"UNFAIR" ARBITRATION CLAUSES

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The use of predispute arbitration agreements, those that require the use of arbitration to resolve future disputes, has been widely debated by both academic scholars and the courts. While federal courts generally enforce these agreements, many academics disfavor their use, especially when used in contracts between businesses and consumers, employers and employees, and franchisors and franchisees. Critics of these types of arbitration agreements label them as mandatory and unfair. In fact, some courts have begun to recognize these criticisms in a variety of decisions that refuse to enforce such arbitration agreements.

In this article, Professor Christopher Drahozal fills a void in the existing literature by utilizing empirical methods to analyze predispute arbitration agreements in consumer contracts. Through his research, Professor Drahozal finds that not only are unfair predispute arbitration agreements less prevalent than the existing literature might suggest, but that not all arbitration clauses can be labeled unfair. In addition, even unfair clauses may actually provide net benefits to the parties. The research identifies the circumstances in which courts and scholars should be wary of arbitration clauses in consumer contracts. At the same time, however, Professor Drahozal paints a more optimistic picture of this type of arbitration.

I. INTRODUCTION

The enforceability of predispute arbitration agreements—agreements that require future disputes to be resolved by arbitration—has been litigated fiercely in the courts and debated widely in academic writings.[1] In the federal courts, the decisions largely have been in favor

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1. Predispute arbitration agreements should be distinguished from postdispute arbitration agreements, or submission agreements, by which parties agree after a dispute has arisen to submit the dispute to arbitration. Unlike predispute arbitration agreements, postdispute arbitration agreements

of enforceability. The U.S. Supreme Court has found in the Federal Arbitration Act (FAA)[2] an "emphatic federal policy in favor of arbitral dispute resolution."[3] The Court repeatedly has held that federal causes of action are subject to arbitration[4] and that the FAA preempts state laws restricting arbitration.[5] Following the Supreme Court's lead, lower federal courts (and many state courts), with some notable exceptions,[6] generally enforce predispute arbitration agreements.[7]

The academic literature is much more critical of predispute arbitration agreements,[8] particularly when between businesses and consumers, employers and employees, and franchisors and franchisees.[9] For want of

are relatively uncontroversial. *E.g.*, Stephen J. Ware, *Consumer Arbitration as Exceptional Consumer Law (With a Contractualist Reply to Carrington & Haagen)*, 29 McGEORGE L. REV. 195, 198 (1998).

2. 9 U.S.C. §§ 1–307 (1994).

3. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 631 (1985).

4. *See* Green Tree Fin. Corp.–Ala. v. Randolph, 531 U.S. 79 (2000); Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer, 515 U.S. 528 (1995); Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 26–27 (1991); Rodriguez de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477, 482–85 (1989); Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220, 238, 242 (1987); *Mitsubishi*, 473 U.S. at 628–40; Scherk v. Alberto-Culver Co., 417 U.S. 506, 515–20 (1974).

5. *See* Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 687 (1996); Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 272–73 (1995); Perry v. Thomas, 482 U.S. 483, 490–91 (1987); Southland Corp. v. Keating, 465 U.S. 1, 16 (1984).

6. *See infra* text accompanying notes 145–48, 155–58, 176–85.

7. *E.g.*, Jean R. Sternlight, *Rethinking the Constitutionality of the Supreme Court's Preference for Binding Arbitration: A Fresh Assessment of Jury Trial, Separation of Powers, and Due Process Concerns*, 72 TUL. L. REV. 1, 25–39 (1997) (criticizing courts for being too willing to enforce agreements to arbitrate).

8. *E.g.*, Paul D. Carrington & Paul H. Haagen, *Contract and Jurisdiction*, 1996 SUP. CT. REV. 331; Paul D. Carrington, *Regulating Dispute Resolution Provisions in Adhesion Contracts*, 35 HARV. J. ON LEGIS. 225 (1998); Sarah Rudolph Cole, *Incentives and Arbitration: The Case Against Enforcement of Executory Arbitration Agreements Between Employers and Employees*, 64 UMKC L. REV. 449 (1996); Paul H. Haagen, *New Wineskins for New Wine: The Need to Encourage Fairness in Mandatory Arbitration*, 40 ARIZ. L. REV. 1039 (1998); David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33; Richard E. Speidel, *Consumer Arbitration of Statutory Claims: Has Pre-Dispute [Mandatory] Arbitration Outlived Its Welcome?*, 40 ARIZ. L. REV. 1069 (1998); Jeffrey W. Stempel, *Bootstrapping & Slouching Toward Gomorrah: Arbitral Infatuation and the Decline of Consent*, 62 BROOK. L. REV. 1381 (1996); Jean R. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 WM. & MARY L. REV. 1 (2000) [hereinafter Sternlight, *Class Action*]; Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 WASH. U. L.Q. 637 (1996) [hereinafter Sternlight, *Panacea*]; Sternlight, *supra* note 7; *see also* Michael Z. Green, *Debunking the Myth of Employer Advantage from Using Mandatory Arbitration for Discrimination Claims*, 31 RUTGERS L.J. 399, 418–42 (2000) (arguing that arbitration is disadvantageous for large employers). *But see* Samuel Estreicher, *Predispute Agreements to Arbitrate Statutory Claims*, 72 N.Y.U. L. REV. 1344, 1349–59 (1997); Ware, *supra* note 1, at 198–205; Stephen J. Ware, *Employment Arbitration and Voluntary Consent*, 25 HOFSTRA L. REV. 83 (1996) [hereinafter Ware, *Voluntary Consent*]; Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Adhesive Arbitration Agreements*, J. DISP. RESOL. (forthcoming).

9. I include franchise contracts together here with consumer contracts and employment contracts because arbitration critics commonly do so. *See* Carrington & Haagen, *supra* note 8, at 375–77, 383–84, 389, 401–02; Carrington, *supra* note 8, at 226–28, 231 app.; Sternlight, *Panacea*, *supra* note 8, at 637, 643; Jean R. Sternlight, *Protecting Franchisees from Abusive Arbitration Clauses*, 20 FRANCHISE L.J., Fall 2000, at 45, 47. *But see* Carrington & Haagen, *supra* note 8, at 386 (arguing that cases involving consumers and employees might be distinguished from cases involving franchisees). As discussed *infra* text accompanying notes 445–55, this treatment is not appropriate.

a better label, I will use the phrase "consumer contract" as shorthand for these types of contracts,[10] even though that phrase ordinarily has a narrower meaning.[11] For ease of description I will refer to the parties to a consumer contract as the "corporation" and the "individual," recognizing that that oversimplifies reality.[12]

The criticisms of predispute arbitration clauses in consumer contracts are many. First, arbitration is "mandatory": individuals have no choice but to agree to arbitrate or do without the good or service altogether, and, once they have agreed to arbitrate, they cannot decide to go to court when a dispute arises.[13] Second, arbitration is "unfair": limited discovery, lack of a jury trial or a right to appeal, repeat-player advantages in selecting arbitrators, no class relief, and excessive fees unfairly disadvantage individuals bringing claims.[14] Finally, arbitration clauses likewise can be "unfair": clauses drafted by corporations provide for biased tribunals and distant locations for hearings, preclude recovery of attorneys' fees and punitive damages, shorten time limits for filing claims, and give the corporation, but not the individual, the ability to go to court for some or all claims.[15]

Court decisions, proposed legislation, and administrative actions increasingly reflect these criticisms. In the last several years, courts have refused to enforce arbitration agreements because the arbitration fee was too high;[16] the mechanism for selecting arbitrators was one-sided;[17] the arbitration proceeding was to be held at a distant location;[18] the arbitration clause shortened the statute of limitations and limited the recovery of attorneys' fees and punitive damages;[19] or the clause gave one party—

10. *See* Ware, *supra* note 1, at 196 n.4 (using "the term 'consumer' to mean ordinary individuals in whatever capacity: employee, tenant, buyer of goods, etc.").

11. *E.g.*, Magnuson-Moss Warranty Act, 15 U.S.C. § 2301(1) (1994) (defining "consumer product" as "any tangible personal property which is distributed in commerce and which is normally used for personal, family, or household purposes").

12. Not all franchisees are individuals. *E.g.*, Franchise Rule, 64 Fed. Reg. 57,294, 57,345 (proposed Oct. 22, 1999) (to be codified at 16 C.F.R. § 436.9(e)) (stating that disclosure requirements not applicable if "franchisee is a corporation that has been in business for at least five years and has a net worth of at least $5 million"); *see also id.* at 57,320 ("[C]ommentators note that franchising today may involve heavily-negotiated, multi-million dollar deals between franchisors and highly sophisticated individual and corporate franchisees who are represented by counsel."). Nor are all businesses or employers incorporated.

13. *See* Schwartz, *supra* note 8, at 37 n.10 ("compelled" arbitration); *see also* discussion *infra* Part II.B.1.

14. *E.g.*, Sternlight, *Panacea*, *supra* note 8, at 682–83; *see also* discussion *infra* Part II.B.2.

15. *E.g.*, Sternlight, *Panacea*, *supra* note 8, at 637; *see also* discussion *infra* Part II.B.3.

16. *E.g.*, Shankle v. B-G Maint. Mgmt. of Colo., Inc., 163 F.3d 1230, 1234–35 (10th Cir. 1999); Cole v. Burns Int'l Sec. Servs., 105 F.3d 1465, 1480–81 (D.C. Cir. 1997); Brower v. Gateway 2000, Inc., 246 A.D.2d 246, 252–53 (N.Y. App. Div. 1998).

