

Arbitration of Disputes Between Consumers and Financial Institutions: A Serious Threat to Consumer Protection

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I. INTRODUCTION

Financial institutions¹ increasingly are requiring consumers² to arbitrate disputes rather than resort to litigation. They have done so at a time when arbitration is exceedingly popular as a means of ameliorating the excessive costs and delays of litigation. Arbitration programs were initially intended to avoid class action lender liability suits demanding punitive damages. However, the emergence of consumer challenges provides opportunities to further examine the issues raised by consumer arbitration and to question the appropriateness of such arbitration.

This Article examines in detail several of the arbitration contracts currently in use. Several findings emerge from this review. For example, the contracts typically cover far more than potential lender liability claims. Indeed, some contracts purport to include disputes of any kind regardless of when they arise. The Article then reviews the state and federal arbitration statutes and case law governing arbitration contracts, and the attacks which consumers can make to challenge their validity. The Article next questions this type of arbitration as a matter of public policy. Finally, the Article discusses legislative approaches to safeguard consumer interests and recommends a course of action for lawmakers.

II. THE MOTIVATING FACTOR: LENDER LIABILITY

Bankers have stated that the major factor triggering the move to arbitration of bank/consumer disputes is the fear of exposure to lender liability lawsuits.³ In order to understand this fear and evaluate whether arbitration is the appropriate response, it is necessary to review briefly the

¹ Although banks have played a leading role in promoting arbitration to resolve disputes with consumers, other financial institutions, such as finance companies and mortgage companies, also have used arbitration agreements in consumer transactions. *See, e.g.,* Bell v. Congress Mortgage Co., 30 Cal. Rptr. 2d 205 (Ct. App. 1994) (mortgage company); McCarthy v. Providential Corp., No. C 94-0627, 1994 U.S. Dist. LEXIS 10122 (N.D. Cal. July 18, 1994) (mortgage company); Patterson v. ITT, 18 Cal. Rptr. 2d 563 (Ct. App. 1993), *cert. denied*, 114 S.Ct. 1217 (1994) (finance company). "Financial institution" is used in the article to refer both to banks and other financial services companies extending credit to consumers.

² A survey conducted by *American Banker* found that in 1992, total bank loans to consumers amounted to \$849.3 billion. Stephen Kleege, *Card Loans Fell Last Year for First Time Since 1981*, AM. BANKER, Aug. 27, 1993, at 25A.

³ Lloyd N. Shields, *The Role of Mandatory Arbitration for Financial Institutions*, ARB. J., Dec. 1991, at 49.

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phenomenon known as "lender liability." This section will describe leading types of lender liability cases, the theories underlying these cases, and the trends in recent decisions.⁴ The section then will examine the impact of arbitration on this case law.

Financial institutions are perhaps most concerned with courts finding lenders in a fiduciary relationship with their borrowers.⁵ This concern arises from the plethora of duties which result when such a relationship is present.⁶ There are three sources of fiduciary relationships. The duty arises when the parties are in certain special relationships such as principal-agent, attorney-client, and guardian-ward.⁷ A second source is when a person entrusts another with money or property. An example occurs when a person puts money into a bank account. The New Hampshire Supreme Court imposed fiduciary responsibilities upon a bank when it used money in one of its customer's account to pay another person's obligations.⁸ A third source is when a person reposes trust and confidence in another. Generally, courts impose fiduciary duties only when the parties do not have equal bargaining power, the weaker party relies on the stronger party, and the stronger party takes financial advantage of the other.⁹ Courts refuse to find a fiduciary relationship on this basis, however, unless there is proof that both parties understand that the weaker party reposed trust or confidence in the other party and the parties reasonably expected the stronger party to act solely or primarily on behalf of the weaker party.¹⁰ Lenders have been held liable for breach of a fiduciary duty when they have provided advice to customers under circumstances where the court has found a reposing of trust or confidence.¹¹

A case such as *Jacques v. First National Bank*,¹² illustrates the type of

⁴ Treatises include within the rubric of lender liability" a wide variety of suits brought against lenders. For example, one lender liability treatise includes leveraged buyouts, environmental cleanups, and securities law violations as well as common law causes of action. MARK E. BUDNITZ, *THE LAW OF LENDER LIABILITY*, chs. 5, 8, 9, 10 (rev. ed. 1994). See GERALD BLANCHARD, *LENDER LIABILITY* (1989). This section will discuss those theories which are most likely to be the basis of lender liability litigation brought by consumers against banks.

⁵ Shields, *supra* note 3, at 49.

⁶ BUDNITZ, *supra* note 4, § 5-24.

⁷ Mark E. Budnitz, *The Sale of Credit Life Insurance: The Bank as Fiduciary*, 62 N.C. L. REV. 295, 301 (1984).

⁸ *Lash v. Cheshire County Sav. Bank, Inc.*, 474 A.2d 980, 981-82 (N.H. 1984).

⁹ Budnitz, *supra* note 7, at 300.

¹⁰ *Id.*

¹¹ BUDNITZ, *supra* note 4, §§ 5-28 to 5-34.

¹² 515 A.2d 756 (Md. 1986) (discussed in BUDNITZ, *supra* note 4, §§ 5-17).

situation which concerns bankers. In *Jacques*, the bank breached its fiduciary duty when it failed to accurately calculate the amount of a mortgage loan for which the borrowers could qualify. Similarly, in *Commercial Cotton Co. v. United California Bank*,¹³ a \$100,000 punitive damages award was upheld for the consumer. The bank had paid \$4,000 to a thief who cashed the customer's forged checks and then refused to recredit the customer's account because the customer did not notify the bank of the forgery within the time required by the Uniform Commercial Code.¹⁴

The doctrine of good faith is also of concern to bankers. The doctrine is embodied in the *Restatement (Second) of Contracts*¹⁵ and the Uniform Commercial Code (UCC).¹⁶ It is applied to lenders having discretion over certain aspects of a transaction, lenders accelerating payment of a loan, and lenders failing to follow their own policies and procedures.¹⁷ In *KMC Co. v. Irving Trust Co.*,¹⁸ the borrower obtained a secured line of credit to finance its wholesale grocery business. According to the terms, the bank would loan the company up to \$3.5 million "in its discretion." When the borrower requested an \$800,000 advance to cover checks that would be presented for payment immediately, the bank refused to extend the requested credit and did not resume financing for three days. As a result, the checks bounced. The borrower eventually liquidated its businesses because of the damage to its reputation caused by the bank's refusal.¹⁹ Under these circumstances, including a request for a fully collateralized extension of credit and the absence of valid business reasons for terminating the line of credit, the court held that the bank violated its good faith obligation. Although the loan documents gave the bank the authority to loan money "in its discretion," the court held the bank was required to notify the borrower in advance of its intention to deny further credit, in order to provide the borrower the opportunity to seek alternative financing.²⁰

Other causes of action in lender liability cases include unconscionability,²¹ Racketeering Influenced and Corrupt Organizations Act (RICO),²² fraud,²³ and duress.²⁴ Courts have awarded treble damages for

¹³ 209 Cal. Rptr. 551 (Ct. App. 1985).

¹⁴ The California Court of Appeals later recanted its *Commercial Cotton* decision in *Copesky v. Superior Court*, 280 Cal. Rptr. 338 (Ct. App. 1991).

¹⁵ RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981).

¹⁶ U.C.C. § 1-203 (1990).

¹⁷ BUDNITZ, *supra* note 4, §§ 4-17 to 4-32.

¹⁸ 757 F.2d 752 (6th Cir. 1985).

¹⁹ *Id.* at 754.

²⁰ *Id.* at 759.

²¹ *Carboni v. Arrospide*, 2 Cal. Rptr. 2d 845 (Ct. App. 1991).

²² 18 U.S.C. § 1961 *et. seq.* (1988); BUDNITZ, *supra* note 4, §§ 6-1 to 6-73.

RICO violations²⁵ and punitive damages for acting in bad faith.²⁶

Banks also have faced class action lender liability suits on grounds specifically related to consumer credit issues.²⁷ For example, in *Perdue v. Crocker National Bank*,²⁸ the California Supreme Court held that a consumer stated a cause of action when he alleged that the amount the bank charged for insufficiently funded accounts was unconscionable. More recently, in *Beasley v. Wells Fargo Bank*,²⁹ a \$5.2 million jury award was upheld on appeal in a case alleging violation of a California statute regulating excessive late and overlimit fees. In a third California case, *Learly v. Wells Fargo Bank*,³⁰ consumers sued three banks for violating state antitrust laws by conspiring to fix interest rates on credit cards. Two of the banks settled for many millions of dollars.³¹

Financial institutions have turned to arbitration not only to avoid the huge monetary awards to which they may be subject,³² but also to escape the publicity which accompanies litigation. Publicity has two deleterious consequences for a financial institution. First, it may substantially tarnish the institution's public image.³³ Second, it may encourage consumers to sue the institution.³⁴ In contrast, arbitration is private.³⁵ Arbitration has other benefits as well. The lengthy and expensive discovery that financial institutions encounter in lender liability suits is largely eliminated in

²³ BUDNITZ, *supra* note 4, §§ 5-30 to 5-48.

²⁴ *Id.* §§ 5-48 to 5-52.

²⁵ BUDNITZ, *supra* note 4, §§ 11-18 to 11-19.

²⁶ *Id.* §§ 11-17 to 11-18.

²⁷ See Dwight Golann, *Consumer Financial Services Litigation: Major Judgments and ADR Responses*, 48 BUS. LAW. 1141 (1993).

²⁸ 702 P.2d 503 (Cal. 1985). See Weyman I. Lundquist, *Alternative Dispute Resolution as a Settlement Strategy in the Wake of Perdue v. Crocker National Bank*, 43 BUS. LAW. 1095 (1988).

²⁹ 1 Cal Rptr. 2d 446 (Ct. App. 1991). In a companion case, the court affirmed a judgment awarding attorney fees, costs, and expenses. *Id.* at 459.

³⁰ No. 866229 (San Francisco City Sup. filed Oct. 28, 1986) (discussed in Golann, *supra* note 27, at 1142).

³¹ Golann, *supra* note 27, at 1143.

³² *Id.* at 1141; see also Shields, *supra* note 3, at 49; Michael B. Cahill, *Why Financial Institutions Are Resolving Disputes Out of Court — A Banker's Perspective* (Sept. 1992) (on file with the *Ohio State Journal on Dispute Resolution*).

³³ Shields, *supra* note 3, at 50. See also Joseph McLaughlin, *Resolving Disputes in the Financial Community: Alternatives to Litigation*, ARB. J., Sept. 1986, at 16, 19 (litigation may damage the bank's reputation with its customers).

³⁴ Shields, *supra* note 3, at 50.

³⁵ *Id.*

arbitration where discovery is severely restricted.³⁶ Arbitration is faster and less costly than litigation.³⁷ Arbitrators are not required to issue written opinions explaining their decision.³⁸ Therefore, financial institutions need not fear that an unfavorable decision, such as those discussed above,³⁹ will encourage others to sue on the same grounds or provide precedent which subsequent arbitrators or judges will feel compelled to follow.

III. THE SOLUTION: ARBITRATION

Bankers have announced that they are turning to arbitration as their major strategy to prevent future losses in lender liability lawsuits.⁴⁰ An examination of the arbitration contracts they have drafted, however, demonstrates that these institutions have decided to use arbitration to take care of a great deal more than merely that type of litigation. Instead, these institutions have decided to enlist arbitration as the remedy, or at least an alternative remedy, in almost every type of dispute with consumers.⁴¹ This section will analyze the arbitration contracts used by four financial institutions with their customers. In addition, this section will analyze a variety of selected arbitration clauses used by financial institutions, whether in consumer or commercial transactions, in order to explore the variety of options available to these institutions, and the problems they may pose if required in consumer transactions. Finally, this section will analyze those contracts in light of federal and state arbitration statutes in order to understand the significance of the provisions drafted by the institutions.

³⁶ Michael F. Hoellering & Peter Goetz, *Piercing the Veil: Document Discovery in Arbitration Hearings*, ARB. J., Sept. 1992, at 59.

³⁷ RODOLPHE J.A. DE SEIFE, DOMKE ON COMMERCIAL ARBITRATION: PRACTICE GUIDE, § 1:01 at 2, § 5:01 at 69 (1987). See also Cheryl Aptowitz, Recent Case Note, 24 SETON HALL L. REV. 998, 998 (1993).

³⁸ *Wilko v. Swan*, 346 U.S. 427, 436 (1953).

³⁹ See *supra* text accompanying notes 8-18.

⁴⁰ Shields, *supra* note 3, at 49.

⁴¹ An exception to this comprehensive coverage is contained in California arbitration contracts. California banks typically provide that the arbitrator has no authority to enter a judgment on any indebtedness secured by a deed of trust on real property. N. Sue Van Sant Palmer, Comment, *Lender Liability and Arbitration: Preserving the Fabric of Relationship*, 42 VAND. L. REV. 947, 981-82 (1989). The objective of this exception is to avoid a state rule which would otherwise limit the lender's remedies. *Annotations to Proposed Arbitration Clause for Financial Institutions* (n.d.), reproduced in ALTERNATIVE DISPUTE RESOLUTION FOR FINANCIAL INSTITUTIONS: REDUCING THE COSTS OF LITIGATION 21 (Am. Arb. Assoc. n.d.) [hereinafter ADR FOR FINANCIAL INSTITUTIONS] (on file with the *Ohio State Journal on Dispute Resolution*).

A. Arbitration Provisions Used by Four Financial Institutions

Several financial institutions have included arbitration contracts in their consumer contracts in the past few years. These institutions include Bank of California,⁴² Bank of America,⁴³ Marathon Bank,⁴⁴ and Zions First National Bank.⁴⁵ These financial institutions have taken a variety of approaches to arbitration, illustrating the many choices available to them and the different types of difficulties consumers may encounter.

For example, Marathon Bank⁴⁶ and the Bank of California⁴⁷ impose mandatory arbitration upon the consumer and the institution whenever there is a dispute.⁴⁸ In contrast, the Bank of America⁴⁹ and Zions⁵⁰ require arbitration only if either party requests it. There may not be any practical difference in the two types of provisions. Presumably, if both of the parties to a dispute subject to the contracts drafted by Marathon and Bank of California agreed they did not want the dispute decided by arbitration, no one would trigger the arbitration process and the dispute would be decided by some other formal or informal dispute resolution mechanism.⁵¹

Bank of California,⁵² Marathon,⁵³ and Zions⁵⁴ employ broad "dragnet" clauses⁵⁵ which subject to arbitration not only disputes arising out of or

⁴² Palmer, *supra* note 41, at 950 n.21.

⁴³ *Id.* at 950.

⁴⁴ Shields, *supra* note 3, at 52.

⁴⁵ Stephen A. Hochman, *A Lawyers Arbitration Forum Is Needed for Commercial Arbitration, Arbitration for the Business Lawyer: The Questions Your Clients Will Ask and the Answers*, presented to the Am. Bar Ass'n Section of Business Law Spring Meeting (April 7, 1994) (on file with the *Ohio State Journal on Dispute Resolution*).

⁴⁶ J.F. Morrow & James R. Butler, *Arbitration: Working in Banking*, 1 AM. ARB. REP. No. 2 (1990), reprinted in *ADR FOR FINANCIAL INSTITUTIONS*, *supra* note 41, at 57.

⁴⁷ Palmer, *supra* note 41, at 982.

⁴⁸ The one exception is disputes involving loans secured by real estate which are not subject to arbitration. *Id.*

⁴⁹ *Id.* at 981.

⁵⁰ Hochman, *supra* note 45, at 45.

⁵¹ First Federal Savings of California has a mandatory arbitration provision for all disputes, but its contract specifically provides that the parties can agree to resolve their dispute otherwise, if they so agree in writing. *ADR FOR FINANCIAL INSTITUTIONS*, *supra* note 41, at 30.

⁵² Palmer, *supra* note 41, at 982.

⁵³ Morrow & Butler, *supra* note 46, at 57.

⁵⁴ Hochman, *supra* note 45, at 45.

⁵⁵ Morrow & Butler, *supra* note 46, at 58.

relating to the agreement the parties executed, but also to any other dispute among the parties. Bank of America's contract confines the scope of arbitration to disputes arising out of or relating to the agreement. One reviewer of that contract noted that by limiting itself in this fashion, Bank of America was allowing many types of disputes to escape arbitration.⁵⁶ The Marathon contract specifically states what may be implicit in the contracts of Bank of California and Zions, namely, that the obligation to arbitrate extends to any "past, present or future transactions, agreements or relationships."⁵⁷

All four banks specify that the arbitration contract considers alleged torts within its scope.⁵⁸ However, they have different ways of expressing this. Bank of California's contract covers any "controversy or claim . . . including any claim based on or arising from an alleged tort."⁵⁹ Bank of America⁶⁰ and Zions⁶¹ cover any controversy or claim "including but not limited to . . . an alleged tort." The Marathon contract covers "any dispute . . . whether sounding in contract, tort, breach of duty, or otherwise" ⁶² The Marathon contract further implicitly covers disputes such as lender liability, collection claims, slip and fall cases which occur in the bank's parking lot, slander or libel, and "injuries using ATMs . . . or whatever."⁶³

Despite the breadth of these scope provisions, the contracts carve out of arbitration either party's right to foreclose on real or personal property, exercise self-help, or maintain a court action for provisional or ancillary remedies.⁶⁴ Such provisions may favor financial institutions. It is the lender who would use the rights granted in the provision; consumers would rarely, if ever, use them.

⁵⁶ Examples of such disputes are: "fraud, constructive fraud, undue influence, breach of fiduciary duty, and similar matters" which relate to the transaction, but arguably do not arise out of the agreement. ADR FOR FINANCIAL INSTITUTIONS, *supra* note 41, at 21.

⁵⁷ Morrow & Butler, *supra* note 46, at 57.

⁵⁸ Palmer, *supra* note 41, at 981-82; Hochman, *supra* note 45, at 45; Morrow & Butler, *supra* note 46, at 57.

⁵⁹ Palmer, *supra* note 41, at 982.

⁶⁰ *Id.* at 981.

⁶¹ Hochman, *supra* note 45, at 45.

⁶² Morrow & Butler, *supra* note 46, at 57.

⁶³ *Id.* at 59.

⁶⁴ Palmer, *supra* note 41, at 981-83; Morrow & Butler, *supra* note 46, at 57. The Zions' contract confers the foreclosure right only upon the bank. Hochman, *supra* note 45, at 46. The contract drafted by the United States National Bank of Oregon lists examples of provisional remedies: "injunction, appointment of receiver, attachment, claim and delivery, and replevin." ADR FOR FINANCIAL INSTITUTIONS, *supra* note 41, at 73.

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Except for the Bank of America, the banks' contracts specify that the arbitrations are to be governed by the Federal Arbitration Act (FAA).⁶⁵ In contrast, the Bank of America's contract provides that arbitrations shall be pursuant to California law.⁶⁶ Bank of America apparently believes California's arbitration law is more favorable than the FAA.⁶⁷ Conversely, one reason Marathon prefers the FAA is its preemption of "conflicting state law theories such as 'contracts of adhesion.'"⁶⁸

All four financial institutions state in their contracts that disputes are to be decided pursuant to the rules of the American Arbitration Association (AAA).⁶⁹ Bank of California⁷⁰ and Zions⁷¹ incorporate the Commercial Arbitration Rules of the AAA. Marathon incorporates both those rules, as well as the Supplemental Procedures for Financial Institution Disputes.⁷²

The four banks provide for the selection of arbitrators according to the methods employed by the AAA. There are differences, however, in their approaches. The contracts used by Bank of California⁷³ and Zions⁷⁴ are silent on selection of arbitrators, but contain general provisions which incorporate the AAA Commercial Arbitration Rules. Consequently, those rules govern selection.⁷⁵ Bank of America's contract provides that selection

⁶⁵ Palmer, *supra* note 41, at 982; Hochman, *supra* note 45, at 46; Morrow & Butler, *supra* note 46, at 57. The FAA is codified at 9 U.S.C. §§ 1-15 (1988 & Supp. IV 1992).

⁶⁶ Palmer, *supra* note 41, at 981.

⁶⁷ See CAL. CIV. PROC. CODE §§ 1280-1288.8 (1982 & Supp. 1995). The authors of a model arbitration clause for use in Colorado recommend application of Colorado law rather than the FAA because Colorado statutes do not allow the arbitrator to award penal damages. *A Model Arbitration Clause for Commercial Loan Agreements: A Report of the ADR Industry Focus Subcommittee*, 20 COLO. LAW. 1159, 1161 n.1 (1991) [hereinafter *Colorado Model*].

⁶⁸ Morrow & Butler, *supra* note 46, at 59.

⁶⁹ Palmer, *supra* note 41, at 981-82; Hochman, *supra* note 45, at 45; Morrow & Butler, *supra* note 46, at 57.

⁷⁰ Palmer, *supra* note 41, at 982.

⁷¹ Hochman, *supra* note 45, at 45.

⁷² Morrow & Butler, *supra* note 46, at 57.

⁷³ Palmer, *supra* note 41, at 983.

⁷⁴ Hochman, *supra* note 45, at 45-46.

⁷⁵ The AAA maintains a National Panel of Commercial Arbitrators from which it compiles lists to submit to parties. ROBERT COULSON, *BUSINESS ARBITRATION, WHAT YOU NEED TO KNOW* 34 (4th ed. 1991). The parties have ten days to cross off the names of persons they object to and number the remainder in order of preference. The AAA then selects the arbitrator preferred by the parties. If the parties fail to agree on any of the persons on the list, the AAA makes the appointment. The AAA appoints one arbitrator if the parties' agreement is silent on this matter. The AAA, however, has authority to appoint a greater number. *Id.* at 37.

is to be made in the same manner as the AAA uses in its proceedings, but there is no reference to the Commercial Arbitration Rules.⁷⁶ Marathon directs the parties to follow the Commercial Arbitration Rules of the AAA and the Supplemental Procedures for Financial Institution Disputes.⁷⁷ But, in a significant departure from the other banks, its contract also provides that either party may require that arbitrators be retired judges.⁷⁸ Selection of a retired judge substantially increases the cost of arbitration by \$200 to \$300 per hour.⁷⁹ The provision has been justified in three ways. First, the prevailing party may be able to recover its arbitration costs — including the arbitrator's fee.⁸⁰ Second, the provision ensures "important protection on the quality of the decision maker."⁸¹ Third, the clause provides an incentive for the parties to be "reasonable" in their approach to resolving the dispute.⁸²

Only the Zions contract specifically provides for the location of the arbitration hearings. That contract specifies that all proceedings will be held in Salt Lake City, Utah.⁸³ Because the other contracts are silent, the location of hearings held in disputes involving the other banks are determined in accordance with the AAA rules. These rules provide that the parties may agree on the locale for the hearing.⁸⁴ Alternatively, one party may request a specific locale; the opposing party has ten days to object. If that party does object, the arbitrator has authority to decide on the locale.

All four contracts use traditional "legalese," much of which presumably would be incomprehensible to most consumers. Examples include: "setoff . . . provisional or ancillary remedies . . . receiver."⁸⁵ Probably more crucial is the omission in the contracts used by three of the banks of an explanation of the arbitration contract's significance and what rights the consumer is surrendering. In stark contrast, the Zions contract includes "plain English" disclosures. The first disclosure states that arbitration is "usually final and binding and subject to only very limited review by a court."⁸⁶ There is no explanation of what final and binding

⁷⁶ Palmer, *supra* note 41, at 981.

⁷⁷ Morrow & Butler, *supra* note 46, at 57.

⁷⁸ *Id.*

⁷⁹ *Id.* at 59.

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² Morrow & Butler, *supra* note 46, at 59.

⁸³ Hochman, *supra* note 45, at 45.

⁸⁴ AMERICAN ARBITRATION ASSOCIATION, COMMERCIAL ARBITRATION RULES § 11 (1984); COULSON, *supra* note 75, at 35.

⁸⁵ Palmer, *supra* note 41, at 983 (Bank of California).

