

2017

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Recommended Citation

Margaret L. Moses, How the Supreme Court's Misconstruction of the FAA Has Affected Consumers, 30 LOY. CONSUMER L. REV. 1 (2017).

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HOW THE SUPREME COURT'S MISCONSTRUCTION OF THE FAA HAS AFFECTED CONSUMERS

*Margaret L. Moses**

Neither the drafters of the Federal Arbitration Act nor the Congress that adopted it intended it to cover consumers or workers, or to displace state jurisdiction or state substantive law. The FAA was simply intended to provide a means for resolving disputes among commercial entities that might voluntarily choose to forego their rights to have their disputes settled in court, in favor of what they deemed to be a simpler and more efficient means of dispute resolution. That point has been lost on the Supreme Court. In a series of cases over the past fifty years, the Court, seemingly more concerned with diminishing the size of judicial caseloads or with ensuring certain substantive policy outcomes than with satisfying its obligation to give effect to congressional intent, has made the FAA a cornerstone of its efforts to circumscribe the rights of workers and consumers and nullify the policy choices of state legislators acting within the legitimate sphere of state policymaking. This article explains how this result came about, and how it has trampled consumer rights.

In 1925, the push to have a federal arbitration act was made by the business community, which wanted to resolve disputes between businesses more efficiently and with less cost.¹ The problem was, that at the time, arbitration clauses were unenforceable. A party could agree to arbitrate, but then at the last minute refuse to

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¹ See generally Ian R. MacNeil, *AMERICAN ARBITRATION LAW* 28, 34-37 (1992).

do so, with no adverse consequences.² Two individuals in the business community, Julius Cohen, a lawyer for the New York Chamber of Commerce, and Charles Bernheimer, a cotton goods merchant who chaired the Chamber's arbitration committee³ had successfully managed to make arbitration agreements enforceable in the State of New York. They had orchestrated the passage of a modern arbitration statute in New York – one that did not permit a party to welsch on its arbitration agreement.

Nonetheless, even after the statute's passage, if a business in New York agreed to arbitrate with a business in Vermont, which did not have such a statute, the arbitration agreement would not be enforceable in Vermont courts. If the matter was in federal courts because of diversity jurisdiction, the federal courts would not enforce the agreement either. Therefore, one of the main purposes of the FAA was to ensure that when parties were from different states, and had different rules about the enforceability of arbitration agreements, these agreements would be enforced in federal court.

Cohen and Bernheimer, however, wanted state, federal and international enforcement of arbitration agreements, so they developed a grand three-step plan. The first step was for Congress to pass a law providing that federal courts could enforce arbitration agreements in interstate and foreign commerce and in admiralty. The second was for the Commissioners on Uniform State Laws to put forth a Uniform Arbitration Act that could be adopted in all states so that arbitration agreements would be enforceable in all state courts. Finally, the third step was for the U.S. to enter into an arbitration treaty with foreign countries to enforce international arbitration agreements and awards.⁴

Cohen and Bernheimer were both strong believers in the efficacy of arbitration. They noted that business people needed solutions that were faster and cheaper than litigation could provide.

² *Id.* (Damages were theoretically available for breach, but not pursued because too difficult to establish.). See also, *McNeil*, *supra* note 1, at 28, 34-37.

³ See *MacNeil*, *supra* note 1, at 20.

⁴ *Arbitration of Interstate Commercial Disputes: Hearing of S. 1005 and H.R. 646 Before the J. Comm. of Subcomms. on the Judiciary, 68th Cong. 16 (1924)* [hereinafter *Joint Hearings*] (statement of Julius Cohen).

Their proposal to Congress was limited – it was for a statute that would apply only to procedure in the federal courts and would not affect state law. Cohen emphasized in Joint Hearings before Congress that because the statute was procedural, it could not infringe upon the prerogatives of the states.⁵

Supporters of the Act made clear in Congressional Hearings the limited nature of the Act. It would not apply to workers, almost all of whom were considered at that time **not** to be in interstate commerce, and it would **not** apply in merchant-to-consumer transactions, only in merchant-to-merchant transactions. Concern was expressed by senators about whether the statute could be applied to adhesion contracts. When Senator Walsh of Montana asked if the legislation would apply to contracts that were not truly voluntary, he was assured by the supporters that the Act would only apply to “a contract between merchants one with another, buying and selling goods.”⁶ Representative Graham noted in the 1924 House floor debate that the bill “provides for one thing...to give an opportunity to enforce...an agreement to arbitrate when *voluntarily* placed in the document by the parties to it.”⁷

The FAA was passed without a single negative vote.⁸ Cohen immediately began to educate the legal community about the

⁵ *Id.* at 39.

⁶ *Id.* at 10. *Prima Paint Corp. v. Flood & Conklin Mfg.*, 388 U.S. 395, 413 (1967) ([The Supreme Court] noted that “[on] several occasions [Members of Congress] expressed opposition to a law which would enforce even a valid arbitration provision contained in a contract between parties of unequal bargaining power . . . Senator Walsh cited insurance, employment, construction, and shipping contracts as routinely containing arbitration clauses and being offered on a take-it-or-leave-it basis to captive customers or employees. He noted that such contracts ‘are really not voluntarily (sic) things at all’ because ‘there is nothing for the man to do except to sign it; and then he surrenders his right to have his case tried by the court * * *.’”) He was emphatically assured by the supporters of the bill that it was not their intention to cover such cases. *Citations omitted.*

⁷ 65 CONG. REC. 1931 (1924) (*emphasis added*).

⁸ Statement of Julius Henry Cohen, *Joint Hearings*, *supra* note 4, at 13 (“Mr. Chairman, the question was asked: Who opposes this bill? There is no open opposition anywhere.”). There had been earlier opposition by seamen and railroad employees, who feared the FAA would apply to them because they actually worked in interstate and foreign commerce. At the time, most workers were considered not to work in interstate commerce and therefore would not be covered. The opposition of seamen and railroad employees had been diffused, however,

value and scope of the Act. He explained in an article in the Virginia Law Review that the new statute was “simply a new procedural remedy, particularly adapted to the settlement of commercial disputes.”⁹ Moreover, he emphasized the voluntary nature of the Act’s application, and that arbitration was intended for merchant disputes, not for more complex points of law involving constitutional or statutory issues.¹⁰ Rather, the proper use of arbitration was to resolve heavily fact-based disputes between merchants, “where all meet upon a common ground.”¹¹

So how did the interpretation of the statute change from being a procedural remedy only applicable in federal court in merchant-to-merchant disputes, to a substantive statute that could pre-empt state law and be imposed involuntarily on consumers and employees?