17. *E.g.*, Hooters of Am., Inc. v. Phillips, 173 F.3d 933, 938–39 (4th Cir. 1999); Ditto v. RE/MAX Preferred Props., Inc., 861 P.2d 1000, 1004 (Okla. Ct. App. 1993).

18. *E.g.*, Keystone, Inc. v. Triad Sys. Corp., 971 P.2d 1240, 1245–46 (Mont. 1998).

19. *E.g.*, Graham Oil Co. v. ARCO Prods. Co., 43 F.3d 1244, 1247–48 (9th Cir. 1994).

but not the other—the ability to go to court.[20] In the 106th Congress, the House of Representatives unanimously passed the Motor Vehicle Franchise Contract Arbitration Act of 2000, which would have permitted motor vehicle franchisees to opt out of predispute arbitration agreements with car manufacturers after a dispute arises.[21] Other proposed legislation would have made predispute arbitration clauses in consumer contracts an unfair trade practice,[22] forbid predispute arbitration agreements in employment contracts,[23] permitted certain retailers[24] to opt out of arbitration after a dispute arises, and required courts instead of arbitrators to adjudicate civil-rights claims.[25] Already in the 107th Congress, proposed legislation would render unenforceable predispute arbitration clauses in consumer credit contracts[26] and certain agricultural contracts[27] as well as excluding civil rights claims from arbitration.[28] State legislatures are considering similar legislation.[29] The Equal Employment Opportunity Commission (EEOC) has issued a policy statement concluding that predispute arbitration agreements in employment contracts are "inconsistent with the [federal] civil rights laws,"[30] on the grounds that, among others, in arbitration there is no trial by jury; discovery is limited; class relief is unavailable; arbitrators may favor the employer, who is a repeat player, over the employee, who is not; and the employer "is free to manipulate the arbitral mechanism to its benefit."[31]

This article offers a critical analysis of the academic literature on "unfair" arbitration clauses. First, it fills a gap in existing analyses, which are based almost entirely on anecdotal reports of the terms of arbitration clauses, by presenting empirical evidence on the use and terms of arbitration clauses in a sample of franchise contracts. Second, it describes plausible circumstances under which fully informed individuals will benefit by agreeing to arbitration clauses that appear unfair. Accordingly, the mere presence of such provisions in predispute arbitration clauses does not itself mean that the arbitration agreement is "unfair." Moreover, invali-

20. *E.g.*, Armendariz v. Found. Health Psychcare Servs., Inc., 6 P.3d 669, 691–94 (Cal. 2000); Iwen v. U.S. W. Direct, 977 P.2d 989, 995–96 (Mont. 1999); Arnold v. United Cos. Lending Corp., 511 S.E.2d 854, 859–60 (W. Va. 1998).

21. *See* H.R. 534, 106th Cong. § 2 (1999).

22. *See* Consumer Fairness Act of 1999, H.R. 2258, 106th Cong. § 2 (1999).

23. *See* H.R. 613, 106th Cong. § 1 (1999).

24. *See* Fairness and Voluntary Arbitration Act, H.R. 534, 106th Cong. § 2 (1999).

25. *See* Civil Rights Procedures Protection Act of 1999, S. 121, 106th Cong. §§ 2–9 (1999) (requiring court adjudication unless the parties enter into a postdispute arbitration agreement); Civil Rights Procedures Protection Act of 1999, H.R. 872, 106th Cong. §§ 2–9 (1999) (same).

26. *See* Consumer Credit Fair Dispute Resolution Act of 2001, S. 192, 107th Cong. § 2 (2001).

27. *See* Securing a Future for Independent Agriculture Act of 2001, S. 20, 107th Cong. § 128(b) (2001).

28. *See* Civil Rights Protection Act of 2001, S. 163, 107th Cong. §§ 2–9 (2001).

29. *See* Jennifer Gerarda Brown, *Protecting Consumers: Legislators Move to Limit Use of Arbitration in Contracts*, DISP. RESOL. MAG., Spring 2000, at 37.

30. EEOC Notice No. 915.002 (July 10, 1997), *available at* http://www.eeoc.gov/docs/mandarb.html.

31. *Id.*

dating or refusing to enforce arbitration clauses with such provisions may impose costs on the parties by forcing them to use a less satisfactory means of dispute resolution. Third, it argues that business reputation and arbitration institutions provide at least some constraint on the corporate opportunism that critics fear is motivating the increasing use of arbitration. As a result, increased government regulation of arbitration may be unnecessary, or at least can be more limited than the regulation that critics often propose.

Part II provides an overview of the legal framework and academic literature on commercial arbitration. It begins by describing the development of modern federal arbitration law, from the enactment of the FAA to the Supreme Court's modern arbitration decisions. It then summarizes academic criticisms of predispute arbitration clauses in consumer contracts and discusses how courts have responded to those criticisms.

Part III presents the results of an empirical study of "unfair" arbitration clauses. The study examines a sample of seventy-five franchise agreements from leading franchisors. It finds that: (1) fewer than half of the franchise agreements contain arbitration clauses; (2) virtually all of the arbitration clauses studied provide for arbitration under the auspices of the American Arbitration Association (AAA), a leading arbitration institution; (3) some of the sorts of provisions identified in the academic literature as "unfair" are quite common in the arbitration clauses in the sample (such as provisions providing for arbitration to take place in the franchisor's home state) although others are quite rare (such as provisions on arbitrator selection that may result in biased panels); and (4) forum-selection clauses contain many of the same "unfair" provisions as arbitration clauses.

Part IV explains that even "unfair" arbitration clauses may provide net benefits to the parties to the transaction, and thus may have some purpose other than simply redistributing wealth from individuals to corporations. It describes a basic model of the decision to arbitrate[32] to identify those circumstances under which arbitration will create a greater net value for parties to an arbitration agreement than would litigation. If the benefits from arbitration are shared with individuals through price reductions (or increased wages), arbitration will make both parties better off. But even if the cost savings are not shared with consumers, this part identifies the real costs that may be incurred if these "unfair" arbitration clauses are not enforced. Finally, this part argues that business reputation and arbitration institutions constrain corporations, to varying degrees, from using arbitration clauses to take advantage of individuals. The result is a more optimistic view of "consumerized" arbitration than

32. *See* Keith N. Hylton, *Agreements to Waive or to Arbitrate Legal Claims: An Economic Analysis*, 8 SUP. CT. ECON. REV. 209 (2000); *see also* Steven Shavell, *Alternative Dispute Resolution: An Economic Analysis*, 24 J. LEGAL STUD. 1 (1995).

typical in the academic literature, but one that identifies circumstances under which courts (and legislatures) might be more skeptical of claims that predispute arbitration agreements in consumer contracts are beneficial.

II. "UNFAIR" ARBITRATION CLAUSES IN CONSUMER CONTRACTS

Arbitration critics are vocal in criticizing the use of predispute arbitration agreements in consumer contracts.[33] The "consumerization" of arbitration corresponds with, and is in part a consequence of, the current legal framework governing the enforceability of arbitration agreements. This part begins by describing the development of that legal framework, from the enactment of the Federal Arbitration Act to its application to "consumerized" arbitration in the Supreme Court's modern arbitration decisions. It then describes in detail various criticisms of arbitration as "unfair" to individuals, and briefly discusses how courts have dealt with those criticisms in cases challenging the enforceability of agreements to arbitrate.

A. *The Supreme Court and the "Consumerization" of Arbitration*

The history of the Federal Arbitration Act (FAA) has often been recounted,[34] so only a brief recap is necessary here. Congress enacted the FAA in 1925 to reverse the common-law hostility toward arbitration.[35]

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33. *See supra* text accompanying notes 10–12 (defining "consumer contracts").

34. For descriptions of that history from varying perspectives, see, for example, IAN R. MACNEIL, AMERICAN ARBITRATION LAW 83–155 (1992); 1 IAN R. MACNEIL ET AL., FEDERAL ARBITRATION LAW §§ 8.1–8.5 at 8:1–8:14, §§ 14.1–14.7 at 14:1–14:48 (1994 & Supp. 1999); Bruce L. Benson, *An Exploration of the Impact of Modern Arbitration Statutes on the Development of Arbitration in the United States*, 11 J.L. ECON. & ORG. 479 (1995); Thomas E. Carbonneau, *Arbitral Justice: The Demise of Due Process in American Law*, 70 TUL. L. REV. 1945, 1950–60 (1996); Carrington & Haagen, *supra* note 8, at 331, 339–46, 361–401; Sternlight, *Panacea*, *supra* note 8, at 644–74; Katherine Van Wezel Stone, *Mandatory Arbitration of Individual Employment Rights: The Yellow Dog Contract of the 1990s*, DENV. U. L. REV. 1017, 1031–49 (1996).

35. *E.g.*, *Sales and Contracts to Sell in Interstate and Foreign Commerce, and Federal Commercial Arbitration: Hearing on S. 4214 Before a Subcomm. of the Senate Comm. on the Judiciary*, 67th Cong. 6 (1923) (remarks of Sen. Walsh) (act sought to "overcome the rule of equity, that equity will not specifically enforce any arbitration agreement"); *see also* H.R. REP. NO. 68-96, at 1–2 (1924) (attributing common law approach to "the jealousy of the English courts for their own jurisdiction"). A commonly cited reason for court hostility to arbitration at common law is the economic self-interest of the judges. *See* Scott v. Avery, 25 L.J. Ex. 308, 313 (H.L. 1856) (Campbell, L.J.).

> The doctrine had its origin in the interests of the judges. There was no disguising the fact that, as formerly, the emoluments of the Judges depended mainly, or almost entirely, upon fees, and as they had no fixed salary there was great competition to get as much as possible of litigation into Westminster Hall . . . . And they had great jealousy of arbitrations whereby Westminster Hall was robbed of those cases.

