. eBay is not a contract exchange as defined above, but it is a close cousin. It is not a contract exchange simply because the contracts between buyers and sellers on eBay are customizable and negotiable in many ways, and the underlying goods for sale are not uniform. Recall that uniformity of contract terms and underlying subject matter is part of the definition of a contract exchange.\textsuperscript{36}

Even so, eBay is a close relative of a contract exchange because it exhibits several of the attributes of contract exchanges. eBay contracts are reliably enforceable.\textsuperscript{37} Also, both members and nonmembers may observe


\textsuperscript{36} See supra Part II.A.

the live auctions and goods for sale on eBay. By letting all web users observe the bids, asks, and transaction prices in real time, eBay benefits the general public through price discovery. For example, someone seeking to hold a garage or yard sale might rely on eBay to determine reasonable prices for household items. In this way, an active, liquid market on eBay not only benefits participants but also can benefit the public. In short, eBay is not truly a consumer contract exchange, but it does possess some of the key attributes of such exchanges and yields some of their benefits.

Similarly, babysitting website Sittercity is not exactly a consumer contract exchange, but it does allow participants to utilize a central market for services. On Sittercity, parents post caregiving jobs depending on their needs, and caregivers can apply to those jobs that correspond to their skills. Parents pay for membership, but caregivers may sign up for free to apply for the posted positions. Sittercity facilitates those looking for, and those seeking to provide services as, babysitters, au pairs, pet sitters, housekeepers, tutors, and others, though babysitting is the heart of the business. Sittercity provides background and identity checks, and parents (or other service seekers) are able to check references, interview candidates, and post reviews. Once a parent finds a suitable babysitter, they contact one another and make a contract for a certain date and time and for a certain rate.

Sittercity is not exactly a contract exchange, because the services provided are not fungible. One babysitter is not equivalent to any other in the way that one bushel of wheat is effectively identical to every other. Still, it is an online marketplace where consumers make contracts with one another, so it is closely related to a contract exchange.

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This part has introduced and examined the benefits of contract exchanges, especially consumer contract exchanges. The next part claims that arbitration is especially well suited to resolving disputes arising out of

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39 eBay is certainly an active, liquid market—there are more than 90 [128] million active traders on the site, and $2,000 worth of goods are sold every second. *eBay: Who We Are*, EBay, http://www.ebayinc.com/who_we_are/one_company (last visited on Apr. 10, 2014).

contract exchanges.

II. Arbitration Holds Special Value for Contract Exchanges

Disputes that arise out of contract exchanges could be resolved in any number of ways, including litigation. But there is reason to think that arbitration is a particularly good fit for deciding contract exchange cases. This Part briefly describes arbitration in general, and then claims that arbitration holds special value for contract exchanges.

A. Arbitration in General

Arbitration is private dispute resolution, conducted by independent decision makers hired and paid for by the parties. The decision rendered by the third-party arbitrator(s) is a definitive and binding resolution, generally with no appeal and limited judicial review.

Once parties have a legal dispute with one another, they have the power to collectively decide to forego court and arbitrate instead. This is known as a post-dispute arbitration agreement. More commonly, though, parties bind themselves by contract, in advance of any disagreement, to arbitrate any disputes that relate to that contract.

Courts are generally uninvolved in arbitrated cases; indeed, that is precisely the point. However, because arbitration is a creature of contract, courts may be called upon to scrutinize the parties' agreement to ascertain whether their contract calls for arbitration, and precisely which type.\footnote{Am. Express v. Italian Colors Rest., 133 S. Ct. 2304, 2309 (2013) (because "arbitration is a matter of contract," "courts must 'rigorously enforce' arbitration agreements according to their terms") (quoting Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213, 221 (1985)).} Under the FAA, courts also police whether the arbitral process was tainted by fraud or corruption, or whether the arbitrators exceeded their powers.\footnote{9 U.S.C. § § 10(a)(1)-(4) (2014).} Apart from this sharply limited review, courts will not offer an appellate forum for parties to arbitration.
1. National Policy Presumed to Favor Arbitration

Arbitration has its proponents, who focus on the cost savings compared to litigation, and its detractors, who fear that the deck is stacked in arbitral forums.\textsuperscript{43} This essay will not, however, attempt to grapple with the question of whether arbitration is efficient and fair as a general matter. Rather, this essay will simply accept as given that the Federal Arbitration Act (FAA) has resolved the issue by announcing "a national policy favoring arbitration."\textsuperscript{44}

B. The Special Value of Arbitration for Contract Exchanges

Arbitration is widely seen as valuable in many contexts, but it is particularly well suited to contract exchanges for at least four reasons.\textsuperscript{45}

\textsuperscript{43} Compare, e.g., MARGARET JANE RADIN, BOILERPLATE 4–8, 32, 130–35 (2012) (offering a critical view of arbitration), with, e.g., Miles B. Farmer, Note, Mandatory and Fair? A Better System of Mandatory Arbitration, 121 YALE L.J. 2346, 2352–55 (2012) (describing some benefits of arbitration); id. at 2352 n.14 (collecting authorities: Samuel Estreicher, Satrums for Rickshaws: The Stakes in the Debate over Predispute Employment Arbitration Agreements, 16 OHIO ST. J. ON DISP. RESOL. 559, 563–64 (2001) (arguing that mandatory arbitration allows many more plaintiffs to bring cases); Dwight Golann, Developments in Consumer Financial Services Litigation, 43 BUS. LAW. 1081, 1091 (1988) ("The primary advantage for consumers in binding arbitration is that it offers at least the possibility of a faster and cheaper decisionmaking mechanism for their complaints."); Stephen J. Ware, Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements, 2001 J. DISP. RESOL. 89, 89–90 (arguing that arbitration reduces businesses' dispute resolution costs and that these savings are ultimately passed on to consumers); see also Warren E. Burger, Isn't There a Better Way?, 68 A.B.A. J. 274, 276–77 (1982) (citing the speed and cost advantages of arbitration); Thomas E. Carbonneau, Arguments in Favor of the Triumph of Arbitration, 10 CARDOZO J. CONFLICT RESOL. 395, 423 (2009) ("[Arbitration] fills wide gaps and makes adjudication accessible to individuals by promoting economy and effectiveness through the provision of expertise, basic fairness, and binding determinations.").\textsuperscript{44}