⁸⁶ Hochman, *supra* note 45, at 45.

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arbitration means, and the contract does not discuss the circumstances under which a court may review an arbitrator's order. The next disclosure, however, goes a long way towards remedying the obscurity of the first disclosure by explaining that the parties are waiving their rights to litigate the dispute in court, and that this includes waiver of their rights to a jury trial. Next, the Zions contract warns that discovery in arbitration is more limited and different than in court proceedings. There is no explanation of what "discovery" includes. The fourth disclosure informs the parties that the arbitrator is not required to issue an opinion containing findings of fact or "legal reasoning." In addition, this disclosure again cautions that the right to appeal the arbitrator's award is limited, but does not explain in what way it is limited. Finally, the contract tells the parties that one of the arbitrators may be affiliated with the banking industry. Zions also provides a brochure which goes into greater detail to explain in "plain English" what arbitration entails.⁸⁷

B. Other Types of Arbitration Provisions

An examination of clauses in other arbitration contracts indicates further options. These contracts include a "proposed" contract,⁸⁸ a "model" contract,⁸⁹ and contracts that financial institutions may use only in commercial transactions. They demonstrate ways in which institutions may clarify ambiguities, further restrict remedies, and increase barriers to consumer redress.

Examples of provisions which fill in gaps or clarify matters include: specifying that statutes of limitations which would be applicable in a judicial proceeding apply in arbitration as well,⁹⁰ and providing that if there is an inconsistency between the AAA Commercial Arbitration Rules and the institution's contract, the contract supersedes the rules.⁹¹

A paragraph in the arbitration contract used by First Federal Savings Bank of California allows pre-hearing motions.⁹² The arbitrator is authorized to decide motions to dismiss and motions for summary adjudication. It is within the arbitrator's discretion whether to conduct a hearing or decide based solely on document submissions. This provision is designed to deal with an anomaly of arbitration proceedings. Consistent

⁸⁷ ZIONS FIRST NAT'L BANK, ARBITRATION IN LENDING (1991) (on file with the *Ohio State Journal on Dispute Resolution*).

⁸⁸ See ADR FOR FINANCIAL INSTITUTIONS, *supra* note 41, at 18.

⁸⁹ *Colorado Model*, *supra* note 67, at 1160-61.

⁹⁰ See ADR FOR FINANCIAL INSTITUTIONS, *supra* note 41, at 18.

⁹¹ *Id.*

⁹² See *id.*

with its objective of eliminating endless pre-trial maneuvering and ensuring a prompt hearing on the merits, arbitration generally eliminates pre-trial motion practice.⁹³ Ironically, in some cases, this actually prevents expeditious resolution of the dispute, because it requires a full arbitration hearing of the entire case, even in those instances where the case could be disposed of on procedural or jurisdictional grounds without any need for a full-blown hearing.

Some contracts are quite specific in regard to the arbitrators. A proposed contract for financial institutions provides that arbitrators must be "knowledgeable in the subject matter of the Dispute."⁹⁴ If retired judges are used, they can be selected through AAA panels, those maintained by the state courts, or even panels established by private organizations. If the arbitrator is an attorney, he or she is limited to awarding no more than \$100,000. If the claim is greater, a retired judge must be the arbitrator unless the complainant seeks more than one million dollars. In the latter case, a panel of three arbitrators is required, at least one of whom must be a retired judge.

Many contracts contain no explicit provision governing venue.⁹⁵ Consequently, in contracts subject to AAA rules, venue is governed by those rules. Under the AAA Commercial Arbitration Rules, in the absence of a provision in the contract and agreement by both parties, the administrator decides the appropriate venue.⁹⁶ *Patterson v. ITT Consumer Financial Corp.*⁹⁷ illustrates the perils of drafting an arbitration contract which contains a venue clause. In *Patterson*, ITT used a contract which stated that any dispute would be subject to the rules of the National Arbitration Forum and resolved "by the National Arbitration Forum, Minneapolis, Minnesota"⁹⁸ The court found that this provision suggests that Minnesota would be the location of any arbitration.⁹⁹ The court further concluded that the arbitration contract was an unenforceable contract of adhesion. While contracts of adhesion are not necessarily objectionable, they become so if they contain provisions which are beyond the reasonable expectations of the weaker party. The court held that it was not within the reasonable expectation of California borrowers that they

⁹³ Shields, *supra* note 3, at 51.

⁹⁴ See ADR FOR FINANCIAL INSTITUTIONS, *supra* note 41, at 19.

⁹⁵ *E.g.*, Palmer, *supra* note 41, at 982-83 (Bank of California); *id.* at 981-82 (Bank of America).

⁹⁶ COULSON, *supra* note 75, at 35.

⁹⁷ 18 Cal. Rptr. 2d 563 (Ct. App. 1993), *cert. denied*, 114 S. Ct. 1217 (1994).

⁹⁸ *Id.* at 566.

⁹⁹ *Id.*, 18 Cal. Rptr. at 566.

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would be subject to arbitration in Minnesota.¹⁰⁰

The Colorado Model Arbitration Contract includes an optional provision which combines mediation and arbitration.¹⁰¹ The provision requires the parties to initially submit their dispute for mediation conducted pursuant to the AAA Commercial Mediation Rules. The contract contains a time limit for the mediation. If, after a set period of time, the parties have not reached a settlement, either party can force the dispute to arbitration. Mediation has the advantage of permitting a solution which may not be permitted by the contract or law if the dispute goes to arbitration.¹⁰² In addition, because it is less adversarial, there is a greater possibility that the parties will emerge with their working relationship intact.¹⁰³

The AAA Commercial Arbitration Rules provide for a single arbitrator to hear cases with discretion to appoint a greater number.¹⁰⁴ First Federal Savings Bank of California's contract provides that a "Qualified Attorney"¹⁰⁵ may hear cases where the amount in controversy is less than \$100,000.¹⁰⁶ Disputes in which the amount is between \$100,001 and \$1,000,001 must be decided by a "Qualified Judge."¹⁰⁷ Cases where the amount in controversy is over one million dollars must be decided by a panel consisting of a Qualified Judge, a Qualified Attorney, and a Qualified Business Person.¹⁰⁸

The Colorado Model Arbitration Contract requires a panel of three arbitrators, one from each of three groups: (1) a lawyer who has practiced commercial law for a set number of years or a retired judge; (2) a person with at least a set number of years of experience in commercial lending; and (3) a person with at least a set number of years of experience in a relevant industry.¹⁰⁹ The model contract provides for disputes under a given amount to be decided by a single arbitrator and under expedited procedures.

Many arbitration contracts used by financial institutions are silent as to

¹⁰⁰ *Patterson*, 18 Cal. Rptr. at 565-66.

¹⁰¹ *Colorado Model*, *supra* note 67, at 1160.

¹⁰² *Id.*

¹⁰³ *Id.* at 1162 n.8.

¹⁰⁴ COULSON, *supra* note 75, at 37.

¹⁰⁵ "Qualified Attorney" is defined as a person who has been a member in good standing of the California Bar for the preceding five years who is familiar with the subject matter of the dispute. ADR FOR FINANCIAL INSTITUTIONS, *supra* note 41, at 32.

¹⁰⁶ *Id.*

¹⁰⁷ "Qualified Judge" is defined as any retired judge of certain California courts or any federal court with panels located in California. *Id.* at 32.

¹⁰⁸ "Qualified Business Person" is defined as a person familiar with the subject matter of the dispute. *Id.*

¹⁰⁹ *Colorado Model*, *supra* note 67, at 1160.

who pays which costs.¹¹⁰ Because they are silent, this issue would be decided according to the rules of the AAA and case law under the FAA or Uniform Arbitration Act.¹¹¹ In contrast, the proposed arbitration contract for financial institutions is very specific on this point. It provides that each party must pay all of its own expenses and an equal share of the arbitrator's fees. The arbitrator, however, has the power to award the arbitrator's fees, as well as attorney's fees and administrative fees, to the prevailing party.

Setting out the provision on fees in the contract instead of silently incorporating the AAA rules has three advantages. First, it eliminates this issue from being subject to changes in AAA rules. Second, it eliminates the issue of which AAA rules apply — rules in force at the time of execution of the contract or those in force at the time of the dispute. Third, it alerts the consumers to the fee issue, which otherwise may not occur to them, and provides them with this crucial information. Otherwise, consumers have no way to know how costs will be allocated unless they obtain copies of the applicable rules. This in itself may be impossible. Whereas some banks specify that the Commercial Arbitration Rules of the AAA apply,¹¹² the Bank of America's contract simply provides that the AAA applies.¹¹³ Consequently, the consumer would not even know what set of rules to request.

The Colorado Model Arbitration Contract provides three alternative approaches to the allocation of costs and fees.¹¹⁴ One alternative requires the arbitrator to award all costs and fees to the prevailing party.¹¹⁵ A second option is for the contract to provide that each party shall bear its own costs and expenses, and that the arbitrators' fees and administrative fees be divided equally.¹¹⁶ A third choice is to allocate the costs as provided for in the provisions of the loan agreement or other documents which relate

¹¹⁰ *E.g.*, Palmer, *supra* note 41, at 982-83 (Bank of California); *id.* at 981-82 (Bank of America).

¹¹¹ The AAA maintains a schedule of the administrative fee which both must pay. COULSON, *supra* note 75, at 40-41. The arbitrator may apportion this fee in his or her award. In the case of extreme hardship, the AAA may reduce or defer the fee. Parties must pay the expenses of their own witnesses. All other expenses are paid equally by the parties unless the parties otherwise agree or the arbitrator apportions the fee otherwise in his or her award.

¹¹² *E.g.*, Hochman, *supra* note 45, at 45.

¹¹³ Palmer, *supra* note 41, at 981.

¹¹⁴ *Colorado Model*, *supra* note 67, at 1160-61.

¹¹⁵ *Id.* at 1160. Costs and fees include: "the arbitrators' fees, administrative fees, travel expenses, out-of-pocket expenses such as copying and telephone, court costs, witness fees, and attorneys' fees." *Id.*

¹¹⁶ *Colorado Model*, *supra* note 67, at 1160. The New York Bank's contract includes this clause. ADR FOR FINANCIAL INSTITUTIONS, *supra* note 41, at 71.

specifically to the transaction over which there is a dispute.¹¹⁷ This option would not be appropriate in those arbitration contracts which purport to cover any and all controversies between the parties, including incidents such as slip and fall claims.¹¹⁸

An important unsettled issue is whether arbitrators have the authority to award punitive damages.¹¹⁹ While many contracts are silent on the matter, the arbitration contract used by Republic National Bank of New York specifically provides that the arbitrator has no such authority.¹²⁰

C. Applicable Federal Arbitration Law

As discussed above,¹²¹ several financial institutions specifically provide that the FAA¹²² shall apply to the arbitration agreement. This section will briefly describe the major features of the FAA and examine those sections and case law which may be of particular benefit to financial institutions that wish to arbitrate disputes with consumers under the aegis of the FAA.

The FAA applies to arbitration agreements "involving commerce."¹²³ "Commerce" is defined as "commerce among the several states."¹²⁴ Because of the interstate nature of financial transactions, most bank-consumer arbitration contracts undoubtedly fall within this definition.

The Act declares that arbitration agreements are "valid, irrevocable, and enforceable" unless grounds exist "at law or in equity" to revoke the agreement. State law governs questions relating to the validity, revocability,

¹¹⁷ *Colorado Model*, *supra* note 67, at 1160-61.

¹¹⁸ See *supra* text accompanying note 63.

¹¹⁹ See *infra* text accompanying notes 158-66, 265.

¹²⁰ Hochman, *supra* note 45, at 48 (the contract's parties are the bank and the guarantor).

¹²¹ See *supra* text accompanying note 65.

¹²² 9 U.S.C. §§ 1-15 (1988 & Supp. IV 1992). Congress did not engage in a careful consideration of arbitration legislation. Consequently, the legislative history is not very helpful. Congress "rubber stamped" the bill proposed by the American Arbitration Association. IAN MACNEIL, *AMERICAN ARBITRATION LAW: REFORMATION-NATIONALIZATION-INTERNATIONALIZATION* 107 (1992).

¹²³ 9 U.S.C. § 2 (1988 & Supp. IV 1992). In *Allied-Bruce Terminix Cos. v. Dobson*, 115 S.Ct. 930 (1995), the Supreme Court broadly construed Section 2 of the FAA to have a meaning identical to statutes governing all transactions "affecting" commerce. The Court rejected the holding of the Alabama Supreme Court which inquired into whether the parties to the agreement contemplated substantial interstate activity when they entered into their agreement. Instead, the Court held the inquiry should be whether, in fact, the transaction involved interstate commerce.

¹²⁴ 9 U.S.C. § 1 (1988 & Supp. IV 1992).

and enforceability of the arbitration contract.¹²⁵ Grounds for revocation include fraud related to the arbitration contract,¹²⁶ mistake, and duress.¹²⁷ Courts have declared arbitration contracts unenforceable because they are unconscionable.¹²⁸ As with any contract, arbitration contracts must satisfy the traditional requirements of contract law including capacity¹²⁹ and consideration.¹³⁰

Under section 3 of the FAA, if a party brings suit instead of going to arbitration, the other party can obtain a stay.¹³¹ If one party refuses to arbitrate, the other party can petition a federal district court for an order directing the parties to arbitrate according to their arbitration agreement.¹³² The court will hold a hearing to determine if a valid arbitration contract exists and if the accused party has failed to arbitrate in accordance with the agreement. If a party claims the agreement is not valid, the court, not the arbitrator, decides that issue.¹³³

The court will appoint a single arbitrator unless the agreement provides for a method to select the arbitrator or provides for more than one arbitrator, or both.¹³⁴ The arbitrator may issue summonses to witnesses as well as subpoena their books, records, etc.¹³⁵ The arbitrator can also petition the district court to compel attendance. If the arbitration agreement so provides, an arbitration award may be confirmed by the district court.¹³⁶ The FAA provides very limited grounds for a court to vacate,¹³⁷ modify, or correct

¹²⁵ Perry v. Thomas, 482 U.S. 483, 493 n.9 (1987).

¹²⁶ Three Valleys Mun. Water Dist. v. E.F. Hutton, 925 F.2d 1136, 1140 (9th Cir. 1991).

¹²⁷ County of Middlesex v. Geryn Constr. Corp., 450 F.2d 53, 56 (5th Cir. 1971), *cert. denied*, 405 U.S. 955 (1972).

¹²⁸ Miller v. AAACon Auto Transp., Inc., 434 F. Supp. 40, 42 (S.D. Fla. 1977). *See infra* text accompanying notes 276-332.

¹²⁹ American Airlines, Inc. v. Louisville - Jefferson County Air Bd., 269 F.2d 811, 817 (6th Cir. 1959).

¹³⁰ Hull v. Norcom, 750 F.2d 1547, 1550 (11th Cir. 1985).

¹³¹ 9 U.S.C. § 3 (1988 & Supp. IV 1992).

¹³² *Id.* § 4.

¹³³ A/S Ganger Rolf v. Zeeland Transp., Ltd., 191 F. Supp. 359, 363 (S.D.N.Y. 1961).

¹³⁴ 9 U.S.C. § 5 (1988 & Supp. IV 1992).

¹³⁵ *Id.* § 7.

¹³⁶ *Id.* § 9.

¹³⁷ *Id.* § 10. *Compare* Bowles Fin. Group, Inc. v. Stifel, 22 F.3d 1010 (10th Cir. 1994) (no grounds to vacate award even though prevailing party informed the arbitrators of opposing party's settlement offers in order to influence the arbitrators) *with* Schmitz v. Zilveti, 20 F.3d 1043 (9th Cir. 1994) (award vacated where arbitrator failed to disclose that his law firm had

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the arbitrator's award.¹³⁸ In short, the FAA promotes arbitration by providing for the enforceability of valid arbitration agreements, the stay of pending litigation, and the finality of the arbitrator's award.

The significance of the FAA's judicial sanction to a non-judicial procedure (which largely precludes access to a judicial forum) can be appreciated by comparing certain features of arbitration and adjudication. Obviously, in arbitration, the parties waive their rights to factfinding by a jury of their peers.¹³⁹ They also surrender their rights to a trial presided over by a judge who is an elected or appointed public official. In addition, the parties surrender their rights to full-blown discovery.¹⁴⁰ The arbitrator can issue a summons *duces tecum* requiring a witness to bring documents to the hearing,¹⁴¹ and if necessary may grant an adjournment so the parties can study them.¹⁴² This is a far cry, however, from a party having at its disposal the wide array of discovery techniques such as interrogatories, motions to produce documents, depositions, etc. While discovery can greatly prolong litigation and increase its cost, it also narrows the issues, reduces surprises,¹⁴³ and may encourage settlement.¹⁴⁴

As a general rule, arbitration's limits on discovery probably favor financial institutions in disputes with consumers. In consumer disputes with financial institutions, it is often impossible for the consumer to prevail absent discovery because the institution or third parties have within their exclusive possession the critical information and documents the consumer

previously represented parent company of one of the parties even though he had no actual bias since he was unaware of law firm's past representation when he decided the arbitration case).

¹³⁸ 9 U.S.C. § 11 (1988 & Supp. 1992).

¹³⁹ The waiver must be knowingly made. *Woodyard v. Merrill Lynch*, 640 F. Supp. 760, 766 (S.D. Tex. 1986).

¹⁴⁰ The restrictions on discovery may have their origins in the nature of early commercial arbitration. "[C]ommercial arbitration originally developed in the context of disputes about a single mercantile transaction such as a shipment of tea, and the notion that additional new and vital facts might be discovered in the course of the proceedings, and [thus] might require amendment of the original claim, was probably foreign to that single-transaction mercantile context." BERTHOLD H. HOENIGER, *COMMERCIAL ARBITRATION HANDBOOK* § 8-6 (1990). In addition to the discovery restrictions of the FAA, extensive discovery is discouraged by the AAA. An arbitrator likely will not order depositions "even if the need is compelling, because such a procedure is outside the norm of AAA practice." *Id.* § 6-34.

¹⁴¹ 9 U.S.C. § 7 (1982).

¹⁴² Nicholas J. Healy, *An Introduction to the Federal Arbitration Act*, 13 J. MAR. L. & COM. 223, 226 (1982).

¹⁴³ Hoellering & Goetz, *supra* note 36, at 58.

¹⁴⁴ Gregory P. Joseph, *Discovery Should Not Be Abolished*, ARB. J., Sept. 1992, at 61.

needs to prove the case.¹⁴⁵ Moreover, in cases involving expert witnesses, it often is necessary for the expert to review material in the opponent's possession before the hearing in order to adequately prepare and present satisfactory testimony. As discussed *infra*, arbitration's restrictions on discovery may be particularly detrimental to consumers in certain types of disputes.¹⁴⁶

The FAA does not require the arbitrator to rule according to the law.¹⁴⁷ In *Wilko v. Swan*, however, the Supreme Court stated in dictum that courts could vacate an award if it is made in "manifest disregard" of the law.¹⁴⁸ In addition, in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*,¹⁴⁹ the Court said that "[b]y agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial forum."¹⁵⁰ Although not adopted by every circuit,¹⁵¹ those courts which have adopted the manifest disregard standard have required something "more than error or misunderstanding with respect to the law."¹⁵² Rather, there must be proof in the record that the arbitrator "knew the law and expressly disregarded it."¹⁵³ As a practical matter it may be impossible for a party to meet this standard because the FAA does not require the arbitrator to explain the reasons for his or her award and there need not be a complete record of the proceedings.¹⁵⁴

Because arbitrators are not required to strictly follow the law, they can do what seems fair¹⁵⁵ or just.¹⁵⁶ It is not clear whether this standard favors

¹⁴⁵ JONATHAN SHELDON, CREDIT DISCRIMINATION 141 (The Consumer Credit & Sales Legal Practice Series, 1993).

¹⁴⁶ See *infra* text accompanying note 356.

¹⁴⁷ *Wilko v. Swan*, 346 U.S. 427, 436 (1953).

¹⁴⁸ *Id.* at 436-37.

¹⁴⁹ 473 U.S. 614 (1985).

¹⁵⁰ *Id.* at 628.

¹⁵¹ Compare *Merrill Lynch v. Bobker*, 808 F.2d 930, 933 (2d Cir. 1986) (court defines and applies the manifest disregard standard) with *Marshall v. Green Giant Co.*, 942 F.2d 539, 550 (8th Cir. 1991) (court declines to decide whether to adopt the manifest disregard standard).

¹⁵² *Merrill Lynch*, 808 F.2d at 933.

¹⁵³ *O.R. Sec., Inc. v. Professional Planning Assocs.*, 857 F.2d 742, 747 (11th Cir. 1988). See also *Merrill Lynch*, 808 F.2d at 933.

¹⁵⁴ *Wilko v. Swan*, 346 U.S. 427, 436 (1953).

¹⁵⁵ *University of Alaska v. Modern Const., Inc.*, 522 P.2d 1132, 1140 (Alaska 1974) (decided under the Uniform Arbitration Act).

¹⁵⁶ *Metropolitan Waste Control Comm'n v. City of Minnetonka*, 242 N.W.2d 830, 832 (Minn. 1976) (decided under the Uniform Arbitration Act). A survey of the arbitration of

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consumers or financial institutions. In cases where a consumer suffers serious injury or the bank's conduct is especially harsh, insensitive, or careless, the consumer loses the opportunity to play upon the jury's emotions. On the other hand, where the consumer is in default on a debt or has a claim based on a legal technicality or boring, complicated facts, an arbitrator might be at least as favorable as a judge and jury.

Arbitration hearings are private. Privacy favors financial institutions which would prefer that disputes with consumers not be made public. Publicity may decrease consumers' trust and confidence in their financial institutions¹⁵⁷ and may disclose practices and procedures which, even if perfectly legal, these institutions would prefer remain private.

One of the financial institution's objectives in requiring consumers to arbitrate is to avoid the punitive damage awards which juries have rendered in lender liability cases.¹⁵⁸ It is not clear whether this objective would be achieved in arbitration cases decided under the FAA. Whereas the Second Circuit has refused to permit arbitrators to award punitive damages,¹⁵⁹ the First,¹⁶⁰ Ninth,¹⁶¹ and Eleventh¹⁶² Circuits have authorized arbitrators to do so. The other circuits have not decided this issue, so a financial institution is risking a possible punitive damage award in those circuits. Moreover, even in the circuits where courts have decided, the results often have depended upon the terms in the arbitration contracts before the courts. For example, courts have been influenced by choice of law clauses¹⁶³ and clauses incorporating the rules of the AAA.¹⁶⁴ Financial institutions

consumer disputes with travel agents in Great Britain found that arbitrators tended to find some merit in both sides' arguments and consequently "split the difference." Tamara Goriely, *How Well Do Consumer Arbitration Schemes Work?*, 141 *NEW L.J.* 535, 536 (1991).

¹⁵⁷ See generally McLaughlin, *supra* note 33.

¹⁵⁸ Memorandum From Attorneys Committee, California League of Savings Institutions, (Feb. 1989), reproduced in *ADR FOR FINANCIAL INSTITUTIONS*, *supra* note 41, at 12.

¹⁵⁹ *Barbier v. Shearson Lehman Hutton, Inc.*, 948 F.2d 117, 122 (2d Cir. 1991); *Fahnestock & Co. v. Waltman*, 935 F.2d 512, 518 (2d Cir. 1991), *cert. denied*, 502 U.S. 942 (1991).

¹⁶⁰ *Raytheon Co. v. Automated Business Sys., Inc.*, 882 F.2d 6, 12 (1st Cir. 1989).

¹⁶¹ *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056, 1062-63 (9th Cir. 1991).

¹⁶² *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378, 1387 (11th Cir. 1988).

¹⁶³ *Todd Shipyards*, 943 F.2d at 1062-63; *Bonar*, 835 F.2d at 1387. Where an arbitration agreement contains no express reference to claims for punitive damages, a contractual choice of law provision does not preclude punitive damages. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 1995 U.S. LEXIS 1820 (March 6, 1995).