Id.; *see also* William M. Landes & Richard A. Posner, *Adjudication as a Private Good*, 8 J. LEGAL STUD. 235, 258 (1979). Others have identified political motives—rivalry between the king and parliament—as a likely explanation. *E.g.*, 1 WILLIAM HOLDSWORTH, A HISTORY OF ENGLISH LAW 210–11 (1922); Benson, *supra* note 34, at 483 & n.7 (citing both "revenue considerations" and "intense political competition between the king with his prerogative courts and the parliament and its ally, the common law courts").

At common law, courts refused specific enforcement of arbitration agreements and permitted parties to revoke predispute arbitration agreements until an award had been made.[36] As a result, commercial arbitration was common only in certain commercial settings, where "nonlegal sanctions such as threats to reciprocal arrangements and to reputation" were sufficient to induce parties to abide by agreements to arbitrate.[37]

Under the FAA, written agreements to arbitrate are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[38] The FAA applies both to predispute arbitration agreements and to postdispute arbitration agreements,[39] in a "maritime transaction or a contract evidencing a transaction involving commerce."[40] The Act establishes procedures by which court proceedings can be stayed pending arbitration and a party refusing to arbitrate can be compelled to arbitrate,[41] and it sets out limited grounds on which courts can review arbitration awards.[42]

As applied for the first four decades after its enactment, the FAA was, "at most, policy-neutral respecting the desirability of arbitration."[43] First, the FAA applied only in federal court, not state court.[44] State arbitration law continued to govern in state courts, even if the contract involved interstate commerce.[45] Second, the Supreme Court narrowly construed the scope of the FAA, so that even in federal court not all contracts were within its reach.[46] Third, the Court held in *Wilko v. Swan*[47] that claims under the Securities Act of 1933 ('33 Act) were not

36. *See* 1 MACNEIL ET AL., *supra* note 34, § 4.2.2.1 at 4:6-4:8 & § 4.3.2.2 at 4:18; Benson, *supra* note 34, at 485–87 (arguing that "the trend of increasing hostility by common law courts toward arbitration was reversed beginning as early as the 1830s").

37. Benson, *supra* note 34, at 484.

38. 9 U.S.C. § 2 (1994).

39. *See id.* (applies to contract "to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal").

40. *Id.*

41. *See id.* §§ 3–4.

42. *See id.* § 10.

43. 1 MACNEIL ET AL., *supra* note 34, § 14.1, at 14:3.

44. *See id.* at 14:2.

45. *See id*. at 14:2 n.1.

46. *See* Bernhardt v. Polygraphic Co., 350 U.S. 198, 200–01 (1956) (finding an employment contract between New York employer and New York employee, to be performed in Vermont, outside the scope of the FAA when "[t]here is no showing that [the employee] while performing his duties under the employment contract was working 'in' commerce, was producing goods for commerce, or was engaging in activity that affected commerce, within the meaning of our decisions").

47. 346 U.S. 427 (1953), *overruled by* Rodriguez de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477, 484 (1989).

subject to arbitration,[48] a holding that courts of appeals extended to claims under other federal statutes.[49]

Indeed, the Supreme Court's narrow view of the FAA in this era seems to reflect, at least to some degree, the common-law courts' skepticism toward arbitration. In *Wilko*, the Court made clear its view that arbitration was inferior to litigation: arbitrators lack "judicial instruction on the law"; make an award "without explanation of their reasons and without a complete record of their proceedings"; and the "[p]ower to vacate an award is limited."[50] Likewise, in *Bernhardt v. Polygraphic Co.*,[51] the Court reasoned that "[t]he change from a court of law to an arbitration panel may make a radical difference in ultimate result," citing the lack of a right to jury trial in arbitration and echoing the criticisms from *Wilko*—that arbitrators have no judicial instruction on the law, need not give reasons for their awards, may not keep a complete record of the proceeding, and make awards that are reviewable only on limited grounds in court.[52]

Beginning with *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*[53] in 1967, the Supreme Court's decisions became more favorable to arbitration. In *Prima Paint*, the Court held that arbitration agreements are severable from the main contract as a matter of federal law. As a result, a question of fraud in the inducement of the contract generally was for the arbitrator to decide rather than for the court, even though state law empowered the court to decide.[54] That interpretation of the FAA was constitutional, according to the Court, because the FAA was based principally on Congress's power to regulate interstate commerce, rather than any power to create substantive rules in diversity cases.[55] *Scherk v. Alberto-Culver Co.*[56] followed *Prima Paint* in 1974. There the Court held that a claim under the Securities Exchange Act of 1934 ('34 Act) was arbitrable.[57] The Court distinguished *Wilko* as not applicable to an arbitration agreement "arising out of [an] international commercial transaction."[58]

48. *See id.* at 438.

49. *E.g.*, Greater Cont'l Corp. v. Schechter, 422 F.2d 1100, 1103 (2d Cir. 1970) (holding claims under 1934 Securities Exchange Act not arbitrable); Am. Safety Equip. Corp. v. J.P. Maguire & Co., 391 F.2d 821, 828 (2d Cir. 1968) (holding claims under federal antitrust laws not arbitrable).

50. *Wilko*, 346 U.S. at 436.

51. 350 U.S. 198, 205 (1956) (holding state arbitration law binding on federal courts in diversity cases not within the scope of the FAA).

52. *See id.* at 203 & n.4.

53. 388 U.S. 395 (1967).

54. *See id.* at 403–04.

55. *See id.* at 404–05.

56. 417 U.S. 506 (1974).

57. *See id.* at 515–20.

58. *Id.* at 519.

By the 1980s, the Supreme Court had found in the FAA an "emphatic federal policy in favor of arbitral dispute resolution."[59] In *Southland Corp. v. Keating*,[60] the Court held for the first time that the FAA applies not only in federal court, but also in state court, relying in part on *Prima Paint*.[61] Accordingly, the FAA preempted a provision of the California Franchise Investment Law, which had been construed by the California Supreme Court to invalidate arbitration clauses in franchise agreements.[62] The Court subsequently reaffirmed *Southland* in *Allied-Bruce Terminix Cos. v. Dobson*,[63] rejecting arguments by the respondents and twenty state attorneys general that *Southland* should be overruled.[64] The Court now has made clear that the FAA preempts state attempts to "invalidate arbitration agreements under state laws applicable *only* to arbitration provisions."[65] Both state laws that make arbitration agreements unenforceable altogether,[66] and those that impose conditions on enforceability,[67] are preempted. Moreover, the Court in *Allied-Bruce* made clear that the FAA extends to the full reach of Congress's commerce power, rejecting any suggestion from *Bernhardt* otherwise.[68]

Meanwhile, following *Scherk*, the Supreme Court found claims under a series of federal statutes to be arbitrable, limiting and eventually overruling *Wilko v. Swan*. In *Mitsubishi Motors Corp. v. Soler Chrysler-*

59. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 631 (1985); *see also* First Options of Chi., Inc. v. Kaplan, 514 U.S. 938, 947 (1995) ("strong arbitration-related policy"); Southland Corp. v. Keating, 465 U.S. 1, 10 (1984) ("national policy favoring arbitration"). Some have suggested that the Supreme Court is encouraging arbitration out of self-interest in reducing its caseload. *See* Cole, *supra* note 8, at 449; Sternlight, *Panacea*, *supra* note 8, at 643. That is not likely the case, however, because the Court has other means of controlling its docket and reducing its caseload, if that is what it wishes to do. *See* Christopher R. Drahozal, *Judicial Incentives and the Appeals Process*, 51 SMU L. REV. 469, 488–89 (1998). A more plausible explanation for the Court's decisions is that the justices, as a matter of their own personal ideologies, believe that reducing the caseload of the lower federal courts is good as a policy matter, and that promoting commercial arbitration through its decisions will help achieve that policy. *See id.* at 489 n.100.

60. 465 U.S. 1 (1984).

61. *See id.* at 11–12, 16; *see also* Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983). The court noted:

> Section 2 is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary. The effect of the section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act.

Id.

62. *See* Keating v. Superior Court, 645 P.2d 1192, 1198–1201 (Cal. 1982) (en banc), *rev'd sub nom.* Southland Corp. v. Keating, 465 U.S. 1 (1984).

63. 513 U.S. 265 (1995).

64. *See id.* at 272–73.

65. Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 687 (1996).

66. *See* Allied-Bruce Terminex Cos. v. Dobson, 513 U.S. 265, 269, 272–73 (1995) (holding that an Alabama statute providing that pre-dispute arbitration agreements are "unenforceable" is preempted); Perry v. Thomas, 482 U.S. 483, 486, 490–91 (1987) (holding that California statute permitting action to recover wages to proceed in court despite arbitration agreement is preempted); *Southland*, 465 U.S. at 10, 16 (holding that the California Franchise Investment Law, which required "judicial consideration of claims" brought under statute, is preempted).

67. *See Doctor's Assocs.*, 517 U.S. at 684, 687–88 (Montana statute forbidding arbitration unless conspicuous notice of arbitration clauses given held preempted).

68. *See Allied-Bruce*, 513 U.S. at 277.