\textsuperscript{44} Southland Corp. v. Keating, 465 U.S. 1, 10 (1984); Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983) (the FAA reflects a "liberal policy favoring arbitration"); see RADIN, supra note 43, at 132. The relevant provision in the FAA provides that contractual arbitration clauses "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2 (2014).\textsuperscript{45}

\textsuperscript{45} See also, e.g., Lisa Bernstein, Opting out of the Legal System: Extralegal Contractual Relations in the Diamond Industry, 21 J. LEG. STUD. 115 (1992); Ian R. Macneil, Contracts: Adjustment of Long-term Economic Relations Under Classical, Neoclassical, and Relational Contract Law, 72 NW. U. L. REV. 854 (1978); Stewart
1. Low Cost

First, recall that a foundational goal of contract exchanges is to lower the cost of contracting. Likewise, the fundamental purpose of arbitration is to lower the cost of resolving disputes over those contracts. One of the most important drivers of contracting costs is the high cost of resolving contract disputes through litigation. But that cost can generally be lowered if the contracting parties agree in advance to mandatory arbitration. On a contract exchange, then, there would be good reason for the exchange to mandate that any disputes arising out of exchange transactions be arbitrated, instead of litigated.

Arbitration endeavors to keep costs down in a number of ways. For one thing, arbitration clause can prevent (or at least discourage) forum shopping. A contractual selection of the arbitral tribunal for dispute resolution functions as a mandatory and exclusive forum-selection clause.

For another, the informal procedures used in arbitration are designed with efficiency in mind. In litigation, for instance, trials on the merits usually only occur after discovery and motion practice, e.g., motions for summary judgment, motions to exclude testimony, et cetera. These preludes to a resolution of the dispute can easily consume a fair bit of time and money in and of themselves, and one has not even advanced to trial yet. The informal arbitration process, by contrast, generally eschews motion practice and tries to get to the merits as soon as possible, potentially resulting in significant cost savings for all concerned.


46 See supra Part II.B.

47 Whether arbitration is always, sometimes, or never less expensive than litigation is a matter of controversy in the academy. See supra note 43. For present purposes, however, it is enough to observe that the goal of arbitration parallels the goal of contract exchanges: to lower costs.

48 First, the cost of potential litigation must be impounded into the price a party can afford to pay. Second, the drafting itself may be more careful and fulsome (and thus expensive) if the cost of litigation is expected to be very high, so as to try to avoid that eventuality.

49 E.g., Golann, supra note 43, at 1091.

50 That said, even the most thoughtfully drafted arbitration clause can be vulnerable to challenge by a creative attorney. See infra Part IV.B.1.

2. Use of Experts

Second, contract exchanges can also benefit by utilizing arbitrators with relevant expertise.\textsuperscript{52} As opposed to generalist judges who preside over most litigation, it is possible to organize a stable of arbitrators who are expert in the specific contracts traded, and any underlying goods on which they are based.\textsuperscript{53} This expertise could benefit all parties if it makes outcomes more certain and easier to predict.

3. Certainty of Forum/Outcome

The types of disputes that arise out of an exchange's form contract are likely to be broadly similar to one another, especially those involving an interpretation of the contract itself. Hence, if all exchange-related disputes were to be channeled to a single decision maker, the parties could have more certainty as to the outcome than they would if the dispute were litigable in any of a number of jurisdictions.\textsuperscript{54}

This certainty would be particularly powerful if arbitrators were to publish written opinions explaining their reasoning, but that is not generally the case.\textsuperscript{55} One important reason for the practice and tradition of arbitrators declining to publish opinions is the "public good" nature of precedents: The costs of generating the precedent are privately borne by the parties to the arbitration, yet the benefits are a public good widely shared among all interested persons.\textsuperscript{56}

This "public good" problem, however, does not mean that arbitrators have never and will never issue written opinions. To the contrary, since arbitration is at bottom a matter of private ordering, parties are free to direct their arbitrators to provide a written explanation of their awards.\textsuperscript{57}

\textsuperscript{52} \textit{See generally} Bernstein, supra note 45, at 115.
\textsuperscript{53} Schmitz, supra note 5, at 123, 136 & n.67.
\textsuperscript{55} \textit{Jay Folberg}, \textit{et al.}, \textit{Resolving Disputes: Theory, Practice, and Law} 599–600 (2d ed. 2010).
\textsuperscript{57} \textit{Folberg, et al.}, supra note 55, at 600. Indeed, there are reports that commercial arbitration agreements found in contemporary business contracts "often" call for written
Furthermore, a contract exchange is precisely the type of group or association that is best able to resolve the public good problem standing in the way of written arbitral decisions.\textsuperscript{58} Members of a contract exchange would all collectively benefit from written decisions, and may therefore presumably be willing to "tax" themselves to pay for the extra cost associated with written decisions.\textsuperscript{59}