This different and expanded scope of the FAA took place mainly in the 1980’s, after the FAA had been considered for over 50 years to be a procedural statute that did not apply to states. In the decade of the 80’s, the Supreme Court began to interpret the law independently from its text and its legislative history. It declared that that the FAA was a substantive statute, and that not only did it apply to the states, but also it pre-empted state law.¹²

when a provision was added in Section 1 of the Act excluding them from coverage. (“...[N]othing contained herein shall apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce.”) See Proceedings of the Forty-Fifth Annual Convention of the American Federation of Labor 52 (1925), cited in *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001), where the Federation explained to its members that it had withdrawn its opposition to the FAA because an amendment had been made that excluded workers. In 1925, immediately after the bill’s passage, the ABA Committee on Commerce, Trade, and Commercial Law noted in an article published in the ABA Journal, “not a single dissenting vote was registered in either House or Senate.” *The United States Arbitration Law and Its Application*, 11 A.B.A. J. 153 (1925) [hereinafter ABA, *United States Arbitration Law*].

⁹ Julius Henry Cohen & Kenneth Dayton, *The New Federal Arbitration Law*, 12 VA. L. REV. 265, 279 (1926).

¹⁰ *Id.* at 281.

¹¹ *Id.*

¹² See generally *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), *Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983), and *Southland Corp. v. Keating*, 465 U.S. 1 (1984). In a subsequent pre-emption case, *Perry v. Thomas*, 482 U.S. 483 (1987), Justice Stevens commented

This new interpretation did not derive from the text of the Act, or from its legislative history. One of the reasons we know that Congress intended the statute to be only procedural, and not substantive (in addition to all of the statements at the Congressional Hearings declaring that it was only a procedural statute) is that Congress did not provide in the statute for any subject matter jurisdiction. The FAA is the only federal statute that is supposedly substantive, where a party cannot get into federal court under the statute itself without some other basis of federal jurisdiction. There is no federal question jurisdiction under the FAA. That is clear from section 4 of the FAA.¹³ The majority in the case of *Southland v. Keating*, which had found that the FAA applied to states and pre-empted state law, was forced to acknowledge this point, and conceded that the FAA “does not create any independent federal-question jurisdiction...”¹⁴

So the lack of federal question jurisdiction underlines the fact that Congress intended the statute to be procedural, and that it was not a statute that provided any substantive rights. In addition, all of the references to courts in the text of the FAA are to federal courts. There is not a single reference to state courts.¹⁵ The absence of any reference to state courts in the text of the statute is telling, and shows that the Supreme Court, in revising the interpretation of the FAA to find it applicable in state courts, not only ignored the legislative history of the Act, but also ignored its text.

Although the Supreme Court's first clear holding that the FAA applied to states and pre-empted state law came in the 80's in *Southland v. Keating*,¹⁶ it came about after a series of decisions

in dissent: “It is only in the last few years that the Court has effectively rewritten the statute to give it a pre-emptive scope that Congress certainly did not intend.” 482 U.S. at 493.

¹³ 9 U.S.C. § 4 provides: A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement.

¹⁴ 465 U.S. at 15, n.9.

¹⁵ See, e.g., 9 U.S.C. §§ 3-4, 7, 9-11 (1947).

¹⁶ 465 U.S. 1 (1984).

that had complicated the general understanding of the interrelation of federal and state law.¹⁷ First, in 1938, the Supreme Court in *Erie v. Tompkins*¹⁸ overruled *Swift v. Tyson*,¹⁹ an 1842 case that had permitted a federal court for nearly a century to decide cases without considering the common law of the state in which it was sitting. *Erie* required federal courts in diversity cases to apply state substantive law.²⁰ Then, in 1945, *Guaranty Trust Co. v. New York* reinterpreted *Erie* to determine that rather than using labels like “procedural” and “substantive” to decide what law should apply, the federal court must apply state law if it was outcome determinative.²¹ The potential impact of this decision on arbitration began to be apparent in the 1956 case of *Bernhardt v. Polygraphic Co. of America*.²² In that case, the Court concluded in *dicta* that a federal rule permitting arbitration would conflict with a state rule permitting revocation of an arbitration agreement, which would mean the state rule should apply.²³ Justice Frankfurter, in concurring, opined that because differences in arbitration and litigation affected the outcome of a case, the FAA was not applicable in diversity cases.²⁴ Although the position in *Bernhardt* was only *dicta*, a decision to that effect would eviscerate the FAA because a principal purpose of the FAA was to permit federal court enforcement when parties were from two different states, one of which did not enforce arbitration agreements.

The issue of whether the FAA would apply in a diversity case arose squarely in *Prima Paint Corp v. Flood & Conklin*.²⁵ In that case, the Supreme Court had to decide what law – the FAA or

¹⁷ See Margaret L. Moses, *Statutory Misconstruction: How the Supreme Court Created a Federal Arbitration Law Never Enacted by Congress*, 34 FLA. ST. U. L. REV. 99, 114-22 (2006) (discussing more in depth the impact of *Erie*, *Guaranty Trust* and progeny.).

¹⁸ 304 U.S. 64, 78 (1938).

¹⁹ 41 U.S. 1, 12 (1842).

²⁰ 304 U.S. at 78.

²¹ 326 U.S. 99, 109 (1945).

²² 350 U.S. 198 (1956).

²³ *Id.* at 202-03.

²⁴ *Id.* at 208 (Frankfurter, J., concurring).

²⁵ 388 U.S. 395 (1967).