Plymouth, Inc.,[69] the Court held that a dispute arising out of the federal antitrust laws was arbitrable, again relying on the international nature of the transaction to distinguish *Wilko*.[70] Then, in *Shearson/American Express, Inc. v. McMahon*,[71] the Court held disputes under the '34 Act and the Racketeer Influenced and Corrupt Organizations Act (RICO) to be arbitrable, even in strictly domestic disputes.[72] This decision paved the way the following term for the overruling of *Wilko* in *Rodriguez de Quijas v. Shearson/American Express, Inc.*[73] Since *Rodriguez*, the Court has upheld the arbitrability of claims under the Age Discrimination in Employment Act (ADEA)[74] and the Carriage of Goods by Sea Act,[75] as well as rejecting a challenge to arbitration of a claim under the Truth in Lending Act based on the possibility that a consumer might have to pay excessive fees.[76] The circuits now seem to agree, joined most recently by the Eleventh Circuit in *Kotam Electronics, Inc. v. JBL Consumer Products, Inc.*,[77] that wholly domestic claims arising under the Sherman Act are arbitrable.[78] Courts have rejected an array of arbitrability challenges to other federal statutes.[79]

Today, more than seventy-five years after the enactment of the FAA, no longer is arbitration the sole province of trade association members, or even limited to contracts between large corporations. Indeed, many of the Supreme Court's leading arbitration decisions resulted in the enforcement of predispute arbitration agreements against indi-

69. 473 U.S. 614 (1985).

70. *See id.* at 628–40.

71. 482 U.S. 220 (1987).

72. *See id.* at 238, 242.

73. 490 U.S. 477, 484–85 (1989) (stating "that *Wilko* was incorrectly decided and is inconsistent with the prevailing uniform construction of other federal statutes").

74. *See* Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 26–27 (1991).

75. *See* Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer, 515 U.S. 528, 534 (1995).

76. *See* Green Tree Fin. Corp.–Ala. v. Randolph, 531 U.S. 79 (2000).

77. 93 F.3d 724 (11th Cir. 1996).

78. *See id.* at 728; *see also* Nghiem v. NEC Elec., Inc., 25 F.3d 1437, 1441–42 (9th Cir. 1994); Hough v. Merrill Lynch, 757 F. Supp. 283, 286 (S.D.N.Y. 1991), *aff'd without opinion*, 946 F.2d 883 (2d Cir. 1991); 2 MACNEIL ET AL., *supra* note 34, § 16.3.3.2 at 16:50 ("The public policy defense for domestic antitrust claims under the FAA is dead.").

79. *See* 2 MACNEIL ET AL., *supra* note 34, § 16.4 at 16:52. The nonarbitrability doctrine has seen somewhat of a revival lately. The Ninth Circuit held in *Duffield v. Robertson Stephens & Co.*, 144 F.3d 1182 (9th Cir. 1998), that in the Civil Rights Act of 1991, Pub. L. No. 102-166, § 118, 105 Stat. 1071, 1081 (1991), "Congress intended to preclude compulsory arbitration of Title VII claims." *Id.* at 1199. *But see, e.g.*, Koveleskie v. SBC Capital Mkts., Inc., 167 F.3d 361, 365 (7th Cir.), *cert. denied*, 528 U.S. 811 (1999); Seus v. John Nuveen & Co., Inc., 146 F.3d 175, 185 (3d Cir. 1998), *cert. denied*, 525 U.S. 1139 (1999). Several courts also have held that at least some claims under the Magnuson-Moss Warranty Act are not arbitrable. *See* Pitchford v. Oakwood Mobile Homes, Inc., 124 F. Supp. 2d 958, 960 (W.D. Va. 2000); Raesly v. Grand Hous., Inc., 105 F. Supp. 2d 562, 573 (S.D. Miss. 2000); Wilson v. Waverlee Homes, Inc., 954 F. Supp. 1530, 1539–40 (M.D. Ala.), *aff'd without opinion*, 127 F.3d 40 (11th Cir. 1997); *In re* Van Blarcum, 19 S.W.3d 484, 495 (Tex. Ct. App. 2000). *But see* S. Energy Homes, Inc. v. Ard, 772 So. 2d 1131, 1135 (Ala. 2000) (overruling S. Energy Homes, Inc. v. Lee, 732 So. 2d 994 (Ala. 1994)); Results Oriented, Inc. v. Crawford, 538 S.E.2d 73, 81 (Ga. App.), *cert. granted*, 2000 Ga. LEXIS 847. In addition, courts have sometimes held statutory claims nonarbitrable when provisions in arbitration clauses conflicted with statutory remedies. *See infra* text accompanying notes 176–85. Whether the Supreme Court will agree if and when it reviews these issues remains to be seen.

viduals: consumers (*Rodriguez*,[80] *Allied-Bruce*,[81] and *Green Tree*[82]), employees (*Perry*[83] and *Gilmer*[84]), and franchisees (*Southland*[85] and *Doctor's Associates*[86]). In the words of Thomas Stipanowich, arbitration has now become "consumerized."[87]

B. Criticizing Unfair Arbitration Clauses

The advent of "consumerized" arbitration has led to growing concern that arbitration is an "unfair" means of resolving disputes between individuals and corporations.[88] Arbitration is unfair, according to its critics, because it is "mandatory"—meaning variously that arbitration clauses are contained in "contracts of adhesion" or that individuals cannot opt out of arbitration once a dispute arises. Arbitration also is unfair because typical characteristics of an arbitration proceeding (the ability to select the arbitrator, the limited availability of discovery, the lack of an appeal, the unavailability of class relief, and the necessity that the parties pay administrative and arbitrator's fees) unfairly disadvantage individuals. Finally, arbitration is unfair because arbitration clauses are drafted in a one-sided manner to favor the corporation at the expense of the individual: they provide for biased selection procedures, hearings to be held in distant locations, limits on fee-shifting, shortened statutes of limitations, waivers of punitive damages, and one-sided exceptions of certain claims from arbitration.

This section describes these criticisms in more detail. It also notes how courts have addressed challenges to arbitration agreements based on such criticisms. Those challenges arise in two forms. First, parties challenge the fairness of arbitration agreements by raising general con-

80. 490 U.S. 477, 486 (1989) (enforcing an arbitration agreement against individual securities investors).

81. 513 U.S. 265, 268 (1995) (holding that a homeowner purchasing a termite-protection plan could not rely on a state arbitration statute to invalidate an arbitration agreement).

82. 531 U.S. 79, 522–23 (2000) (concluding that the borrower failed to carry the burden of showing that the costs of arbitration would preclude resolution of the statutory claims).

83. 482 U.S. 483, 492 (1987) (enforcing an arbitration agreement against an employee of a brokerage firm).

84. 500 U.S. 20, 23 (1991) (enforcing an arbitration agreement against a securities representative); *see also id.* at 25 n.2 (holding that the contract was not an employment contract within the meaning of the FAA).

85. 465 U.S. 1, 4 (1984) (holding that the Federal Arbitration Act preempts a state law which rendered an agreement between a franchisor and a convenience-store franchisee unenforceable).

86. 517 U.S. 681, 689 (1996) (holding that a sandwich-shop franchisee could not rely on a state statute to invalidate an arbitration agreement when the statute conflicts with the FAA).

87. *See* Thomas J. Stipanowich, *The Growing Debate over 'Consumerized' Arbitration: Adding Cole to the Fire*, DISP. RESOL. MAG., Summer 1997, at 20 [hereinafter Stipanowich, *Growing Debate*]; Thomas J. Stipanowich, *Punitive Damages and the Consumerization of Arbitration*, 92 NW. U. L. REV. 1, 9 (1997) [hereinafter Stipanowich, *Punitive Damages*]; *see also* Speidel, *supra* note 8, at 1072 (stating that "arbitration has become 'consumerized'").

88. As noted previously, *see supra* note 1, the criticisms are directed only toward predispute agreements to arbitrate, not postdispute agreements.

tract defenses, such as unconscionability or lack of mutuality.[89] Second, parties challenge the fairness of arbitration agreements in arguing that various statutory claims are not subject to arbitration. Although the Supreme Court has consistently held in recent years that federal statutory claims are arbitrable,[90] lower federal courts have revived the nonarbitrability doctrine to some degree by refusing to order statutory claims to arbitration after finding that the particular arbitration clause at issue interferes with statutory rights and remedies.[91]

1. *"Mandatory" Arbitration*

A frequent criticism of arbitration in consumer contracts is that it is "mandatory."[92] The criticism is rhetorically powerful because viewing arbitration as "mandatory" is contrary to the whole idea of arbitration: that it is the product of an agreement between the parties.[93] But as Richard Speidel explained, this label is "misleading because it connotes arbitration that is compelled by law regardless of consent."[94] Arbitration is mandatory when required by law, such as mandatory arbitration of public-employee grievances.[95] No law requires that parties to consumer contracts arbitrate disputes. Instead, what critics of arbitration generally mean when they call arbitration "mandatory" is either that (1) individuals have no choice but to agree to arbitration if they wish to buy the product, continue being employed, or the like; or (2) by agreeing to arbitrate, the contract "mandates" individuals to resolve disputes by arbitration even if they later wish to go to court.

This first meaning equates "mandatory" arbitration with arbitration clauses in "contracts of adhesion"—standard form contracts offered to individuals on a "take it or leave it" basis.[96] Arbitration is "mandatory"

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89. *See infra* text accompanying notes 179–84.

90. *See supra* text accompanying notes 56–58, 69–80.

91. *See infra* text accompanying notes 176–85.

92. *E.g.*, EEOC Notice No. 915.002, *supra* note 30; Haagen, *supra* note 8, at 1042, 1048; Stempel, *supra* note 8, at 1411 ("national policy of mandatory arbitration"); *see* Ware, *Voluntary Consent*, supra note 8, at 104 & nn.102–03 (citing examples).