4. Consolidation

Finally, an arbitral forum based at or associated with a contract exchange is well placed to consolidate associated disputes. For example, a default on a delivery would presumably affect many counterparties in much the same way, and it would clearly make sense to resolve them collectively. This may be possible to achieve in litigation via class actions, multi-district litigation or in rem proceedings, but those are slow, expensive, and cumbersome procedures. By contrast, an arbitral body can obtain essentially the same result as these types of proceedings, but much more quickly and without the complicated maneuvering necessary to litigation.\textsuperscript{60}

* * *

These theoretical notions appear to be borne out in practice. The next Section will describe how real-world contract exchanges make much use of arbitration.
C. Practical Evidence of this Special Value

The last Part made the claim that arbitration is well suited to resolving disputes relating to contract exchanges. This Part provides evidence for that claim by looking at the real world use of arbitration by existing contract exchanges. First it will describe how the major commodities exchanges, such as the CBOT, make extensive use of arbitration, and even have specific rules against litigation. Then it will discuss how the New York Stock Exchange and other stock exchanges likewise rely on Financial Industry Regulation Authority (FINRA) arbitration to resolve exchange-related disputes. As will appear, this is both a matter of private ordering and regulatory fiat.

The evidence considered in this Section is consistent with this Essay's claim of a special relationship between arbitration and the contract exchange.

1. Commodities Exchanges

Traditional commodities contract exchanges use arbitration in two distinct ways. First, as a matter of exchange rules (which are themselves a form of contract), they generally require that members of the exchange arbitrate any disputes they may have with other members. Second, both pursuant to the federal Commodity Exchange Act and associated regulations issued by the CFTC, commodities exchanges are legally obliged to provide an arbitral forum where customers may seek redress against members of the exchange.

a. Member-versus-Member Arbitration

Contracts created or traded on a commodities exchange may become the subject of a dispute, just like any contract might. If, for instance, the butter delivered under a CME contract turns out not to meet specifications, or is late, the buyer would have a claim for breach of contract. Disputes such as these are ordinarily the proper basis for litigation.

Nevertheless, the rules of these traditional contract exchanges traditionally require that contract disputes between members be arbitrated, rather than litigated. The relevant CBOT Rule begins with a simple and broad policy statement that it is "contrary to the objectives and policy of the

61 Though they may not be "contract" exchanges, the arbitration of disputes between investors and their brokers is relevant here to show how arbitration fits well with exchanges.
Exchange for members to litigate claims" against one another over exchange transactions.\textsuperscript{62} The Rule then states that a variety of disputes "between and among members . . . shall be subject to mandatory arbitration" by an internal arm of the CBOT.\textsuperscript{63}

Most importantly, the Rule states that "claims between members that relate to or arise out of any transaction on" the exchange must be arbitrated.\textsuperscript{64} Members also must arbitrate claims relating to "trading rights on the Exchange," non-compete clauses, and certain other matters.\textsuperscript{65}

Exchanges take the mandatory arbitration regime very seriously, as indicated by the language used in their rules. It is an "offense" against the CBOT for a member "to fail to submit to arbitration any dispute which Exchange staff, an arbitration panel or the Board decides should be arbitrated . . . or to fail to comply with a final arbitration award."\textsuperscript{66} Furthermore, the CBOT Rules provide: "A Member who commences a legal action against . . . another Member of the Exchange without first resorting to and exhausting . . . mandatory arbitration . . . shall be deemed to have committed an act detrimental to the interest or welfare of the Exchange."\textsuperscript{67}

The CBOT has been used as an exemplar here, but the other major commodities exchanges have similar rules regarding mandatory arbitration for intra-member disputes. For instance, the Rules of the Minneapolis Grain Exchange state: "All disputes that arise out of trades, contracts, agreements or other transactions . . . shall be settled by arbitration."\textsuperscript{68} And the Rules of the London Metals Exchange provide that "any dispute . . . arising out of any Contract shall be referred to arbitration."\textsuperscript{69} Other examples could be given.\textsuperscript{70}

\begin{thebibliography}{10}
\bibitem{CBOT Rulebook} CBOT RULEBOOK, \textit{supra} note 3, § 600.A.
\bibitem{Id} \textit{Id.}
\bibitem{CME and NYMEX} The CME and NYMEX have essentially identical rules in their respective rulebooks, as all three exchanges are held by the CME Group.
\bibitem{Id} \textit{Id.} The Rule exempts certain types of disputes from mandatory arbitration: "Nothing in this rule, however, shall require a member employee to submit to arbitration any claim that includes allegations of a violation of federal, state or local employment discrimination, wage payment or benefits laws."
\bibitem{CBOT Rulebook} CBOT RULEBOOK § 432(R) (2013).
\bibitem{CBOT Rulebook} CBOT RULEBOOK § 440 (2013).
\bibitem{Rules and Regulations} RULES AND REGULATIONS OF THE MINNEAPOLIS GRAIN EXCH. § 402.00. The parties to the dispute may opt out of arbitration by express mutual consent.
\bibitem{London Metal Exchange} LONDON METAL EXCH. RULEBOOK, Part 4 Contract Regulations § 10.1.
\bibitem{E.g.} \textit{E.g.,} INTERCONTINENTAL EXCHANGE RULEBOOK R. 20.02(b); \textit{see also} Lisa Bernstein, \textit{Understanding the Limits of Court-Connected ADR: A Critique of Federal Court-Annexed Arbitration Programs}, 141 U. PA. L. REV. 2169, 2249 (1993).
\end{thebibliography}
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In short, the major commodities exchanges generally require that exchange-related disputes between exchange members be arbitrated.\(^71\)

b. Customer-versus-Member Arbitration

Members of traditional contract exchanges frequently create or trade contracts on behalf of customers, as opposed to their own account. Inevitably, disputes between members and their customers will arise from time to time, and these disputes could be either litigated or arbitrated. Yet federal law has long favored the arbitration of these disputes.