New York state law – would govern whether the court or the arbitrator had the competence to decide a question of fraud in the inducement of the contract.²⁶ New York state law gave this power to the court, and the FAA gave it to the arbitrator.²⁷ To avoid an outcome determinative solution that would make New York law applicable, the Court declared that the question to be decided was “not whether Congress may fashion federal substantive rules to govern questions arising in simple diversity cases. . . [but] whether Congress may prescribe how federal courts are to conduct themselves.”²⁸ This suggests that the Court continued to view the application of the FAA as fundamentally procedural. Nonetheless, the Court ultimately held that Federal law could apply in a diversity case because “it is clear beyond dispute that the federal arbitration statute is based upon and confined to the incontestable federal foundations of ‘control over interstate commerce and over admiralty.’”²⁹

This was wholly inconsistent with legislative history. The two main prongs on which the FAA was based were first, that the FAA related solely to procedure of the Federal courts, and second, that Congress’ power to adopt the statute “rests upon the constitutional provision by which congress is authorized to establish and control inferior Federal courts.”³⁰ By holding that interstate commerce and admiralty were the exclusive bases for the statute, the

²⁶ *Id.* at 396-97.

²⁷ *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402 (2d Cir. 1959). (This was the holding in the Second Circuit).

²⁸ 388 U.S. at 405.

²⁹ 388 U.S. at 405 (*citing* H.R.Rep.No.96, 68th Cong., 1st Sess., 1 (1924); S.Rep.No.536, 68th Cong., 1st Sess., 3 (1924)).

³⁰ Joint Hearings, *supra* note 4, at 39. In his dissent to *Prima Paint*, 388 U.S. at 418-19, Justice Black set out fundamental legislative history that the majority ignored: “...[I]t is clear that Congress in passing the Act relied primarily on its power to create general federal rules to govern federal courts. Over and over again the drafters of the Act assured Congress: ‘The statute establishes a procedure in the Federal courts. It rests upon the constitutional provision by which Congress is authorized to establish and control inferior Federal courts. So far as congressional acts relate to the procedure in the Federal courts, they are clearly within the congressional power.’ And again: ‘The primary purpose of the statute is to make enforceable in the Federal courts such agreements for arbitration, and for this purpose Congress rests solely upon its power to prescribe the jurisdiction

Court made possible the major rewriting of the statute in future decisions.

In addition to disregarding text and legislative history, the Court also did not make any attempt to limit the effect of its decision.³¹ It could have made clear, for example, as Justice Black noted in his dissent, that Congress never intended the FAA, or the body of federal substantive law created by federal judges under the Act, to be applied by state courts.³² It also could have cabined its decision by explaining the predominantly procedural nature of the FAA, an understanding suggested by its statement that the question it was deciding was “whether Congress may prescribe how federal courts are to conduct themselves.”³³ Instead, it proclaimed such a broad basis for the statute that it essentially opened the floodgates for courts in subsequent decisions to completely re-create the FAA.

Two of the cases in the 80’s that pushed the expansion of the reach and impact of the FAA beyond any conception of the

and duties of the Federal courts.’ One cannot read the legislative history without concluding that this power, and not Congress’ power to legislate in the area of commerce, was the ‘principal basis’ of the Act. Also opposed to the view that Congress intended to create substantive law to govern commerce and maritime transactions are the frequent statements in the legislative history that the Act was not intended to be ‘the source of substantive law.’ As Congressman Graham explained the Act to the House: ‘It does not involve any new principle of law except to provide a simple method in order to give enforcement. It creates no new legislation, grants no new rights, except a remedy to enforce an agreement in commercial contracts and in admiralty contracts.’ (Black, J., dissenting). *Citations omitted*.

³¹ Justice O’Connor noted in her dissent in *Southland*, 465 U.S. at 24, that the *Prima Paint* decision “carefully avoided any explicit endorsement of the view that the Arbitration Act embodied substantive policies that were to be applied to all contracts within its scope, whether sued on in state or federal courts.” *Citations omitted*.

³² *Prima Paint*, 388 U.S. at 424 (Black, J., dissenting) (“The Court here does not hold today . . . that the body of federal substantive law created by federal judges under the Arbitration Act is required to be applied by state courts. A holding to that effect—which the Court seems to leave up in the air— would flout the intention of the framers of the Act.”

³³ 388 U.S. at 405.

drafters or the 1925 Congress were *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*³⁴ and *Southland Corp. v. Keating*.³⁵ In *Moses H. Cone*, the Supreme Court announced for the first time the purported existence of a federal policy favoring arbitration that was not based on anything that had been said or done by Congress or by the drafters of the Act. Without citing any authority, the Court simply announced that there was a strong federal policy favoring arbitration, and that “any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration.”³⁶ It then repeatedly used this policy in subsequent years to justify many of its decisions.

The declaration of a strong federal policy is surprising because the 1925 Congress never discussed or indicated in any way that arbitration should be a favored method of dispute resolution. Rather, the Supreme Court itself created this policy, with no source to support it. Congress had simply adopted a procedural statute that would provide for enforcement of arbitration agreements that had previously been unenforceable.³⁷

In *Moses H. Cone*, the Court also stated in *dicta*, again

³⁴ 460 U.S. 1 (1983).

³⁵ 465 U.S. 1 (1984).

³⁶ 460 U.S. 1 (1983).

