
**Statement Regarding the Arbitration Fairness Act of 2009, H.R. 1020, S. 931.**

October, 2009

The International Commercial Disputes Committee, Arbitration Committee, Federal Courts Committee and International Law Committee of the New York City Bar Association write to express our concerns regarding the Arbitration Fairness Act of 2009, H.R. 1020, introduced in the 111th Congress (the "House Bill"). We also raise certain concerns with respect to the Senate version of the Arbitration Fairness Act of 2009, S. 931 (the "Senate Bill"). As our Committee names denote, the committees together focus on the resolution of international and domestic commercial disputes in the courts, by arbitration and through other forms of dispute resolution. These bills are therefore of central interest and importance to our Committees. Our Committees include leading members of the bar and academia, outside counsel and in-house counsel with substantial experience and expertise in international and domestic arbitration and litigation both in the United States and overseas. A list of the members of our Committees is attached hereto for your reference. We have also consulted and received the input of the Consumer Affairs and Civil Court Committees of the Bar Association.

The Association is one of the oldest and largest local bar associations in the United States, with a current membership of over 23,000 lawyers. The Association serves not only as a professional association, but also as a leader and advocate in the legal community on a local, state, national and international level. The Association pursues its advocacy through the work of 160 committees, including the committees noted above. Among other activities, the Association's committees prepare comments for legislative bodies, regulatory association and rule-making committees on pending and existing laws, regulations and rules that have broad legal, regulatory, practical or policy implications. Further information about the Association can be found at its web site, www.nycbar.org.

Arbitration is a dispute resolution process that has been used to resolve disputes for many hundreds of years. The growth of arbitration in the United States began with the passage of the Federal Arbitration Act ("FAA") in 1925. Surveys and experience have repeatedly demonstrated that arbitration is the preferred dispute resolution mechanism in many commercial transactions as it typically resolves disputes flexibly, efficiently, privately and relatively amicably with the benefit of adjudicators with specific, relevant expertise. In international transactions, arbitration has become a widely accepted dispute resolution mechanism because it also allows parties to select a neutral forum and to enforce awards across borders much more easily than court judgments.

We note the view of our colleagues on the Civil Court and Consumer Affairs Committees that arbitration may not be well suited for resolving disputes emanating from consumer financial transactions. Use of arbitration in consumer matters raises particular concerns, including the fact that if disputes are resolved in arbitration, it precludes the development of a body of precedent on which consumers can rely. Consumer financial transactions encompass not only credit cards transactions, but also door-to-door sales, debt settlement promotions, and other transactions in which consumers are commonly subject to deceptive conduct. There are also issues of procedural fairness, including repeat-player and repeat-arbitrator bias, that emerge when credit card companies or debt buyers utilize private arbitration forums in large volume.[1]

Federal legislation can be crafted to both preserve commercial arbitration and afford protections for designated classes, including consumers, employees and small franchisees. We urge that Congress take care to do so

**Specific Objections to the AFA**

1. Maintaining Chapter 1. Since its enactment in 1925, the FAA, 9 U.S.C. Ch. 1 has provided a stable and consistent legal framework for arbitration in the U.S. Chapter One has benefited from judicial construction, scholarly analysis and practical application. It sets out the United States' fundamental policy regarding arbitration. To avoid diluting this policy or creating confusion and unnecessary litigation regarding the interpretation of the FAA in the large number of cases to which it applies, protections for discrete classes should be located elsewhere in the Code Providing for protections outside of the Federal Arbitration Act has been the avenue utilized by Congress for similar legislation and allows for tailoring the legislation to address the needs of the specific class protected. *See, e.g.*, 15 U.S.C. § 1226 (motor vehicle franchises); 7 U.S.C. § 197c (poultry growers); and 10 U.S.C. §987 (credit for military personnel). Accordingly, we oppose the framing of legislation as in the House Bill to protect discrete parties as an amendment of the Federal Arbitration Act, 9 U.S.C. Ch. 1.and strongly urge Congress to locate this legislation elsewhere in the Code as is accomplished by the Senate Bill which establishes a new Chapter 4 to Title 9.