The federal Commodities Futures Trading Commission Act of 1974 requires commodities exchanges to make arbitration available for disputes between customers and members, and that members submit to arbitration if a customer so requests.\(^72\) All traditional contract exchanges must "provide a fair, equitable, and expeditious procedure through arbitration or otherwise for the settlement of customers' claims and grievances against any member."\(^74\)

2. Consumer Contract Exchanges

The few consumer contract exchanges that currently exist make broad use of arbitration (or other alternative dispute resolution mechanisms) to resolve exchange-related disputes, just like their traditional brethren. This provides further practical evidence that arbitration is particularly well suited to all types of contract exchange. This Section offers a few examples of the way in which a few real-life consumer contract exchanges employ arbitration.\(^75\)

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\(^71\) It appears that arbitrators for the traditional commodities exchanges do not generally issue written opinions. See generally FOLBERG, supra note 55, at 599–600.

\(^72\) Geldermann, Inc. v. CFTC, 836 F.2d 310, 313 (7th Cir. 1987) (under CFTC regulations, a contract market is obliged to "provide a procedure where the member must arbitrate when called upon to do so").

\(^73\) For present purposes, the term "traditional contract exchange" is assumed to be coextensive with "designated contract market," defined as a contract exchange that is regulated by the CFTC pursuant to the Commodities Exchange Act. See 7 U.S.C. § 7 (2012). There are about fifty active designated contract markets in the country today, including well-known ones like the CBOT, Minneapolis Grain Exchange and ICE.


\(^75\) For additional discussion of "Online Dispute Resolution," see, e.g., Amy J. Schmitz, Access to Consumer Remedies in the Squeaky Wheel System, 39 PEPPI. L. REV. 279, 324–28 (2012); Louis Del Duca et al., Facilitating Expansion of Cross-Border E-
Prosper requires all exchange participants, both lenders and borrowers, to sign highly detailed arbitration agreements. The agreements are not between lenders and borrowers, but rather between Prosper and lenders, and between Prosper and borrowers. And Prosper has distinct arbitration agreements for each group.

The lender registration agreement includes an elaborate arbitration clause for disputes between Prosper and lenders. The clause states that "[a]ny Claim may be resolved, upon the election of both [Prosper] and [lender], by binding arbitration." Hence lenders are not required to arbitrate against Prosper unless they consent to do so once a dispute has arisen.

In contrast, the agreement to which borrowers must agree allows Prosper to force arbitration even absent consent: "Any Claim shall be resolved, upon the election of either us or you, by binding arbitration." That said, borrowers are able to opt-out of the arbitration provisions of the agreement by sending to Prosper written notice of rejection within thirty days of signing the agreement. If borrowers choose to reject the arbitration provision, they will not have the right to seek arbitration down the road.

Finally, as for direct disputes between exchange members, i.e., lenders and borrowers, Prosper specifically forbids lenders to contact or in any way seek collection of late payments by borrowers. So there is no arbitration permitted or required directly between lenders and borrowers.

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76 For a general description of Prosper, see supra Part II.D.2.


79 Id. at § 22(i). It is unknown how many borrowers mail this written notice, but it seems likely to be very few, since almost none of them will read the agreement in the first place. See Florencia Marotta-Wurgler, Does Increased Disclosure Help? Evaluating the Recommendations of the ALI's "Principles of the Law of Software Contracts", 78 U. CHI. L. REV. 165, 168 (2011) (reporting on empirical finding that less than one percent of users read such agreements).

b. eBay

eBay has an in-house dispute resolution process that it calls "Buyer Protection" for "when buyers claim to sellers that their item was not received or the item they received was different from what was described in the listing." This "on-eBay resolution process is the primary avenue for settling disputed eBay transactions."

Buyers have the option of electing Buyer Protection and are not obliged to do so. But once a case is filed with Buyer Protection, "Buyers and sellers permit us to make a final decision, in our sole discretion, on any case that a buyer files with eBay under the eBay Buyer Protection Policy."

c. Sittercity

Sittercity's Terms of Use, to which all market participants must agree, includes a terse and not entirely clear arbitration clause: "Any controversy, claim, suit, injury or damage arising from or in any way related to Sittercity services "shall be settled by binding arbitration" in Chicago. Caregivers and parents agree to the arbitration clause, within the Terms of Use, by simply using the website.

The clause may be read to encompass all disputes between parents and
babysitters that make contracts via Sittercity, as those contracts and any damages or injury that arise therefrom, are clearly "related to" Sittercity services. This reading, while literal, may not be the intended one. For instance, it would seem to call for arbitration for claims arising out of a child's injury while under the care of a Sittercity caregiver. But the parties likely would not want that to be covered by the clause.

In the end, the intended meaning of Sittercity's arbitration clause is not apparent. But Sittercity has only been around for a few years, and over time the clause may be clarified.

III. REGULATION OF EXCHANGE ARBITRATION

Traditional contract exchanges are regulated by various government agencies, including the CFTC and the SEC, as well as "self-regulatory" bodies, such as FINRA (who are themselves regulated). All aspects of the exchange are regulated, including the use of arbitration to resolve exchange-related disputes.