93. *E.g.*, Volt Info. Sci., Inc. v. Bd. of Tr., 489 U.S. 468, 479 (1989) ("Arbitration under the [FAA] is a matter of consent, not coercion . . . .").

94. *See* Speidel, *supra* note 8, at 1069; 2 MACNEIL ET AL., *supra* note 34, § 17.1.2.2 at 17:8-17:9. Macneil et al. note:

> Using such terms as *compulsory* or *mandatory* in such circumstances is, at best, highly confusing. At worst, it constitutes question-begging: The very question at stake where such questions arise is whether whatever consent to arbitrate as has been manifested should or should not be given full contractual effect. To call the arbitration compulsory or mandatory is to answer by label, not by attention to the facts and by analysis.

Id.

95. *E.g.*, 5 U.S.C. § 7121(b)(1)(c)(iii) (1994) ("[A]ny grievance not satisfactorily settled under the negotiated grievance procedure shall be subject to binding arbitration which may be invoked by either the exclusive representative or the agency."); 1 MACNEIL ET AL., *supra* note 34, § 11.7 at 11:38–11:40; *see also id.* § 2.5 at 2:35 (giving examples of mandatory arbitration).

96. *E.g.*, Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 632 (1943); Edwin W. Patterson, *The Delivery of a Life-Insurance Policy*, 33

because the individuals have no choice to go to court, particularly if the use of arbitration is widespread in the industry.[97] Arbitration critics contend that individuals lack both the information and the economic incentive to evaluate predispute arbitration agreements contained in form contracts, so that corporations can take advantage of individuals and evade their legal obligations.[98] The U.S. Supreme Court, however, has refused to invalidate arbitration agreements solely on the ground that they are contained in adhesion contracts.[99]

The second meaning equates "mandatory" arbitration with the enforceability of predispute arbitration agreements.[100] David Schwartz calls this "compelled" arbitration in an attempt to avoid the confusion of labels.[101] He defines arbitration as "compelled" when "a party has agreed to arbitrate future disputes but, once the dispute arises, would prefer to litigate rather than arbitrate."[102] That arbitration is "compelled" or "mandatory" indicates, according to arbitration critics, that arbitration is unfair to individuals. As Professor Sternlight has put it: "[I]f binding arbitration were indeed always as wonderful and fair as its advocates claim, why make it mandatory? Why not allow employees, consumers or others to choose arbitration over litigation knowingly, after the dispute has arisen?"[103]

HARV. L. REV. 198, 222 (1919); Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1174, 1183 (1983).

97. *See* Frederick L. Miller, *Arbitration Clauses in Consumer Contracts: Building Barriers to Consumer Protection*, 78 MICH. B.J., Mar. 1999, at 302, 303 ("Arbitration clauses, once introduced by big banks, sellers or lenders, tend to become standard in an industry, leaving the consumer no way out."); Stempel, *supra* note 8, at 1410–11 ("When the securities industry, for example, moves massively toward mandatory arbitration, a free market ceases to exist, at least as to dispute resolution, unless the customer or the employee has some meaningful alternatives. The presence of alternatives is part of the essence of a free market.").

98. *See* Edward Brunet, *Arbitration and Constitutional Rights*, 71 N.C. L. REV. 81, 105–06 (1992); Haagen, *supra* note 8, at 1059–60 ("information failures [about dispute resolution] are likely to lead to inefficient market results"); Schwartz, *supra* note 8, at 55–58; Sternlight, *supra* note 7, at 36 ("often in these cases a large company may have used its superior knowledge and power to impose an arbitration clause providing the company with a dispute-resolution advantage").

99. *See* Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 33 (1991) ("Mere inequality in bargaining power, however, is not a sufficient reason to hold that arbitration agreements are never enforceable in the employment context."); *see also* Pritzker v. Merrill Lynch, 7 F.3d 1110, 1118 (3d Cir. 1993) (noting that the Supreme Court ruled that arbitration agreements are enforceable even if they involve unequal bargaining power). *Cf.* Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585, 596–97 (1991) (upholding a forum-selection clause in cruise-line ticket).

100. *E.g.*, Sternlight, *supra* note 7, at 7; John Vail, *Defeating Mandatory Arbitration Clauses*, TRIAL, Jan. 2000, at 70, 70–71 ("'Mandatory arbitration' is distinct from voluntary arbitration . . . . Voluntary arbitration waives rights only after a dispute has occurred and serves as a substitute for settlement. Mandatory arbitration waives consumers' rights before a dispute has occurred and serves as a substitute for trial.").

101. *See* Schwartz, *supra* note 8, at 37 n.10.

102. *Id.*

103. Jean R. Sternlight, *Steps Need to be Taken to Prevent Unfairness to Employees, Consumers*, DISP. RESOL. MAG., Fall 1998, at 5, 7. Schwartz notes that "when it comes time to enforce the agreement by making a motion to compel arbitration and to stay litigation, the employer is invariably seeking to arbitrate, and the employee is seeking to litigate," taking this as evidence that "the pro-arbitration regime favors employers." Schwartz, *supra* note 8, at 62. Schwartz examined "published

Recent proposed legislation would outlaw predispute arbitration clauses altogether in certain types of contracts or for certain claims,[104] or else would allow parties to opt out of arbitration after the dispute arises[105]—in other words, effectively reinstate the common-law doctrine of revocability. Some commentators likewise favor this approach.[106]

2. *"Unfair" Characteristics of Arbitration*

Arbitration critics decry as unfair many typical characteristics of arbitration. The ability to select the decision maker, limits on discovery, unavailability of class relief, and lack of an appeal all, in the view of the critics, favor corporations at the expense of individuals.[107] In addition, the fact that arbitration is not subsidized by the government but requires parties to pay for administrative services and the arbitrator's fees is seen as unfairly increasing individuals' costs of resolving disputes.

First, unlike litigation, in which the judge generally is assigned randomly,[108] in arbitration parties select the decision maker. The methods of selecting arbitrators are varied. For a single arbitrator, the parties may

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federal cases involving arbitration of employment disputes between 1994 and 1996" and found that in all forty cases the employer moved to compel arbitration of a claim by an employee. *Id.* at 62 n.88.

104. *See* Securing a Future for Independent Agriculture Act of 2001, S. 20, 107th Cong. § 128(b) (2001) (making void predispute arbitration clauses in certain agricultural contracts); Consumer Credit Fair Dispute Resolution Act of 2001, S. 192, 107th Cong. § 2 (2001) (providing that predispute arbitration clauses in consumer credit contracts are not valid or enforceable); Consumer Fairness Act of 1999, H.R. 2258, 106th Cong. § 2 (1999) (making predispute arbitration clauses in consumer contracts "unenforceable" and "an unfair and deceptive trade act or practice"); H.R. 613, 106th Cong. § 1 (1999) (stating that arbitration may be used to settle employment dispute only if the parties agree to arbitration after the dispute arises); Civil Rights Procedures Protection Act of 2001, S. 163, 107th Cong. §§ 2–9 (2001) (requiring court adjudication unless the parties enter into a postdispute arbitration agreement); Civil Rights Procedures Protection Act of 1999, S. 121, 106th Cong. §§ 2–9 (1999) (same); Civil Rights Procedures Protection Act of 1999, H.R. 872, 106th Cong. §§ 2–9 (1999) (same).

105. *See* Motor Vehicle Franchise Contract Arbitration Fairness Act of 2000, H.R. 534, 106th Cong. § 2 (2000). The proposed Act provides:

> [W]henever a motor vehicle franchise contract provides for the use of arbitration to resolve a controversy arising out of or relating to the contract, each party to the contract shall have the option, after the controversy arises and before both parties commence an arbitration proceeding, to reject arbitration as the means of settling the controversy.

Id.; *see also* Fairness and Voluntary Arbitration Act, H.R. 534, 106th Cong. § 2 (1999) (making predispute arbitration clauses in sales and services contracts revocable).

106. *See* Carrington & Haagen, *supra* note 8, at 385 ("The most effective way to assure that the arbitration is fair to both parties is the traditional way that Alabama followed, making the arbitration clause revocable and thus renegotiable by the parties at a time when the dimensions of their dispute are known and both have consulted counsel.").

107. Because my focus is on asserted unfairness toward the individual who is a party to the arbitration agreement, I will not address two other criticisms of arbitration that focus on the effect of arbitration on third parties: that the confidentiality of arbitration proceedings enables wrongful practices to continue longer than if the dispute were subject to litigation, and that the growing use of arbitration may result in the underproduction of legal precedents, because arbitrators, unlike courts, often do not issue published opinions. *See* EEOC Notice No. 915.002, *supra* note 30.

108. *See* Orley Ashenfelter et al., *Politics and the Judiciary: The Influence of Judicial Background on Case Outcomes*, 24 J. LEGAL STUD. 257, 266–70 (1995). The parties have some ability to choose the court in which the case will be decided, but not the identity of the judge within that court.

agree on who is to serve as the arbitrator.[109] A common method is that regularly used by the American Arbitration Association, which circulates a list of prospective arbitrators to the parties. The parties strike objectionable names, rank the rest, and the highest ranking remaining name serves as the arbitrator.[110] For three arbitrators, each party chooses one and the two arbitrators then select the third and presiding arbitrator.[111]

The ability to select the decision maker can benefit the parties to an arbitration agreement. Parties can choose an arbitrator with expertise relevant to the dispute, and thus increase the accuracy of the award.[112] In addition, because arbitrators are chosen by the parties rather than having cases assigned to them, arbitrators must compete for business with other arbitrators. This competition in the market for arbitration services gives arbitrators the incentive to make decisions that benefit the parties to the agreement, so as to increase the likelihood that the arbitrator will be selected in the future.[113]

One consequence of the parties' selection of expert arbitrators is that the case will not be tried by a jury. Although this is cited as an advantage of arbitration from the corporation's viewpoint,[114] from the individual's viewpoint this could be a disadvantage, because the jury may favor individual rather than corporate defendants. Several legal commentators argue that predispute arbitration clauses are unconstitutional waivers of the Seventh Amendment right to a jury trial,[115] and thus are unenforceable.[116] Courts, however, generally have rejected this argument.[117]

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109. 1 MACNEIL ET AL., *supra* note 34, § 2.1.3.3.