2. Overruling Settled Law Balancing Roles. The House Bill 's section 2(c) provides:

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[1] **Compare** Public Citizen, The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on Arbitration (2008), **available** at http://www.citizen.org/documents/ArbitrationDebateTrap(Final).pdf **and** Public Citizen, The Arbitration Trap: How Credit Card Companies Ensnare Consumers (2007), **available at** http://www.citizen.org/documents/ArbitrationTrap.pdf **with** Peter B. Rutledge, Arbitration -- A Good Deal for Consumers: A Response to Public Citizen (April 2008) (report prepared for and released by the U.S. Chamber Institute for Legal Reform), **available at** http://www.instituteforlegalreform.com/issues/docload.cfm?docId=1091. Most recently, the Minnesota Attorney General sued the largest arbitration provider, the National Arbitration Forum, alleging that the NAF is substantially owned and controlled by entities that also own and control large debt collection companies. The NAF, without admitting these allegations, withdrew from the field of consumer credit arbitrations in response to this litigation (Minneapolis *Star Tribune*, July 20, 2009).

> "An issue as to whether this chapter applies to an arbitration agreement shall be determined by Federal law. Except as otherwise provided in this chapter, the validity or enforceability of an agreement to arbitrate shall be determined by the court, rather than the arbitrator, irrespective of whether the party resisting arbitration challenges the arbitration agreement specifically or in conjunction with other terms of the contract containing such agreement.**"**

This legislation, applicable to all arbitration, would alter settled law that balances arbitrator and court roles. Decades of U.S. Supreme Court precedents, as well as arbitration statutes and institutional rules in use throughout the world, recognize the principles of "separability" and "competence-competence." These principles mean that while it is for a court to determine if there is a valid agreement to arbitrate, it is generally for the arbitrators to decide if a contract is otherwise valid or if a specific dispute falls within the scope of the arbitration clause. These principles, viewed as the conceptual cornerstones of arbitration, promote efficiency in the arbitration process by providing arbitrators with the first opportunity to decide jurisdictional challenges that are not based specifically on the arbitration clause itself. *See, e.g., Prima Paint v. Flood & Conklin*, 388 U.S. 395, 404 (1967), *First Options of Chicago v. Kaplan*, 514 U.S. 938 (1995), *Buckeye Check Cashing v. Cardegna*, 546 U.S. 440 (2006). Yet the House Bill would invest the courts with sole authority to determine the validity of arbitration agreements, "irrespective of whether the party resisting arbitration challenges the arbitration agreement specifically or in conjunction with other terms of the contract containing such agreement."

This would be a monumental change in arbitration law for business arbitrations. As a practical matter, it would mean that the arbitrator would have to halt the proceedings if a party merely alleged that the contract was for any reason—fraud, breach or any other of the many grounds frequently raised in a contract dispute—invalid or unenforceable, even if that party had no specific objection to the arbitration clause itself and does not dispute that there was an agreement to arbitrate. The House Bill would thus make the courts the gatekeepers of virtually all arbitrations as parties that consented to arbitrate when entering into the contract, when faced with an actual dispute, choose to delay the proceedings. The House Bill would frustrate the efficiency for which the parties contracted. What is more, it is not clear whether the House Bill is intended to apply only to contracts affecting interstate commerce, or also to intra-state contracts whose arbitrability is currently governed by state law. On its face, the House Bill's prohibition of certain types of arbitration clauses appears to be absolute, and thus to effectuate a change not only to federal law, but also to the laws of all 50 states.