¹⁶⁴ *Bonar*, 835 F.2d at 1379-80; *Raytheon*, 882 F.2d at 9-10.

frequently incorporate the AAA rules,¹⁶⁵ apparently because incorporation allows them to use the services of the AAA and the rules prove to be an efficient and effective framework in which to arbitrate. Ironically, incorporating those rules helps to persuade some courts that the arbitrator has the power to award punitive damages because the AAA rules do not prohibit the award of such damages.¹⁶⁶ Even in jurisdictions which allow the arbitrator to award punitive damages, financial institutions may be better off than in court. Juries composed of other consumers who themselves or whose relatives and friends may have had unsatisfactory experiences with financial institutions may be more inclined to award punitive damages — or punitive damages in greater amounts — than an arbitrator who is likely to be a business person or an attorney.

Class actions have been a fruitful and efficient device for consumers to achieve redress.¹⁶⁷ In addition, they likely deter many creditors from violating consumer protection laws. Lenders have found class actions to be an expensive threat and thus resort to arbitration, in part, to avoid them.¹⁶⁸ Neither the FAA nor the UAA contain provisions that specifically address the availability of class arbitration, and the courts are split on this issue. In *Gammara v. Thorp Consumer Discount Co.*,¹⁶⁹ a federal district court held that it was without power to order a dispute to proceed to arbitration as a class action because the arbitration agreement failed to provide for class treatment of disputes. In contrast, other courts have held that class treatment is allowed, although some decisions provide that the trial court should intervene to insure the integrity of the procedure.¹⁷⁰

¹⁶⁵ See *supra* text accompanying notes 69–72.

¹⁶⁶ “The arbitrator may grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement of the parties” COULSON, *supra* note 75, at 40.

¹⁶⁷ See YVONNE W. ROSMARIN & DANIEL A. EDELMAN, *CONSUMER CLASS ACTIONS* 15 (2d ed. 1990).

¹⁶⁸ McLaughlin, *supra* note 33, at 24; Shields, *supra* note 3, at 52.

¹⁶⁹ 828 F. Supp. 673, 674–75 (D. Minn. 1993), *appeal dismissed*, 15 F.3d 93 (8th Cir. 1994).

¹⁷⁰ See *Dickler v. Shearson Lehman Hutton, Inc.*, 596 A.2d 860, 864–67 (Pa. Super. Ct. 1991) (allowing class treatment even though no explicit authorization in arbitration contract; trial court should certify class, insure adequate provision for notice, and review order to make certain that absent class members are properly represented); *Izzy v. Mesquite Country Club*, 231 Cal. Rptr. 315, 321 (Ct. App. 1986) (court may need to be involved to insure appropriate procedures are followed, but should not unduly interfere so advantages of arbitration are lost); *Callaway v. Carswell*, 242 S.E.2d 103, 106 (Ga. 1978) (trial judge properly limited those who could be in class to insure practicability of class treatment). See also Note, *Classwide Arbitration: Efficient Adjudication or Procedural Quagmire?*, 67 VA. L.

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The arbitrator is not required to follow the law or write an opinion finding facts and explaining the basis for the award.¹⁷¹ This spares the financial institution the bad publicity surrounding unfavorable factual determinations and the leverage other consumers would receive from legal precedents beneficial to them. On the other hand, it also precludes the opportunity to counter publicity of alleged problems with favorable arbitration factfinding and legal precedent. Where the law is unsettled, both parties are deprived of clear rules to guide future conduct.¹⁷²

Finally, banks which have chosen to arbitrate under the FAA have the benefit of a Supreme Court which in recent years has enthusiastically and uncritically embraced the FAA.¹⁷³ It was not always so. In the 1953 case of *Wilko v. Swan*,¹⁷⁴ the Court recognized some of the fundamental differences between arbitration and adjudication. These include the lack of a complete record, awards without reasoned explanations and without the requirement of correctly applying the law, as well as the unavailability of judicial review for errors of law.¹⁷⁵ The Court held that Congress did not intend to deprive investors suing under section 12(2) of the Securities Act of 1933 of the right to adjudicate their claims.¹⁷⁶ One factor influencing the Court was that the parties did not "deal at arm's length on equal terms"¹⁷⁷ because of the brokers' superior knowledge of business factors affecting securities. The Court was persuaded that Congress intended to protect investors from this disadvantageous situation. This factor also is present in consumer relations with financial institutions where the institution has superior knowledge and greater bargaining power, and Congress seeks to protect the consumer.¹⁷⁸

Subsequent cases have completely undermined *Wilko*, both in terms of its protective approach to investors¹⁷⁹ and its generally cautious approval of

REV. 787, 800-01 (1981).

¹⁷¹ *Wilko v. Swan*, 346 U.S. 427, 436 (1953).

¹⁷² See *infra* text accompanying notes 359-62, 453.

¹⁷³ In addition to the Supreme Court decisions noted herein, former Chief Justice Warren Burger actively promoted arbitration and other forms of alternative dispute resolution as a solution to court congestion and other societal problems. See Warren E. Burger, *The State of Justice*, A.B.A. J., Apr. 1984, Cit. 62.

¹⁷⁴ 346 U.S. 427 (1953).

¹⁷⁵ *Id.* at 436-37.

¹⁷⁶ *Id.* at 438.

¹⁷⁷ *Id.* at 435.

¹⁷⁸ See, e.g., KATHLEEN E. KEEST & ERNEST L. SARASON, *TRUTH IN LENDING* 25 (2d ed. 1989).

¹⁷⁹ *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 228-29 (1987) (refusing to extend *Wilko* to the Securities Exchange Act of 1934); *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 481 (1989) (overruling *Wilko*).

arbitration. Presently, the Court presumes that arbitration contracts should be upheld. The burden is on the party opposing arbitration to prove that Congress intended to preclude waiver of judicial remedies for statutory rights.¹⁸⁰ The Court has specifically rejected its previous decisions in which unequal bargaining power was a factor.¹⁸¹ The fundamental differences between arbitration and adjudication have been dismissed without any recognition of those differences. For example, in *Shearson/American Express, Inc. v. McMahon*, the majority, in an opinion written by Justice O'Connor, derided *Wilko* as "reflect[ing] a general suspicion of the desirability of arbitration and the competence of arbitral tribunals,"¹⁸² and "mistrust of the arbitral process."¹⁸³ The Court found that the *Wilko* attitude toward arbitration was unjustified, given the SEC's oversight authority which would ensure the adequacy of the process.¹⁸⁴ In addition, the Court rejected the assumption that arbitrators would not decide cases consistent with the law. This rejection was based on the belief that judicial review "is sufficient to ensure that arbitrators comply with the requirements of the statute."¹⁸⁵ Rather than explain how the limited judicial review permitted under the FAA and case law provided this assurance, the Court referred to portions of the *Mitsubishi* decision in which the court noted, in a case involving an international transaction, that an international arbitration tribunal is not obligated to follow the legal norms or statutory dictates of any one country.¹⁸⁶ If the parties, however, have agreed that the tribunal has the authority to decide claims "arising from the application of American antitrust law, the tribunal therefore should be bound to decide that dispute in accord with the national law giving rise to the claim."¹⁸⁷ Justice Blackmun dissented in *McMahon*, noting that "[e]ven those who favor the arbitration of securities claims do not contend, however, that arbitration has changed so significantly as to eliminate the essential characteristics noted by the *Wilko* Court."¹⁸⁸

¹⁸⁰ See *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985).

¹⁸¹ *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 31 (1991).

¹⁸² *McMahon*, 482 U.S. at 231.

¹⁸³ *Id.*

¹⁸⁴ *Id.* at 233. A GAO report found that the SEC needed to improve its oversight of securities industry arbitration. *Markey Says GAO Report Finds Flaws in Arbitration of Discrimination Cases*, 26 Sec. Reg. & L. Rep. (BNA) 509, 510 (April 8, 1994).

¹⁸⁵ *McMahon*, 482 U.S. at 233.

¹⁸⁶ *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 636 (1985).

¹⁸⁷ *Id.* at 636-37.

¹⁸⁸ *McMahon*, 482 U.S. at 259 (Blackmun, J., dissenting).

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Justice Stevens has dissented in various FAA cases based on his review of the legislative history of the FAA. He concluded that it was not Congress' intention to include within the FAA either statutory claims or "form contracts between parties of unequal bargaining power."¹⁸⁹ In his estimation, recent Court decisions construing the FAA amount to the Court rewriting the Act.¹⁹⁰

Supreme Court cases have left unclear the power of state legislatures to prohibit the arbitration of disputes governed by the FAA. In *Southland Corp. v. Keating*,¹⁹¹ the Court considered a California franchise investment law which the California Supreme Court had interpreted to require judicial determination of any disputes arising under the law. The Court held that the FAA preempts state laws which "require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration."¹⁹² In *Volt Information Sciences, Inc. v. Board of Trustees*,¹⁹³ the parties' arbitration contract provided that the contract "shall be governed by the law of the place where the Project is located."¹⁹⁴ The Supreme Court upheld the Court of Appeals finding that this provision had the effect of incorporating California arbitration rules which permitted a stay of arbitration under the circumstances of the case. The Court acknowledged that the contract was governed by the FAA and the FAA had no provision allowing a stay in this situation. The Court justified adhering to state law, nevertheless, by insisting it was merely enforcing the parties' agreement. It is interesting to note, in light of *Southland* and other decisions in which the Court blindly followed the FAA, that in *Volt* the Court stated that "[t]he FAA contains no express pre-emption [sic] provision, nor does it reflect a congressional intent to occupy the entire field of arbitration."¹⁹⁵ The issue of preemption is important because several states exempt consumer transactions from arbitration.¹⁹⁶ These state exemptions appear to be ineffective after *Southland*. After *Volt*, the ineffectiveness may be dependent upon language in the parties' contract.¹⁹⁷

¹⁸⁹ *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 42 (1991) (Stevens, J., dissenting).

¹⁹⁰ *Perry v. Thomas*, 482 U.S. 483, 493 (1987) (Stevens, J., dissenting).

¹⁹¹ 465 U.S. 1 (1984).

¹⁹² *Id.* at 10.

¹⁹³ 489 U.S. 468 (1989).

¹⁹⁴ *Id.* at 470.

¹⁹⁵ *Id.* at 477.

¹⁹⁶ See *infra* text accompanying notes 268-71.

¹⁹⁷ IAN R. MACNEIL ET AL., 2 FEDERAL ARBITRATION LAW 16:90 (1994) ("[T]he *Volt* doctrine is in its infancy, and how far it goes in conferring freedom on the parties to choose state law remains unclear.").

In contrast to the possible softening of approach evidenced in *Volt*, the Supreme Court in *Allied-Bruce Terminix Cos. v. Dobson*¹⁹⁸ adopted a broad reading of the FAA's preemptive effect where a transaction involves interstate commerce, and strongly reaffirmed *Southland* in the face of a concurring opinion and two dissents which questioned the correctness of *Southland*. Justice O'Connor, concurring, expressed the concern that the majority's decision would "displace many state statutes carefully calibrated to protect consumers . . . and state procedural requirements aimed at ensuring knowing and voluntary consent."¹⁹⁹ In apparent response, the majority stated that states could still protect consumers by applying general contract law principles.²⁰⁰ In addition, the Court noted that Section 2 of the FAA authorizes a court to invalidate an arbitration clause if grounds exist for doing so under the rules for revoking contracts. The next section of this article discusses state arbitration law and should be read in the context of the expansive reach of the FAA as construed in *Allied-Bruce*.

D. Applicable State Arbitration Law

The persons promoting the UAA were motivated by their belief that it would encourage increased use of arbitration in commercial transactions.²⁰¹ Thirty-five states have adopted the UAA.²⁰² The UAA is substantially similar to the FAA. For purposes of this article, it is instructive to examine UAA case law for the lessons that case law can teach banks and consumers concerning problem areas. Bank of America's contract provides that California arbitration law applies rather than the FAA,²⁰³ and other financial institutions may follow its example. In addition, individual states have adopted unique ways to deal with certain situations which provide insights on how rules for bank-consumer disputes might be structured. These insights will be explored in Part VI.

Several aspects of the arbitration contract have been explored in cases decided under the UAA. These cases are also relevant to litigation decided under the FAA because state law applies to questions involving the validity

¹⁹⁸ 115 S.Ct. 930 (1995).

¹⁹⁹ *Id.*

²⁰⁰ *Id.*

²⁰¹ MACNEIL, *supra* note 122, at 44.

²⁰² UNIF. ARB. ACT, 7 U.L.A. 1 (Supp. 1993). An Alabama statute declares predispute arbitration agreements to be unenforceable. ALA. CODE § 8-1-41 (1993). The scope of such statutes may have been considerably narrowed by the Supreme Court's broad construction of the interstate commerce reach of Section 2 of the FAA in *Allied-Bruce Terminix Cos. v. Dobson*, 130 L. Ed. 2d 753 (1995).

²⁰³ Palmer, *supra* note 41, at 981.

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of contracts under the federal Act.²⁰⁴ The Florida Court of Appeals has established minimum requirements for arbitration contracts which provide guidance to institutions drafting those agreements. The court stated that an arbitration contract must be definite enough to give the parties some idea of what matters are to be submitted to arbitration.²⁰⁵ The court warned that it would construe ambiguous provisions in favor of the party seeking a ruling that the arbitration contract is invalid. As discussed in Part IV, this may present problems for the wide-ranging “dagnet” clauses used by some banks.²⁰⁶ In addition, the court required arbitration contracts to provide some detail as to the arbitration procedure which will apply.²⁰⁷ As discussed in Part IV, this requirement raises the issue of whether simply referring to AAA procedures in a contract with a consumer is adequate.²⁰⁸

The burden is on the party seeking to enforce an arbitration agreement to show that the opposing party “knowingly, intelligently, and voluntarily” waived his or her right to a trial in court.²⁰⁹ Missouri attempted to assure this by enacting a non-uniform amendment to its UAA which requires arbitration contracts to include the following disclosure in ten point capital letters: THIS CONTRACT CONTAINS A BINDING ARBITRATION PROVISION WHICH MAY BE ENFORCED BY THE PARTIES.²¹⁰ Michigan goes even further, requiring that patients be furnished brochures describing the arbitration procedure they are subjecting themselves to by signing an agreement to arbitrate malpractice claims.²¹¹

Contracts subject to the UAA have been attacked as unconscionable, with results varying depending upon the facts. In one case, the contract provided that insureds were bound by arbitration awards, but the insurance company was bound only if it consented in writing.²¹² The court declared

²⁰⁴ Perry v. Thomas, 482 U.S. 483, 489 (1987).

²⁰⁵ Wood-Hopkins Contracting Co. v. C.H. Barco Contracting Co., 301 So. 2d 479, 480 (Fla. Dist. Ct. App. 1974).

²⁰⁶ See *infra* text accompanying note 326.

²⁰⁷ Wood-Hopkins Contracting Co., 301 So. 2d at 480.

²⁰⁸ See *infra* text accompanying notes 313-15, 322.

²⁰⁹ Roberts v. McNamara-Warren Community Hosp., 360 N.W.2d 279, 281 (Mich. Ct. App. 1984).

²¹⁰ MO. ANN. STAT. § 435.460 (Vernon 1989). See Hefele v. Catanzaro, 727 S.W.2d 475, 476-77 (Mo. Ct. App. 1987). But see Hamilton Metals, Inc. v. Blue Valley Metal Prod. Co., 763 S.W.2d 225, 226-27 (Mo. Ct. App. 1989) (arbitration contract is enforceable even if it omits required disclosure if opposing party had actual notice of the arbitration agreement).

²¹¹ Roberts, 360 N.W.2d at 281.

²¹² Fritz v. Nationwide Mut. Ins. Co., Civ. No. 1369, 1990 WL 186448 (Del. Ch. Nov. 26, 1990).

the contract unconscionable because it was "unfairly structured."²¹³ On the other hand, in a medical malpractice case, a court rejected an unconscionability claim based on the argument that the AAA's fees were oppressive.²¹⁴ The court pointed out that the fees were much less than the cost of litigating the claim. Moreover, the AAA Commercial Arbitration Rules provide that "in the event of extreme hardship" the administrative fee can be deferred or reduced.²¹⁵

The Delaware Supreme Court has held that certain insurance arbitration contracts are against public policy.²¹⁶ The contract in *Worldwide* provided that if the arbitration award exceeded the state financial responsibility limits, either party could appeal the decision for a judicial trial *de novo*. If the award was below those limits, however, the award was not appealable. Noting that the practical effect was to provide the insurance company with the right to appeal while denying that right to the insured, the court struck down the contract and declared that it "promotes litigation, circumvents the arbitration process and provides an escape device in favor of the insurance company."²¹⁷

Some states have dealt with claims that the arbitration contract should be struck down because it provides for a forum inconvenient to one of the parties. A Michigan statute declares unenforceable arbitration clauses in franchise agreements requiring arbitration outside Michigan unless, at the time of arbitration, the franchisee agrees to arbitrate outside the state.²¹⁸ Oregon's arbitration statute invalidates contracts that provide for arbitration outside the state.²¹⁹ Courts have interpreted Florida's law as rendering agreements calling for out of state arbitration unenforceable.²²⁰

The arbitrator obviously is a key player in the arbitration process. Guill and Slavin have expressed serious concerns about their selection, qualification, and ethics.²²¹ Whereas judges are subject to careful public scrutiny prior to appointment or election, neither the public nor any

²¹³ *Fritz*, Civ. No. 1369, 1990 WL 186448.

²¹⁴ *Broemmer v. Otto*, 821 P.2d 204, 209 (Ariz. Ct. App. 1991).

²¹⁵ COULSON, *supra* note 75, at 40-41.

²¹⁶ *Worldwide Ins. Group v. Klopp*, 603 A.2d 788, 790 (Del. 1992). On the relationship between the public policy defense and the FAA, see MACNEIL ET AL., *supra* note 196, at 16:11-16:16.

²¹⁷ *Worldwide Ins. Group*, 603 A.2d at 791.

²¹⁸ MICH. COMP. LAWS ANN. § 445.1527(f) (West 1989). See *Hambell v. Alphagraphics Franchising Inc.*, 779 F. Supp. 910, 913 (E.D. Mich. 1991).

²¹⁹ OR. REV. STAT. § 36.305 (1991).

²²⁰ *Donmoor, Inc. v. Sturtevant*, 449 So. 2d 869, 870 (Fla. Dist. Ct. App. 1984).

²²¹ James L. Guill & Edward A. Slavin, *Rush to Unfairness: The Downside of ADR*, 28 JUDGE'S J., Summer 1989, at 8.

governmental body has input into the process private arbitration organizations use to determine whether arbitrators are qualified.²²² The National Academy of Arbitrators found that AAA's membership committee had inadequate information by which to judge an arbitrator's qualifications.²²³ The parties can only prevent their case being heard by an arbitrator they consider unqualified or biased by not selecting that arbitrator. A "repeat player" such as a lender which determines the arbitration organization and uses arbitration frequently, however, has a decided advantage over the "one shot" player such as the consumer. The repeat player is far more likely to know the persons in the arbitration pool.²²⁴ Moreover, the pool may be severely limited. A GAO report found that most arbitrators in employment discrimination cases involving the securities industry were white males with an average age of 60.²²⁵ Finally, authorities question whether the parties have sufficient assurance the arbitrator will act ethically. Although there is an arbitrator's code of professional responsibility,²²⁶ a report by the Committee on Professionalism of the National Academy of Arbitrators "reported no working ethics enforcement mechanism."²²⁷

Courts, however, generally have been unsympathetic to challenges to the selection of the arbitrator.²²⁸ When a brokerage employee objected to the arbitration tribunals established by the New York Stock Exchange to hear employee grievances, the Second Circuit refused to side with the employee absent evidence of actual unfairness in the way the tribunals

²²² Guill & Slavin, *supra* note 221, at 11.

²²³ *Id.*

²²⁴ *Id.* at 10. See also 1994 Cal. Legis. Serv. 1202 (West) requiring proposed neutral arbitrators to disclose the names of prior and pending cases in which they served as party arbitrators, and the names of cases involving any party to the instant arbitration agreement or the lawyer for a party for which the proposed person served as neutral arbitrator, and the results of each case. For a general analysis of the concepts of repeat and one shot players, see Marc Galanter, *Why the 'Haves' Come Out Ahead: Speculations on the Limits of Legal Change*, 9 LAW & SOC'Y REV. 95 (1974).

²²⁵ Markey Says GAO Report Finds Flaws in Arbitration of Discrimination Cases, *supra* note 184, at 510. See generally Guill & Slavin, *supra* note 221, at 12, citing a New York Times article reporting that most arbitrators are white males over the age of 65.

²²⁶ Guill & Slavin, *supra* note 221, at 12.

²²⁷ *Id.* at 11.

²²⁸ De Seife explains the importance of the arbitrator: "[I]t is the arbitrator who must build a record to satisfy himself that justice is served. In this nonadversarial, inquisitorial role, it is the arbitrator who must see to it that proper discovery is made; therefore, the importance of picking a good arbitrator cannot be underestimated." DE SEIFE, *supra* note 37, at 39.

operated.²²⁹ The court expressed its appreciation for those willing to serve as arbitrators, for it believed arbitration is a "generally thankless task" and those agreeing to be arbitrators are performing a service. A person with a medical malpractice claim asked a court to strike down as unconscionable an arbitration clause which required the arbitrator to be an obstetrician.²³⁰ The court refused to assume that an obstetrician would be biased; consequently, the court required the patient to prove actual bias. The California Supreme Court has shown somewhat more of an inclination to entertain challenges to the selection of arbitrators where the arbitration agreement is an adhesion contract where the possibility of overreaching is present.²³¹ The court insisted upon a standard of "minimal levels of integrity."²³² The objective of this standard was to ensure that the weaker party would have a "realistic and fair opportunity to prevail in a dispute."²³³

The neutrality of arbitrators is an important issue in those situations where the institution imposing arbitration on a weaker party specifies a for-profit company as the source of the arbitrator. "For-profit arbitrations . . . generate inherent conflicts of interest, including the ADR provider's pursuit of repeat business from high-volume customers."²³⁴ In addition to the courts' reluctance to interfere, at least one of the major for-profit companies has no internal review procedure to assure neutrality and quality control.²³⁵

Further complicating the issue of the neutrality of arbitrators is the use of sitting judges as arbitrators. In *DDI Seamless Cylinder v. General Fire Extinguisher*,²³⁶ the parties agreed that an independent auditor would decide

²²⁹ Drayer v. Krasner, 572 F.2d 348, 359-60 (2d Cir. 1978).

²³⁰ Broemmer v. Otto, 821 P.2d 204, 209 (Ariz. Ct. App. 1991).

²³¹ Graham v. Scissor-Tail, Inc., 623 P.2d 165 (Cal. 1981). See also Neaman v. Kaiser Found. Hosp., 11 Cal. Rptr. 2d 879, 883 (Ct. App. 1992) (improper for arbitrator to fail to disclose that he served as the party-chosen arbitrator for one of the parties to the instant action).

²³² Graham, 623 P.2d at 176.

²³³ *Id.*

²³⁴ Richard C. Reuben, *The Dark Side of ADR*, 14 CAL. LAW. 53, 54. See also *Alternative Dispute Resolution: A Roundtable*, THE RECORDER 1, 11 (Spring 1993); Moore v. Conliffe, 871 P.2d 204, 222-23 (Cal. 1994) (Baxter, J., dissenting) (neutral decision-making cannot be guaranteed where person serves repeatedly as arbitrator for same institutional litigant). This problem was probably exacerbated by the merger of two of the largest ADR firms, Judicial Arbitration & Mediation Services, Inc. and Endispute. See generally Bill Rankin, *Merger of Two Companies Forms America's Largest Mediation Firm*, ATLANTA CONST., May 13, 1994, at E2.

²³⁵ Reuben, *supra* note 234, at 53.

²³⁶ 14 F.3d 1163 (7th Cir. 1994).