110. *See* AMERICAN ARBITRATION ASSOCIATION, COMMERCIAL DISPUTE RESOLUTION PROCEDURES, Rule R-13 (as amended Sept. 1, 2000), *available at* http://www.adr.org/rules/commercial/AAA235.0900.htm (last visited Feb. 27, 2001) [hereinafter 2000 AAA RULES].

111. *See* GARY B. BORN, INTERNATIONAL COMMERCIAL ARBITRATION IN THE UNITED STATES 61 (1994).

112. *See* Shavell, *supra* note 32, at 6.

113. *See* GORDON TULLOCK, TRIALS ON TRIAL 127–33 (1980); Robert D. Cooter, *The Objectives of Private and Public Judges*, 41 PUB. CHOICE 107, 107 (1983); Robert D. Cooter & Daniel L. Rubinfeld, *Trial Courts: An Economic Perspective*, 24 LAW & SOC'Y REV. 533, 545 (1990); Drahozal, *supra* note 59, at 502; Steven Walt, *Decision by Division: The Contractarian Structure of Commercial Arbitration*, 51 RUTGERS L. REV. 369, 430–31 (1999).

114. *E.g.*, Martin J. Oppenheimer & Cameron Johnstone, *A Management Perspective: Mandatory Arbitration Agreements Are an Effective Alternative to Employment Litigation*, DISP. RESOL. MAG., Fall 1997, at 19 ("From an employer's point of view, arbitration provides much-needed protection from the unpredictability of jury awards, which, in recent years, have been known to reach astronomical heights—awards that appear inappropriate even to the most objective observers.").

115. *See* U.S. CONST. amend. VII ("In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved.").

116. *See* Richard C. Reuben, *Public Justice: Toward a State Action Theory of ADR*, 85 CAL. L. REV. 577 (1997); Sternlight, *supra* note 7, at 69–77; *see also* Brunet, *supra* note 98, at 102–13.

117. *See* Smith v. Am. Arbitration Ass'n, Inc., 233 F.3d 502, 507 (7th Cir. 2000); Duffield v. Robertson Stephens & Co., 144 F.3d 1182, 1202 (9th Cir.), *cert. denied*, 525 U.S. 982 (1998); Dillard v. Merrill Lynch, 961 F.2d 1148, 1155 n.12 (5th Cir. 1992); *see also* Davis v. Prudential Sec., Inc., 59 F.3d 1186, 1191–93 (11th Cir. 1995) (no state action); FDIC v. Air Fla. Sys., 822 F.2d 833, 842 n.9 (9th Cir. 1987) (same).

Moreover, critics argue, the competition among arbitrators leads to biased results that favor corporations. Unlike individuals, corporations are likely to be repeat players in arbitration and have better information about prior decisions by an arbitrator than individuals.[118] Arbitrators who seek to be hired in the future, the argument goes, thus have an incentive to favor corporate parties—the corporation will be more likely to select them in the future, but individuals, lacking sufficient information, will not know of the bias.[119]

Second, parties generally have a more limited ability to obtain discovery in arbitration than in court. Again, proponents frequently cite reduced discovery as one of the advantages of arbitration for corporations.[120] But arbitration critics fear that parties with meritorious claims will be unable to prove those claims without discovery.[121] Litigants, including corporations, are unlikely to turn over voluntarily information that is detrimental to their case.[122]

Third, arbitration does not ordinarily provide a right to appeal. Although parties could, by contract, agree to an appellate arbitral tribunal, such agreements are exceedingly rare.[123] Instead, review of arbitral awards takes place in court actions to enforce (or resist enforcement of) the awards. Statutes limit such review to specific grounds.[124] Legal error is not a ground for vacating an arbitral award.[125] Moreover, arbitration

118. *See* EEOC Notice No. 915.002, *supra* note 30, Part V.B; Lisa B. Bingham, *On Repeat Players, Adhesive Contracts, and the Use of Statistics in Judicial Review of Employment Arbitration Awards*, 29 McGEORGE L. REV. 223, 235–39 (1998); Cole, *supra* note 8, at 474–79; Alan Scott Rau, *Integrity in Private Judging*, 38 S. TEX. L. REV. 485, 521–29 (1997); Schwartz, *supra* note 8, at 60–61; Sternlight, *Panacea*, *supra* note 8, at 685; *see also* Marc Galanter, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change*, 9 LAW & SOC'Y REV. 95 (1974).

119. *See* EEOC Notice No. 915.002, *supra* note 30, Part V.B; Carrington & Haagen, *supra* note 8, at 346; Cole, *supra* note 8, at 476–77; Sternlight, *Panacea*, *supra* note 8, at 685.

120. *E.g.*, Alan S. Kaplinsky & Mark J. Levin, *Alternative to Litigation Attracting Consumer Financial Services Companies*, *in* ARBITRATION OF CONSUMER FINANCIAL SERVICES DISPUTES 845, 847 (PLI Corp. Law Practice Course, Handbook Series No. 1102, 1999) ("Consumer financial services companies may find arbitration preferable to litigation because . . . it substantially reduces the amount of permissible discovery.").

121. *See* Carrington & Haagen, *supra* note 8, at 348 ("While discovery may be regarded as a mixed blessing at best, because of its costs, it cannot be doubted that the availability of discovery assures that courts in general are more effective than arbitral tribunals in detecting wrongdoing and enforcing the rights of victims."); Haagen, *supra* note 8, at 1053 ("More restrictive discovery may leave a plaintiff with a meritorious claim unable to prove it."); Miller, *supra* note 97, at 303; Schwartz, *supra* note 8, at 61; Sternlight, *supra* note 7, at 37.

122. *E.g.*, Bruce L. Hay, *Civil Discovery: Its Effects and Optimal Scope*, 23 J. LEGAL STUD. 481, 496 (1994) (arguing that there is no incentive to turn over evidence that would not otherwise appear at trial).

123. *See* Drahozal, *supra* note 59, at 501; Steven Shavell, *The Appeals Process as a Means of Error Correction*, 24 J. LEGAL STUD. 379, 423 (1995). *But see* JAMS, EMPLOYMENT ARBITRATION RULES AND PROCEDURES, Rule 30, *available at* http://www.jamsadr.com/employment_arb. asp (revised Nov., 2000) (on file with *University of Illinois Law Review*) (discussing optional appeal procedure).

124. *See* 9 U.S.C. § 10 (1994); 4 MACNEIL ET AL., *supra* note 34, § 40 at 40:1 (discussing grounds for vacating arbitration awards).

125. *E.g.*, Todd Shipyards Corp. v. Cunard Line, Ltd., 943 F.2d 1056, 1060 (9th Cir. 1991); Advest, Inc. v. McCarthy, 914 F.2d 6, 8 (1st Cir. 1990); Miller v. Prudential Bache Secs., 884 F.2d 128, 130 (4th Cir. 1989); Stephen J. Ware, *"Opt-In" for Judicial Review of Errors of Law Under the Revised Uniform*

awards often lack any statement of reasons for the award, making further review difficult.[126] Because of the lack of court oversight, arbitration critics fear that arbitrators will disregard the applicable law—particularly laws that favor individuals over corporations.[127]

Fourth, class relief generally is unavailable in arbitration. Although state courts are split,[128] the federal courts generally hold that courts may not order arbitration proceedings consolidated,[129] much less require class-

Arbitration Act, 8 AM. REV. INT'L ARB. 263 (1997) ("'[E]rror of law' by the arbitrator is not listed in the FAA as a ground for vacating the arbitrator's award."). *Cf.* Wilko v. Swan, 346 U.S. 427, 436–37 (1953) (indicating that "manifest disregard" of the law by the arbitrator may be subject to judicial review); Halligan v. Piper Jaffray, Inc., 148 F.3d 197, 202 (2d Cir. 1998), *cert. denied*, 526 U.S. 1034 (1999). On occasion, parties will provide in their arbitration clause that courts are to review any arbitral award on a heightened standard, including for errors of law. *See infra* text accompanying note 264. Courts have not finally resolved whether such clauses are to be given effect. *Compare* Lapine Tech. Corp. v. Kyocera Corp., 130 F.3d 884, 890 (9th Cir. 1997) (giving effect to clause), *and* Gateway Techs., Inc. v. MCI Telecomm, Corp., 64 F.3d 993, 996–97 (5th Cir. 1995) (same), *with* Chi. Typographical Union No. 16 v. Chi. Sun-Times, Inc., 935 F.2d 1501, 1505 (7th Cir. 1991) (dictum) (refusing to give effect to clause).

126. *See* 1 MACNEIL ET AL., *supra* note 34, § 3.2.3 at 3:13; Stephen J. Ware, *Default Rules from Mandatory Rules: Privatizing Law Through Arbitration*, 83 MINN. L. REV. 703, 721 (1999).

127. *See* Carrington & Haagen, *supra* note 8, at 347–48; Miller, *supra* note 97, at 303; Sternlight, *supra* note 7, at 36–37.