Thus the House Bill as currently proposed would have unnecessary and unintended consequences for many forms of domestic and international commercial arbitration and could lead to harmful impacts on U.S. activity in international commerce.[2] It would likely cause significant delays and additional costs in international and domestic commercial disputes. There is also a significant risk that if the House Bill becomes law,

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[2] *See* Edna Sussman, *The Proposed U.S. Arbitration Fairness Act: A Threat to U.S. Business*, 18 Am. Rev. Int'l. Arb. 455 (2009); Mark Kantor, *Legislative Proposals Could Significantly Alter Arbitration in the United States*, 74 ARBITRATION 444-452 (2008).

the U.S. will no longer be viewed as a friendly forum for international arbitration, as has already been noted by prominent foreign arbitration practitioners.[3] Many parties engaged in international commerce, particularly those located in civil law countries that do not utilize extensive pretrial discovery, have traditionally relied on the enforceability of arbitration clauses when doing business with U.S. entities to avoid the risk of lengthy and invasive discovery and/or punitive damages awards, all of which are not permissible under the domestic law of the countries in which they reside. It is impossible to predict the impact on commerce if Congress creates unprecedented uncertainty as to the ability of a business to rely on domestic and international arbitration remedies. We do not believe that such a chilling effect is necessary to achieve Congressional objectives.

It does not appear that the sponsors of the House Bill intended this result. In response to these concerns, the sponsors of the parallel Senate Bill modified the legislation to call for the creation of a new Chapter 4 of Title 9 for the classes to be protected and modified the Senate bill to limit the proposed legal changes regarding competence-competence and separability to the classes identified in Chapter 4 rather than to all arbitrations.

3. Overbroad Invalidation of Arbitration Agreements. The House Bill's proposed amendment to section 2(b)(2) of the FAA would void any pre-dispute arbitration agreement if it requires arbitration of a "dispute arising under a statute intended to protect civil rights" but does not specify which statutes this language implicates. Civil rights have been said to include all rights protected by the U.S. Constitution and the right to obtain other benefits set out by law. The scope of this provision would appear to encompass multiple statutes. It arguably includes not only U.S. but also foreign statutes. The continued inclusion of "civil rights statutes," without limiting its applicability to specific statutes may enable creative litigants to assert claims in commercial disputes under a statute, domestic or foreign, argued to fall within this rubric.

The Senate Bill is a substantial improvement to the House Bill, as it provides a detailed definition of the term "civil rights disputes." This term, as defined in the bill, would only include disputes "in which at least one party alleging a violation of the Constitution of the United States, a State constitution, or a statute prohibiting discrimination is an individual." Civil rights disputes would, therefore, include only claims arising under domestic law and exclude those arising under foreign law. Furthermore, this definition limits the provision's applicability to business cases by providing that it applies only in cases in which at least one individual with a civil rights claim is a party to the dispute. However, the inclusion of all disputes arising under the Constitution of the United States or the Constitution of a State can create a basis of claims in business disputes of a wide variety of unidentified "rights" under these many Constitutions that are unrelated to the kind of discrimination claims Congress appears to be attempting to address. This issue could be addressed by limiting the application to Federal and State Constitutional claims that prohibit discrimination.

[3] *See e.g.*, Emmanuel Gaillard, *International Arbitration Law*, New York Law Journal, April 4, 2008

4. Invalidation of Franchise Arbitration Agreements. The House Bill would invalidate pre-dispute arbitration clauses in all franchise disputes. Franchises constitute a vast sector of both domestic and international businesses. Many franchising relationships are substantial in size with sophisticated parties on both sides. Arbitration can be essential to maintain the quality and integrity of the franchise brand for the benefit of both franchisor and franchisee. Congress should consider crafting language to limit the scope of this invalidation of arbitration agreements to mom-and-pop type franchisees in need of protection.