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what losses were sustained by each party, and if the parties objected, the magistrate judge to whom their case was assigned would act as an arbitrator. The parties decided upon this arrangement in order to obtain a speedier resolution of their dispute. The Seventh Circuit upheld this agreement. While acknowledging that neither the FAA nor other federal law permits federal judges to act as arbitrators, the court characterized their agreement as one which established "an abbreviated, informal procedure" for the judge to follow in his "judicial capacity."²³⁷ In addition, the court assumed that the parties intended that the appellate court's judicial review of the judge's decision in their dispute would be limited to the narrow grounds permitted in arbitration. The court found the parties had the power to agree to a limited review. The only fault the court found in the agreement was the parties' references to arbitration.²³⁸ The parties should have agreed to follow arbitration procedures, but avoided using that term. Connecticut has adopted a variation of this setup. In Connecticut, sitting judges can work for a firm, STA-FED ADR, Inc., which mediates and arbitrates disputes.²³⁹ Critics have expressed concern over the "potential for conflicts of interest" in this scheme.²⁴⁰

The state courts have supported the doctrine allowing arbitrators to decide based on what is fair²⁴¹ and just²⁴² rather than what the law requires.²⁴³ Some state courts²⁴⁴ have adopted the "manifest disregard" standard proposed for FAA cases in *Wilko v. Swan*.²⁴⁵ The courts refuse to consider "even gross errors of judgement in law" unless they are apparent on the face of the award.²⁴⁶ This precludes most challenges based on an erroneous application of the law because the arbitrator is not required to give reasons for the award.²⁴⁷ The Michigan Supreme Court is somewhat more inclined to consider an arbitrator's error of law where the arbitration contract provides that the arbitration award may be entered as a judgment in

²³⁷ *DDI Seamless Cylinder*, 14 F.3d at 1166.

²³⁸ *Id.*

²³⁹ CONN. GEN. STAT. ANN. §§ 51-47(c); 51-50c(g); 51-50k; 52-434(g) (West 1991 & Supp. 1994).

²⁴⁰ Kirk Johnson, *Public Judges as Private Contractors: A Legal Frontier*, N.Y. TIMES, Dec. 10, 1993, at D20 (quoting Judge Wayne D. Brazil).

²⁴¹ *University of Alaska v. Modern Constr., Inc.*, 522 P.2d 1132, 1140 (Alaska 1974).

²⁴² *Metropolitan Waste Control Comm'n v. City of Minnetonka*, 242 N.W.2d 830, 832-33 (Minn. 1976).

²⁴³ See Aptowitz, *supra* note 37, at 1001-06.

²⁴⁴ *Batten v. Howell*, 389 S.E.2d 170, 172 (S.C. Ct. App. 1990).

²⁴⁵ 346 U.S. 427, 436-37 (1953).

²⁴⁶ *Johnson v. Baumgardt*, 576 N.E.2d 515, 519 (Ill. App. Ct. 1991).

²⁴⁷ *Batten*, 389 S.E.2d at 172.

that state's courts. That court rejected the manifest disregard standard and held that the arbitrator cannot "ignore controlling principles of law, either intentionally or unintentionally, even with the consent of the parties, and expect ultimate judicial imprimatur as well." ²⁴⁸

In an attempt to foreclose most review of appeals based on an alleged error of law, the New Jersey Supreme Court declared that in arbitration cases, it does not sit as a court to hear such appeals.²⁴⁹ The court went on, however, to state that it was willing "to safeguard against interpretive error that may be characterized on its face as gross, unmistakable, undebatable, or in manifest disregard of the applicable law and leading to an unjust result."²⁵⁰ Two years later the court rejected this standard and permitted judicial review based only on narrow statutory grounds and exceptional public policy reasons.²⁵¹

The California Supreme Court, often a bellwether, held that an arbitrator's decision is binding and final and therefore cannot be reviewed on the basis of an error of law. In *Moncharsh v. Heily & Blase*,²⁵² the court noted that although California had not adopted the UAA, its statutory provisions on judicial review "largely mirror" those of the UAA.²⁵³ Those provisions list the grounds for review; no other grounds are permissible. Therefore, the court would not consider the contention that the arbitrator committed an error of law which appeared on the face of the decision.²⁵⁴ The court justified its ruling, *inter alia*, on the basis that the parties had agreed to arbitrate their dispute; consequently, they decided a possible non-reviewable error of law was an "acceptable cost" in light of the benefits of arbitration.²⁵⁵ Furthermore, the court stated that even if the arbitration agreement had not demonstrated the parties' intent that the arbitrator's decision be final and binding, this intent is implied in every arbitration contract.²⁵⁶ The court left only one loophole. A court could consider a claim that the entire underlying transaction was illegal. The instant case was

²⁴⁸ *Detroit Auto. Inter-Ins. Exch. v. Gavin*, 331 N.W.2d 418, 430 (Mich. 1982). The error, however, must be "so material or so substantial as to have governed the award, and but for which the award would have been substantially otherwise." *Id.* at 434.

²⁴⁹ *Perini Corp. v. Greate Bay Hotel & Casino, Inc.*, 610 A.2d 364, 372-73 (N.J. 1992).

²⁵⁰ *Id.* at 373.

²⁵¹ *Tretina Printing, Inc. v. Fitzpatrick & Assocs., Inc.*, 640 A.2d 788, 793 (N.J. 1994).

²⁵² 832 P.2d 899 (Cal. 1992).

²⁵³ *Id.* at 915.

²⁵⁴ *Id.* at 916.

²⁵⁵ *Id.* at 905.

²⁵⁶ *Id.* at 903.

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distinguished because only one provision of the challenged employment contract was alleged to be illegal, not the whole contract. Furthermore, a court could review such a transaction only if "granting finality . . . would be inconsistent with the protection of a party's statutory rights."²⁵⁷ The court went on to suggest it also would require a clear legislative statement that it would be against public policy to decide the matter by arbitration.²⁵⁸

In a strong dissent, Justice Kennard contended a court's obligation to "do justice" overrode the state's policy favoring arbitration.²⁵⁹ Therefore, a court could review an arbitrator's decision if it is erroneous on its face and results in substantial injustice.²⁶⁰ He ridiculed the notion that the parties to arbitration "agree also to be bound by an award that on its face is manifestly erroneous and results in substantial injustice."²⁶¹ The dissent criticized the majority for equating a mere mistake with substantial injustice.

The California Court of Appeal, in *Bell v. Congress Mortgage Co.*,²⁶² has tried, apparently unsuccessfully, to limit the scope of *Moncharsh* to cases where the parties have equal bargaining power.²⁶³ The court refused to assume that "elderly, unsophisticated and financially distressed" consumers²⁶⁴ who refinanced their homes through the defendant mortgage company, fully appreciated the consequences of agreeing to arbitrate. In deciding to order that *Bell* not be published in the official reports, the California Supreme Court seems to be signalling its continuing satisfaction with *Moncharsh*.

The courts deciding cases under the UAA are split on whether the arbitrator has the authority to award punitive damages. Some courts hold the arbitrator has the power to do so where the arbitration clause is broad, such as those covering any dispute which arises under the underlying contract.²⁶⁵ Other courts refuse to grant the arbitrator the authority to award punitive damages unless the arbitration contract expressly authorizes the award of such damages.²⁶⁶ As seen above,²⁶⁷ some banks have drafted very

²⁵⁷ *Moncharsh*, 832 P.2d at 919.

²⁵⁸ *Id.* at 899.

²⁵⁹ *Id.* at 920 (Kennard, J., concurring and dissenting).

²⁶⁰ *Id.*

²⁶¹ *Id.*

²⁶² 30 Cal. Rptr. 2d 205 (Ct. App. 1994).

²⁶³ *Id.* at 210.

²⁶⁴ *Id.* at 209.

²⁶⁵ *Ehrich v. A.G. Edwards & Sons, Inc.*, 675 F. Supp. 559, 565 (D.S.D. 1987); *Willoughby Roofing & Supply Co. v. Kajima Int'l, Inc.*, 598 F. Supp. 353, 358 (N.D. Ala. 1984), *aff'd*, 776 F.2d 269 (11th Cir. 1985).

²⁶⁶ *International Union of Operating Eng'rs v. Mid-Valley, Inc.*, 347 F. Supp. 1104, 1109 (S.D. Tex. 1972).

broad arbitration contracts. While these have the advantage of preventing consumers from seeking judicial redress for a wide variety of claims, ironically those broadly drafted contracts also may prompt some courts to hold that the arbitrator has authority to award punitive damages.

Several states have excluded certain types of transactions from coverage under their arbitration statutes.²⁶⁸ Of particular interest are exclusions of consumer transactions.

Indiana excludes consumer leases, sales, or loan contracts Texas, Montana, and Georgia exclude transactions where the consideration is less than a certain dollar amount. Texas includes such contracts within the law if the arbitration agreement is separately signed or initialed. Georgia also has a similar provision for residential real estate contracts.²⁶⁹

In addition, some states require that all arbitration contracts meet certain minimum standards. These standards are:

[P]resumably to guard against 'surprise' and to insure that consent to arbitration has been knowing and informed. These include requirements that arbitration provisions include certain language, that they appear in a certain size of type, that they be separately initialed, and even that they be signed by both parties and the parties' attorneys. Arbitration agreements that do not comply with these requirements are unenforceable.²⁷⁰

The Nebraska Supreme Court has held that its arbitration statute, modeled after the UAA, violates the state's constitution to the extent it authorizes the arbitration of future disputes.²⁷¹ Echoing a doctrine that other courts rejected years ago, the court found that the arbitration statute was unconstitutional because it ousted the courts of their jurisdiction and therefore was against public policy.

²⁶⁷ See *supra* text accompanying notes 52-57.

²⁶⁸ Jonathan E. Breckenridge, *Bargaining Unfairness and Agreements to Arbitrate: Judicial and Legislative Application of Contract Defenses to Arbitration Agreements*, 4 ANN. SURV. AM. L. 925, 955-63 (1991); Henry C. Strickland, *The Federal Arbitration Act's Interstate Commerce Requirement: What's Left for State Arbitration Law?*, 21 HOFSTRA L. REV. 385, 401-04 (1992).

²⁶⁹ Breckenridge, *supra* note 268, at 959-60 (citations omitted).

²⁷⁰ Strickland, *supra* note 268, at 403-04 (citations omitted).

²⁷¹ *State v. Nebraska Ass'n of Pub. Employees*, 477 N.W.2d 577, 580 (Neb. 1991).

IV. CONSUMER CHALLENGES TO ARBITRATION CONTRACTS

Some consumers may welcome arbitration of their disputes with financial institutions. Generally, arbitration is faster and less expensive than litigation.²⁷² The arbitrator may have greater expertise than a judge. The arbitration contract may allow the consumer to force the institution to arbitrate its collection action, which may make such actions more costly and time-consuming than a summary action in court.²⁷³

Other consumers may decide to challenge the arbitration contracts into which they have entered with financial institutions. Perhaps they object to the structural features of arbitration such as the loss of a jury trial and a judge, the limited right of discovery and appeal, the unlikelihood of class relief, or the lack of publicity. Or perhaps they object to specific provisions in the contracts drafted by their creditor. Finally, they may have a generalized hostility to arbitration because they or someone they know about had a bad experience with lender arbitration or with other types of ADR such as non-judicial resolution of disputes under lemon laws.²⁷⁴ This section will explore both causes of action which consumers already have alleged in financial institution-consumer arbitration cases and grounds which consumers may use in future suits.

Before considering challenges to arbitration contracts, it is important to keep in mind what types of challenges the court has authority to decide and what types of attacks are the province of the arbitrator. The court decides "issues relating to the making and performance of the agreement to arbitrate."²⁷⁵ Therefore, the court considers attacks on the validity of the arbitration contract.²⁷⁶ The arbitrator rules on issues relating to the underlying transaction or contract.²⁷⁷

Section 2 of the FAA provides that arbitration contracts are valid,

²⁷² Dwight Golann, *Developments in Consumer Financial Services Litigation*, 43 BUS. LAW. 1081, 1091 (1988).

²⁷³ *Id.*, at 1092.

²⁷⁴ Ronald J. Adams, *Florida's Motor Vehicle Arbitration Board — A Two-Year Review*, 47 ARB. J. 36, 38-42 (1992). See generally Goriely, *supra* note 156.

²⁷⁵ *Prima Paint v. Flood & Conklin*, 388 U.S. 395, 404 (1967).

²⁷⁶ Richard Speidel, *Arbitration of Statutory Rights Under the Federal Arbitration Act: The Case for Reform*, 4 OHIO ST. J. ON DISP. RESOL. 157, 177 (1989). Once the federal district court upholds the validity of the contract and orders the parties to proceed to arbitration, the contract's validity cannot be challenged in the court of appeals until an arbitration award is issued and the winner seeks enforcement in the district court. *Gammara v. Thorp Consumer Discount Co.*, 15 F.3d 93 (8th Cir. 1994).

²⁷⁷ Speidel, *supra* note 276, at 177.

enforceable, and irrevocable, except insofar as "grounds . . . exist at law or in equity for the revocation of any contract."²⁷⁸ Pursuant to this provision, arbitration contracts can be challenged as unconscionable.²⁷⁹ A lawsuit filed as a class action successfully attacked ITT's arbitration contract on the grounds of unconscionability.²⁸⁰ The contract stated that any dispute would be resolved "by the National Arbitration Forum, Minneapolis, Minnesota"²⁸¹ The court applied the two alternative approaches used by California courts when deciding unconscionability claims. One approach applies to adhesion contracts. If the court finds the contract to be adhesive, it will deny enforcement if the challenged provision is "outside the reasonable expectations of the weaker party,"^D²⁸² or the provision is "unduly oppressive or unconscionable."^D²⁸³ The court found that ITT's arbitration contract was adhesive because it was drafted by the stronger party and gave the weaker party the choice of either accepting or rejecting it. Next, the court found that the provision was outside the reasonable expectations of consumers by suggesting that California residents would be required to arbitrate their disputes in Minnesota. Finally, the court held that the procedures employed under ITT's arbitration program were oppressive to unsophisticated consumers with few resources where small amounts were in dispute.²⁸⁴

The court also analyzed the ITT arbitration contract in terms of substantive and procedural unconscionability. Substantive unconscionability focuses on "whether the contract allocates the risks of the bargain in an

²⁷⁸ 9 U.S.C. § 2 (1994).

²⁷⁹ Speidel, *supra* note 276, at 176 n.92. See Dwight Golann, *Taking ADR to the Bank: Arbitration and Mediation in Financial Services Disputes*, 44 ARB. J. 3, 10 (1989).

²⁸⁰ *Patterson v. ITT Consumer Fin. Corp.*, 18 Cal. Rptr. 2d 563, 566 (Ct. App. 1993). In another case, however, the ITT arbitration clause was found not to be unconscionable by a federal district court. *Gammara*, 15 F.3d at 95.

²⁸¹ *Patterson*, 18 Cal. Rptr. 2d at 564.

²⁸² *Id.* at 565.

²⁸³ *Id.* When the FAA was being considered by Congress, a member of the U.S. Senate expressed concern about the adhesive nature of many arbitration contracts. MACNEIL, *supra* note 122, at 90, 215.

²⁸⁴ Under those procedures, if the consumer submits a written denial to Minnesota, he or she is deemed to have conferred jurisdiction on an arbitration forum in that state and the arbitrator will decide solely on the basis of documents. If the consumer wants a hearing, he or she must promptly demand one and pay a fee. The fee would amount to \$850 for a dispute involving \$2000. There is a procedure to waive the requirement of paying fees prior to the hearing, but the provision explaining the process for waiving the fee was 'incomprehensible.' *Patterson*, 18 Cal. Rptr. 2d at 566.

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objectively unreasonable or unexpected manner.”²⁸⁵ Procedural unconscionability asks whether the contract provision at issue is oppressive and surprising.²⁸⁶ According to the *Patterson* court, California cases require a finding of both procedural and substantive unconscionability in order for a court to have the authority to declare the provision unenforceable.²⁸⁷ The court found the ITT contract substantively unconscionable because the process was structured in such a way that the consumer would not likely be able to obtain a hearing. The court also objected to ITT’s reluctance to disclose to the consumer how the process operated until an arbitration claim is made. Finally, some of the consumers claimed they had not read the arbitration provision and no one at ITT had called the provision to their attention. The court found that this showed unfairness and surprise — the elements of procedural unconscionability.

It is unclear whether the contracts used by other financial institutions are subject to attacks on unconscionability grounds. Although the *Patterson* court found the forum selection clause used by ITT to be unconscionable, other courts may not find such clauses objectionable.²⁸⁸ Other types of clauses which courts have found substantively unconscionable in consumer cases include clauses giving creditors remedies which under the circumstances courts considered unfair such as: cross-collateralization clauses, waiver of defense clauses, blanket security agreements, and acceleration clauses.²⁸⁹ *Patterson* may be regarded as a case in which the court ruled that the creditor remedy was unconscionable because the court found the arbitration procedure discouraged consumers from responding to the lender’s notice of claim.²⁹⁰

Despite the consumer’s success in *Patterson*, California cases subsequent to *Patterson*, not involving distant forum clauses, have rejected challenges based on unconscionability. In *McCarthy v. Providential Corp.*,²⁹¹ a federal district court held that consumers had failed to prove that an arbitration clause was unconscionable. In regard to their procedural unconscionability claims, the court found the clause was “clear and

²⁸⁵ *Patterson*, 18 Cal. Rptr. 2d at 565.

²⁸⁶ *Id.* ITT’s contract also was found to be unconscionable in *Aetna Fin. Co. v. McGhee*, No. 246287 (Ohio Ct. Common Pleas 1993).

²⁸⁷ *Patterson*, 18 Cal. Rptr. 2d at 565. In *Graham v. Scissor-Tail, Inc.*, 623 P.2d 165 (Cal. 1981), however, the court held an arbitration contract to be unconscionable without separately identifying what aspects were procedurally and substantively unconscionable.

²⁸⁸ See *infra* text accompanying notes 329–30.

²⁸⁹ YVONNE W. ROSMARIN & JONATHAN SHELDON, *SALES OF GOODS AND SERVICES* 615 (1989).

²⁹⁰ 18 Cal. Rptr. 2d at 566.

²⁹¹ No. C 94-0627, 1994 U.S. Dist. LEXIS 10122 (N.D. Cal. July 18, 1994).

unambiguous."²⁹² The inequality of bargaining power between the consumers and the mortgage company defendant was not enough, by itself, to constitute procedural unconscionability. The consumers claimed that the mortgage company had a duty to explain the arbitration clause. Holding that federal law applies to attacks on the enforceability of arbitration provisions, the court declared that federal law does not require any such explanation. Finally, the court held no substantive unconscionability exists because arbitration clauses are not automatically biased in favor of one party, and the consumers failed to show the arbitration tribunal, the American Arbitration Association, would not treat their case fairly. Furthermore, a California superior court has upheld Bank of America's arbitration clause.²⁹³ The court found the plaintiff failed to prove the arbitration clause was beyond a consumer's reasonable expectations and that arbitration is designed and operates in a manner unfavorable to consumers in that its costs are exorbitant and adequate discovery is not available.

Cases not involving lenders, however, may be useful to consumers. For example, the arbitration contract in one case bound the insured to the arbitration award, but bound the insurance company only if it consented in writing.²⁹⁴ The court held that the contract was unconscionable because it was "unfairly structured." Courts may consider the structure of arbitration contracts in determining whether they are set up in a manner which unfairly disadvantages the consumer. For example, the clauses used by several banks exclude actions for provisional remedies from arbitration.²⁹⁵ Because only the bank would have occasion to take advantage of that exclusion, it may be considered unconscionable.

The court in *Broemmer v. Otto*²⁹⁶ rejected a challenge to arbitration, but the arguments made in that challenge are nevertheless relevant. In that case, a patient with a medical malpractice claim arising from an abortion alleged the arbitration contract was unconscionable because it required the arbitrator to be an obstetrician/gynecologist. The court refused to assume that such an arbitrator would be biased toward the doctor or hospital. Rather, the court required the patient to prove bias. Furthermore, the court pointed out that the AAA rules allow a party to object to any proposed arbitrator and require disclosure of information about any proposed

²⁹² *McCarthy*, No. C 94-0627, 1994 U.S. Dist. LEXIS 10122.

²⁹³ *Badie v. Bank of Am.*, No. 944916, 94 Daily Journal D.A.R. 12377 (Cal. Super. Aug. 18, 1994).

²⁹⁴ *Fritz v. Nationwide Mut. Ins. Co.*, Civ. No. 1369, 1990 WL 186448 (Del. Ch. Nov. 26, 1990), *reh'g denied*, 1991 WL 23585 (Feb. 19, 1991).

²⁹⁵ See *supra* text accompanying note 64.

²⁹⁶ 821 P.2d 204 (Ariz. Ct. App. 1991).

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arbitrator which would affect that person's ability to be objective.²⁹⁷ Despite the court's reluctance to find unconscionability in that case, consumers may be able to successfully challenge arbitration pools if such pools consist only of current or retired creditors and data demonstrates that consumers rarely obtain favorable relief in arbitration.²⁹⁸

In most states, the consumer is also required to prove procedural unconscionability. Procedural unconscionability focuses on the circumstances surrounding the formation of the contract. Courts have found this type of unconscionability where oppression or unfair surprise exists.²⁹⁹ These elements are present where the consumer enters into the contract without doing so voluntarily and without a clear realization to what she is agreeing.³⁰⁰ Courts look at the consumer's lack of sophistication. Most require "some combination of consumer ignorance and seller guile."³⁰¹ The operative concept in many cases is "lack of meaningful choice" which includes: "a gross inequality of bargaining power"³⁰² and consumer ignorance of contract terms because of the seller's deception or "terms hidden in a maze of fine print."³⁰³ Courts have found procedural unconscionability where the consumer has no understanding of the contract terms³⁰⁴ or additional terms are added after the contract is signed.³⁰⁵ Standard form contracts are subject to attack where virtually all other sellers use the same type of form.³⁰⁶

To the extent that contracts include terms reproduced in fine print on the reverse side of a document³⁰⁷ and use excessive "legalese," they are subject to attack. Also, if the consumer challenging the clause is non-English speaking,³⁰⁸ poor,³⁰⁹ or unsophisticated,³¹⁰ a court is more likely to

²⁹⁷ *Accord* Drayer v. Krasner, 572 F.2d 348 (2d Cir. 1978) (court refused to assume unfairness of New York Stock Exchange arbitration panels).

²⁹⁸ See generally GENERAL ACCOUNTING OFFICE, SECURITIES ARBITRATION: HOW INVESTORS FARE 7-8 (1992) (no indication of pro-industry bias, but industry needs to improve procedures for selecting and training arbitrators).

²⁹⁹ See U.C.C. § 2-302, Comment 1.

³⁰⁰ ROSMARIN & SHELDON, *supra* note 289, at 611.

³⁰¹ *Id.*

³⁰² Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449 (D.C. Cir. 1965).

³⁰³ *Id.*

³⁰⁴ Jefferson Credit Corp. v. Marciano, 302 N.Y.S.2d 390 (Civ. Ct. N.Y. 1969).

³⁰⁵ Chrysler Corp. v. Wilson Plumbing Co., 208 S.E.2d 321 (Ga. App. 1974).

³⁰⁶ Henningsen v. Bloomfield Motors, Inc., 161 A.2d 69 (N.J. 1960).

³⁰⁷ John Deere Leasing Co. v. Blubaugh, 636 F. Supp. 1569 (D. Kan. 1986).

³⁰⁸ Jefferson Credit Corp. v. Marciano, 302 N.Y.S.2d 390 (Civ. Ct. N.Y. 1969).

³⁰⁹ ROSMARIN & SHELDON, *supra* note 289, at 613.