128. *Compare* Keating v. Superior Court, 645 P.2d 1192, 1209 (Cal. 1982) (holding court authorized to order class-wide arbitration), *rev'd in part on other grounds*, Southland Corp. v. Keating, 465 U.S. 1 (1984), Dickler v. Shearson Lehman Hutton, Inc., 596 A.2d 860 (Pa. Super. Ct. 1991) (same), *and* Bazzle v. Green Tree Fin. Corp., No. 97-CP-18-258 (S.C. Ct. C.P. Jan. 2, 1998), *reported in* Alan S. Kaplinsky, *Arbitration and Class Actions—A Contradiction in Terms*, *in* ARBITRATION OF CONSUMER FINANCIAL SERVICES DISPUTES 697, 712–13 (PLI Corp. Law Practice Course, Handbook Series No. 1102, 1999), *with* Med Ctr. Cars, Inc. v. Smith, 727 So. 2d 9 (Ala. 1998) (refusing to order class-wide arbitration), Stein v. Geonerco, Inc., 17 P.3d 1266 (Wash. App. 2001) (same), *and* Steinberg v. Prudential/Bache Sec., Inc., 1986 WL 5024 (Del. Ch. 1986) (same). *Cf.* Blue Cross of Cal., Inc. v. Superior Court, 78 Cal. Rptr. 2d 779, 794 (Cal. Ct. App. 1998) (holding that FAA does not preempt California rule authorizing courts to order class-wide arbitration), *cert. denied*, 527 U.S. 1003 (1999). *See generally* Daniel R. Waltcher, Note, *Classwide Arbitration and 10B-5 Claims in the Wake of Shearson/American Express, Inc. v. McMahon*, 74 CORNELL L. REV. 380 (1989); Note, *Classwide Arbitration: Efficient Adjudication or Procedural Quagmire*, 67 VA. L. REV. 787 (1981).

129. *See* Gov't of the U.K. v. Boeing Co., 998 F.2d 68, 74 (2d Cir. 1993) (no consolidation); Am. Centennial Ins. Co. v. Nat'l Cas. Co., 951 F.2d 107, 108 (6th Cir. 1991) (same); Baesler v. Cont'l Grain Co., 900 F.2d 1193, 1195 (8th Cir. 1990) (same); Protective Life Ins. Co. v. Lincoln Life Ins. Corp., 873 F.2d 281, 282 (11th Cir. 1989) (per curiam) (same); Del E. Webb Constr. v. Richardson Hosp. Auth., 823 F.2d 145, 150 (5th Cir. 1987) (same); Weyerhaeuser Co. v. W. Seas Shipping Co., 743 F.2d 635, 637 (9th Cir. 1984) (same). *But see* Conn. Gen. Life Ins. Co. v. Sun Life Assurance Co., 210 F.3d 771, 775 (7th Cir. 2000) (construing arbitration agreement to permit court-ordered consolidation); N. River Ins. Co. v. Phila. Reinsurance Corp., 63 F.3d 160, 165 (2d Cir. 1995) (reconciling *Boeing* and *Nereus*); New Eng. Energy, Inc. v. Keystone Shipping Co., 855 F.2d 1, 5 (1st Cir. 1988) (ordering consolidated arbitration based on state law authorizing consolidation); Compania Espanola de Petroleos, S.A. v. Nereus Shipping, S.A., 527 F.2d 966, 975 (2d Cir. 1975) (finding authority for court to order consolidation). *See generally* 3 MACNEIL ET AL., *supra* note 34, § 33.3; Thomas J. Stipanowich, *Arbitration and the Multiparty Dispute: The Search for Workable Solutions*, 72 IOWA L. REV. 473 (1987). A number of state laws authorize courts to consolidate related arbitration proceedings, as does the Revised Uniform Arbitration Act. *See* CAL. CIV. PROC. CODE § 1281.3 (Deering 1997); GA. CODE ANN. § 9-9-6 (1997); MASS. GEN. LAWS ch. 251, §2A (1997); N.J. STAT. ANN. § 2A:23A-3 (West 1998); REVISED UNIFORM ARBITRATION ACT § 10(a) (2000), *available at* http://www.law.upenn.edu/bll/ulc/uarba/arbitrat1213.htm (last visited Feb. 28, 2001); *see also* S.C. CODE ANN. § 15-48-60 (1997) (joinder); UTAH CODE ANN. § 78-31a-9 (1997) (joinder).

wide arbitration.[130] Indeed, the presence of an arbitration clause precludes parties from proceeding with a class action in court, at least as to those contracts containing the arbitration clause.[131] Arbitration critics charge that corporations are using arbitration to insulate themselves from liability for claims that cannot economically be brought on an individual basis.[132]

Each of these criticisms of arbitration was raised and rejected in *Gilmer v. Interstate/Johnson Lane Corp.* as a basis for excluding age-discrimination claims from arbitration.[133] The Supreme Court rejected various arguments that arbitration procedures were inadequate to protect statutory rights, characterizing such arguments as "'rest[ing] on suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be complainants'" and thus "far out of step" with current arbitration doctrine.[134] It refused to presume bias, and found that the relevant arbitration rules "provide protections against biased panels."[135] The employee likewise made no showing that the more limited discovery available in arbitration would be inadequate to enable him to prove his claim.[136] The Court found the argument that "judicial review of arbitration decisions is too limited" unpersuasive, reasoning that "'such review is sufficient to ensure that arbitrators comply with the requirements of the statute' at issue."[137] The Court also rejected an argument that "arbitration procedures cannot adequately further the pur-

130. *See* Iowa Grain Co. v. Brown, 171 F.3d 504, 510 (7th Cir. 1999); Champ v. Siegel Trading Co., 55 F.3d 269, 274–77 (7th Cir. 1995); Randolph v. Green Tree Fin. Corp., 991 F. Supp. 1410, 1423–24 (M.D. Ala. 1997), *rev'd on other grounds*, 178 F.3d 1149 (11th Cir. 1999), *aff'd in part and rev'd in part*, 531 U.S. 79 (2000); Gammaro v. Thorp Consumer Discount Co., 828 F. Supp. 673, 674 (D. Minn. 1993), *appeal dismissed*, 15 F.3d 93 (8th Cir. 1994); McCarthy v. Providential Corp., 1994 WL 387852, at *8 (N.D. Cal. July 19, 1994); Green Tree Fin. Serv. Corp. v. Corrin, Civil Action No. 97-72273 (E.D. Mich. Mar. 25, 1998), *reported in* Kaplinsky, *supra* note 128, at 703–04.

131. *E.g.*, Zawikowski v. Beneficial Nat'l Bank, 1999 WL 35304, at *2 (N.D. Ill. Jan. 11, 1999); Hunt v. Up N. Plastics, 980 F. Supp. 1046, 1047 (D. Minn. 1997); Collins v. Int'l Dairy Queen, Inc., 169 F.R.D. 690, 694 (M.D. Ga. 1997); *ex parte* Green Tree Fin. Corp., 723 So. 2d 6, 10 & n.3 (Ala. 1998). Note that the arbitration rules of the National Association of Securities Dealers and the New York Stock Exchange provide that a "claim submitted as a class action shall not be eligible for arbitration." NASD Code § 12(d); N.Y. STOCK EXCHANGE, INC., CONSTITUTION AND RULES, Rule 600(d)(i) (Sept. 1999); *see* 2 MACNEIL ET AL., *supra* note 34, at § 18.9.2.

132. *E.g.*, Sternlight, *Class Action*, *supra* note 8, at 1; Sternlight, *supra* note 7, at 36–38; Miller, *supra* note 97, at 303.

133. *See* Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991). The Court rejected the criticisms in broad terms, although it left open the possibility it might conclude otherwise on a different record. *See id.* at 30–31.

134. *Id.* at 30 (quoting Rodriguez de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477, 481 (1989)).

135. *Id.* at 30–31.

136. *See id.* at 31.

137. *Id.* at 32 n.4. The employee also argued that the lack of written opinions in arbitration would result "in a lack of public knowledge of employers' discriminatory policies, an inability to obtain effective appellate review, and a stifling of the development of the law." *Id.* at 31. The Court dismissed this argument on the grounds that the relevant arbitration rules required all awards to be in writing, including a description of the award, and made public; courts would continue to adjudicate age-discrimination claims, so that judicial precedent would continue to develop; and the employee's "concerns apply equally to settlements of ADEA claims, which . . . are clearly allowed." *Id.* at 31–32.

poses of the ADEA because they do not provide for . . . class actions."[138] Merely because the ADEA permitted class actions did not mean "'that individual attempts at conciliation were intended to be barred.'"[139]

Finally, although proponents often cite reduced cost as one of the advantages of arbitration,[140] unlike litigation, parties to an arbitration proceeding must pay the fees of both the arbitrator and the administering institution.[141] A party bringing an arbitration claim must pay an up-front fee that often exceeds the filing fee that would be required to proceed in court.[142]

In several recent cases, courts have found the up-front fee required to proceed with arbitration to be a ground for refusing to enforce the arbitration agreement. In *Brower v. Gateway 2000, Inc.*,[143] a New York court held unconscionable a provision requiring arbitration of consumer disputes over purchase of a computer before the International Chamber

138. *Id.* at 32.