For the exchanges and their participants (who broadly seem to favor arbitration), the regulation of their arbitration agreements and procedures has various costs, but it also has at least one very important benefit for them: It provides comfort to a court that the arbitration agreement and process are sufficiently fair for it to compel arbitration or confirm an arbitral decision.

This extra level of comfort may not be strictly necessary, however. Under the Federal Arbitration Act, federal courts are obliged to enforce arbitration clauses pursuant to "the terms of the [parties'] agreement," "save upon such grounds as exist at law or in equity for the revocation of any contract." But those other grounds include, for instance, unconscionability, so there is a chance that a court could refuse to enforce an arbitration agreement. However, if that agreement were previously approved by a regulatory body, then the court—even if hostile to arbitration, as some seem

89 In addition to the private cost of compliance by regulated entities, there may be a social cost of regulation arising out of agency capture and other regulatory pathologies. See generally Jeffrey J. Rachlinski & Cynthia R. Farina, Cognitive Psychology and Optimal Government Design, 87 CORNELL L. REV. 549, 550–51 (2002).
90 This Essay is focused on arbitration clauses at the "front-end" of arbitration. See 9 U.S.C. §§ 2–4 (2014). The arbitration process as well as the review and confirmation of arbitration award are beyond the scope of the present work. See generally 9 U.S.C. § 10 (2014).
to be—is practically certain to enforce it. This is a major benefit to the exchanges.

Section A of this Part pertains to traditional contract exchanges. It first describes the current regulatory framework for arbitration arising out of such exchanges then marshals case law to show that the courts are highly respectful of arbitration clauses that have been approved by regulators.

Section B relates to consumer contract exchanges and thus treads on thinner ground, for these exchanges are too new to have traditional ways of doing things. There is no regulatory framework for consumer contract exchange arbitration, and there is no case law on the subject either. Writing on this blank slate, this Section ultimately concludes that regulation of consumer contract exchange arbitration would not benefit these emerging exchanges.

A. Regulation of Traditional Contract Exchange Arbitration

The CFTC regulates and oversees the arbitration of disputes arising out of commodities exchanges. The Commission does not review individual arbitration hearings or decisions, but rather the broad process, to ensure that it is generally fair. To that end, the CFTC has issued specific rules governing consumer-versus-member arbitration.

Under the Commodities Exchange Act, an exchange must require that their members submit to arbitration when called upon by a customer,92 but that the use of arbitration by customers "shall be voluntary."93 Prior to the 1974 federal legislation, it was apparently commonplace for customers to be asked to assent to mandatory pre-dispute arbitration clauses "as a precondition to doing business" with a member of a business contract exchange.94 "Indeed, this practice was found [by the CFTC] to be so prevalent that a customer might effectively be frozen out of the futures market if he refused to execute a pre-dispute agreement."95 Hence, the CFTC has construed this voluntariness requirement as to prohibit exchange

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92 Geldermann, Inc. v. CFTC, 836 F.2d 310, 313 (7th Cir. 1987) (under CFTC regulations, a contract market is obliged to "provide a procedure where the member must arbitrate when called upon to do so").
93 7 U.S.C. § 21(b)(10)(A) (2014) (the use of arbitration by a customer "shall be voluntary").
95 Id.
members from requiring customers to enter into mandatory arbitration contracts as a condition of obtaining the member's services.\textsuperscript{96}

Customers may, if they wish, enter into mandatory pre-dispute arbitration agreements with these professionals, but to try to ensure that the agreement is truly voluntary, the CFTC requires that the customer "separately endorse the clause" and that it includes specific "cautionary language" "printed in large boldface type."\textsuperscript{97}

CFTC regulations provide additional protections for customers. For one thing, customers must be given "the opportunity to select the location of the arbitration proceeding from among several major cities in diverse geographic

\textsuperscript{96} Gans v. Merrill Lynch Futures, Inc., 814 F.2d 493, 496 (8th Cir. 1987) ("The Commission has sanctioned arbitration and promulgated regulations to assure that arbitration agreements are fair and to protect customers from making an uninformed decision to agree to arbitration."); Felkner v. Dean Witter Reynolds, Inc., 800 F.2d 1466, 1469 (9th Cir. 1986) ("The CFTC wanted to encourage arbitration, but its regulations reflect its concern over the adhesive and overreaching nature of arbitration clauses that had been used by brokers and dealers trading in the contracts markets.").

\textsuperscript{97} 17 C.F.R. § 166.5(c) (2014). The required text is as follows:

Three Forums Exist for the Resolution of Commodity Disputes: Civil Court litigation, reparations at the Commodity Futures Trading Commission (CFTC) and arbitration conducted by a self-regulatory or other private organization.

The CFTC recognizes that the opportunity to settle disputes by arbitration may in some cases provide many benefits to customers, including the ability to obtain an expeditious and final resolution of disputes without incurring substantial costs. The CFTC requires, however, that each customer individually examine the relative merits of arbitration and that your consent to this arbitration agreement be voluntary.

By signing this agreement, you: (1) may be waiving your right to sue in a court of law; and (2) are agreeing to be bound by arbitration of any claims or counterclaims which you or [name] may submit to arbitration under this agreement. You are not, however, waiving your right to elect instead to petition the CFTC to institute reparations proceedings under Section 14 of the Commodity Exchange Act with respect to any dispute that may be arbitrated pursuant to this agreement. In the event a dispute arises, you will be notified if [name] intends to submit the dispute to arbitration. If you believe a violation of the Commodity Exchange Act is involved and if you prefer to request a section 14 "Reparations" proceeding before the CFTC, you will have 45 days from the date of such notice in which to make that election.