³⁷ Although a policy to favor commercial arbitration has no basis in any workings of Congress, it may be that the Court was indiscriminately imposing a standard from the labor arbitration context. Indeed, the Court in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985), cited not only *Moses H. Cone* for the proposition that “any doubts...should be resolved in favor of arbitration” but also *United Steelworkers v. Warrior and Gulf Navigation Co.*, 363 U.S. 574 (1960), a labor arbitration case, perhaps in order to compensate for the lack of authority for the statement in *Moses H. Cone*. However, the policy of favoring arbitration in the labor context grew out of a national policy favoring collective bargaining agreements, and is justified by a national policy of preventing strikes and worker violence, to preserve labor peace, and to promote industrial stabilization. None of these policy reasons applies in the context of commercial arbitration. See David S. Schwartz, *Correcting Federalism Mistakes in Statutory Interpretation: The Supreme Court and the Federal Arbitration Act*, 67 LAW & CONTEMP. PROBS. 5, 43-44 (2004) (“[T]he analogy between federal labor policy and the FAA is faulty. Arbitration pursuant to collective bargaining agreements is a part of a substantive national labor policy. It is a quid pro quo for a union’s giving up the right to strike, [and] promotes industrial stabilization and industrial peace nationwide.”).

without citing any authority, that the FAA created a body of substantive law and that it applied in both state and federal court.³⁸ The next year, in *Southland*, counsel for the appellees, based on this *dicta*, assumed that the FAA applied to the states and conceded the point in its brief. Thus, the Court in *Southland* had little difficulty holding that “the substantive law the Act created was applicable in state and federal courts”³⁹ and finding that the FAA preempted California Franchise Investment Law, which did not allow arbitration.

Although the issue had not been fully briefed when the Supreme Court decided it, nonetheless, the Court refused to reconsider its holding in subsequent decisions, despite urging to do so by at least twenty attorneys general.⁴⁰ Even though the Court had held in other cases that only a clear statement of congressional intent can provide a basis for federal law to displace state law,⁴¹ in *Southland*, the Court could point to no such clear statement, because in the FAA there is in fact no reference whatsoever to the application of the FAA to states, and substantial indication that the statute was only a procedural remedy to be applied in federal courts.⁴² As Justice O’Connor noted in her dissent in *Southland*, the text and structure of the FAA clearly indicated that it does not apply to proceedings in state court.⁴³

The Supreme Court’s willingness to find that the FAA applied in state courts and pre-empted state law had an immediate

³⁸ 460 U.S. 1 at 24.

³⁹ 465 U.S. 1 at 12.

⁴⁰ Brief for Attorney of Alabama et al. as Amici Curiae Supporting Respondents at 7, *Allied Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995) (“*Southland*’s extension of the FAA to state courts was rendered without briefing based on an imprudent concession by a private litigant, is demonstrably incorrect, and is in tension with important principle of judicial restraint and federalism...”; Brief for State of California et al. as Amici Curiae Supporting Respondent at 4, *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001) (“[A]n interpretation of the FAA to apply to contracts of employment will seriously impair the States’ ability to enact and enforce laws protective of employees by preempting a significant body of state law in an area traditionally within the States’ police power.”).

⁴¹ See, e.g., *Gregory v. Ashcroft*, 111 S. Ct. 2395, 2403 (1991).

⁴² See *supra* notes 4, 14-15 and accompanying text.

⁴³ *Southland*, 465 U.S. at 21-36 (O’Connor, J., dissenting).

impact on consumers and employees. State laws and rules adopted to support state policies to protect their citizens, were routinely struck down in the name of the FAA's pre-emption power. In *Perry v. Thomas*,⁴⁴ the Court struck down a section of the California Labor Code that provided that wage claims had to be brought in a judicial forum. Such a state law, according to the Court, was pre-empted by the FAA. In *Doctor's Associates Inc. v. Casarotto*,⁴⁵ the Court struck down a requirement in Montana that if a contract was subject to an arbitration clause, this information must be "typed in underlined capital letters on the first page of the contract," or the agreement was not enforceable.⁴⁶ In Montana, the legislature had recently voted to make arbitration agreements enforceable under state law. However, because this was a new law, the legislators wanted citizens to be aware of it, since an arbitration agreement was no longer revocable at will. The Montana Supreme Court had held that the statute was **not** pre-empted by the FAA because the state law's purpose was to ensure that arbitration was knowing and voluntary, and this did not undermine the purpose of the FAA.⁴⁷

The Supreme Court disagreed. In finding that the FAA pre-empted the Montana law, the Supreme Court stated that one purpose of the FAA was to place arbitration agreements "on the same footing as other contracts."⁴⁸ The equal footing policy had begun to be articulated in *Prima Paint*, where the court said that the purpose of Congress in 1925 was to make arbitration agreements **as enforceable as other contracts, but not more so**.⁴⁹ However, the Court has **not** tended to interpret arbitration clauses as **only** as enforceable as other contracts because it has created a policy of deference to arbitration.

The "equal footing" policy, as we will see, is in tension with the policy that says arbitration is to be favored, and that all doubts are to be resolved in favor of arbitration. In the Montana case, for

⁴⁴ 482 U.S. 483 (1987).

⁴⁵ 517 U.S. 681 (1996).

⁴⁶ *Id.* at 683.

⁴⁷ *See id.* at 685, *citing* *Casarotto v. Lombardi*, 886 P.2d 931, 942 (Mont. 1994).

⁴⁸ 517 U.S. at 687.

⁴⁹ *Prima Paint*, 388 U.S. at 404, n.12.

example, although the Court gave lip service to the equal footing policy, it did not support that policy when it struck down the requirement in Montana that there must be a conspicuous sentence on the front page of the contract calling attention to the arbitration clause. There are, in fact, a number of contract laws that require certain provisions of law to be conspicuous. For example, under the UCC (section 2-316(2)), a disclaimer of the implied warranty of merchantability must be conspicuous. So, if arbitration agreements were actually on an equal footing with other contracts, then making an arbitration agreement conspicuous should not offend the FAA.

However, in the Montana case, the Court gave a very broad interpretation to section 2 of the FAA, known as the “savings clause.” Section 2 provides that a written arbitration agreement “shall be valid, irrevocable and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”⁵⁰ This essentially says that an arbitration agreement cannot be revoked **except** for the same reasons that any other contract could be revoked. But the Court interpreted “any contract” to mean “all contracts” or “contracts generally,”⁵¹ leading courts to find that any kind of restriction of arbitration, unless that same restriction is found in contracts generally, or in virtually **every** contract, is pre-empted by the FAA. This has led to substantial pre-emption, virtually any time any form of restriction on arbitration appears. The Pennsylvania Supreme Court has referred to the FAA as “The Supreme Court’s pre-emption juggernaut, ...crushing everything in its path.”⁵² An arbitration agreement therefore does not at present appear to be on “the same footing” as other contracts, but rather on a much higher footing in terms of any effort to revoke it.