³¹⁰ *Id.* at 620.

find procedural unconscionability. While the typical bank consumer may be a relatively sophisticated and well-educated middle class person, more and more low income consumers are becoming customers as states mandate basic banking.³¹¹ In addition, courts which view banking services as necessities are more likely to be sympathetic to arbitration challenges based on unconscionability.³¹² Courts in some jurisdictions are more of a threat to these clauses than others. For example, the California Court of Appeal in the successful arbitration challenge in *Patterson*³¹³ relied heavily on a previous California decision in a commercial case in which the court justified its finding of unfairness by pointing out that the seller had failed to call the disputed contract to the attention of the buyer.³¹⁴

Even if arbitration contracts are in bold-faced type, they may be vulnerable to a procedural unconscionability attack on the grounds that the contract fails to adequately explain the arbitration procedure and what the consumer is surrendering.³¹⁵ As described above,³¹⁶ most arbitration contracts used by banks simply refer to the procedural rules of the AAA rather than describing those rules. Banks may be able to cure this by including with the arbitration contract a copy of the AAA rules. Zions First National Bank has adopted an approach somewhere between incorporation and supplying the rules. Their brochure briefly describes the AAA's process.³¹⁷ With the exception of the Zions arbitration contract, none of the contracts examined gave consumers a hint as to what they were surrendering. Zions' disclosures were very brief, but at least provided some warning to the consumer.³¹⁸ Consumers can argue that contracts which fail to provide adequate disclosures concerning matters as fundamental as loss of the right to a judicial proceeding, judicial review, and a decision based upon the law preclude a meaningful choice.

Courts often are hesitant to find a contract's provisions

³¹¹ EDWARD L. RUBIN & ROBERT COOTER, *THE PAYMENT SYSTEM: CASES, MATERIALS, AND ISSUES* 147-58 (1989). Edward L. Rubin, *The Lifeline Banking Controversy: Putting Deregulation to Work for the Low-Income Consumer*, 67 *IND. L.J.* 213, 216 (1992).

³¹² Cf. *Personal Fin. Co. v. Meredith*, 350 N.E.2d 781 (Ill. App. 1976).

³¹³ *Patterson v. ITT Consumer Fin. Corp.*, 18 Cal. Rptr. 2d 563 (1993).

³¹⁴ *A & M Produce Co. v. FMC Corp.*, 186 Cal. Rptr. 114 (1982).

³¹⁵ This line of reasoning was rejected in another consumer arbitration case in which the court held federal law applied and that law imposed no duty on the mortgage company to explain the arbitration clause where it clearly provided for the arbitration of disputes. *McCarthy v. Providential Corp.*, No. c 94-0627, 1994 U.S. Dist. LEXIS 10122 (N.D. Cal. July 18, 1994).

³¹⁶ See *supra* text accompanying notes 69-72.

³¹⁷ ZIONS FIRST NAT'L BANK, *supra* note 87.

³¹⁸ See *supra* text accompanying note 87.

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unconscionable.³¹⁹ If consumers can frame their objections in terms of other traditional legal concepts, however, some courts are willing to strike down the clauses. For example, because arbitration contracts must satisfy the usual requirements for any contract,³²⁰ one party challenged the failure of his contract to explain the arbitration process, not on the basis of unconscionability, but on the grounds the contract was not sufficiently definite to be enforceable. The court agreed with the plaintiff, finding the contract too indefinite, *inter alia*, because it did not set forth some procedures which would be followed if a dispute between the parties went to arbitration.³²¹

Instead of arguing unconscionability due to lack of meaningful choice, the consumer can rely on cases holding that a party seeking to enforce an arbitration agreement must show the other party's waiver of the right to judicial access was knowing, intelligent, and voluntary.³²² Particularly in the case of a less sophisticated customer, a consumer can argue that standard bank arbitration contracts fail to provide sufficient information for waiver to be knowing and intelligent.

The California Court of Appeal was influenced by the fact that arbitration results in the waiver of the right to a jury trial in a case involving adhesion contracts and "elderly, unsophisticated and financially distressed" consumers.³²³ The court found the consumers had not made a clear and informed waiver where the arbitration agreement was contained in an unhighlighted paragraph in the middle of a page which was part of a packet of documents. The court concluded that in order to be enforceable, an arbitration clause in an adhesion contract must "appear in clear and unmistakable form by highlighting, bold type, or with an opportunity for specific acknowledgement by initialing. Enforceability requires a clear

³¹⁹ ROSMARIN & SHELDON, *supra* note 289, at 625.

³²⁰ See *supra* text accompanying notes 129 and 130.

³²¹ Wood-Hopkins Contracting Co. v. C.H. Barco Contracting Co., 301 So. 2d 479 (Fla. Ct. App. 1974).

³²² Roberts v. McNamara-Warren Community Hosp., 360 N.W.2d 279 (Mich. Ct. App. 1984). A waiver which does not meet this standard may violate due process. Armstrong v. Manzo, 380 U.S. 545, 552 (1965); Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306 (1950).

³²³ Bell v. Congress Mortgage Co., 30 Cal. Rptr. 2d 205, 209 (Ct. App. 1994), *petition for review denied and order not to publish in official reports*, 94 Daily J. 10597 (Cal. July 28, 1994). See Kathleen V. Fisher, *Depublication Was in Public's Best Interest*, *Bank Counsel Says*, THE RECORDER, Aug. 8, 1994, at 5; Barbara Stewart, *Banking on the Attorney General: When the AG's Office Asked For the Depublication of a Ruling that Limited Mandatory Arbitration, It Was Following the Request of Bank of America*, THE RECORDER, Aug. 3, 1994, at 1.

recitation that the parties knowingly waive their right to a jury trial."³²⁴

Waiver requirements pose a difficult challenge for banks, for even if they acknowledge the legitimacy of this argument, it is uncertain how much information would be necessary to withstand a challenge made on this basis. For example, is it sufficient to briefly describe the arbitration procedure and explain that by agreeing to arbitration they are surrendering their right to a trial in court and that judicial review will be extremely limited? Or must the bank also describe the various advantages and disadvantages of arbitration as compared to litigation, including aspects such as discovery, class actions, and punitive damages? In *Patterson*,³²⁵ the court found the arbitration clause unconscionable, *inter alia*, because the financial institution did not provide consumers with a copy of the procedural rules followed by the entity which administered the arbitration at the time the agreement was signed. The rules were not sent until ITT initiated a claim against the consumer. As an alternative to unconscionability, the court might have ruled that a consumer could not knowingly and intelligently waive the right to a judicial forum without information about those rules at the signing of the arbitration contract.

Under certain circumstances, a consumer may be able to successfully argue that a waiver is invalid because it is not voluntary. Credit and other financial services are a necessity for many persons.³²⁶ To the extent most financial institutions require arbitration, the consumer will lack a meaningful choice and will be forced to waive the right to a judicial forum.

The contract rule requiring some degree of definiteness also may be used to the advantage of the consumer challenging arbitration contracts. One court, for example, has required the arbitration contract to be definite enough so parties have some idea as to what matters may be submitted to arbitration.³²⁷ As seen above,³²⁸ some banks use dragnet clauses which purport to cover all disputes, past, present and future, as well as all disputes involving the bank and its consumer, whether or not related to the underlying transaction accompanying the arbitration agreement. Such a

³²⁴ *Bell*, 30 Cal. Rptr. 2d at 209. Cf. *Howard v. Bank S.*, 433 S.E.2d 625 (Ga. Ct. App. 1993), *aff'd on other grounds*, 444 S.E.2d 799 (Ga. 1994) (guarantor could not have knowingly and voluntarily waived right to jury trial in written guaranty because he had no way to anticipate future claim).

³²⁵ 18 Cal. Rptr. 2d 563 (Ct. App. 1993).

³²⁶ PRIVACY PROTECTION STUDY COMM'N, PERSONAL PRIVACY IN AN INFORMATION SOCIETY, THE REPORT OF THE PRIVACY PROTECTION STUDY COMMISSION 42 (1977).

³²⁷ *Wood-Hopkins Contracting Co. v. C.H. Barco Contracting Co.*, 301 So. 2d 479, 480 (Fla. Ct. App. 1974).

³²⁸ See *supra* text accompanying notes 52-57.

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clause is designed to cover unrelated claims, such as slip and fall cases.³²⁹ A consumer could argue that an arbitration contract lacks the requisite definiteness if it fails to describe with some particularity the types of disputes which are covered by the dragnet clause. This will pose a problem for banks seeking to draft arbitration contracts which will sustain a challenge on this basis. If the bank drafts a clause which lists all the possible types of claims a consumer might bring, one of two things may happen. First, the consumer may refuse to agree to arbitrate. Second, even if the consumer does agree, if a dispute arises which is not listed, it probably will be construed not to be included even if the contract includes general all-inclusive language in addition to the list.

A consumer may also attack an arbitration contract providing for arbitration in distant forums. As discussed above, at least one court has found such a clause unconscionable.³³⁰ Outside the arbitration context, courts have found distant forum provisions unconscionable.³³¹ In a case which did not involve arbitration, the Supreme Court has upheld a distant forum provision.³³² The Court pointed out, however, that the plaintiff conceded that she received adequate notice of the contract provision providing for all disputes to be litigated in the distant forum. Moreover, the Court acknowledged that not all distant forum provisions would pass the requirement of fundamental fairness. For example, the clause would not be upheld if the drafter of the clause inserted it in bad faith or obtained the other party's consent through fraud or overreaching measures. Subsequently, a distant forum challenge was brought before the California Court of Appeal in a case in which the plaintiffs did not concede they had received adequate notice.³³³ The court remanded the case for a determination of whether the plaintiffs had received adequate notice of the distant forum provision before entering into their contracts. As the *Patterson* case illustrates³³⁴ distant forum provisions may be present and subject to attack in arbitration contracts involving consumers and financial institutions.

At least one court has struck down an insurance company's arbitration clause on public policy grounds. In *Worldwide Insurance Group v.*

³²⁹ J.F. Morrow & James R. Butler, *Arbitration Working in Banking*, 1 AM. ARB. REP. NO. 2 (1990), reprinted in ADR FOR FINANCIAL INSTITUTIONS, at 59.

³³⁰ See *supra* text accompanying notes 280-87. See generally *Wineland v. Marketex Int'l, Inc.*, 627 P.2d 967 (Wash. App. 1981).

³³¹ *ROSMARIN & SHELDON*, *supra* note 289, at 615.

³³² *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991).

³³³ *Carnival Cruise Lines, Inc. v. Superior Court*, 286 Cal. Rptr. 323 (Ct. App. 1991).

³³⁴ *Patterson v. ITT Consumer Fin. Corp.*, 18 Cal.Rptr. 2d 563 (Ct. App. 1993).

Klopp,³³⁵ the contract provided that if the arbitration award exceeded the state financial responsibility limits, the award could be appealed by either party for a judicial trial *de novo*. On the other hand, if the award was below the state limits, the award was not appealable. The court pointed out that the only party who would want to take advantage of the appeal provision would be the insurance company. Consequently, the provision merely provided an "escape hatch" for the insurance company and therefore violated public policy.³³⁶ The one-sided nature of the contract in *Worldwide* may be comparable to the bank arbitration contracts examined above in which provisional remedies are excepted from arbitration.³³⁷ The only party likely to have the opportunity to avail itself of this provision is the bank.

Finally, bank arbitration contracts may be subject to challenge in those states which have "plain language" statutes. For example, New York law requires every contract in a consumer transaction to be "[w]ritten in a clear and coherent manner using words with common and every day meanings; [and] [a]ppropriately divided and captioned by its various sections."³³⁸ In 1993, Pennsylvania enacted a plain language law which excludes documents used by financial institutions.³³⁹ While this evidently excludes banks, the law may nevertheless apply to finance companies and mortgage companies.³⁴⁰ The boilerplate language employed by many banks³⁴¹ may fail to comply with these requirements.

Presumably, financial institutions will learn how to draft arbitration contracts which will sustain legal challenges brought by consumers against them. They will draft contracts in plain language or will prepare accompanying brochures which clearly and comprehensively explain the arbitration procedure and compare the advantages and disadvantages of arbitration and adjudication. They will draft contracts which evenly balance the rights and obligations of both parties and avoid provisions which seem to give the institutions an advantage, such as distant forum clauses. They will develop, perhaps in conjunction with the AAA, procedural rules designed specifically for consumer disputes and will establish panels of

³³⁵ 603 A.2d 788 (Del. 1992).

³³⁶ *Id.* at 791.

³³⁷ See *supra* text accompanying note 64.

³³⁸ N.Y. GEN. OBLIG. LAW § 5-702 (McKinney 1989). See also N.J. REV. STAT. 56:12-2 (1989).

³³⁹ Plain Language Consumer Contract Act, 73 PA. STAT. ANN. §§ 2201-2212 (1993).

³⁴⁰ The Act exempts documents used by financial institutions subject to examination or supervision by federal or state regulatory authorities. *Id.* § 3(b)(5). See Leonard A. Bernstein, *Avoiding Practitioner Pitfalls Under the New Pennsylvania 'Plain Language' Law*, 64 PA. BAR A. Q. 215, 215 (1993).

³⁴¹ See *supra* text accompanying note 85.

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arbitrators specially trained to deal with these types of disputes. Even if financial institutions are able to accomplish all of this, however, the question remains whether arbitration is an appropriate mechanism to deal with consumer disputes.

V. THE APPROPRIATENESS OF ARBITRATION OF CONSUMER DISPUTES WITH FINANCIAL INSTITUTIONS

This section explores the issue of whether arbitration of consumer disputes with financial institutions is appropriate in the sense of whether it is wise social and legal policy. The legality of arbitration of these disputes is assumed, even if the consumer's claim is based on a federal statute providing for suit in a state or federal district court.³⁴² If a bank's arbitration contract is drafted so as to withstand the challenges discussed in Part IV, it is quite certain the Supreme Court will look favorably upon the arbitrability of any type of dispute pursuant to the contract, unless Congress has clearly stated otherwise.³⁴³ The effectiveness of arbitration is assumed: it is assumed that for the most part³⁴⁴ arbitration of these disputes can be done in a prompt, inexpensive³⁴⁵ manner.³⁴⁶ This section asks whether, even if legal and effective, arbitration of these disputes represents a public policy which should be encouraged and promoted.

A. Characteristics of Disputes Between Financial Institutions and Consumers

In order to determine whether arbitration is appropriate for consumer disputes, it is necessary to ascertain what types of disputes would be brought to arbitration. It is probably a safe assumption that the primary basis for a financial institution's grievance against a consumer is the failure to pay; in other words, most suits would be collection cases.³⁴⁷ One may

³⁴² *E.g.*, Truth in Lending Act, 15 U.S.C. § 1640 (1988).

³⁴³ *Cf.* Shearson/Am. Express v. McMahon, 482 U.S. 220 (1987); *see generally* Speidel, *supra* note 276.

³⁴⁴ *But see infra* text accompanying note 356. Arbitration may not be efficient in cases involving documents.

³⁴⁵ *But see infra* text accompanying note 367-68.

³⁴⁶ *See* Speidel, *supra* note 276, at 162 (distinction between inappropriate and effective arbitration).

³⁴⁷ *See* Golann, *supra* note 272, at 1092. Banks would have other types of claims such as against consumers who violate their security agreements far less frequently (*see* JONATHAN SHELDON & ROBERT A. SABLE, REPOSSESSIONS (1988)) and consumers who fail to return their safe deposit keys when their lease expires.

wonder why a financial institution would want to resort to arbitration to collect a debt, for state collection law provides summary procedures facilitating judgment and procedures to enforce that judgment.³⁴⁸ The procedure is especially efficient because many consumers never file an answer or appear at the hearing, resulting in a default judgment.³⁴⁹ Arbitration might be slower and more expensive. Moreover, if the consumer refused to comply with the arbitrator's award, the institution would have to go to court anyway. Nevertheless, institutions may reasonably decide the benefits of foreclosing lender liability lawsuits which may involve class actions and punitive damages is worth the cost of bringing collection suits to arbitration.

In stark contrast, the consumer has a wide variety of potential actions against financial institutions. In all likelihood, these claims would be brought as the arbitration equivalent to counterclaims or defenses in reaction to an action brought by the institution. For purposes of evaluating the appropriateness of arbitration to these actions, it is useful to categorize them as: (1) disputes in which the consumer's claims are grounded largely on common law rules; and (2) claims based on consumer protection statutes.

1. Claims Based on Common Law Concepts

Consumers can be expected to bring to arbitration claims based on alleged fraud, duress, unconscionability, breach of fiduciary duty, and breach of contract. Cases based on these types of claims are typically fact intensive and based on common law concepts. At first blush these cases appear to be ideally suited for arbitration. Arbitration originated to a substantial extent as a method of resolving fact based disputes among merchants.³⁵⁰ Consumer disputes based on the above claims seem to be a first cousin to those for which arbitration was designed. Arbitrators are trained to resolve factual disagreements, and those chosen for consumer cases can be expected to be familiar with common law principles and rules. Moreover, as a general rule, arbitrators are not required to follow the law unless the arbitration agreement specifically requires them to do so.³⁵¹ Rather, they are required merely to follow their own notions of fairness³⁵²

³⁴⁸ Golann, *supra* note 272, at 1092.

³⁴⁹ MICHAEL GREENFIELD, CONSUMER TRANSACTIONS 616 (2d ed. 1991).

³⁵⁰ MacNeil, *supra* note 122, at 44. William Cantron Jones, *Three Centuries of Commercial Arbitration in New York: A Brief Survey*, 1956 WASH. U. L.Q. 193, 207, 213-14.

³⁵¹ *University of Alaska v. Modern Constr., Inc.*, 522 P.2d 1132 (Alaska 1974). *Contra* *Detroit Auto. Inter-Ins. Exchange v. Gavin*, 331 N.W.2d 418 (Mich. 1982).

³⁵² *University of Alaska*, 522 P.2d at 1140.

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and justice.³⁵³ Doctrines such as good faith and unconscionability are largely equitable in nature³⁵⁴ and therefore suitable even for an arbitrator who decides based on fairness and justice rather than a strict reading of the law. These cases tend not to be appropriate for class action treatment if they are fact intensive because differences in the facts from transaction to transaction preclude a finding of common questions of fact, which is a prerequisite to class action treatment.³⁵⁵

Nevertheless, even these types of consumer claims may be inappropriate for arbitration. For example, arbitration's restrictions on discovery may make it impossible for consumers to prepare their case. Even in a case based on alleged fraudulent representations made by employees of a financial institution, a consumer may well need documents in the possession of the institution in order to prove the case. For instance, documents may be necessary to prove a relationship between the institution and the consumer, and to prove statements at odds with the institution's oral representations. The institution's training manuals may be crucial to the consumer's fraud case. Even if the bank provided the consumer with copies of crucial documents, the consumer may need discovery to obtain those documents within a meaningful time before the hearing because the consumer's copies may be illegible.³⁵⁶ Even if the arbitrator orders the bank to make these documents available before the hearing, the arbitrator is unlikely to order depositions which may be crucial to the consumer's preparation of the case.

One element of an unconscionability claim often is that the price charged for a banking service is excessive.³⁵⁷ Arbitration's severe discovery restrictions would make it impossible to engage in the discovery of financial data related to the bank's actual costs, overhead expenses, and profit margins, which are needed for the consumer to prevail.

As described above,³⁵⁸ some banks employ dragnet clauses which purport to cover any and all consumer claims of whatever nature, including tort claims such as slip and fall cases. These may be appropriate for arbitration to the extent they are merely routine tort cases. Increasingly, however, banks are facing claims of responsibility for the customer's safety

³⁵³ *Metropolitan Waste Control Comm. v. City of Minnetonka*, 242 N.W.2d 830, 832 (Minn. 1976).

³⁵⁴ ROSMARIN & SHELDON, *supra* note 289, at 609 (unconscionability). See Robert S. Summers, 'Good Faith' in *General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 201-07 (1968).

³⁵⁵ See FED. R. CIV. P. 23(a).

³⁵⁶ *Rowland v. Magna Millikin Bank*, 812 F. Supp. 875 (C.D. Ill. 1992).

³⁵⁷ *Perdue v. Crocker Nat'l Bank*, 702 P.2d 503 (Cal. 1985).

³⁵⁸ See *supra* text accompanying notes 52-57.

in new situations, such as when they use automated teller machines.³⁵⁹ The state of the law is unclear,³⁶⁰ and some jurisdictions have enacted their own regulations specifically tailored to meet this problem.³⁶¹ It is questionable whether it is appropriate for arbitrators to decide disputes involving novel, developing, and emerging areas of the law such as these.

Even some legal standards which have their origin in the common law may be inappropriate for arbitration. For example, the concepts of good faith and ordinary care which apply to negotiable instrument transactions may sound time-worn and well understood. In actuality, the official definitions and applications of these concepts in Articles 3 and 4 of the UCC were recently revised and represent significant departures from the former UCC.³⁶² This new statutory definition needs case law development to give parties to these transactions guidance in applying these concepts to various fact patterns.

Another example involves an area of lender liability, about which bankers are particularly concerned.³⁶³ Fiduciary doctrine has a venerable common law history.³⁶⁴ Nevertheless, the case law has struggled with inconclusive results to determine how to apply the doctrine to consumer transactions with creditors.³⁶⁵ If all of these cases are decided in private arbitration, the case law will come to a sudden stop before it has adequately evolved.

These cases also may be inappropriate for arbitration because of their private nature. Absent arbitration, a consumer complains to state and federal consumer protection agencies and files lawsuits. Filing lawsuits is precluded by arbitration agreements. A consumer is most likely to complain to government agencies, not primarily to inform the agencies of alleged wrongdoing, but in an effort to persuade the agency to help resolve the consumer's individual problem in conjunction with pending or contemplated litigation. It is reasonable to expect that if forced to resolve disputes solely by arbitration in which government agencies are excluded, the consumer will not bother to inform government agencies of the dispute being resolved by arbitration. The prohibition against lawsuits and the disincentive to

³⁵⁹ David Teitelbaum, *Violent Crime at ATMs*, 45 BUS. LAW. 1967 (1990).

³⁶⁰ *Id.*

³⁶¹ Matt Barthel, *Lawmakers Playing Politics with ATMs?*, AM. BANKER, June 1, 1994, at 14. Matt Barthel, *Nation Following New York's Lead on Safety at ATMs*, AM. BANKER, Oct. 20, 1992, at 3.

³⁶² Gail K. Hillebrand, *Revised Articles 3 and 4 of the Uniform Commercial Code: A Consumer Perspective*, 42 ALA. L. REV. 679 (1991).

³⁶³ See *supra* text accompanying notes 5-14.

³⁶⁴ Budnitz, *supra* note 7, at 299-301.

³⁶⁵ *Id.* at 301-19.

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complain to agencies deprive those agencies of the data they need in order to identify patterns and practices. The lack of such data severely impinges upon their ability to take appropriate enforcement and regulatory actions.

The privacy of arbitration has another detrimental effect in terms of consumer protection. In the real world, there are severe limits on the ability of individual lawsuits and government actions to protect the general public. The publicity generated by a verdict of fraud or similar behavior serves to alert the consumer of practices or institutions of which to be wary. Although arbitration proceedings are private, the consumer who receives a favorable award from an arbitrator is not prevented from discussing it with the press.³⁶⁶ However, because arbitrators are not required to submit written decisions and are not required to provide any reasons for their awards, the most that a successful consumer can report to the press is an award of X dollars. This lacks the force of specific findings of fact and rulings of law which accompany judicial proceedings. Moreover, most consumers probably lack the sophistication and aggressiveness needed to persuade the press to publish stories.

One of the purported advantages of arbitration is its relative inexpensiveness. Whether this holds true for consumer arbitration depends upon the nature of the case. As discussed above,³⁶⁷ a creditor can resolve its collection case more cheaply by going to court. A consumer's case based on breach of contract and involving a small amount of damages can be resolved for less cost by bringing an action in small claims court.³⁶⁸ Consequently, arbitration is inappropriate in these cases because one of the principal benefits of arbitration cannot be achieved.