You need not sign this agreement to open or maintain an account with [name].

\textit{See} 17 CFR 166.5.

17 C.F.R. § 166.5(c)(7) (2014).
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The SEC plays a similar oversight role with respect to securities arbitration, but rather than issuing specific rules like the CFTC has done, the SEC has deputized the self-regulatory organization FINRA, which handles more than 95% of securities arbitrations.100 FINRA is obliged under the federal securities laws to file with the SEC its rules and regulations governing securities arbitration and await SEC approval.101 Any changes to FINRA arbitration rules would have to be published and put out for public comment.102

1. A Benefit of Regulatory Oversight: Enhanced Judicial Respect for Arbitration

The regulatory regime just described yields an important benefit for contract exchange arbitration. By obtaining regulatory approval for their arbitration clauses, commodities and securities exchanges receive increased judicial respect for their agreements. A regulated arbitral regime can encourage courts to enforce an arbitration clause, thus enhancing arbitration's ability to provide a speedy and low-cost method of dispute resolution.

The judicial solicitude for a regulated arbitration can be seen in a series of Supreme Court cases: Wilko v. Swan,103 Shearson/American Express v. McMahon104 and Rodriguez De Quijas v. Shearson/American Express.105 In Wilko, decided back in 1953, the Supreme Court held that courts could not compel arbitration of Securities Act claims on the ground that "arbitration was inadequate as a means of enforcing the provisions of the Securities

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98 17 C.F.R. § 166.5(c)(5)(i)(C) (2014).
99 Id.
102 Gross, supra note 100, at 512–513.
But in the 1980s, the Supreme Court reversed itself, taking the position in the two Shearson/American Express cases that arbitration actually is an adequate forum to enforce Securities Act claims.107

What changed between the 1950s and the 1980s to compel this conclusion? In the 1950s, the SEC "had only limited authority over the rules governing self-regulatory organizations (SROs)—the national securities exchanges and registered securities associations—and this authority appears not to have included any authority at all over their arbitration rules."108 But in 1975, Congress amended the Securities Exchange Act to give the SEC "expansive power to ensure the adequacy of the arbitration procedures employed by the SROs."109 These "intervening regulatory developments" meant that SRO arbitration was now an adequate and permissible forum for resolving Securities Act claims, and courts may properly compel arbitration for such claims.110

Today, as a matter of doctrine, when a party challenges an arbitration clause that complies with CFTC regulations as being unfair or unconscionable, they generally lose on the theory that it would be wrong for a court to second-guess the carefully calibrated regulatory scheme.111 The

106 McMahon, 482 U.S. at 228 (characterizing Wilko).
107 482 U.S. 220; 490 U.S. 477 ("Wilko was incorrectly decided").
108 482 U.S. at 233.
109 Id.
110 482 U.S. at 233; 490 U.S. at 483 (describing McMahon as "reject[ing] the Wilko Court's aversion to arbitration as a forum for resolving disputes over securities transactions, especially in light of the relatively recent expansion of the Securities and Exchange Commission's authority to oversee and to regulate those arbitration procedures").
111 E.g., Ingbar v. Drexel Burnham Lambert Inc., 683 F.2d 603, 605 (1st Cir. 1982) (The "strict conditions imposed by the CFTC regulations assure that broker-customer arbitration agreements are entered into voluntarily and are fair. The regulations therefore meet the practical concerns as to relative bargaining power and broker overreaching that underlay" the unconscionability doctrine); cf. e.g., Cohen v. Wedbush, Noble, Cooke, Inc., 841 F.2d 282, 286 (9th Cir. 1988) ("Because Congress has committed to the SEC the task of ensuring that the federal rights established by the Securities Acts are not compromised by inadequate arbitration procedures, we are bound by the Commission's determination that the procedures at issue here are satisfactory. Any contrary holding would frustrate this carefully crafted federal regulatory scheme."); id. ("[T]he extensive regulatory oversight performed by the SEC . . . compel[s] the conclusion that agreements to arbitrate disputes in accordance with SEC-approved procedures are not unconscionable as a matter of law . . . . "), overruled on other grounds by Ticknor v. Choice Hotels Intern., Inc., 265 F.3d 931 (9th Cir. 2001); Gonick v. Drexel Burnham Lambert, Inc., 711
contracts traded on traditional contract exchanges are clearly contracts of adhesion, as that term is defined, and yet courts properly abstain from applying the unconscionability doctrine (and unsettling them) because the CFTC has approved them.

Consider, for example, the case of *Ingbar v. Drexel Burnham Lambert Inc.*,\(^{112}\) in an opinion by then-Circuit Judge Breyer, is illustrative. In that case, Ingbar had brought a federal civil action against Drexel, a commodities brokerage firm for investments losses. At the time Ingbar opened his account with Drexel, however, he had signed Drexel's two-page form contract, as well as separately signed its arbitration clause that covered "any controversy" between Drexel and he.\(^{113}\) He sought to argue that the arbitration clause was "invalid" because he did not read the agreement, and therefore it was "involuntary."\(^{114}\)

The court paid short shrift to Ingbar's arguments of invalidity and ordered the parties to arbitrate. The court observed that "the strict conditions imposed by the CFTC regulations assure that broker-customer arbitration agreements are entered into voluntarily and are fair. The regulations therefore meet the practical concerns as to relative bargaining power and broker overreaching."\(^{115}\)

Many other cases like *Ingbar* could be recounted.\(^{116}\) The important point is that the judiciary appears to give extra respect to an arbitration agreement that has been pre-approved by a regulator. As such, regulated arbitration agreements are more likely to be strictly enforced, all else being equal, which is a clear benefit to those who favor arbitration.

