

Consumer Protection:

Choices of Law, Forum, and Arbitration -- Consumer (and Small Business) Frontiers

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A. The Substance

1. Background and Trends

- a. Choice of law and forum and "mandatory" arbitration clauses are beginning to appear in adhesion contracts to a degree unimagined even twenty years ago.
 - (1) In the mid-20th Century, contractual choice of law and forum clauses had questionable power in *any* context
 - (a) The 1952 UCC Article I was the first widely-enacted statute to permit parties to select (from "related" law) the law that would apply to their contract
 - i) First Restatement of Conflict of Laws did not recognize party choice of law
 - (b) Choice of forum clauses were said to "oust the court of jurisdiction" until the Supreme Court in *The Bremen* recognized their utility
 - (2) The recognition of these clauses in the adhesion contract context is probably an outgrowth of several Supreme Court cases:
 - (a) *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 92 S.Ct. 1907, 32 L.Ed.2d 513 (1972)
 - (b) *Southland Corp. v. Keating*, 465 U.S. 1 (1984)
 - (c) *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991)
 - (3) In this context, almost everyone agrees that the forms are seldom read and that "choice" or "consumer preference" is largely non-existent
 - (4) The Academy has not embraced a widely-accepted theory for enforcement of such provisions in this context

b. Implications of this development are debatable:

- (1) Choice of law clauses may enable drafters to avoid State business regulation
 - (a) Limitations on interest rates become avoidable
 - i) *See*:
 - a) *Marquette Nat'l Bank v. First Omaha Serv. Corp.*, 439 U.S. 299, 58 L. Ed. 2d 534, 99 S. Ct. 540 (1978) (National Bank Act permits bank to charge customers nationwide the interest rate permitted in home state)
 - b) *Woods-Tucker Leasing Corp. of Ga. v. Hutcheson-Ingram Dev. Co.*, 642 F.2d 744 (5th Cir. 1981) (Less restrictive Mississippi usury law successfully selected in Texas lease via UCC 1-105)
 - (b) State protection for franchisees may be avoidable:
 - i) *Compare*:
 - a) *Tele-Save Merchandising Co. v. Consumers Distributing Co. Ltd.*, 814 F.2d 1120 (6th Cir. 1986)(franchisee protection avoidable through choice of law provision) *with*
 - b) *Electrical and Magneto Service Co. Inc. v. AMBAC Intern. Corp.*, 941 F.2d 660 (8th Cir. 1991)(90 day notice of termination not avoidable through choice of law provision)

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- (c) State law governing non-compete employment provisions may be avoidable:
 - i) *Compare* Machado-Miller v. Mersereau & Shannon, LLP , 43 P.3d 1207 (Or. Ct. App. 2002)(choice of Oregon law avoids California statute rendering no-compete agreement unenforceable(in context of legal malpractice case) *with*
 - ii) Application Group, Inc. v. Hunter Group, Inc. , 72 Cal. Rptr. 2d 73 (Cal. Ct. App. 1998) (opposite)
 - (d) Other applications?
 - (2) Choice of forum clauses may disadvantage customers, particularly those with small disputes:
 - (a) A distant forum obviously increases costs of dispute resolution for customers (and may decrease it for drafters)
 - (b) Sometimes the chosen forum will have procedural advantages to the drafter, such as no class action device:
 - i) *E.g.*, America Online, Inc. v. Booker, 781 So. 2d 423 (Fla. Dist. Ct. App. 2001)
 - (3) Contractual arbitration has come to be known as "mandatory arbitration" thereby embedding the adhesive nature of the provisions in its name
 - (a) Arbitration eliminates juries, much discovery, public records and access, and the corrective function of appeal
 - (b) If desired by drafters (why not?), class actions might be foreclosed
 - i) Edelist v. MBNA Am. Bank, 790 A2d 1249 (Del. Super. Ct. 2001) (enforceable, not unconscionable under Delaware law)
 - ii) Ting v. AT&T, 319 F3d 1126 (9th Cir. 2003) (unenforceable because unconscionable under California law)
 - (c) Pending California case, combines the drafter's choice of Delaware law with mandatory arbitration, arguing that Delaware law, not California law, should determine the unconscionability question.
 - i) Discover Bank v. Super. Ct. of L.A. County, 129 CalRptr2d 393 (Cal. Ct. App. 2003), review granted, 65 P3d 1285(Cal. 2003)
 - (d) Mandatory arbitration, boosted by the Supreme Court's interpretation of the Federal Arbitration Act, is being marketed as a solution to the "medical malpractice crisis" and such clauses may soon move dispute resolution in the products liability area to the private sphere as well.
 - c. Competition, profit maximization, and globalization may drive these developments.
 - (1) One can hardly blame a drafter for inserting a "no-class action" provision into her client's form contract
 - (2) Whether consumers as a group "win" in the end (and whether this is even the right question) is debatable
 - d. Normative views on these developments vary:
 - (1) Law & economics commentators argue that the market can best control. *Some* people read such clauses and agree anyway. This means that the clauses are not so bad and customers choose lower prices over traditional dispute resolution
 - (a) Early effort: Alan Schwartz & Louis. L. Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127