2. Claims Based on Consumer Protection Statutes

In contrast to consumer claims based largely on the common law theories are claims based on violation of consumer protection statutes. The statutes upon which consumers may rely include Truth in Lending Act,³⁶⁹ Equal Credit Opportunity Act,³⁷⁰ Fair Credit Billing Act,³⁷¹ Electronic Funds Transfer Act,³⁷² state Small Loan Acts,³⁷³ and Unfair and Deceptive

³⁶⁶ Golann, *supra* note 272, at 1093.

³⁶⁷ See *supra* text accompanying notes 345-46.

³⁶⁸ Moore v. Conliffe, 871 P.2d 204, 220, 225-26 (Cal. 1994) (Baxter, J., dissenting).

In arbitration, costs are usually split between the parties. ROSMARIN & SHELDON, *supra* note 289, at 570.

³⁶⁹ 15 U.S.C. §§ 1601-1665b (1982).

³⁷⁰ *Id.* §§ 1691-1691f.

³⁷¹ *Id.* §§ 1666-1666j.

³⁷² *Id.* §§ 1693-1693r.

Acts and Practices. It is inappropriate for this type of claim to be decided by arbitration as it is currently constituted.

Typically the consumer's claims are based on allegations centered on documents such as the contract, disclosure forms, perhaps a security agreement, and perhaps a signature card. Some or all of the documents which the consumer needs may be in the possession of the financial institution.³⁷⁴ Obtaining these may be difficult due to the limited discovery permitted in arbitration.³⁷⁵ Generally, the parties in arbitration are limited to subpoenas *duces tecum*. These may be inadequate for several reasons. First, the consumer may not be able to identify all of the documents needed at the outset. Only after seeing a set of documents may the consumer realize what other documents are necessary. The subpoena *duces tecum* merely requires the opposing party to bring certain documents to the arbitration hearing. If the consumer studies those documents and requests additional documents, the arbitrator may be loathe to grant the consumer's request because that will require rescheduling the hearing which is contrary to the goals of arbitration to limit discovery and eliminate the delays of adjudication. Second, a case involving claims such as usury or miscalculation of the Annual Percentage Rate under Truth in Lending Act may involve analyzing complex documents and performing complicated calculations. There is no way a consumer and attorney can properly prepare based on the subpoenaed documents unless the arbitrator grants a recess, resulting in further delay. A consumer alleging violation of the Equal Credit Opportunity Act and needing documentation from the bank from which he or she can prove discrimination under the "effects test" would have an especially difficult time if burdened by arbitration's discovery restrictions.³⁷⁶ Third, arbitration does not include adjudication procedures which simplify the trial of a document case. These include discovery in which documents are obtained and studied a meaningful time prior to the trial and requests for admissions including admissions of the genuineness of documents.³⁷⁷

In addition to the problems posed by limited discovery, it may be

³⁷³ KEVIN W. BROWN & KATHLEEN E. KEEST, *USURY AND CONSUMER CREDIT REGULATION* 30-35 (1987).

³⁷⁴ Many consumers do not maintain adequate records. RICHARD L. ABEL, *THE CONTRADICTIONS OF INFORMAL JUSTICE*, 1 *THE POLITICS OF INFORMAL JUSTICE* 296 (Richard L. Abel ed., 1982).

³⁷⁵ See *supra* notes text accompanying 140-42.

³⁷⁶ See *Cherry v. Amoco Oil Co.*, 490 F. Supp. 1026 (N.D. Ga. 1980) (discussion of data needed for consumer to prove credit discrimination based on zip code criterion used by creditor).

³⁷⁷ See FED. R. CIV. P. 36.

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difficult to find qualified persons to sit as arbitrators of claims based on these statutes, especially outside large urban areas.³⁷⁸ These are very difficult cases. First, the subject matter is complex. A simple loan transaction may involve principal, interest charges, points or various other front-end charges, and fees of many types including recording fees, appraisal fees, and late fees. In a typical case involving claims of usury as well as Truth in Lending Act violations, the arbitrator will have to know state usury law, which may vary depending upon whether the loan is covered by the state's retail installment act, motor vehicle retail installment act, or small loan act. The Truth in Lending Act has its own concepts in which the finance charge is altogether different from the interest rate. In addition, the statutes themselves often are only the starting point. State credit laws frequently are supplemented by state banking regulations. The federal statutes are supplemented by regulations and official commentary, both of which change periodically.

State statutes outlawing unfair and deceptive acts or practices on the surface appear similar to common-law fraud doctrine which would not pose problems for an arbitrator lacking expertise in consumer protection law. Furthermore, because of their apparent similarity to fraud, these statutes may not seem to raise public policy concerns. Although cases raising claims under these statutes, like fraud cases, often are fact intensive, unlike fraud cases, they are based on statutory law, state unfair and deceptive acts and practices (UDAP) statutes, not the common law. Most importantly, the objective of UDAP statutes is to offer an alternative specifically drafted to provide the consumer with far more protection than common law fraud. Applying the law correctly requires an expert in the field. These statutes typically incorporate the Federal Trade Commission Act.³⁷⁹ Even the FTC has had tremendous difficulty defining and applying their own Act.³⁸⁰

³⁷⁸ A GAO study found that the New York Stock Exchange and the National Association of Securities Dealers (NASD) did not necessarily give top priority to expertise in selecting persons to arbitrate disputes under their jurisdiction. *Markey Says GAO Report Finds Flaws in Arbitration of Discrimination Cases*, Sec. Reg. & L. Rep. (BNA) 509, 510 (April 8, 1994). In apparent acknowledgement of their arbitrators' lack of competence, in January, 1994, the NASD began a mandatory training program, resulting in a drastic drop in the number of qualified arbitrators pending arbitrators' fulfillment of this requirement. *NASD Proposal For Large Arbitrations Would Let Parties Decide Panel's Pay*, 25 Sec. Reg. & L. Rep. (BNA) 1662, 1663 (Dec. 10, 1993). See generally Constantine N. Katsoris, *Should McMahon Be Revisited?*, 59 BROOK. L. REV. 1113, 1129-31 (1993).

³⁷⁹ JONATHAN SHELDON, UNFAIR AND DECEPTIVE ACTS AND PRACTICES 90 (3d ed. 1991).

³⁸⁰ See, e.g., *In re International Harvester Co.*, 104 F.T.C. 949 (1984); Patricia P. Bailey & Michael Pertschuk, *The Law of Deception: the Past as Prologue*, 33 AM. U. L.

Because the arbitrator is not required to follow the law, however, the arbitrator may instead apply unconscionability or good faith concepts or even fraud concepts on the assumption that they are similar. Even if the arbitrator awards damages to the consumer based on a finding that the bank engaged in unfair or deceptive practices, he or she may disregard the UDAP provisions which in certain instances award the consumer treble damages³⁸¹ and attorney's fees.³⁸² Because it is lawful for the arbitrator to ignore the state's UDAP statute, the question arises whether it is appropriate for banks to be able to avoid the legislature's decision to protect the consumer by means of this law.

Lacking sufficient expertise, the arbitrator may try to apply the law anyway. The arbitrator's task will be made more difficult as arbitration is used increasingly, resulting in less case law to provide guidance on how to decide cases pursuant to these laws. There is no way to know whether arbitrators lacking expertise who try to apply the law will reach results far astray from those intended by the legislature.

In the alternative, arbitrators may simply ignore the law and nevertheless have their awards sustained on appeal. There are many cases holding that arbitrators are not required to follow the law.³⁸³ Instead, these cases allow arbitrators to follow their own notions of fairness³⁸⁴ and justice.³⁸⁵ The case law is not uniform, however. In *Wilko v. Swan*,³⁸⁶ the Supreme Court stated that the arbitrator could not act in "manifest disregard" of the law.³⁸⁷ In *Mitsubishi Motor Corp. v. Soler Chrysler-Plymouth*,³⁸⁸ the Court strongly supported arbitration, but stated that arbitrators should decide in accordance with statutory law.³⁸⁹ Some state courts under the UAA have adopted the manifest disregard standard.³⁹⁰ Others have rejected it.³⁹¹

Assuming the arbitrator is sitting in a jurisdiction where he or she is allowed to follow individual notions of fairness and justice, the question arises whether it is possible to do so when the consumer alleges violations

REV. 849 (1984).

³⁸¹ SHELDON, *supra* note 379, at 422.

³⁸² *Id.* at 442-43.

³⁸³ *See supra* text accompanying notes 243-64.

³⁸⁴ *See supra* text accompanying note 241.

³⁸⁵ *See supra* text accompanying note 242.

³⁸⁶ 346 U.S. 427 (1953).

³⁸⁷ *Id.* at 436.

³⁸⁸ 473 U.S. 614 (1985).

³⁸⁹ *Id.* at 628.

³⁹⁰ *See Batten v. Howell*, 389 S.E.2d 170 (S.C. Ct. App. 1990).

³⁹¹ *See Detroit Auto. Inter-Ins. Exchange*, 331 N.W.2d 418 (Mich. 1982).

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of these statutes. For example, how can an arbitrator decide a Truth in Lending Act case on the basis of fairness or justice? This complex regulatory scheme mandates certain disclosures. The Act and regulations represent a carefully tailored regulatory scheme which tries to balance the consumer's need for disclosure of certain information against the creditor's need for clear rules and protection from unwarranted liability.³⁹² When a consumer bases a case on the Truth in Lending Act, the only question before the decision maker should be whether or not the statute has been violated.

Even if it were possible to decide a Truth in Lending Act or comparable case on the basis of fairness or justice, it would be inappropriate to do so. Consumer protection statutes impose requirements upon creditors. This is clearly indicated by the many provisions phrased in terms of "shall."³⁹³ This is in contrast to other statutes, such as the Uniform Commercial Code (UCC), which provide default rules.³⁹⁴ The UCC, for example, states that as a general rule, its provisions may be varied by agreement unless the UCC specifically provides that they cannot be varied.³⁹⁵ Many sections of the UCC emphasize this point by using the phrase "unless otherwise agreed"³⁹⁶ or "unless otherwise provided in the instrument."³⁹⁷ Consumer protection statutes do not permit the parties to "opt out." Arbitration agreements, nevertheless, enable the financial institution to accomplish this in the context of a contract of adhesion where one party is far more powerful than the other, and it is questionable whether the weaker party realizes that agreeing to arbitration has the effect of waiving his or her consumer protection rights.

Moreover, as Professor Sterk has noted, "an agreement to arbitrate should not be enforced when the statute or case law principle at issue has aims other than promoting justice between the parties."³⁹⁸ Where a statute

³⁹² JOHN SPANOGLE ET AL., CONSUMER LAW, CASES AND MATERIALS 106-07 (2d ed. 1991).

³⁹³ See, e.g., Truth in Lending, 15 U.S.C. § 1605a (1982) (determination of finance charge); Credit Billing, *id.* § 1666c (prompt crediting of payments); Consumer Leases, *id.* § 1667a (1982) (required disclosures); Consumer Credit Reporting, *id.* § 1681e (maintenance of specified procedures); Equal Credit Opportunity, *id.* § 1691 (declaring certain discrimination unlawful).

³⁹⁴ I am indebted to Professor Michael Greenfield of Washington University School of Law for pointing out this distinction.

³⁹⁵ U.C.C. § 1-102(3).

³⁹⁶ E.g., U.C.C. §§ 2-210(2), 2-307, 3-203, 8-316, 9-112, 9-207(2).

³⁹⁷ E.g., U.C.C. §§ 3-107, 3-112.

³⁹⁸ Stewart S. Sterk, *Enforceability of Agreements to Arbitrate: An Examination of the Public Policy Defense*, 2 CARDOZO L. REV. 481, 486 (1981).

was enacted to promote objectives other than justice, the legislature's intention should not be undermined by allowing an arbitrator to decide cases on that basis. For example, one of the goals of Truth in Lending Act was to deal with the problem faced by creditors and consumers who were subject to widely disparate state credit disclosure laws. Congress believed uniform disclosure rules would ameliorate this problem.³⁹⁹ It would be inappropriate in any given case for an arbitrator to ignore this federal policy of uniformity and instead to substitute his or her belief as to what was fair to the parties in the instant case. Furthermore, no matter how much expertise arbitrators have, they do not have the wisdom to substitute their feelings for the combined wisdom of entities such as Congress and the Board of Governors of the Federal Reserve System, who have many years of experience deciding what national policy should be on credit disclosure.

Finally, even if it were feasible to establish an adequate pool of neutral, thoroughly trained arbitrators who could correctly apply the various statutes relied on by consumers, consumers would still be denied the protection guaranteed by Congress.⁴⁰⁰ This is because arbitration limits discovery, has no procedure for dealing with class actions, does not require written opinions containing findings of fact and rulings of law, and contains no mechanism for transmitting data to regulatory and enforcement agencies.

B. Systemic Deficiencies of Arbitration of Consumer Disputes with Financial Institutions

In light of the types of claims consumers likely will make and the consumer protection statutes which are involved when their disputes are forced into an arbitration forum, it is fitting to question the movement to arbitration of these controversies. Looking back at the origins of modern commercial arbitration provides insights into the current controversy. As related by Professor Auerbach, in the early 20th century the business community favored arbitration and the lawyers opposed it because they feared they would be shut out of the process.⁴⁰¹ As Professor Shell has noted, "[t]he debate over the role of law was really a dispute over the role of lawyers."⁴⁰² Arbitration by the AAA was established once the lawyers' concerns were calmed by ensuring them a meaningful role. But this was not

³⁹⁹ GREENFIELD, *supra* note 349, at 167.

⁴⁰⁰ This discussion assumes the arbitrators would enforce laws such as the Truth in Lending Act's provisions for statutory damages, costs, and attorneys' fees. 15 U.S.C. § 1640.

⁴⁰¹ J. AUERBACH, *JUSTICE WITHOUT LAW* 5 (1983).

⁴⁰² G. Shell, *The Role of Public Law in Private Dispute Resolution: Reflections on Shearson/American Express, Inc. v. McMahon*, 26 AM. BUS. L. J. 397, 418 (1988).

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a victory for the rule of law. As we have seen, courts generally hold that arbitrators are not required to follow the law, and the lack of written opinions would make enforcement of a rule requiring them to follow the law impossible as a practical matter. To understand why this approach developed, one must look at the nature of commercial arbitration which is the type of arbitration at the core of modern arbitration and which influenced the approach taken by the courts.⁴⁰³

The model of arbitration that gained acceptance in the 1920s involved primarily resolution of disputes *between members* of an industry. In such cases, all parties are members of the community that established the arbitration process and all are likely to know and accept the norms and customs that govern the industry. There is no pressing need for legal accountability when the parties share a strong set of legally acceptable values and seek to use arbitration as a means of preserving and enhancing their relationship.⁴⁰⁴

Professor Shell contrasts the model of commercial arbitration with its shared norms to securities industry arbitration in which investors sue their brokers. In the latter instance, there is a dispute "*between an industry and 'outsiders'* pursuant to standard form contracts . . . [in which] arbitration is being imposed by an industry on another interest group that knows little of the industry's form of arbitration and understands less of the industry's customs."⁴⁰⁵

Arbitration between financial institutions and consumers bears a strong resemblance to Shell's characterization of arbitration between brokers and investors. Like securities arbitration, it is not accurate to view this as arbitration between an individual financial institution and an individual consumer who happened to have agreed to arbitrate their disputes. Rather, as we have seen,⁴⁰⁶ this is a carefully planned strategy by influential members of the financial services industry to resolve lender liability and other claims made by consumers as a group.

Professor Shell also points out that the federal securities laws enacted in

⁴⁰³ AUERBACH, *supra* note 401, at 101-02.

⁴⁰⁴ Shell, *supra* note 402, at 418 (emphasis in original). See Richard Danzig, *A Comment on the Jurisprudence of the Uniform Commercial Code*, 27 STAN. L. REV. 621 (1975). Merchants' commercial law disputes are often resolved in private forums. Merchants' relationships usually involve several transactions over a period of time. Commercial law's "primary rules derive from a sense of fairness widespread — if imprecisely defined within the commercial community." *Id.* at 622-23.

⁴⁰⁵ Shell, *supra* note 402, at 418-19 (emphasis in original).

⁴⁰⁶ See *supra* text accompanying notes 3, 32-39.

the 1930s are "interest group statutes . . . intended to address perceived imbalances between an industry that had failed to protect the public's welfare and the public itself."⁴⁰⁷ Consequently, "[a]rbitrators deciding such statutory claims are being asked to assume a role in the public regulation of an industry."⁴⁰⁸ As we have seen,⁴⁰⁹ consumer claims generally fall into two categories. One set of claims involves common law doctrines. The other set involves statutory claims where state legislatures and Congress have sought to protect consumers as a group because of the failure of common law doctrines to provide that protection. In addition, the legislatures have granted authority to government agencies to regulate and enforce these statutes. As in securities arbitration, to force these disputes into arbitration has the effect of delegating to arbitrators the role of an industry regulator.

Along with these similarities, there are three major differences between securities arbitration and bank-consumer arbitration, two of which lend support to critics of arbitration in bank-consumer disputes. First, investors generally are more sophisticated than many consumers. People who deal with brokers have discretionary income which generally means they have higher incomes and better education than the general public. Consumers deal with banks and other financial institutions because they offer essential services. In fact, as banks increase their outreach with low-cost, no-frills basic banking services as a result of legislative mandate⁴¹⁰ or voluntary practice, their customer base will include persons of ever more modest means. The lower level of sophistication of consumers coupled with the use of standard form contracts likely means consumers understand arbitration less than investors.

Another major difference between securities arbitration and consumer arbitration with financial institutions is the lack of government oversight in the former. In *Shearson/American Express, Inc. v. McMahon*,⁴¹¹ the Court justified its holding in part by pointing out that the S.E.C. carefully supervised securities arbitration. No supervisory agency has this role in regard to consumer arbitration with financial institutions.⁴¹²

The third difference between securities arbitration and consumer

⁴⁰⁷ Shell, *supra* note 402, at 419.

⁴⁰⁸ *Id.*

⁴⁰⁹ See *supra* part V.A.

⁴¹⁰ RUBIN, *supra* note 311, at 216 n.18.

⁴¹¹ 482 U.S. 220 (1987).

⁴¹² There are signs that securities arbitration is not working as well as expected. The NASD has urged parties to use mediation, rather than relying exclusively on arbitration. Dave Pettit, *NASD, Awash in Arbitration Cases, Urges Investors to Turn to Mediation*, WALL ST. J., Aug. 30, 1993, at B4A.

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arbitration cuts the other way by ameliorating the negative impact which arbitration may have on consumers. Although arbitration contracts are universal for margin and option accounts in the securities industry,⁴¹³ they are far from being so in the financial services industry. Consequently, consumers still have a viable option: they can take their business to a financial institution which does not require arbitration. This option is subject to two significant qualifications, however. First, unless consumers are provided with an adequate description of the advantages and disadvantages of both litigation and arbitration, they cannot fully appreciate the need to consider finding a financial institution which does not require arbitration. As described above,⁴¹⁴ most arbitration contracts do not provide such a description. Second, it is likely that in the future, financial institutions increasingly will require arbitration, leaving the consumer with no choice but to accept arbitration or stop doing business with financial institutions altogether. This absence of alternatives is especially possible in rural or low income areas where few financial institutions may provide services.

The above discussion suggests that consumer arbitration with financial institutions differs from the traditional model of commercial arbitration in two principal ways. First, the role of law is important in consumer arbitration because, unlike commercial arbitration, financial institutions and consumers do not share the norms and customs of the industry. Because of this lack of shared values, arbitration awards need to follow the law in order to be legitimate in the eyes of the consumer. This is because a consumer, not sharing the norms and customs of the industry, needs assurance the arbitrator has an impartial basis for his or her decision.⁴¹⁵ An inevitable concomitant to requiring the arbitrator to follow the law is to require written decisions explaining the arbitration decision.

In a typical commercial arbitration proceeding, the parties often are "repeat players." Consequently, there is usually little likelihood of serious damage being done when an arbitrator ignores or incorrectly applies the law and the result is substantially counter to what it would have been had the arbitrator applied the law. This is "because the law of averages will insure that a party who loses one routine arbitration out of ten that he should have won will win one out of ten that he should have lost, and in the process he

⁴¹³ Norman S. Poser, *When ADR Eclipses Litigation: The Brave New World of Securities Arbitration*, 59 BROOK. L. REV. 1095, 1101 (1994); see also William A. Gregory & William J. Schneider, *Securities Arbitration: A Need for Continued Reform*, 17 NOVA L. REV. 1223, 1228 (1993).

⁴¹⁴ See *supra* text accompanying note 86-87.

⁴¹⁵ Edward Brunet, *Questioning the Quality of Alternative Dispute Resolution*, 62 TUL. L. REV. 1, 26-27 (1987).

will have saved a substantial amount of legal expense, as well as time."⁴¹⁶ The injustice that results from an erroneous arbitration award rendered against a "one-shot" player such as a consumer, however, may be very grave.⁴¹⁷ The amount of money involved is usually far more significant to an individual consumer than a financial institution.

In certain types of disputes, moreover, the arbitration forum is inimicable to our legal system even though arbitrators follow the law and write opinions, indeed even if there is full disclosure in arbitration contracts, a full panoply of discovery, and routine transmission of data to enforcement agencies. Commentators examining areas of the law other than consumer law make the distinction between public disputes and private disputes. In a private dispute, "only the interests and behavior of the immediate parties to the dispute are at issue."⁴¹⁸ Because of the "localized" nature of the dispute, the privacy of arbitration proceedings does not conflict with the interests of society in public decision-making forums.⁴¹⁹

In contrast, a public dispute has been defined as one involving the enforcement of "society-wide norms."⁴²⁰ These controversies involve laws intended to protect the "public at large."⁴²¹ Arbitration is an improper method of deciding these types of controversies because the public's interest in enforcing the norms embodied in the laws involved in these disputes is not represented in arbitration.⁴²²

The case for distinguishing public from private disputes is especially strong where the norms are in statutes which the legislature has enacted to protect a carefully defined disadvantaged segment of the public from the documented abuses of a specific industry. An additional element which illustrates the public nature of the dispute is contained in statutes in which the legislature has designated an agency of the government to promulgate regulations. Often such an agency has other regulatory and supervisory responsibilities over that industry. Consequently, the consumer protection statute at issue may be an integral part of a comprehensive regulatory scheme. Indeed, the agency with regulatory authority over the institution may examine the institution specifically to monitor compliance with the statute.⁴²³ Allowing an arbitrator, who is not even required to follow the

⁴¹⁶ Nicholas J. Healy, *An Introduction to the Federal Arbitration Act*, 13 J. MAR. L. & COM. 223, 234 (1982).

⁴¹⁷ See generally Golann, *supra* note 272, at 1091.

⁴¹⁸ Owen Fiss, *Forward: The Forms of Justice*, 93 HARV. L. REV. 1, 30 (1979).

⁴¹⁹ *Id.* at 30-32.

⁴²⁰ *Id.* at 31.

⁴²¹ Sterk, *supra* note 398, at 492.

⁴²² *Id.*

⁴²³ *E.g.*, the Board of Governors of the Federal Reserve System.

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regulations, to decide a case governed by this type of statute tears at the fabric of this regulatory scheme. Another element which may indicate the public nature of the dispute is a statute which has social goals beyond achieving justice among the parties.⁴²⁴

The validity of this distinction between public and private disputes and the strength of the conclusion that public disputes should not be decided by arbitration can be tested by examining specific consumer protection statutes which consumers may rely upon in disputes covered by arbitration contracts. Another way to test this conclusion is to analyze the types of issues which arise in cases claiming violations of these laws.

The Equal Credit Opportunity Act (ECOA)⁴²⁵ prohibits discrimination "with respect to any aspect of a credit transaction" on the basis of "race, color, religion, national origin, sex or marital status, or age,"⁴²⁶ or because all or part of the consumer's income is from public assistance.⁴²⁷ In addition to being consumer protection legislation, it also is properly considered one part of a comprehensive package of civil rights legislation⁴²⁸ including the Fair Housing Act,⁴²⁹ the Community Reinvestment Act,⁴³⁰ the Home Mortgage Disclosure Act,⁴³¹ and the Women's Business Ownership Act.⁴³² The ECOA originally prohibited discrimination only against women. It was adopted by Congress as a response to data collected by the National Commission on Consumer Finance.⁴³³ Under the ECOA, Congress provided the consumer with a private right of action which the consumer could pursue in state or federal court, as an individual or class action.⁴³⁴ The ECOA specifically authorizes the award of punitive damages, costs, and attorney's fees.⁴³⁵ The Federal Reserve Board is authorized to promulgate regulations⁴³⁶ and has done so.⁴³⁷ Administrative enforcement is

⁴²⁴ Sterk, *supra* note 398, at 483. See *infra* text accompanying notes 453-54.