2. The Federal Arbitration Act May Be Sufficient on Its Own

The last subsection claimed that an arbitration clause that itself has been approved by a regulator is practically certain to be strictly enforced out of

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\(^{112}\) *Ingbar*, 683 F.2d at 605.

\(^{113}\) *Id.* at 604.

\(^{114}\) *Id.* at 604, 607.

\(^{115}\) *Id.* at 604.

\(^{116}\) See supra note 110.
judicial solicitude for the regulatory process. True enough. But if the goal is maximum legal certainty that an arbitration clause will be enforced by its terms, it may well be that the protection offered by the FAA is enough. Or, at least, the marginal additional level of legal certainty that regulatory approval provides may not be worth the significant costs it imposes.

The FAA states that written arbitration clauses are "valid, irrevocable, and enforceable,"117 and must be enforced pursuant to their terms.118 Such a clause may be denied enforcement, however, "upon such grounds as exist at law or in equity for the revocation of any contract."119

A series of recent Supreme Court cases, including *Concepcion*,120 *Stolt-Nielson*,121 and *Italian Colors*,122 construes the FAA expansively. Among other things, the FAA is now understood to nullify state law doctrines that single out arbitration clauses for special adverse treatment. Importantly for present purposes, neither the FAA nor this body of Supreme Court case law takes any account of whether the arbitration clause at issue has been approved by any regulatory authority (and in fact, in those cases, they were not).

In *American Express v. Italian Colors Restaurant*, for example, the Supreme Court held that a contractual arbitration agreement with a class action waiver binds the contracting parties, even as to a federal antitrust claim that would be economically infeasible to pursue on an individual basis.123 The FAA alone protected this clause. *Italian Colors* built upon other important Supreme Court cases, including *Concepcion*124 and *Stolt-Nielson*,125 which read the FAA as strongly favoring the enforcement of arbitration clauses precisely as drafted.

But even the FAA, by its terms, empowers a court to decline to compel arbitration on "such grounds as exist at law or in equity for the revocation of any contract,"126 such as fraud, duress or unconscionability. Regulatory

118 Id. § 3.
119 Id. § 2.
120 AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740, 1752 (2011).
123 Id.
124 Concepcion, 131 S. Ct. at 1752.
125 Stolt-Nielson, 559 U.S. at 1775.
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approval, by contrast, could possibly insulate arbitration clauses from unconscionability and related attacks to an even greater degree. So there is a substantive difference between the greater protections afforded by regulatory approval versus the lesser protection provided by the FAA standing alone.

In conclusion, while the FAA standing alone opens the door to some potentially costly judicial review of an arbitration agreement and process, regulatory approval can provide an extra level of certainty. The value of that additional quantum of comfort is possibly quite modest, however, at least with the FAA and its key precedents in place, and the cost may be rather high.

B. Potential Regulation of Consumer Contract Exchange Arbitration

The last Section described the regulation of traditional contract exchange arbitration and the benefit that it provides. This Section tries to extrapolate from that experience to the context of consumer contract exchange arbitration.

There is presently no regulator that is tasked with overseeing consumer contract exchanges, let alone consumer contract exchange arbitration, for the simple reason that they have only recently come into existence. This lack of regulation may benefit the exchanges in various ways, but it deprives them of the shield from judicial review that regulatory approval can provide.

That shield has proved worthwhile, it seems, for traditional contract exchanges, and there is reason to think it would have a similar effect for consumer contract exchanges. These nascent exchanges, then, may welcome regulation by relevant bodies, whether the SEC, the CFTC or perhaps the newly formed Consumer Financial Protection Bureau (CFPB).127


Regardless of the precise form it takes, it is certainly possible for consumer contract exchanges to come under the regulatory aegis of one agency or another. And just as in the traditional context, this should provide

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127 Prosper is already subject to SEC oversight, but some commentators suggest the CFPB is a better alternative. E.g., Paul Slattery, Square Pegs in a Round Hole: SEC Regulation of Online Peer-to-Peer Lending and the CFPB Alternative, 30 YALE J. ON REG. 233 (2013); Andrew Verstein, The Misregulation of Person-to-Person Lending, 45 U.C. DAVIS L. REV. 445 (2011).
at least one significant benefit to the exchanges by enhancing judicial respect for
their exchange arbitration agreements and procedures. And this effect is
especially important for consumer contract exchanges because "consumer
contracts" are precisely the type of contract most vulnerable to claims of
unconscionability and related doctrines.

Non-negotiable standard form consumer contracts, or "contracts of
adhesion," are subject to a special body of law that ordinary negotiated
contracts are not. Pursuant to the unconscionability doctrine, courts are to
cconduct a substantive review of the terms of adhesion contracts and, if they
find any such terms (or the agreement as a whole) to be "harsh or overly one-
sided," they are empowered to refuse enforcement in whole or part. As a
matter of doctrine, many courts apply a two-part test that requires a party to
establish both "procedural" and "substantive" unconscionability to succeed.
The procedural component refers to the manner of bargaining and drafting
the contract. The substantive component refers to the bargain that the parties
actually made in the end.