U. Pa. L. Rev. 630, 660 (1979).

- (b) Compare Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 Stan. L. Rev. 211, 244 (1995); Michael I. Meyerson, *The Efficient Consumer Form Contract: Law and Economics Meets the Real World*, 24 Ga. L. Rev. 583 (1990) (argue the contrary)
- (2) Virtually all organized consumer groups reject the proposition that these provisions are "good for consumers"

2. Countercurrents

a. UCC Article 1 on Choice of Law (Proposed UCC Sec. 1-301)

- (1) Thrust of the revision was "party autonomy"
 - (a) "Deregulate" choice of law to eliminate the requirement that law parties choose has to be related to them, their contract, or something beyond the fact they chose it. "People should be able to contract for what they want!"
- (2) Concerns about "autonomy" of consumers led to carve-out for consumer transactions and explicit "fundamental public policy" exception to enforcement
 - (a) Consumer provision was limited to "scope of the UCC" making the protection both unwieldy and very narrow
 - (b) As drafted, no protection for small business people or mass market or similar small transactions involving adhesion contracts
- (3) Received tepid welcome from consumer groups; opposition from anti-UCITA coalition and American Bankers' Association
- (4) Provision has been blocked or rewritten into current UCC 1-105 in every State where it's been introduced. Small business people receiving adhesion contracts, and unprotected by the carve-out, were probably winners.
- (5) Seems dubious this is a "loss" for consumers, but that's debatable because choice of law clauses are now being used to disadvantage consumers:
 - (a) The court in an unreported Washington case (*Sheifley v. Capital One Bank*, CV 03-2801 (W.D. Wash 2004)) said "The court does not agree with plaintiff's implicit claim that Washington law must apply if it is more protective of consumer's rights than the law of the agreed upon state." That "agreed-upon" state was Delaware.
 - (b) Bank in the pending California arbitration case makes a similar claim: Delaware unconscionability law should apply to consumer because that law was "chosen" in the contract
 - (c) In any event, UCC 1-301's narrow consumer protection would not likely have applied to the underlying transaction because beyond the scope of the UCC
- (6) On the normative debate over "party autonomy" in contractual choice of law in the UCC context,
 - (a) In favor of deleting the requirement that the parties are limited to choosing law "related" to their contract:
 - i) Erin A. O'Hara & Larry E. Ribstein, *From Politics to Efficiency in Choice of Law*, 67 U. Chi. L. Rev. 1151 (2000); but compare Larry E. Ribstein, *From Efficiency to Politics in Contractual Choice of Law*,

37 Ga. L. Rev. 363 (2003)

(b) Against it:

- i) Richard K. Greenstein, *Is the Proposed U.C.C. Choice of Law Provision Unconstitutional?*, 73 Temp. L. Rev. 1159, 1161 (2000); William J. Woodward, Jr., *Contractual Choice of Law: Legislative Choice in an Era of Party Autonomy*, 54 S.M.U. Law Rev. 697 (2001)

b. Bomb Shelters and Choice of Law and Forum

- (1) Bomb Shelters, defined broadly, are statutes that protect a State's residents from other States' laws or dispute resolution procedures perceived to be threatening to residents.
- (2) Spawned by enforcement of choice of law clauses
- (3) Current bomb shelters are virtually the same and apply only to choice of law in "computer information contracts"
 - (a) Designed to foreclose application of UCITA in States where UCITA has not been enacted or has been rejected.
 - (b) Example from West Virginia: W. Va. Code, Sec. 55-8-15, (in supp. materials)
- (4) AFFECT, an anti-UCITA coalition has drafted a "Model Bomb Shelter" (In supp. materials) that adds 3 ideas:
 - (a) It shelters the enacting State's citizens from choice of forum clauses as well
 - (b) It specifies that it is "fundamental policy" of the enacting state
 - (c) It provides an exception for fully negotiated contracts

c. Mandatory Arbitration

- (1) Unconscionability attacks on mandatory arbitration
 - (a) Latest is *Discover Bank v. Superior Court*, pending, Calif. Supreme Court
 - i) Does class action waiver make an arbitration clause unenforceable under Calif(Delaware??) law and, if so, is that preempted by the FAA?
 - ii) Preemption debate is whether such an unconscionability holding singles out arbitration for special treatment under FAA and is therefore invalid or whether, by also applying to a class action waiver outside arbitration, it survives preemption
- (2) Efforts to Limit arbitration to a "home" forum
 - (a) Montana court used (stretched?) pre-existing statutes to require that an arbitration provision specifying a California location had to take place in Montana instead
 - i) *Keystone, Inc. v. Triad Systems Corporation*, 292 Mont. 229, 971 P.2d 1240 (1998)
 - ii) Rebuff to Supreme Court for *Doctors Associates v. Casarotto*, 517 US 681 (1996)?
 - (b) AFFECT's Model Bomb Shelter (for computer information contracts) makes voidable a clause in a computer information contract providing for "litigation or *another dispute resolution process*" to occur in another State.

- (c) A State could easily expand such a proposal to cover all adhesion contracts or all adhesion contracts under a specified size
 - i) *cf.* Patrick J. Borchers, *Forum Selection Agreements in the Federal Courts After Carnival Cruise: A Proposal for Congressional Reform*, 67 Wash. L. Rev. 55, 110 (1992) (Congress should do so for contracts worth less than \$50,000)
- (3) The Market
 - (a) Either the market is already "controlling" mandatory arbitration clauses because people read them and don't care about them, or there is market failure. No empirical data are available. Corporate marketing departments probably have useful data.
 - (b) Market developments
 - i) Fannie Mae and Freddie Mac have refused to buy residential mortgages with arbitration clauses in them
 - ii) *Givebackmyrights.com* website
 - a) Marketing new (debatable) term "BMA" or "Binding Mandatory Arbitration"
 - b) Site informs prospective customer of vendors *without* arbitration clauses
 - c) Gives customers forms to send back to their vendors
 - d) Raises consciousness through advertising and press involvement

B. Teaching contract provisions for law, forum, and arbitration:

1. **Contracts course (Macaulay et al. materials):**
 - a. What law applies to a given dispute (first or second day) with choice of law *by contract* added in
 - b. ADR materials: introduce court-annexed arbitration; introduce (negotiated) contractual arbitration; introduce the possibility of arbitration by form contract
 - c. Adhesion contract materials; revisit choice of law by contract; arbitration
 - d. Jury trial waivers in form contracts
 - e. Policing the bargain—the limitations of cases like *Doctor's Associates* and *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978)
2. **Sales course (Keating materials)**
 - a. Interpreting agreements: functional analysis (*e.g.*, lease v. secured transaction) versus formal analysis (*e.g.*, CISG v. other law) in interpreting agreements that select applicable law
 - b. Formation / Terms: *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (7th Cir. 1997); *Brower v. Gateway 2000, Inc.*, 676 N.Y.S.2d 569 (N.Y. 1998) for substance of arbitration provision

Supplementary materials:

West Virginia Bomb Shelter
AFFECT Model Bomb Shelter
National Arbitration Forum marketing brochure for mandatory arbitration in health care

disputes