⁴²⁵ 15 U.S.C. §§ 1691 *et seq.* (1982).

⁴²⁶ *Id.* § 1691.

⁴²⁷ *Id.* § 1691(a)(2).

⁴²⁸ MICHAEL GREENFIELD, CONSUMER TRANSACTIONS 245 (2d ed. 1991).

⁴²⁹ 42 U.S.C. § 3605 (1982).

⁴³⁰ 12 U.S.C. §§ 2901 *et seq.* (1982).

⁴³¹ *Id.* §§ 2801 *et seq.*

⁴³² Pub. L. No. 100-533, 102 Stat. 2689, 2692-93 (1988).

⁴³³ JOHN SPANOGLE & RALPH RHONER, CONSUMER LAW CASES & MATERIALS 424 (1979).

⁴³⁴ 15 U.S.C. § 1691e (1982).

⁴³⁵ *Id.* See, e.g., *Marine Am. State Bank v. Lincoln*, 433 N.W.2d 709 (Iowa 1988) (award of attorneys' fees and punitive damages).

⁴³⁶ 15 U.S.C. § 1691b (1982).

⁴³⁷ Regulation B, 12 C.F.R. § 202 (Nov. 20, 1985).

delegated to various government agencies depending on the type of financial institution involved,⁴³⁸ with the Federal Trade Commission having the authority to enforce the Act in regard to any institution not otherwise provided for.⁴³⁹

Civil rights legislation is universally regarded as embodying societal norms, not just a means to resolve a private dispute between two individuals. The ECOA was a specific response to a documented problem. Government agencies examining financial institutions specifically investigate whether the institution is complying with the ECOA.⁴⁴⁰ In addition, the Federal Reserve Board is required to report annually to Congress on the extent to which institutions are complying with the Act.⁴⁴¹ The Act incorporates the "private attorney general" concept by encouraging consumer lawsuits through authorization of class actions, punitive damages, costs, and attorney's fees. Arbitration is inappropriate because it is designed to resolve factual disputes between individuals, not to enforce national social policy enacted specifically to protect a given disadvantaged segment of the population against documented systematic abuse by an industry. The privacy of arbitration conflicts with the examination and data collection responsibilities of government agencies. The consumer's right to class actions, punitive damages, costs, and attorney's fees is not guaranteed in arbitration.

The type of issues which typically arise in ECOA cases also demonstrate the inappropriateness of the arbitration forum. ECOA cases often do not involve factual disputes, but rather questions about the interpretation of the ECOA and the regulations promulgated pursuant to it. Examples include who qualifies as an "applicant" under the ECOA⁴⁴² and what types of leases are subject to the ECOA.⁴⁴³ These cases raise difficult issues of statutory construction. In regard to the lease issue, for example, even the Federal Trade Commission and the Federal Reserve Board cannot agree.⁴⁴⁴ In addition, some ECOA cases require interpretation and application of civil rights concepts such as the "effects test."⁴⁴⁵ Even if an arbitrator were an expert in the ECOA and civil rights law, one may wonder about the appropriateness of having private arbitrators rather than judges

⁴³⁸ 15 U.S.C. § 1691c (1982).

⁴³⁹ *Id.* § 1691c(c) (1982).

⁴⁴⁰ RALPH C. CLONTZ, EQUAL CREDIT OPPORTUNITY MANUAL 6-6 (4th ed. 1988).

⁴⁴¹ 15 U.S.C. § 1691f (1982).

⁴⁴² See GERRY AZZATA, EQUAL CREDIT OPPORTUNITY ACT 30-31 (1988).

⁴⁴³ *Id.* at 25-26.

⁴⁴⁴ *Id.*

⁴⁴⁵ *Id.* at 48.

deciding civil rights issues.⁴⁴⁶

Apart from not sharing a civil rights aspect, the Truth in Lending Act shares many of the same attributes as the ECOA. The Act was passed by Congress in order to correct an exhaustively documented problem in the marketplace.⁴⁴⁷ The consumer was in an unfairly disadvantageous position. Credit cost disclosures were made in such confusing ways that a consumer could not possibly determine the true cost of credit or engage in comparison shopping which would have promoted a more competitive marketplace.⁴⁴⁸ In addition, Congress found evidence of widespread abuse by creditors who, for example, did not include many fees in the percentage interest rate and who included much crucial information in tiny print drafted in incomprehensible legal jargon.⁴⁴⁹ Like the ECOA, the Act includes the type of "private attorney general" provisions intended to encourage private lawsuits in state and federal courts.⁴⁵⁰ The Federal Reserve Board is authorized to promulgate regulations,⁴⁵¹ and administrative enforcement is granted to various agencies depending upon the nature of the creditor.⁴⁵² The Federal Reserve Board is required to file an annual report with Congress which includes its assessment of the degree of compliance with the Act.⁴⁵³ As with the ECOA, one may question how relegating these cases to private arbitrators comports with Congress' intent. The Truth in Lending Act has resulted in a substantial volume of litigation. The cases focus, not on factual disputes, but on how to interpret and apply the Act and regulations. For example, many of the cases are concerned with the definition of "finance charge" and how to determine what is included in that term.⁴⁵⁴ The Act has greatly confused banks.⁴⁵⁵ The Federal Reserve Board has attempted to ameliorate the situation by issuing Official Commentary.⁴⁵⁶

⁴⁴⁶ A judge is a "public officer; paid for by public funds; chosen not by the parties but by the public or its representatives; and empowered by the political agencies to create society-wide norms . . . as a way, . . . of giving meaning to our public values." Fiss, *supra* note 418, at 31.

⁴⁴⁷ H.R. REP. No. 1040, 90th Cong., 2d Sess. *reprinted in* 2 U.S.C.C.A.N. 1962, 1970.

⁴⁴⁸ KEEST & SARASON, *supra* note 178, at 25.

⁴⁴⁹ *Id.* at 26.

⁴⁵⁰ 15 U.S.C. § 1640 (1982).

⁴⁵¹ *Id.* § 1604. Those regulations appear in Regulation Z, 12 C.F.R. § 226.

⁴⁵² 15 U.S.C. § 1607 (1982).

⁴⁵³ *Id.* § 1613.

⁴⁵⁴ KEEST & SARASON, *supra* note 178, at 60-85.

⁴⁵⁵ See ROLAND E. BRANDEL ET AL., TRUTH IN LENDING: A COMPREHENSIVE GUIDE, 3-7 (2d ed. 1994).

⁴⁵⁶ Official Staff Commentary to Regulation Z, 12 C.F.R. § 226 (1993).

Nevertheless, published case law is necessary to provide guidance to banks. Arbitration eliminates that source of guidance.

On the surface, state usury laws seem more suitable for arbitration than the ECOA or the Truth in Lending Act. Usury laws are primarily creations of state law, rather than federal law.⁴⁵⁷ Some states exempt large segments of the consumer credit industry from coverage of their usury laws.⁴⁵⁸ Cases alleging usury violations would seem to be quite close to regular breach of contract cases for which arbitration is far more appropriate than ECOA or the Truth in Lending Act. Professor Sterk, however, has made a persuasive argument that arbitration is inappropriate for usury cases.⁴⁵⁹ Sterk points out that usury cases are significantly different from routine breach of contract cases because usury statutes are designed to protect a particular class of borrowers who are especially vulnerable to substantial abuse. Moreover, the position of borrowers who need this protection is such that they are likely to be "unaware or unconcerned" when they execute a loan agreement of the significance of the rights they are waiving when they agree to arbitrate their disputes.⁴⁶⁰ Sterk also notes that these cases are not appropriate for the arbitrator who is allowed to decide based on notions of justice or fairness. Usury laws are not designed to promote these goals. To the contrary, compliance with usury ceilings may make it impossible for a financial institution to lend to many of the borrowers who need loans the most. In a given case, it may be "fair" to allow the lender to violate the usury laws if that makes it possible for the lender to be able to afford to make a loan to a "worthy" borrower. Nevertheless, it would completely undermine the usury laws if lenders could evade them by diverting all consumer loan disputes to arbitrators to whom lenders could make an appeal to fairness or justice.⁴⁶¹ Finally, Sterk notes that in some states a lender who violates the usury laws is subject to criminal sanctions. That feature lends to usury laws the aura of public law, as embodying societal norms. As such, a strong argument can be made that arbitration of these disputes is inappropriate.

There is a trade-off in arguing that consumer protection statutes involving public law are inappropriate for arbitration. Arbitration ordinarily

⁴⁵⁷ See generally BROWN & KBEST, *supra* note 373.

⁴⁵⁸ *E.g.*, Fleet Fin. Inc. v. Jones, 430 S.E.2d 352 (Ga. 1993).

⁴⁵⁹ Sterk, *supra* note 398, at 523-27.

⁴⁶⁰ *Id.* at 526.

⁴⁶¹ See generally Gail Elaine Papermaster, Note, *Will the Courts Scherk the Little Old Lady in Dubuque? The Impact of Scherk v. Alberto-Culver on the Individual Investor in a Global Securities Market*, 21 TEX. INT'L. L.J. 129, 138 (1985) (seeking an equitable result in arbitration undermines goal of securities laws "to deter violations by imposing predictable harsh penalties").

provides easier, cheaper, and faster access to a forum that can resolve the consumer's dispute. "Formal law . . . is less accessible but may be more worth striving for . . . the aggrieved can *demand* state redress as of right rather than depend on a paternalistic construction of what is best."⁴⁶² Having access to a forum which is obligated to enforce rights provides consumers with an institution which can empower them.⁴⁶³ ADR is not a grass roots movement initiated by individuals dissatisfied with the court system. It is imposed upon them by the state or businesses.⁴⁶⁴ Because ADR isolates consumers, they tend to blame themselves and believe they cannot alter the world around them.⁴⁶⁵ Isolating disputes through ADR promotes an individual consumer's feeling that he or she is at fault and that the transaction happens only to that consumer and no others.⁴⁶⁶ Individual complainants will not be able to achieve meaningful redress unless they can defend themselves as organized groups.⁴⁶⁷ In contrast, arbitration isolates the consumer, which makes collective action more difficult. Consumer protection statutes often are the result of successful collective action on the part of the empowered consumer.⁴⁶⁸ It would be ironic if their efforts, conducted in the grand tradition of the exercise of their democratic franchise, were to come to naught at the hands of an essentially anti-democratic move to impose arbitration clauses which ignore the rights secured by that legislation.

Another systemic deficiency of arbitration is its confidentiality. It undermines the government enforcement and regulatory apparatus designed to protect the consumer and ensure a fair marketplace.⁴⁶⁹ It makes it more difficult for a consumer to obtain information about the experiences of

⁴⁶² ABEL, *supra* note 374, at 308 (emphasis in original).

⁴⁶³ Arbitration "will always reflect existing currents of power." MACNEIL, *supra* note 122, at ix.

⁴⁶⁴ *Id.* at 297.

⁴⁶⁵ *Id.* at 290. In contrast, participants in consumer class actions directed their negative feelings toward the defendants. Doris Van Doren et al., *The Effects of a Class Action Suit on Consumer Attitudes*, 11 J. PUB. POL'Y & MARKETING 45, 50 (1992).

⁴⁶⁶ MACNEIL, *supra* note 122 at 290-91.

⁴⁶⁷ *Id.* at 294.

⁴⁶⁸ See, e.g., Valeria Block, *Concerns Linger Over Credit Report Act Reform*, AM. BANKER, June 28, 1994, at 15 (consumer activists involved in proposed revision of Fair Credit Reporting Act); Howard Kapiloff, *Activists and Bankers in New York Pushing Their Agendas for Lower Minimum Balances*, AM. BANKER, June 29, 1994, at 5 (Brooklyn Wide Interagency Council on the Aging working to promote low cost banking legislation); Howard Kapiloff, *Mass. Banks Move to Cut Fees, Ease Rules on Checking Accounts*, AM. BANKER, June 29, 1994, at 5 (consumer activists work for low cost bank accounts).

⁴⁶⁹ See *supra* text accompanying notes 398, 423.

others. This not only increases the transaction costs for a consumer who seeks information about a financial institution, it also isolates the consumer. Individual consumers "can't feel they are part of a larger group."⁴⁷⁰ While thereby weakening the consumer, the confidentiality of arbitration increases the power of financial institutions because confidentiality allows the financial institution to control information. "The control of information is an important form of power in our society."⁴⁷¹ With that control, financial institutions can present a positive image of the company.⁴⁷² "[A] most powerful tool of law and order is public opinion."⁴⁷³

Arbitration is specially designed to resolve disputes which arise in a certain context. Consequently, it is beneficial to the parties in that context, but has a dysfunctional impact when torn from it and imposed upon parties in a setting which is significantly different. It is designed for disputes between parties with a continuing relationship who share common values and a common understanding of the standards by which factual disputes should be decided.⁴⁷⁴ It is beneficial today for parties who wish to preserve an ongoing relationship.⁴⁷⁵ The essence of the arbitration contract is that it is not imposed by the state. It is a contract to which both parties can agree after negotiations which result in a contract custom tailored to meet the needs of each party.⁴⁷⁶ "The great beauty of arbitration . . . is complete flexibility — a flexibility vastly greater than that afforded by litigation."⁴⁷⁷ Consumer arbitration contracts with financial institutions lack any flexibility; they are adhesion contracts imposed by a powerful party upon a relatively powerless party who has no ability to negotiate. These contracts are entirely different from the agreements from which arbitration derives its legitimacy.⁴⁷⁸

These systemic deficiencies of arbitration pose a challenge for legislatures. They must weigh many competing values and consider the

⁴⁷⁰ LAURA NADER, *NO ACCESS TO LAW* 67 (1980).

⁴⁷¹ *Id.*

⁴⁷² *Id.* at 66.

⁴⁷³ *Id.*

⁴⁷⁴ *See supra* text accompanying note 405.

⁴⁷⁵ DE SEIFE, *supra* note 37, § 1:02 at 3; *id.* § 4:02 at 40.

⁴⁷⁶ HOENIGER, *supra* note 139, at 1-8, 1-9. Hoeniger strongly recommends that the parties draft provisions dealing with the following issues: what law the arbitrator must apply; the arbitrator's authority, such as the power to award punitive damages; whether the arbitrator can award attorney's fees to the prevailing party. *Id.* at 6-2.

⁴⁷⁷ *Id.* at 1-9.

⁴⁷⁸ Arbitration is useful" if "(1) all parties really wish to bind themselves to use it; (2) the context, particularly the power relations of the parties, justifies giving effect to their consent to be so bound." MACNEIL, *supra* note 122, at ix.

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contentions of different constituencies. The decisions they make will have a significant impact on the future of consumer protection.

VI. PROPOSALS FOR REFORM

The preceding sections have discussed concerns in the arbitration of disputes between financial institutions and consumers. This section sets forth several legislative proposals for dealing with these concerns, analyzing the benefits and drawbacks of each. The reference to the legislature in this discussion refers to both Congress and state legislatures, unless otherwise noted.

A. The Laissez Faire Approach: Hear No Evil, See No Evil, Do Nothing

One possible approach is for the legislature to do nothing. Inaction can be justified on several bases. First, there is not as yet evidence that many consumers have been seriously abused by arbitration proceedings with financial institutions. It is better to wait until problems emerge. First, perhaps no problems will emerge. Second, legislative solutions can best be designed in light of the problems which do arise. With actual problems before it, the legislature can tailor solutions which deal with whatever abuses actually occur. Also, legislatures can avoid overbroad treatment, addressing only those issues which need legislative tinkering. This in turn can help consumers as well as financial institutions. For example, actual experience may indicate the consumer has a good understanding of how arbitration differs from litigation. Therefore, a consumer does not need a brochure describing those differences. The consumer, who arguably is already confused by information overload, is benefitted by not requiring unnecessary disclosures.⁴⁷⁹

Those favoring a free market, laissez faire approach to market regulation also could justify doing nothing in this instance.⁴⁸⁰ Under this theory, if a consumer is concerned about the problems which may arise in doing business with an institution which requires arbitration, or if the consumer is treated in ways contrary to self-interest, the consumer will refuse to do business with those financial institutions which require arbitration.⁴⁸¹ Although individuals need the services such institutions

⁴⁷⁹ Jeff Sovern, *Toward a Theory of Warranties in Sales of New Homes: Housing the Implied Warranty Advocates, Law and Economics Mavens, and Consumer Psychologists Under One Roof*, 1993 WIS. L. REV. 13, 27-30.

⁴⁸⁰ See generally RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* (3d ed. 1986).

⁴⁸¹ Bruce Fein, *Keeping Bank Customers Out of Courts*, FULTON COUNTY DAILY REP.,

provide, there is no danger that businesses not requiring arbitration will not be available. The free market will operate to provide such firms, because entrepreneurs will see that some consumers prefer no arbitration and will step in to offer that service.⁴⁸² In addition, it is not an all-or-nothing proposition. A financial institution could offer both a service which requires arbitration, and one which is priced somewhat higher and does not impose that requirement.

In *Carnival Cruise*,⁴⁸³ Justice Blackmun purports to show how this laissez faire approach actually benefits consumers. Applying his reasoning to arbitration, one could argue that arbitration reduces the institution's costs by its speed and reduced likelihood of class actions and punitive damages. Arbitration clauses which include distant forum provisions discourage consumer actions, thus contributing further to reduced operating costs. The increased expense incurred by ever more government regulation is reduced by arbitration because regulatory and enforcement agencies will not have the empirical data supplied by litigation to justify new action on their part. All of this is good for the consumer because the institution can pass those savings on to the consumer.⁴⁸⁴ Furthermore, it will pass the savings on because this will help it compete for consumer business.

Consumer advocates can be expected to oppose the laissez faire approach, making the following responses.⁴⁸⁵ They believe it is wrong to wait until there is sufficient evidence of consumer suffering. While the laissez faire proponents deal with consumers in the aggregate as an economic unit, the consumer advocates focus on the individuals who will be deprived of remedies to which they are legally entitled and the resulting hardship to these persons. They are concerned with those most likely not to realize the impact arbitration may have on them: the poor, the uneducated, and the unsophisticated. The consumer advocates feel their concerns are justified by the strategy thus far adopted by financial institutions. For example, financial institutions have made no effort to explain to consumers the benefits and drawbacks of arbitration. The arbitration "agreements" seem designed to ensnare consumers who will not realize they are agreeing to anything at all. This is done by including the arbitration contracts as stuffers with the monthly statements rather than requiring the consumer's signature on a separate document properly introduced and explained. The inclusion of dragnet clauses illustrates that the bank's strategy seems to be to win consumer acquiescence absent consumers understanding what they

Sept. 25, 1992, at 7.

⁴⁸² Fein, *supra* note 481, at 7.

⁴⁸³ *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991).

⁴⁸⁴ Fein, *supra* note 481, at 7.

⁴⁸⁵ See generally ROSMARIN & SHELDON, *supra* note 289, at 569-70.

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are agreeing to.

Consumer advocates are reluctant to wait until they, government agencies, or legislative committees have documented substantial abuses involving many consumers and financial institutions. First, most consumers do not complain.⁴⁸⁶ Second, it is always uncertain how much evidence will be necessary to attract the attention of the legislature. Even if overwhelming evidence is gathered, in any given year, a legislature may be preoccupied with other matters such as a budget deficit. Once the legislature turns its attention to the need for legislation, there probably will be a substantial time lag before any legislation will pass. The consumer financial services lobby is certain to oppose strong measures. In addition, the legislature will have several alternative approaches to consider, as discussed below.⁴⁸⁷ Finally, it is better to act now, while consumer arbitration with financial institutions is in its formative stages. If legislatures postpone action until adequate documentation of actual consumer harm is available, many more financial institutions probably will have adopted arbitration, drafted contracts, and instituted procedures. If legislation subsequently is proposed, these institutions will complain about the cost and disruption new laws will cause.

The economic theory espoused by the free market proponents is justified only if the market is truly competitive and the consumer has adequate information.⁴⁸⁸ This does not require all consumers to possess adequate information, but only numbers sufficient to influence the market by the action they take in response to that information. The consumer advocates question the competitiveness of the market. Two factors support their skepticism. First, the trend is toward far fewer financial institutions, which likely will lead to less competition.⁴⁸⁹ This is occurring as a result of the failure of vast numbers of banks and savings and loans, the repeal of many state restrictions on interstate banking, and the resulting mergers and buyouts of many banks.⁴⁹⁰ Financial institutions are least likely to compete for the business of those on the bottom rungs of the socioeconomic ladder who are least likely to be able to protect themselves. Lacking strong

⁴⁸⁶ Arthur Best & Alan R. Andreasen, *Consumer Response to Unsatisfactory Purchases: a Survey of Perceiving Defects, Voicing Complaints, and Obtaining Redress*, 11 LAW & SOC'Y REV. 701 (1977).

⁴⁸⁷ See *infra* parts VI. B, C, & D.

⁴⁸⁸ POSNER, *supra* note 480; NADER, *supra* note 470, at 70.

⁴⁸⁹ Cf. Bill Atkinson, *Start-Up Plan Triggers Feud in Tiny Georgia Town*, AM. BANKER, May 24, 1994, at 6 (the two existing banks in town fight to keep out a third). "Mr. Miller was so angry about the possibility of having another competitor that he made a rare request for a public hearing before the banking department." *Id.*

⁴⁹⁰ Kenneth Cline et al., *The Interstate Banking Game: Who Gets Eaten?*, AM. BANKER, May 25, 1994, at 4.

competition, it is unlikely the cost savings realized by arbitration would be passed on to consumers.

Consumer advocates also question whether sufficient numbers of consumers will be able to obtain adequate information about the advantages and disadvantages of arbitration.⁴⁹¹ It is unlikely that any consumer protection institution presently on the scene has the resources to launch a sustained consumer education campaign on this issue. In addition, even if these institutions oppose arbitration in principle, they have many other priorities competing for their limited resources. Furthermore, any informational campaign would have to counter efforts by financial institutions and arbitration organizations which can be expected to promote arbitration. Finally, a consumer information campaign would have to counter the institution's efforts to gain consumer approval without a consumer realizing exactly what is being agreed to (dragnet clauses), if anything at all (stuffers in mailings not requiring signature).

The consumer advocates believe an adequate bank of information presently exists to justify and allow legislatures to properly design a statutory response. This information bank is based on the arbitration contracts presently in use,⁴⁹² the experience of working with consumer protection laws,⁴⁹³ the responses several states have already taken,⁴⁹⁴ and the experience with arbitration in general.⁴⁹⁵

Finally, the consumer advocates decry the impact arbitration has on the comprehensive scheme of consumer protection laws which have been enacted. It deprives the consumer of the laws which their elected representatives passed for the consumer's benefit. It deprives the system of case law which is needed to interpret and apply consumer protection statutes in those transactions not covered by arbitration, and deprives regulatory and enforcement agencies of needed data.

B. The Consumer Protection Approach: Minimum Standards

Several alternatives are available to those who reject the laissez faire approach. These include distinguishing the level of protection required according to the type of claim made by a consumer with a dispute. Alternatively, a legislature could prohibit arbitration altogether for all or certain types of claims. Regardless of the approach taken, this section

⁴⁹¹ Patricia Sturtevant & Dwight Golann, *Face-Off: Should Binding Arbitration Clauses Be Prohibited in Consumer Contracts?*, 1 DISP. RESOL. MAG. 4, 4 (Summer 1994).

⁴⁹² See *infra* part III. A.

⁴⁹³ See *infra* parts IV. and V.