The arbitration clause is probably the most frequently challenged as
unconscionable, and some of these challenges are successful. For example,
in Bragg v. Linden Research, Inc., players of the online video game
"Second Life" brought suit against the operator of the game for expropriating
their property. The game operator moved to compel arbitration based on an
arbitration clause found in the "Terms of Service" for Second Life. The
Terms of Service were a commonplace "clickwrap" contract of adhesion that
were offered on a take-it-or-leave-it basis. The only way to gain access to
Second Life was to agree to the Terms of Service by clicking an "accept"
button.

In response to the motion to compel arbitration, the players argued that it

128 Schwartz, supra note 1, at 354–57.
contracts are subject to judicial scrutiny for fundamental fairness."); Williams v. Walker-
Thomas Furniture Co., 350 F.2d 445, 449–50 (D.C. Cir. 1965) (When a contract is
adhesive, "the usual rule that the terms of the agreement are not to be questioned should
be abandoned and the court should consider whether the terms of the contract are so
unfair that enforcement should be withheld.").
130 See, e.g., Armendariz v. Found. Health Psychcare Services, 6 P.3d 669 (Cal.
2000).
132 Id. at 603.
133 Id. at 606.
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was "both procedurally and substantively unconscionable" and should not be enforced. The Terms of Service being a contract of adhesion, the court quickly found procedural unconscionability and moved on to a substantive review of the arbitration clause. Taking careful stock of each aspect of the clause, the court ultimately found "multiple defects" with it and refused to enforce it.

In short, thanks to the unconscionability doctrine, arbitration clauses in contracts of adhesion are vulnerable to searching judicial review. And the contracts that are created or traded on consumer contract exchanges are clearly contracts of adhesion. So, there is a real possibility of intrusive judicial review into every consumer contract exchange arbitration—which would make the arbitral system unworkable.

This outcome can be avoided, this Essay suggests, through the shield of regulatory oversight. Just as ex ante regulatory review can substitute for ex post judicial review in the traditional context, so too can it with regard to consumer contract exchanges. If a consumer contract exchange arbitration agreement and process has been approved by a government regulator, courts should extend their precedents and routinely deny unconscionability claims.

Regulatory oversight can benefit consumer contract exchanges by garnering judicial respect for arbitration, but hopefully that oversight can be flexible, given the developing nature of the market. As discussed supra in Part III.C.2, the consumer contract exchanges that currently exist have diverse arbitration clauses and employ arbitration in a variety of different ways. Regulators should try to permit such experimentation in these early years of this phenomenon and avoid a one-size-fits-all before the industry has a chance to establish itself and its preferences.

134 Id. at 605.
135 Id. at 606–07.
136 Id. at 608–11.
137 Bragg, 487 F. Supp. 2d at 611 ("Taken together, the lack of mutuality, the costs of arbitration, the forum selection clause, and the confidentiality provision that Linden unilaterally imposes through the TOS demonstrate that the arbitration clause is not designed to provide Second Life participants an effective means of resolving disputes with Linden. Rather, it is a one-sided means which tilts unfairly, in almost all situations, in Linden's favor."). Sometime after the Bragg case, Second Life changed several aspects of the arbitration clause in its Terms of Service, apparently to respond to the concerns expressed there. In a subsequent case, Evans v. Linden Research, Inc., the court contrasted the new clause with the old one and indicated that the revised one was not unconscionable. 763 F. Supp. 2d 735, 741–42 (E.D. Pa. 2011).
138 See Schwartz, supra note 1 at 316.
2. The FAA is Likely Sufficient

Again, like the traditional contract exchanges, consumer contract exchanges can consider the possibility of relying solely on the power of the FAA to have their arbitration clauses "rigorously enforce[d]." Regulation pre-approval would certainly help in this regard, but the costs of regulation may be especially high in an emerging industry.

Compliance costs could be significant, both financially and in terms of distractions from business goals. Moreover, consumer contract exchanges are only just getting started, and it is impossible to know what the future holds. Regulatory oversight in such circumstances could easily stifle innovation in this emerging marketplace.

It is a close call whether consumer contract exchanges would welcome regulation of their arbitration clauses. Arbitration clauses are at their most vulnerable when they involve consumers, so regulatory approval would potentially provide greater value here than in the traditional commodities context. However, this industry is in an embryonic phase, so it is important not to box it in to pre-existing categories, to the detriment of all.

In the end, the overriding importance of freedom and flexibility seems to counsel that consumer contract exchanges should rely on the FAA, for now, to protect their arbitration clauses, and not invite regulatory oversight on this point. While regulation of consumer contract exchange arbitration would engender a high level of judicial respect for outcomes and awards, the downsides appear to outweigh this benefit. It is important to let this nascent field develop organically, and it would be unwise to fetter it with concepts and rules that derive from a different place and time. Furthermore, the FAA as presently understood provides strong protection to arbitration and arbitration clauses.

V. CONCLUSION

This Essay claimed that arbitration holds a special value for contract exchanges as a matter of theory and showed that the existing traditional and consumer contract exchanges make much use of arbitration in practice. It demonstrated that government regulation of exchange arbitration can lead to enhanced judicial respect for arbitration clauses, as has been the case in

\[^{139}\text{Am. Express Co. v. Italian Colors Rest., 133 S. Ct. 2304, 2309 (2013).}\]

\[^{140}\text{Schwartz, supra note 1 at 354–57.}\]
traditional contract exchanges. For consumer contract exchanges, however, this Essay concluded that the Federal Arbitration Act likely provides sufficient protection to arbitration clauses and that regulation of such clauses would not be appropriate at this time.