This, of course, gives the Supreme Court a basis for intruding on a core state law function (such as contract law) any time a provision appears to limit the enforceability of an arbitration

⁵⁰ 9 U.S.C. § 2 (1947).

⁵¹ *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 447 (2006). (The Court referred to Section 2 of the FAA as “the FAA’s substantive command that arbitration agreements be treated like **all** other contracts.”) (emphasis added).

⁵² *Taylor v. Extencicare Health Facilities, Inc.*, 147 A.3d 490, 504 (Pa. 2016).

agreement, if contracts generally are not limited in the same way. However, when it suits, the Court has ignored this rule, in favor of striking a limitation on arbitration even though the same limitation is also applied to litigated matters, as we see in a class action waiver case decided by the Court in 2011 – *AT&T Mobility LLC v. Conception*.⁵³ In this case, the Court has not only misconstrued the FAA, but also has misconstrued its own doctrines in ways that prevent consumers and small businesses from having recourse for violations of law by large companies.

Based on *Doctor's Associates*, the Court appeared to have interpreted the savings clause to mean that a restriction of arbitration would not be pre-empted by the FAA unless the restriction also applied to contracts generally. However, in *AT&T v. Conception*, the Court struck down the rule prohibiting class action waivers, even though it applied equally to both arbitrated matters and litigated matters. The rule was known as the Discover Bank rule, which had been upheld by the California Supreme Court. This was a judicially-created rule of unconscionability. It provided that waivers of class actions were unconscionable if a company had “carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money.”⁵⁴ But even though this rule applied both to waivers concerning **class litigation** as well as waivers concerning **class arbitration** – so it was a rule on equal footing with other contracts – the Supreme Court nonetheless struck it down as “interfer[ing] with fundamental attributes of arbitration and thus creat[ing] a scheme inconsistent with the FAA.”⁵⁵ Justice Scalia looked at what he considered the pros and cons of class action arbitration and concluded that class action arbitration is just bad for everybody, but particularly for companies – it is slower, more costly, requires more procedural formality, greatly increases risk to defendants, and would be a disincentive to companies to arbitrate.⁵⁶

⁵³ 563 U.S. 333 (2011).

⁵⁴ *Id.* at 340.

⁵⁵ *Id.* at 341, 352.

⁵⁶ *Id.* at 348-51. (“First, the switch from bilateral to class arbitration sacrifices the principal advantage of arbitration—its informality—and makes the process slower, more costly, and more likely to generate procedural morass than

In dissent, Justice Breyer emphasized the importance of putting arbitration on the same footing with other contracts, and stated that that is precisely what the Discover Bank rule does.⁵⁷ Because the same legal principle of unconscionability is applied to both litigation and arbitration, he concluded the Court should not be weighing the pros and cons of class arbitration. Rather, that is a decision the California legislature should make.⁵⁸ Breyer further stated that the principles of federalism should lead the court to uphold California State Law, not to strike it down.⁵⁹

Interestingly, at no point did Breyer reference the “strong federal policy favoring arbitration.” However, Justice Scalia, writing for the majority, mentioned it several times, including noting that prior cases have “repeatedly described the Act as embodying “a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary.”⁶⁰ This was, of course, a Court-invented policy, not one conceived or established by Congress.⁶¹

Not surprisingly, in the next class action waiver case, *American Express v. Italian Colors* (“*Italian Colors*”), also authored by Justice Scalia, the justice began with the statement that the FAA requires courts to “rigorously enforce arbitration agreements according to their terms.”⁶² In this case, the Court eviscerated the effective vindication rule – a rule that provides that the court should invalidate arbitration agreements on public policy grounds if the costs of arbitration were so large that they would prevent a party from pursuing a claim.⁶³ *Italian Colors* involved small businesses

final judgment...Second, class arbitration *requires* procedural formality...Third, class arbitration greatly increases risks to defendants.”).

⁵⁷ *Id.* at 362.

⁵⁸ *Id.* at 365.

⁵⁹ *Id.* at 367.

⁶⁰ *Id.* at 346.

⁶¹ See *supra* text accompanying notes 36-37.

⁶² *American Express v. Italian Colors*, 133 S. Ct. 2304, 2309 (2013).

⁶³ See *Green Tree Fin. Corp. v. Randolph*, 531 U.S. 79, 90 (2000) (Court suggested that “the existence of large arbitration costs could preclude a litigant . . . from effectively vindicating her federal statutory right in the arbitral forum,” and in that case, an arbitration agreement could be unenforceable.); *Mitsubishi Motors Corp v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637, n.19 (1985) (where the Court expressed willingness to invalidate arbitration agreements that

that wanted to challenge on anti-trust grounds American Express's use of its monopoly power to require the merchants pay fees 30% higher for credit card use than the fees of competing credit card companies.⁶⁴ American Express's mandatory arbitration clause not only prohibited class actions, but also disallowed any kind of joinder or consolidation of claims.⁶⁵ Moreover, a confidentiality provision would prevent parties from informally arranging to share information, such as an expert's report.⁶⁶

Because arbitration is supposed to be a more efficient process than litigation, upholding arbitration clauses that exclude any kind of cooperation among individual claimants appears economically irrational. Evidence showed that Italian Colors could not prevail in an individual anti-trust arbitration without an economic analysis that would cost between several hundred thousand and one million dollars.⁶⁷ Even if Italian Colors could individually afford such an analysis, it would be prohibited from sharing it with any other claimant.

In any event, Italian Colors could not pay more than \$100,000 to obtain an analysis when the maximum recovery that it could hope for would be around \$12,850, or \$38,549, if it was awarded treble damages under the anti-trust laws.⁶⁸ Thus, when the Court decided that the arbitration clause should be upheld, despite the fact that it prevented recourse under the anti-trust law for the claimants, who could not afford to pursue the case individually, it struck another blow to small businesses and consumers, undercutting their ability to enforce statutory rights.⁶⁹ According to the

operated "as a prospective waiver of a party's right to pursue statutory remedies."). Cf. *Italian Colors*, 133 S. Ct. at 2311, (in which Justice Scalia acknowledged the rule but asserted that just because a right is not worth the expense involved in proving it does not eliminate the right to pursue it. The Court thus held class action waivers enforceable even though they rendered it functionally impossible for plaintiffs to vindicate their rights.).

