INDIANA UNIVERSITY
KELLEY SCHOOL OF BUSINESS

MEMORANDUM

TO: Tim Heinsz

FROM: Stephen Hayford

DATE: February 10, 1998

SUBJECT: Preemption-Related Adhesion Contract Questions

You asked me to speak to the preemption problems with two of the possible approaches to the adhesion contracts issue: (i) specific statutory language in each section of the RUAA touching on adhesion issues and concerns; and (ii) separate statutes for consumer and individual employment contracts. The problem with either approach is that, despite the strong equitable arguments favoring regulation of this nature, it cannot be achieved without ignoring the Supreme Court's consistent admonition that arbitration agreements must be enforced under the same set of rules used to enforce all other contracts. The Court has made clear its belief that to permit special rules for the enforcement of arbitration agreements would place such agreements on an unequal footing with other contracts and therefore cannot be tolerated. Any state law provision that singles out arbitration agreements for scrutiny or treatment different from all other contracts are preempted by the FAA.

The key here is the anti-arbitration nature of such state statutes. These laws are intended to limit arbitration and prevent the enforcement of otherwise enforceable arbitration agreements. I am convinced the problem with these "arbitration-specific statutes (or statutory provisions) is the failure of their advocates to acknowledge the Supreme Court's belief that that the common law contract doctrines of consent (knowing and voluntary agreement) and unconscionability provide sufficient vehicles for ensuring that arbitration agreements are fairly enforced. The Court's attitude is most clearly reflected in *Southland* and *Cassarotto*, but it also runs through *Terminix, Perry* and the related cases.

> "§2 [of the FAA] gives States a method for protecting consumers [and employees] against unfair pressure to agree to a contract with an unwanted arbitration provision. States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause 'upon such grounds as exist at law or in equity for the revocation of *any* contract..' (9 U.S.C.§2) *What States may not do is decide that a contract is fair enough to enforce all of its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause.*

> *The [FAA] makes any such state policy unlawful, for that kind of policy would place arbitration clauses on and unequal "footing," directly contrary to the Act's language and Congress's intent***."** (emphasis supplied)

Allied-Bruce Terminix v. Dobson, 115 S. Ct. 834, 843 (1995)(quoting *Volt Information Science, Inc. v. Stanford*, 489 U.S. 466, 474, 109 S. Ct. 1248, 1253 (1989)) *quoted in Doctor's Associates, Inc. v. Cassarotto*, 116 S. Ct. 1652, 1655 (1996). "Courts may not, however, invalidate arbitration agreements under state laws applicable only to arbitration provisions. (citations omitted) *By enacting §2, we have several times said, Congress precluded States from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed 'upon the same footing as other contracts.* **"** *Cassarotto*, 116 S. Ct. at1656 (quoting *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511, 94 S. Ct. 2449, 2453 (1974)). (emphasis supplied).

The adhesion contract-related proposals do exactly what the Supreme Court has said the States cannot do. They single out the arbitration provision of warranty, service agreement, purchase contract, employment contract, etc. that is otherwise valid and enforceable and say that the arbitration provision (agreement) will not be enforceable unless it meets special requirements intended to protect "little guys. A special statute or separate provisions within various portions of the RUAA would define arbitration agreements as *per se* unconscionable and therefore unenforceable without permitting courts to apply relevant state law "'concerning the validity, revocability, and enforceability of contracts generally.' Instead, such statutory provisions would establish a state law principle that "takes its meaning precisely from the fact that a contract to arbitrate is at issue.

The type of statutory provisions at issue would conflict with the Supreme Court's edict of no special rules for the enforcement of arbitration agreements. They are also, at their core, anti-arbitration. Consequently, I believe any attempt to establish separate rules for the enforcement of consumer and employment arbitration agreements will create a palpable risk of FAA preemption. The Supreme Court has made absolutely clear its belief that the law of enforceability of commercial arbitration agreements is found in §2 of the FAA and state contract law regarding enforceability, consent (Knowing and voluntary acceptance), unconscionability, and revocation. Any attempt to "level the playing field for consumer, employees and others will run straight on into the "equal footing rule of *Southland*, *Perry, Cassarotto*, et. al. The preemption that will certainly result would have a very significant deleterious effect on the RUAA. This is a result the Drafting Committee must ensure against.

The better approach is to insert language in the enforcement-related provisions of the RUAA emphasizing that the common law doctrines pertaining to the requirements of knowing and voluntary consent and the doctrine of unconscionability are fully applicable to arbitration agreements. Similar emphatic emphasis should appear in the Reporter's Comments to this effect, clarifying the Drafting Committee's belief that these common law doctrines should be used by the courts to ensure fairness and to prevent businesses and employers from abusing their dominant position vis a vis consumers and employees. Any action beyond that will beg for FAA

preemption.