In the international arena arbitration is particularly critical to protect U.S. franchisors from being forced into unfamiliar foreign courts that may favor the local party. The narrower definition of a franchise dispute in the Senate Bill is a notable improvement as applied to international disputes as it limits applicability to franchisees "with a principal place of business in the U.S." and thus allows U.S. franchisors to pursue arbitration remedies in their relationships with franchisees located outside the U.S. However the Senate Bill still invalidates pre-dispute agreements between foreign franchisors and domestic franchisees. This could dissuade foreign franchisors from opening, expanding or continuing franchise operations in the U.S., a result which would be contrary to U.S. economic interests. Moreover, this invalidation of arbitration agreements that fall within the definition of Chapter 2 of Title 9 would likely mean a breach by the U.S. of the terms or the spirit of U.S. treaty obligations under the New York Convention as the courts apply the legislation. This gap could be easily corrected if the definition of franchise disputes were to require that both the franchisee and franchisor be located in the United States and provide that a corporation shall be deemed to be located in any State in which it has been incorporated and of the State where it has its principal place of business.

5. Invalidation of Employee Arbitration Agreements – Although we are also mindful of the desire to promulgate legislation intended to protect employees, we oppose Section 2(b)(1) because it is overbroad as currently drafted in its application to all employment agreements, an area in which arbitration has historically played a significant and socially useful role. Both the House Bill and the Senate Bill would invalidate pre-dispute arbitration provisions in all employment agreements including those between sophisticated parties with significant bargaining power who actively negotiate and freely enter into agreements containing arbitration provisions. For example, it is commonplace in mergers and acquisitions, closed family corporations, professional practices and cross border employment agreements to include a negotiated arbitration clause. Enabling these disputes to be thrown into court would not only upset the economic balance of these heavily negotiated agreements but could lead to meaningful added costs and delays for all parties.

Both the House and the Senate Bills are broadly defined to including any: "dispute between an employer and employee arising out of the relationship of employer and employee as defined in section 3 of the Fair Labor Standards Act ("FLSA") of 1938 (29 U.S.C. § 203)." Section 3 of the FLSA in turn defines the employer-employee relationship very broadly. A more narrowly and precisely drawn definition may protect employees who have no genuine bargaining power yet preserve arbitration for employees

who willingly agree to it. For example, reference can be made to Section 13 of the FLSA which distinguishes among various categories of employees, including any employee in a "bona fide executive, administrative or professional capacity." 29 U.S.C. § 213(a)(1), and regulations promulgated by the Department of Labor thereunder at 29 C.F.R. §§ 541.100-106, 541.200-204, 541.300-304, 541.600-606.

6. Overriding Chapters 2 and 3

The Senate Bill raises concerns by providing that Chapter 2 and Chapter 3 of Title 9 apply only to the extent that they are not in conflict with Chapter 4 of Title 9. This is contrary to the treatment of Chapter 1 in Chapters 2 and 3; Sections 208 and 307 of Title 9 provide that Chapter 1 applies only to the extent it is not in conflict with Chapter 2 and 3. The Senate Bill's provision would allow courts to reject the applicability of Chapter 2 and Chapter 3 solely based on the existence of a conflict with Chapter 4. This rejection could set an unfortunate precedent for the enactment of domestic laws that provide that they trump treaty obligations and damage perceptions as to the U.S.'s commitment to international obligations.

This provision in the Senate bill is not necessary to accomplish Congressional objectives with respect to consumers, employees, and civil rights claims by individuals and should be omitted. The United States entered a reservation to the New York Convention, which provides that the U.S. will only apply the Convention "to differences arising out of relationships . . . that are considered commercial under the national law." Such claims should not be viewed as commercial. If Congress wishes to assure itself of this result in international disputes as well as the domestic disputes unquestionably covered by the bill, it could specifically so state in the legislation.

We appreciate this opportunity to share our concerns regarding the AFA and similar legislation. If you or your staff have any questions or would like to meet and discuss these issues, please feel free to contact Edna Sussman at esussman@sussmanadr.com or 212-213-2173. Thank you for your consideration.