⁶⁴ *Italian Colors*, 133 S. Ct. at 2308.

⁶⁵ See *id.* at 2316 (Kagan, J., dissenting).

⁶⁶ See *id.*

⁶⁷ See *id.* at 2316 (Kagan, J., dissenting).

⁶⁸ See *id.* at 2308.

⁶⁹ See *Carnegie v. Household Int'l, Inc.*, 376 F.3d 656, 661 (7th Cir. 2004). ("The realistic alternative to a class action is not 17 million individual suits, but

Court in these two cases, the FAA can pre-empt state law attempts to ban unconscionable provisions in arbitration clauses, and can foreclose meritorious statutory claims by creating safe harbors for companies who violate Congressionally-created rights.

So, what is the impact on consumers of this Court-created edifice of the FAA? One effect is that companies have begun to load their arbitration clauses with unconscionable contract terms. A recent article in the *Texas Law Review* by Professor Christopher Leslie, refers to this process as “arbitration bootstrapping.”⁷⁰ Firms embed provisions in their arbitration clause that will shorten statutes of limitations, reduce damages, prohibit coordination among claimants (non-coordination clauses) and preclude injunctive relief. Such provisions could be struck down as unconscionable in a number of states if they were not contained in the arbitration clause. However, because the Supreme Court has interpreted the FAA to require deference to arbitration clauses, many courts have refused to strike such provisions. Professor Leslie states with respect to the two cases discussed above – *AT&T v. Concepcion* and *American Express v. Italian Colors* – that although they involved class action waivers, in fact, they operate to dismantle entire fields of law, including laws against fraud, deception, predatory conduct, antitrust violations and employment discrimination.⁷¹ His article focuses on how the so-called federal policy favoring arbitration has caused many courts to feel compelled to enforce terms in the arbitration clause that would be unenforceable if not embedded there

There are a number of good studies, books, and articles about the adverse impact of forced arbitration on consumers.⁷²

zero individual suits, as only a lunatic or a fanatic sues for \$30.”), *cert. denied*, *H & R Block, Inc. v. Carnegie*, 543 U.S. 1051 (2005).

⁷⁰ Christopher R. Leslie, *The Arbitration Bootstrap*, 94 *TEX. L. REV.* 265 (2015).

⁷¹ *See id.* at 267.

⁷² *See, e.g.*, Lauren Guth Barnes, *How Mandatory Arbitration Agreements and Class Action Waivers Undermine Consumer Rights and Why We Need Congress to Act*, 9 *HARV. L. & POL’Y REV.* 329 (2015); Theodore Eisenberg, Geoffrey Miller, Emily Sherwin, *Arbitration’s Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 *U. MICH. J.L. REFORM* 871, 883-85 (2008); David Horton & Andrea Cann Chandrasekher, *After the Revolution: An Empirical Study of Consumer Arbitration*,

They point out that mandatory arbitration leads to fewer claims brought by consumers, as well as lower recoveries and less deterrence of corporate wrongdoing.⁷³ The most recent report by the Consumer Financial Protection Bureau (“CFPB”) found that very few arbitrations are brought in the financial services industry.⁷⁴ Having concluded that class action waivers were harmful to consumers, the CFPB requested comments on a proposed rule banning such waivers in the financial service industry, and after receiving over 110,000 comments, issued a rule in July 2017, that barred class action waivers in arbitration claims against financial companies.⁷⁵ However, both the House and the Senate have voted to block the rule.⁷⁶

Other empirical studies have also found that the banning of consumer class actions in arbitration has not caused consumers to

104 GEO. L.J. 57 (2015); Margaret Radin, *BOILERPLATE: THE FINE PRINT, VANISHING RIGHT AND THE RULE OF LAW* (2013); Jean R. Sternlight, *Mandatory Binding Arbitration Clauses Prevent Consumers from Presenting Procedurally Difficult Claims*, 42 Sw. L. Rev., 87 (2012); David S. Schwartz, *Claim-Suppressing Arbitration: The New Rules*, 87 IND. L.J. 239 (2012); David S. Schwartz, *Correcting Federalism Mistakes in Statutory Interpretation: The Supreme Court and the Federal Arbitration Act*, 67 LAW & CONTEMP. PROBS. 5, 17 (2004).

⁷³ See *id.*

⁷⁴ *Arbitration Study: Report to Congress, Pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a)*, CONSUMER FINANCIAL PROTECTION BUREAU, (Mar. 2015), http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf.

⁷⁵ See Press Release, *CFPB Issues Rule to Ban Companies from Using Arbitration Clauses to Deny Groups of People Their Day in Court*, CONSUMER FINANCIAL PROTECTION BUREAU, (Jul. 2017), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-issues-rule-ban-companies-using-arbitration-clauses-deny-groups-people-their-day-court/>.

⁷⁶ See Donna Borak and Ted Barrett, CNN, *Senate kills rule that made it easier to sue banks* (Oct. 2017). Available at www.cnn.com/2017/10/24/politics/senate-cfpb-arbitration-repeal/index.html, Richard Cordray, head of the CFPB, stated that the Senate vote was “a major setback for every consumer in the country. Wall Street won and ordinary consumers lost.” See *id.* See also, David Cherfinski, *House Votes to Undo Federal Consumer Bureau's Arbitration Rule*, WASH. POST, (Jul. 2017), <http://www.washington-times.com/news/2017/jul/25/house-votes-to-undo-consumer-financial-protection-/>.

engage in a flood of low value claims.⁷⁷ Instead, they simply do not pursue their claims.⁷⁸ This is not surprising, given that the purpose of class actions is to permit low value claims to be joined to make litigation of such claims worthwhile in order to hold corporate entities accountable for small harms that can collectively provide large corporate profits.⁷⁹ In addition, another result of the banning of class actions is that where companies have had to defend against a number of claims, they develop expertise as repeat players, and they are very successful in bilateral arbitrations against consumers.⁸⁰