⁴⁹⁴ See *supra* text accompanying notes 268-71.

⁴⁹⁵ See *infra* parts III. C & D.

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proposes that if a legislature decides to amend its laws to protect consumers from the adverse consequences of arbitration, a statute should contain the following standards, as an absolute minimum.

The very essence of arbitration is that it is a voluntary agreement between two parties. Given the disparity of power and knowledge between consumers and financial institutions, the often necessitous circumstances under which a consumer seeks financial services, and the potentially all-encompassing scope of the arbitration contract, legislation should require that a consumer is not bound unless the arbitration contract is signed. Several states already impose this requirement.⁴⁹⁶

The legislature should consider whether or not to impose format requirements on the contract. Examples include: requiring the contract to be on a separate page from any other contract, requiring the contract to be written in plain language, and requiring the contract to be printed in at least ten point type. An alternative approach is to delegate to a government agency the task of issuing format guidelines. Examples of appropriate agencies are the Federal Trade Commission or Federal Reserve Board on the federal level, and departments of consumer affairs and consumer protection divisions of offices of the Attorney General on the state level.

Financial institutions may object that this will impose tremendous administrative and cost burdens upon them. They will argue that the burden will be especially severe in regard to current customers. The institution will have to mail a contract to each customer. They will have to monitor every customer account to determine if that customer has returned a properly signed contract. In addition, because some consumers will not return the contract, either because they object to it or just do not get around to mailing it back, the institution will have two categories of customers to deal with: those whose disputes are subject to arbitration, and those whose disputes are not. Unless substantial numbers of consumers return signed contracts, it may not be feasible to implement an arbitration program. If an arbitration program is implemented, the institution will have to be careful, when a dispute arises, not to try to impose arbitration upon a customer who has not signed the agreement. The institution's problem is less severe in regard to new customers. They will be presented with an arbitration contract at the time they are signing up for the institution's services, and probably will sign the arbitration contract with the same lack of attention they are paying to the numerous other forms they are signing. It would be easy to keep a record of those few new customers who refuse to sign the contract.

Requiring financial institutions to obtain customer signatures on arbitration contracts raises issues related to persons who do not sign these agreements. The preceding discussion assumes that a current customer

⁴⁹⁶ See *supra* text accompanying note 270.

cannot be denied service due to the failure to sign. That customer agreed to purchase services at a stated price, and the institution should not be able to unilaterally impose a modification which fundamentally alters the agreement.⁴⁹⁷ The position of a new customer may be more precarious. If the consumer refuses to sign the arbitration contract, can the financial institution refuse to provide services? At first glance, it appears refusal is a legitimate course of action. The problem arises in the situation of a customer needing essential banking services, living and working in a community where there are very few banks which all require a new customer to sign arbitration agreements. Under these circumstances the waiver of the judicial forum is not voluntary. The legislature may wish to require banks to serve a new customer under those circumstances, even where arbitration contracts are not signed.

Every consumer should receive a brochure accompanying the arbitration contract. Without a brochure explaining the consequences of signing the agreement, a consumer cannot intelligently and knowingly waive his or her right to access to the judicial process.⁴⁹⁸ At least one bank, Zions First National Bank, has voluntarily produced a brochure.⁴⁹⁹ It describes the arbitration procedure and points out the benefits of arbitration. Unfortunately, it does not compare the advantages and disadvantages of both arbitration and litigation. Legislatures should take into account the failure of all other financial institutions to meaningfully inform their customers what is being agreed to as well as the deficiencies in the material produced by the one bank which decided to provide information. In light of this conduct, legislatures should consider mandating that financial institutions must provide a brochure describing the advantages and disadvantages of arbitration as compared to litigation.⁵⁰⁰ Institutions faced

⁴⁹⁷ Under certain circumstances, courts have struck down creditors' unilateral change in contract terms, even when the agreement with the customer authorized unilateral modifications. *See, e.g.,* *Best v. United States Nat'l Bank*, 739 P.2d 554 (Or. 1987); *Lester v. Resort Camplands Int'l, Inc.*, 605 A.2d 550 (Conn. Ct. App. 1992); *In re Orkin Exterminating Co.*, 108 F.T.C. 263 (1986), *aff'd* 849 F.2d 1354 (11th Cir. 1988), *cert. denied*, 488 U.S. 1041 (1989).

⁴⁹⁸ *See supra* text accompanying notes 322-24. Patricia Sturdevant, the attorney who has brought the major court challenges to consumer-bank arbitration clauses, does not oppose arbitration outright. As with sex, she says, "It's o.k. between consenting adults." Karen Donovan, *Bound to Arbitration? Bank Trial to Decide*, NAT'L L.J., Jan. 17, 1994, at 1.

⁴⁹⁹ ZIONS FIRST NAT'L BANK, *supra* note 87.

⁵⁰⁰ Michigan requires that patients be provided a brochure when they sign arbitration contracts in regard to their malpractice claims. MICH. COMP. LAWS ANN. § 600.5041(6) (1987). Failure to provide the brochure renders the arbitration contract unenforceable. *Roberts v. McNamara-Warren Community Hosp.*, 360 N.W.2d 279 (Mich. Ct. App. 1985).

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with such legislation may want to defer to a neutral body such as the American Arbitration Association, asking them to draft a brochure. Another alternative is for the legislation to include a list of what topics such a brochure must discuss. Legislatures may prefer instead to delegate that task to an appropriate agency.

A third minimum standard should be legislation which prohibits clauses providing for hearings in distant forums.⁵⁰¹ Because of limited consumer resources and relatively small amounts involved in most consumer suits, the expense and inconvenience of arbitration hearings great distances from a consumer residence effectively precludes the consumer from exercising contractual rights to arbitrate. Some states already protect citizens from this abuse. Florida courts have held that a contract which provides for arbitration in another state is not enforceable under the Florida Arbitration Code, and the provision can be voided by either party.⁵⁰² Michigan has enacted a narrowly drawn statute which gives distant forum protection to franchisees.⁵⁰³

Fourth, the legislation should limit the costs of arbitration to the consumer. Arbitration can be more expensive than litigation because typically each party shares the cost of the arbitrator.⁵⁰⁴ A financial institution could easily make arbitration infeasible to a consumer by requiring use of an arbitration organization whose filing and arbitrator fees are excessive in relation to the amount of the consumer's claim or the consumer's resources. Legislation restricting costs would not unduly burden consumer arbitration. The American Arbitration Association, for example, imposes modest costs and has a procedure for accommodating low income parties.⁵⁰⁵

Fifth, legislation should require financial institutions to forward the results of arbitrations to a central repository. This information would serve as a data base for regulatory and enforcement agencies. The information also should be open to the public so every consumer and the media can monitor consumer arbitration and spot institutions to avoid. The securities industry has established such a system.⁵⁰⁶

⁵⁰¹ The drafters of the FAA did not intend to subject parties to an inconvenient forum and believed they had obviated the problem by requiring personal service. MACNEIL, *supra* note 121, at 95, 98.

⁵⁰² *Damora v. Stresscon Int'l, Inc.*, 324 So.2d 80, 82 (Fla. 1976); *see Donmoor, Inc. v. Sturtevant*, 449 So.2d 869, 870 (Fla. Ct. App. 1984).

⁵⁰³ *See supra* text accompanying notes 218-20.

⁵⁰⁴ ROSMARIN & SHELDON, *supra* note 289, at 370.

⁵⁰⁵ *See supra* note 111.

⁵⁰⁶ Susan Anilla, *N.A.S.D. Is Expanding Information on Brokers*, N.Y. TIMES, Sept. 18, 1993, at 32. *Investors to Have Access to More Information on Brokers*, ATLANTA CONST.,

The minimum standards legislation proposed in this part would be appropriate both for Congress and state legislatures because they affect arbitration under both the FAA and state arbitration statutes. One problem, however, can be solved only by Congress. As discussed above,⁵⁰⁷ decisions of the Supreme Court have made unclear the power of states to prohibit the arbitration of disputes arising out of certain types of transactions. Congress should amend the FAA to permit states to do so, at least in consumer transactions. Usury statutes and statutes regulating unfair and deceptive acts and practices illustrate the wisdom of such an amendment. The wide variety of state legislative approaches to these areas⁵⁰⁸ indicate there is no national consensus on the best way to regulate them. This lack of uniformity may reflect differences in the political power of interest groups from state to state, or may reflect different prevailing local norms, economic conditions, degree of urbanization, whether a few major financial institutions dominate the market, and so forth. To the extent Congress has felt a need for federal legislation, it has enacted it, for the most part leaving the states the authority to legislate in areas not covered.⁵⁰⁹ Congress should make it clear that it does not intend the FAA to take from state legislatures the authority to exempt consumer transactions from arbitration.

C. The Consumer Protection Approach: Alternative I — Base Safeguards On Type Of Claim

As discussed above,⁵¹⁰ consumer claims can be differentiated based on the type of claim the consumer alleges. Some cases are based on common law theories such as fraud, good faith, unconscionability, and breach of contract. Others are based on state and federal consumer protection statutes. As discussed, the former are similar to commercial arbitration and less infused with public policy implications. Therefore, legislatures may feel consumers need fewer safeguards when disputes based on these claims go to arbitration.

In regard to consumer claims based on common law theories, in addition to the minimum standards discussed above,⁵¹¹ a consumer may need more liberal discovery rules in order to prove each case.⁵¹² Banks will

June 22, 1993, at C7.

⁵⁰⁷ See *supra* text accompanying notes 191-200.

⁵⁰⁸ See BROWN & KEEST, *supra* note 373; SHELDON, *supra* note 379.

⁵⁰⁹ KEEST & SARASON, *supra* note 178, at 208.

⁵¹⁰ See *supra* part V. A1.

⁵¹¹ See *supra* part VI. B.

⁵¹² Severe restrictions on discovery were reasonable for the simple transactions for

oppose this, arguing that such departures from traditional arbitration procedure destroy its benefits. New Jersey's Alternative Procedure for Dispute Resolution Act,⁵¹³ however, represents a measured compromise which retains most of the advantages of arbitration while permitting depositions and the inspection and copying of documents. Interrogatories are permitted when authorized by the decisionmaker, called an "umpire."⁵¹⁴ Discovery must be completed within 60 days, but the umpire can extend that time and can limit or terminate discovery. The umpire's discovery decisions are subject to appeal. Legislatures may want to adopt these discovery rules for all consumer cases based on common law claims.

In regard to consumer claims based on consumer protection statutes, legislatures should consider two alternatives. One option is to prohibit arbitration altogether.⁵¹⁵ This is consistent with the laws of several states which exempt consumer cases from their arbitration statutes.⁵¹⁶ As discussed above,⁵¹⁷ there is a strong rationale for this approach. Arbitration procedures are ill-suited for resolving these disputes, substantial consumer rights and remedies are by-passed, and case law development is stifled. Arbitration ignores the legislature's overall regulatory and enforcement scheme, to balance the interests of consumers and financial institutions. Arbitration eviscerates the judiciary's role in interpreting and applying statutes with major public policy implications.

The second alternative is to allow arbitration of disputes in which the consumer's claims are based on consumer protection statutes, but to require substantial safeguards. One of the chief complaints about arbitration of claims based on consumer protection laws is the arbitrator's freedom to ignore those laws, flouting the legislature's will and depriving the consumer of rights. This objection could be solved by requiring the arbitrator to follow the law. This is not a revolutionary concept. The New Jersey Alternative Procedure for Dispute Resolution Act requires that the umpire decide the case "in accordance with applicable principles of substantive

which arbitration was originally designed. HOENIGER, *supra* note 140, at 8-6.

⁵¹³ N.J. STAT. ANN. §§ 2A:23A-1 *et seq.* (1987 & Supp. 1993). *See generally* John V. O'Hare, *The New Jersey Alternative Procedure for Dispute Resolution Act: Vanguard of a Better Way?*, 136 U. PA. L. REV. 1723 (1988).

⁵¹⁴ N.J. STAT. ANN. § 2A:23A-10 (1962).

⁵¹⁵ DANIEL A. EDELMAN, COMPULSORY ARBITRATION OF CONSUMER DISPUTES, NATIONAL CONSUMER RIGHTS LITIGATION CONFERENCE 54, 67 (1994) (proposing legislation providing that federal and state claims which provide a penalty or statutory damages would not be subject to arbitration).

⁵¹⁶ *See supra* text accompanying notes 268-71.

⁵¹⁷ *See supra* part V. B.

law."⁵¹⁸ The arbitration rules of the Center for Public Resources "clearly contemplate a 'legal' award rather than a broad, unfettered exercise of equitable discretion."⁵¹⁹ The only way to know if the arbitrator followed the law is to require a "reasoned" decision which includes findings of fact and determinations of law. The New Jersey law provides for this type of award.⁵²⁰ Reasoned awards are the norm in international commercial arbitration and arbitration administered by the Society of Maritime Arbitrators⁵²¹ and are required by the arbitration rules of the Center for Public Resources.⁵²² Because of the breadth and complexity of consumer protection statutes, legislation also should require a training program in consumer protection for arbitrators. It makes no sense to require the arbitrator to follow the law if there is no assurance the arbitrator is familiar with it.

The legislature should consider whether to allow judicial review of an arbitration award on the grounds that the arbitrator did not correctly apply the applicable law. New Jersey permits this.⁵²³ Financial institutions can be expected to oppose it, arguing that judicial review on that basis obliterates one of arbitration's chief advantages for them. Courts may balk as well, because judges see arbitration as a means of reducing dockets.⁵²⁴ Consumer advocates will argue that judicial review is the only method by which a consumer can be assured that arbitration awards do indeed preserve consumer rights. Furthermore, it is reasonable to expect that the number of actual appeals would be very small since the typical consumer does not

⁵¹⁸ N.J. STAT. ANN. § 2A:23A-12 (1962). The American Arbitration Association is considering adopting this rule in employment discrimination cases. *Arbitration Group May Change Rules for Job Bias Cases*, DALLAS MORNING NEWS, Aug. 2, 1994, at 2D.

⁵¹⁹ HOENIGER, *supra* note 140, at 6-48.

⁵²⁰ N.J. STAT. ANN. § 2A:23A-12 (1962).

⁵²¹ HOENIGER, *supra* note 140, at 6-51.

⁵²² *Id.* at 6-48.

⁵²³ N.J. STAT. ANN. § 2A:23A-13(c)(5) (1962).

⁵²⁴ There has been considerable disagreement about the extent to which there has been a litigation "explosion" requiring drastic measures, and the sources and reasons for current docket levels. *See, e.g.*, Marc Galanter, *Reading the Landscape of Disputes: What We Know and Don't Know (And Think We Know) About Our Allegedly Contentious and Litigious Society*, 31 UCLA L. REV. 4 (1983). Arbitrating consumer-bank disputes may not have a substantial impact on court caseloads. A recent study conducted by the University of Wisconsin and RAND Institute for Civil Justice found that the largest category of lawsuits filed in federal court involved contract disputes between Fortune 1000 companies. The next largest categories were personal injury cases and product liability lawsuits. *Who's Suing Whom? This May Surprise*, 3 BUS. L. TODAY 52 (May/June 1994).

complain when dissatisfied.⁵²⁵

A legislature that wishes to prevent arbitration from obliterating the public policy objectives of consumer protection statutes must consider what remedies to preserve in arbitration. Consumer protection statutes typically authorize the court to award a successful consumer costs and attorney's fees and provide for minimum statutory damages.⁵²⁶ This recognizes that the consumer acts as a private attorney general promoting the common good when the consumer successfully brings actions under these statutes, and it is therefore appropriate to provide incentives to encourage such actions. The incentives are necessary due to the fact that the amount of money often involved in these cases, while very significant to the average consumer, is not enough to justify these actions. This feature is especially crucial to preserve in arbitration where the consumer's share of the arbitrator's fee may make arbitration more expensive for the consumer than litigation. Punitive damages are important to deter companies from engaging in outrageous conduct. Consumer advocates therefore argue that legislation should provide the arbitrator with the authority to award punitive damages in appropriate cases.⁵²⁷ Class actions are sometimes a highly efficient way to correct violations of consumer protection statutes, especially where the violation is a defect in standard form contracts which affect every consumer who signed those contracts. Therefore, consumer advocates argue the arbitrator should have the authority to treat the case as a class action where appropriate and feasible.⁵²⁸

Financial institutions likely would oppose the above proposals, contending that they incorporate so much of the elements of litigation in the judicial forum that they lose the benefits of arbitration. Consumer advocates would counter that without these safeguards, consumers stand to lose the rights these laws guarantee them. In addition, these laws are part of the legislature's overall financial institution regulatory scheme. These laws help not only the consumer, but also the business community because they prohibit conduct which allows a firm engaging in socially undesirable conduct to gain an unfair advantage over firms which do not. Consumer advocates also could point out that even with the above safeguards incorporated into arbitration, it is nevertheless advantageous to financial institutions compared to litigation. For example, cases would be heard and decided more quickly because the arbitrator does not have to compete with a criminal court docket. Even if discovery is allowed to the extent proposed here, it is more limited than discovery in a court case. Arbitrators do not

⁵²⁵ Best & Andreasen, *supra* note 486.

⁵²⁶ *E.g.*, Truth in Lending Act, 15 U.S.C. § 1640 (1982).

⁵²⁷ Sturdevant & Golann, *supra* note 491, at 5.

⁵²⁸ *Id.*

adhere to strict rules of evidence, so both sides can more easily present their proof and argue their positions. Financial institutions would still be able to determine the scope of disputes covered by arbitration, whether to follow the AAA's procedures or other procedures on selection of arbitrators and many other items. In other words, even with the suggested safeguards, the financial institution remains in the driver's seat to a large extent, unlike its position in the judicial forum.

Finally, the legislature should consider requiring that arbitration in cases involving consumer protection statutes be nonbinding.⁵²⁹ There is ample precedent for this approach. Under the Magnuson-Moss Warranty Act, sellers are authorized to establish informal dispute resolution mechanisms. If the mechanisms are consistent with FTC rules, a consumer must submit the dispute to the nonbinding mechanism before filing a complaint in court.⁵³⁰ If consumer arbitration of disputes with financial institutions was nonbinding, the legislature would not be as concerned about the need to incorporate litigation safeguards into arbitration. Judge Wayne Brazil who oversees an ADR program in a federal court, suggests that if arbitration is a sound alternative to litigation, financial institutions should have enough confidence in it to support a nonbinding procedure. In addition, nonbinding arbitration would increase the legitimacy of this method of dispute resolution in the eyes of a consumer.⁵³¹ Financial institutions can be expected to oppose this proposal, contending that nonbinding arbitration lacks the finality which is one of arbitration's main benefits. Past experience suggests, however, that few consumers would have the stamina to pursue a complaint in the courts even if dissatisfied with the results of arbitration.⁵³² Moreover, binding arbitration may not result in

⁵²⁹ Sturdevant & Golann, *supra* note 491, at 5. See Comments of Gail Hillebrand, Litigation Counsel, West Coast Regional Office of Consumer Union, in *Alternative Dispute Resolution: A Roundtable*, THE RECORDER 10 (Spring 1993) ("If nonbinding, I think I would agree that they [arbitration clauses] are of benefit."). *But see* Schaefer v. Allstate Ins. Co., 590 N.E. 2d 1242 (Ohio 1992) (nonbinding arbitration is an oxymoron; contract providing for such arbitration is unenforceable).

⁵³⁰ Rosmarin & Sheldon, *supra* note 289, at 500.

⁵³¹ Obviously my strong preference is for nonbinding circumstances. . . . And if the proponents of the service have enough confidence in its rationality and its fairness to say, 'Look. We'll go through this with you. If you don't like what happens, then you have your right to the Seventh Amendment.' If the proponents say that, they can encourage respect for them and the process they want their people to use, both as a political and philosophic matter.

Alternative Dispute Resolution: A Roundtable, *supra* note 529, at 14.

⁵³² Best & Andreasen, *supra* note 486.

meaningful finality. Its confidential awards have no precedential or widespread effect; consequently, others with the same problem will have to seek redress. While there may be finality to resolution of the individual consumer's case, there is no finality in terms of resolving the underlying problem which will give rise to many subsequent cases.⁵³³ Financial institutions also may oppose this proposal based on the fear that those who do go to court after nonbinding arbitration will be precisely those for whom the institutions most want binding arbitration: consumers with class action claims or those seeking punitive damages or both. Nevertheless, legislatures may find nonbinding arbitration an attractive solution because it preserves traditional arbitration while providing access to the judicial forum.

D. Consumer Protection Approach: Alternative II — Across The Board Rules To Govern Consumer Disputes

The proposal discussed above sets up a two-tiered system, with one set of arbitration rules for cases where the consumer's claims are based on common law theories and another set of stricter rules for those cases based on consumer protection statutes. Even if one agrees legislatures should adopt laws to safeguard the consumer in arbitration, one can question the advisability of this two-tiered system. In such a system, the consumer will be tempted to make claims based on consumer protection statutes in order to gain the advantages of the attendant safeguards. The financial institution and consumer consequently will become engaged at the outset in a battle over whether the consumer has a legitimate basis for making that type of claim. Furthermore, some might argue that a claim based on a common law cause of action such as fraud may be far more significant to the public interest than one based on a technical violation of a disclosure requirement in a consumer credit statute.

For these reasons, the legislature should consider an alternative approach. If the legislature does not wish to make distinctions between types of claims, the legislature could instead treat all claims alike. The legislature that wants to protect the consumer in arbitration could simply provide that arbitration of consumer disputes is prohibited. This solution eliminates any confusion. It eliminates any need for the legislature to decide what types of safeguards to incorporate into arbitration.

On the other hand, the legislature may want to preserve the arbitration option while treating all consumer arbitration alike. This could be done by retaining consumer arbitration but building in some or all of the safeguards

⁵³³ "Private nonlitigative methods of resolving disputes may 'give the appearance of resolving some disputes while avoiding a finding of more extensive liability or leaving fundamental issues unsettled.'"Guill & Slavin, *supra* note 221, at 12.

suggested above. How many and which safeguards is a function of how serious the legislature is about preserving consumer rights. As in most human endeavors, every benefit to one group may result in a cost to another group. Every consumer safeguard built into arbitration makes arbitration somewhat less "efficient" for financial institutions. On the other hand, allowing financial institutions to avoid judicial forums by means of adhesion contracts when their actions violate statutes which specifically provide consumers with those forums is a serious deprivation of consumer rights and an evisceration of legislative purpose.

VII. CONCLUSION

Legislatures must decide whether they wish to seriously protect consumers. If they do, they must modify arbitration law so its effect is not to eviscerate consumer protection. Richard Abel has described the essential difference between formal justice, which is the traditional judicial system, and informal justice, which includes arbitration and other types of ADR. Informal justice institutions "neutralize conflict."⁵³⁴ They do so by providing easy access to a resolution forum, isolating the individual complainant, and resolving the dispute in a quick and inexpensive manner. Informal justice, however, does nothing to solve the underlying problem which is the cause of many consumer complaints. This is because ADR's focus is on "process not outcome."⁵³⁵ ADR deals with disputes in a way that does not "challenge basic structures."⁵³⁶ Professor Abel characterizes ADR as "antinormative" because ADR does not try to change behavior or act in a judgmental manner.⁵³⁷ In other words, ADR is a band-aid. Formal justice, in contrast, has the capacity to meaningfully deal with and solve underlying problems which give rise to complaints.⁵³⁸ The state and federal legislatures have done their part by enacting a comprehensive body of consumer protection laws, designed, not merely to resolve consumer disputes, but also to provide meaningful remedies to serious market failure. The problems those laws were designed to combat cannot be solved, however, unless they can be enforced through the courts. Therefore, unless the legislatures wish their legislative efforts to come to naught, they will have to adopt at least some of the proposals discussed herein.

⁵³⁴ ABEL, *supra* note 373, at 284.

⁵³⁵ *Id.* at 294 (emphasis in original).

⁵³⁶ *Id.* at 283.

⁵³⁷ *Id.* at 290.

⁵³⁸ *Id.* at 285.