Another empirical study found that firms that impose arbitration on their customers and employees tend **not** to put arbitration contracts in their negotiated contracts.⁸¹ In this study, less than 10% of the companies' negotiated, non-consumer, non-employment contracts included arbitration clauses.⁸² This suggests that companies prefer litigation when dealing with peers, and do not believe that arbitration provides superior fairness or efficiency to the parties.⁸³

Moreover, the U.S. system of imposing mandatory arbitration on consumers is in sharp contrast with how other countries

⁷⁷ See David Horton & Andrea Cann Chandrasekher, *After the Revolution: An Empirical Study of Consumer Arbitration*, 104 GEO. L.J. 57, 124 (2015). (Concluding based on four and a half years of empirical data that "few plaintiffs pursue low-value claims, and that high level...repeat-playing companies perform particularly well.")

⁷⁸ See *id.*

⁷⁹ Barry Sullivan and Amy Kobelski Trueblood, *Rule 23(f): A Note on Law and Discretion in the Courts of Appeals*, 246 F.R.D. 277 (2008). ("[The class action has] potential to compensate many victims who individually suffer harm on a relatively small scale at the hands of one defendant who would not otherwise be held to account for that multitude of small harms which may, because of their number, translate into large profits.") *Citations omitted.*

⁸⁰ See *id.*

⁸¹ Theodore Eisenberg, Geoffrey Miller, Emily Sherwin, *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Non-consumer Contracts*, 41 U. MICH. J. L. REFORM 871, 883-85 (2008).

⁸² See *id.*

⁸³ See *supra* text accompanying notes 4, 5, 10 and 11. (This is a rather ironic outcome, given the original belief of Messrs. Cohen and Bernheimer that arbitration would significantly benefit companies of more or less equal economic strength.)

treat their consumers. In Europe, a Directive prohibits arbitration with consumers unless the consumers **agree** to arbitrate **after** the dispute has arisen.⁸⁴ The Europeans believe that binding consumers to non-negotiated terms “causes a significant imbalance in the parties’ rights and obligations . . . to the detriment of the consumer.”⁸⁵

In contrast, the U.S. system of imposing arbitration on consumers without their full understanding or consent has reduced their access to court systems, which means no right to a jury trial, no right to a class action (even if a class action is the only effective means of recourse), and, because an arbitrator’s decision is not reviewable on the merits, no supervision by the courts as to whether arbitration is properly protecting consumer rights. Moreover, the Supreme Court has run roughshod over principles of federalism by interpreting the FAA as pre-empting state laws intended to protect consumers and employees.⁸⁶ As Justice Scalia noted about *Southland*, the first case holding that the FAA applied in state courts and preempted state law, “*Southland* clearly misconstrued the Federal Arbitration Act” and “entails a permanent, unauthorized eviction of state-court power to adjudicate a potentially large class of disputes.”⁸⁷

Despite views expressed by the 1925 Congress that the FAA was a purely procedural statute not applicable in state courts, and that the FAA should not be imposed in a take-it-or-leave-it context, that is, without the actual, meaningful consent of the economically weaker party, and despite assurances by the drafters that this could not happen, the Supreme Court has turned the FAA into exactly the opposite of what Congress intended. It is, at present, a statute which intrudes on state police powers, pre-empts state law

⁸⁴ Council Directive 93/13/EEC, 1993 O.J. (L 095).

⁸⁵ *Id.* at art. 3(1). See also, Jean R. Sternlight, *Is the U.S. Out on a Limb? Comparing the U.S. Approach to Mandatory Consumer and Employment Arbitration to That of the Rest of the World*, 56 U. MIAMI L. REV. 831, 839 (2002).

⁸⁶ See generally David S. Schwartz, *Correcting Federalism Mistakes in Statutory Interpretation: The Supreme Court and the Federal Arbitration Act*, 67-SPG LAW & CONTEMP. PROBS. 5 (2004).

⁸⁷ *Allied Bruce Terminex Cos. v. Dobson*, 513 U.S. 265, 284-85 (1995) (Scalia, J., dissenting).

protection of consumers, and is enforceable despite a lack of meaningful consumer consent.

In a thoughtful article analyzing the theoretical underpinnings of a statute that was not intended to intrude on state police powers or pre-empt state laws, Professor Luke Norris has shown that Congress excluded workers in section 1 of the FAA⁸⁸ in order to prohibit arbitration in instances where there were broad power disparities between parties, as between businesses and consumers, or employers and workers.⁸⁹ The concern about take-it-or-leave-it contracts expressed by legislators in hearings on the FAA reflected a progressive theory of political economy, which the author explains as focusing on “how in light of the development of economic power relationships, the state had affirmative obligations to use public process to protect less advantaged parties.”⁹⁰ Firms privileged by our legal system, should not, according to the FAA drafters, be able to force weaker parties out of the public process of adjudication and prevent the state from any ability to ensure enforcement of protections adopted to benefit those weaker parties.⁹¹ However, the Supreme Court has instead viewed the FAA as requiring enforcement of all contracts requiring arbitration, even adhesion contracts, and has ignored the drafters’ concerns about inequality of bargaining power. The resulting impact on employers and consumers has been devastating.

The following perspective of a District Court judge in Massachusetts sums up the impact of forced arbitration on consumers and workers:

Today, forced arbitration bestrides the legal landscape like

⁸⁸ Section 1 of the FAA states that the Act shall not apply “to contracts of employment of seamen, railroad employees or any other class of workers engaged in foreign or interstate commerce.” 9 U.S.C. § 1. However, the Supreme Court, in *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001), construed this language, against all legislative and textual evidence, as excluding only seamen, railroad workers and transportation workers, and therefore applying to workers generally.

⁸⁹ See generally Luke Norris, *The Parity Principle*, 93 N.Y.U. L. REV. (forthcoming 2018).

⁹⁰ See *id.* at ____.

⁹¹ See *id.* at ____.

a colossus, effectively stamping out the individual's statutory rights wherever inconvenient to the businesses which impose them. What is striking is that, other than the majority of the Supreme Court, whose questionable jurisprudence erected this legal monolith, no one thinks they got it right – no one, not the inferior federal courts, not the state courts, not the Equal Employment Opportunity Commission, and...not the academic community... . Although hundreds of millions of consumers and employees are obliged to use arbitration as their remedy, almost none do so – rendering arbitration not a vindication but an unconstitutional evisceration of statutory and common law rights... . The cumulative effect of the Supreme Court's jurisprudence on arbitration has been to produce an unconstitutional system that undermines both the legitimacy of arbitration and the functions of courts.⁹²

This is a very dire assessment of the current situation. Moreover, in the current political climate, the possibility of changes to the current interpretation of the law seems quite limited. However, it is somewhat reassuring that there is increasing public awareness of the adverse impact of arbitration on consumers and employees. For example, in 2015, there were several front-page articles in the *New York Times* informing the public of the harms of forced arbitration.⁹³ The Times noted that “millions of Americans have lost a fundamental right: their day in court.”⁹⁴ It is also encouraging that some Federal agencies have taken steps to regulate the use of arbitration,⁹⁵ but these efforts tend to be piece-

⁹² *In re Nexium*, 309 F.R.D. 107, 146-48 (D. Mass 2015).

⁹³ Jessica Silver-Greenberg & Michael Corkery, *A Privatization of the Justice System*, N.Y. TIMES, Nov. 2, 2015, at A1; Jessica Silver-Greenberg & Robert Gebeloff, *Arbitration Everywhere, Stacking Deck of Justice*, N. Y. TIMES, Nov. 1, 2015, at A1; Michael Corkery & Jessica Silver-Greenberg, *When Scripture is the Rule of Law*, N.Y. TIMES, Nov. 3, 2015, at A1.

⁹⁴ Silver-Greenberg & Corkery, *Privatization*, *supra* note 93.

⁹⁵ David Noll, *Regulating Arbitration*, 105 CAL. L. REV. 985 (2017), notes 4-10, discussing regulation of arbitration by agencies such as the National Labor Relations Board, the Securities and Exchange Commission, and Centers for

meal.

A possible pathway to change – one that has not worked so far, however – is a challenge to forced arbitration as a violation of a party's right to go to court. Article III of the Constitution is considered to grant parties a personal right to an impartial and independent federal adjudication before an Article III court.⁹⁶ The right can be waived, but the Supreme Court has held that the waiver must be knowing and voluntary.⁹⁷ In *Wellness Int'l v. Sharif*,⁹⁸ the Supreme Court held that if litigants knowingly and voluntarily consented, a bankruptcy judge could hear the claims, but that absent such consent, the bankruptcy court, which is not an Article III court, could not hear them.⁹⁹ Another very important consideration was that the bankruptcy judges were “subject to control by Article III courts.”¹⁰⁰

The relevance of *Wellness* for arbitration came in focus during oral argument, with several justices questioning whether there was a difference between the arbitrator and the bankruptcy judge in terms of Article III waivers.¹⁰¹ Although consent among parties to bankruptcy may be readily found, it is difficult to find any knowing and voluntary waivers of the right to public adjudication by consumers in forced arbitrations when studies such as that of the CFPB show that consumers frequently have no idea

Medicare & Medicaid Services. However, a rule adopted by the Consumer Financial Protection Bureau in July 2017, which would prohibit banks and credit card companies from banning consumer class actions has been disapproved by the House and the Senate. *See supra* note 76.

⁹⁶ *See Wellness Int'l Network, LTD v. Richard Sharif*, 135 S. Ct. 1932 (2015). (Article III of the Constitution provides that “[t]he judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish.”). U.S. CONST. art. III, § I.

⁹⁷ *See Wellness Int'l Network, LTD*, 135 S. Ct. at 1948. *See also* *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 848-49 (1986).

⁹⁸ *See Wellness Int'l Network, LTD*, 135 S. Ct. at 1948.

⁹⁹ *See id.* at 1949.

¹⁰⁰ *See id.* at 1944-46. (Bankruptcy judges are appointed by court of appeals judges, they receive cases on referral from district courts, they are subject to removal by Article III judges, and their decisions are subject to court review.).

¹⁰¹ Oral Argument, *Wellness Int'l, Network, Ltd., et al., Petitioners, v. Richard Sharif*, 2015 WL 2399401 (2015).

that they have been subjected to arbitration.¹⁰² According to the Court in *Wellness*, although the entitlement to an Article III adjudicator is a personal right ordinarily subject to waiver,¹⁰³ the key inquiry as to whether a party properly consented to waive the right is “whether the litigant or counsel was made aware of the need for consent and the right to refuse it, and still voluntarily appeared to try the case before the non-Article III adjudicator.”¹⁰⁴

If this specific *Wellness* standard of knowing and voluntary consent were applied to consumer forced arbitration disputes, it could not be met. Consumers who are parties to adhesion contracts are not made aware of either the need for consent or the right to refuse it. Moreover, unlike a decision in bankruptcy, court review of an arbitral award is extremely limited, since awards cannot be vacated for mistakes of fact or law.¹⁰⁵ Therefore, mandatory arbitration has many fewer safeguards than bankruptcy. Because it involves no meaningful consent and no meaningful court review, mandatory arbitration is far more likely than bankruptcy decisions to violate an individual's personal right to have a dispute determined by an Article III judge in a public adjudication. At the very least, *Wellness* indicates increased attention to this question by the Supreme Court. However, given the current composition of the Supreme Court, and the current composition of Congress, one cannot be sanguine that even this path can lead to relief for the colossus of forced arbitration.

¹⁰² See *supra* note 74.

¹⁰³ See *Wellness*, 135 S. Ct. at 1943.

¹⁰⁴ *Id.* at 1948. (The right to refuse should mean the right to litigate disputes in the contract instead of arbitrating them, not merely the right to go initially to a different company, which would most likely offer the same take-it-or-leave-it arbitration clause.).

¹⁰⁵ See 9 U.S.C. § 10 (1947).