139. *Id.* (quoting Nicholson v. CPC Int'l Inc., 877 F.2d 221, 241 (3d Cir. 1989) (Becker, J., dissenting)); *see* Johnson v. W. Suburban Bank, 225 F.3d 366, 374 (3d Cir. 2000) (holding that "compelling arbitration of the claim of a prospective class action plaintiff [does not] irreconcilably conflict with TILA's goal of encouraging private actions to deter violation of the Act"), *cert. denied*, 69 U.S.L.W. 3552 (Feb. 20, 2001). *But see* Lozada v. Dale Baker Oldsmobile, Inc., 91 F. Supp. 2d 1087, 1105 (W.D. Mich. 2000) (noting that the "remedial purposes of [Truth in Lending Act] are substantially defeated or impaired by arbitration clauses such as the clause in this case"); Baron v. Best Buy Co., 75 F. Supp. 2d 1368, 1370–71 (S.D. Fla. 1999); Powertel, Inc. v. Bexley, 743 So. 2d 570, 577 (Fla. Dist. Ct. 1999), *review denied*, 763 So. 2d 1044 (Fla. 2000). The U.S. Supreme Court in *Green Tree Financial Corp.–Alabama v. Randolph*, 531 U.S. 79 (2000), declined to address an argument that "the arbitration agreement is unenforceable on the alternative ground that the agreement precludes respondent from bringing her claims under TILA as a class action." *Id.* at 523 n.7.

140. *E.g.*, Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 280 (1995) (quoting H.R. REP. NO. 542, 97th Cong., 2d Sess. 13 (1982)).

> The advantages of arbitration are many: it is usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties; it is more often flexible in regard to scheduling of times and places of future hearings and discovery devices.

Id.; Theodore O. Rogers, Jr., *Mandatory Pre-Dispute Arbitration: Self-Interested Critics Only Spinning Truth About a Process That Has Been Approved by Congress*, DISP. RESOL. MAG., Fall 1998, at 5 (describing arbitration as "a congressionally approved mechanism for resolution of claims that saves *all parties time and expense*") (emphasis added); Boyd A. Byers, *Want to Stay Out of Court? Consider Pre-Dispute Arbitration Agreements*, KAN. EMP. L. LETTER, May 1998, at 2 ("Arbitration promises time and money savings.").

141. *See* Miller, *supra* note 97, at 303. The necessity of paying an up-front fee is tempered by (1) the availability of low-cost consumer arbitration, *see infra* text accompanying notes 470–72; (2) the willingness of some arbitral institutions to waive or at least reduce fees for indigent claimants, *see* CODE OF PROCEDURE Rule 45 (National Arbitration Forum), *available at* http://www.arb-forum.com/library/nafcode.pdf (visited Feb. 21, 2001) [hereinafter NAF Rules] (waiver of fees for indigent party); 2000 AAA RULES, *supra* note 110, Rule R-51; and (3) the fact that "the consumer, if successful in the arbitration, would be most likely to recover all of its costs, including the administrative fee, from its opponent." Hans Smit, *May an Arbitration Agreement Calling for Institutional Arbitration Be Denied Enforcement Because of the Cost Involved?*, 8 AM. REV. INT'L ARB. 167 (1997); *see* 2000 AAA RULES, *supra* note 110, Rules R-45(c) & R-52.

142. *E.g.*, Carrington & Haagen, *supra* note 8, at 384–85 ("operative effect of the [arbitration] clause in the termite removal contract [in Allied-Bruce Terminix, Cos. v. Dobson, 513 U.S. 265 (1995)] was to deny many homeowners having small claims access to any forum at all"); Schwartz, *supra* note 8, at 61 (citing "[h]igher threshold costs to plaintiff" as a reason "why corporate defendants like arbitration").

143. 676 N.Y.S.2d 569 (App. Div. 1998).

of Commerce, which had a minimum fee of $4000 for small claims.[144] In *Cole v. Burns International Security Services*,[145] the D.C. Circuit enforced a predispute arbitration agreement between an employee and employer only after interpreting a general agreement to arbitrate under the rules of the American Arbitration Association as requiring the employer "to pay all of the arbitrator's fees necessary for a full and fair resolution of [the employee's] statutory claims."[146] In dicta, the court indicated that an employee "could not be required to agree to arbitrate his public-law claims as a condition of employment if the arbitration agreement required him to pay all or part of the arbitrator's fees and expenses."[147] The Tenth Circuit followed the *Cole* dicta and refused to enforce an arbitration agreement in an employment contract.[148] In *Green Tree Financial Corp.-Alabama v. Randolph*,[149] however, the U.S. Supreme Court rejected an argument that an arbitration clause in a consumer contract was unenforceable because it was silent as to who was to pay arbitration

144. *See id.* at 571, 574–75. As a result of other litigation, the plaintiffs had the option to arbitrate under the auspices of the American Arbitration Association (AAA) instead of the ICC. *See id.* at 573 (citing the unreported case of Filias v. Gateway 2000, Inc., No. 97C 2523 (N.D. Ill. Jan. 15, 1998)). Arbitrating before the AAA, the parties agreed, required payment of a "nonrefundable filing fee of $500." *See id*. at 574. The appeals court in *Brower* indicated that it could not "determine on this record whether the AAA process and costs would be so 'egregiously oppressive' that they, too, would be unconscionable" and remanded the case for further proceedings. *Id.* at 574–75.

145. 105 F.3d 1465 (D.C. Cir. 1997).

146. *Id*. at 1485. The court of appeals found both the arbitration agreement and the AAA rules silent on the responsibility for paying the arbitrator's fees, and construed the "ambiguous" provisions against the employer, which drafted the agreement. *Id.* at 1486.

147. *Id.* at 1485. The court dismissed fears of any resulting bias in favor of the employer as follows:

> If an arbitrator is likely to "lean" in favor of an employer—something we have no reason to suspect—it would be because the employer is a source of future arbitration business, and not because the employer alone pays the arbitrator. It is doubtful that arbitrators care about who pays them, so long as they are paid for their services.
>
> Furthermore, there are several protections against the possibility of arbitrators systematically favoring employers because employers are the source of future business. For one thing, it is unlikely that such corruption would escape the scrutiny of plaintiffs' lawyers or appointing agencies like AAA. Corrupt arbitrators will not survive long in the business. In addition, wise employers and their representatives should see no benefit in currying the favor of corrupt arbitrators, because this will simply invite increased judicial review of arbitral judgments. Finally, if the arbitrators who are assigned to hear and decide statutory claims adhere to the professional and ethical standards set by arbitrators in the context of collective bargaining, there is little reason for concern.

Id.

148. *See* Shankle v. B-G Maintenance Mgmt. of Colo., 163 F.3d 1230, 1234–35 (10th Cir. 1999); *see also* Paladino v. Avnet Computer Techs., Inc., 134 F.3d 1054, 1062 (11th Cir. 1998) (Cox, J., concurring). *But see* Bradford v. Rockwell Semiconductor Sys., Inc., 238 F.3d 549 (4th Cir. 2001); Williams v. Cigna Fin. Advisors, 197 F.3d 752, 763–64 (5th Cir. 1999), *cert. denied*, 120 S. Ct. 1833 (2000); Dobbins v. Hawk's Enter., 198 F.3d 715, 717 (8th Cir. 1999); Rosenberg v. Merrill Lynch, 170 F.3d 1, 15–16 (1st Cir. 1999); Doctor's Assocs., Inc. v Hamilton, 150 F.3d 157, 163 (2d Cir. 1998), *cert. denied*, 525 U.S. 1103 (1999); Doctor's Assocs., Inc. v. Stuart, 85 F.3d 975, 980–81 (2d Cir. 1986); Arakawa v. Japan Network Group, 56 F. Supp. 2d 349, 353–55 (S.D.N.Y. 1999); Howard v. KPMG Peat Marwick, 36 F. Supp. 2d 183, 186 (S.D.N.Y. 1999); McGaskill v. SCI Mgmt. Corp., No. 00 C 1543, 2000 WL 875396, at *3 (N.D. Ill June 22, 2000); Brown v. Surety Fin. Serv., Inc., No. 99 C 2405, 2000 WL 528631, at *4 (N.D. Ill. March 24, 2000); Thompson v. Ill. Title Loans, Inc., No. 99 C 3952, 2000 WL 45493, at *5 (N.D. Ill. Jan. 11, 2000).

149. 531 U.S. 79 (2000).

costs.[150] The Court concluded "that where, as here, a party seeks to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive, that party bears the burden of showing the likelihood of incurring such costs."[151] The Court then held that the plaintiff in *Green Tree* failed to carry that burden.[152]

3. *"Unfair" Provisions in Arbitration Clauses*

Because arbitration is a matter of contract, the parties have the power to change many characteristics of the arbitration proceeding by agreement. Arbitration critics argue that corporations misuse this power by including provisions in arbitration clauses that one-sidedly favor the corporation. Professor Jean Sternlight contends:

> [D]rafters of arbitration clauses will inevitably be tempted to use arbitration clauses to provide themselves with various unfair advantages. For example, such clauses have been structured to allow disputes to be resolved by biased panelists, to *increase* claimants' dispute resolution costs compared to litigation by imposing high arbitration fees or setting the arbitration in a distant location, to shorten claimants' statutes of limitation, or to limit the types of relief that can be afforded to claimants, such as the availability of punitive or compensatory damages. Recognizing that arbitration can at times be more costly and less effective than litigation, drafting parties have sometimes reserved to themselves the option to litigate claims important to them, while limiting the consumer or franchisee to arbitral remedies. Sadly, too many of such clauses have been upheld by too many courts.[153]

As Professor Sternlight's listing illustrates, the sorts of provisions criticized as making arbitration clauses "unfair" are numerous.

Arbitration clauses sometimes permit one party to select a majority of the arbitrators or impose qualifications that severely restrict those eligible to be arbitrators, provisions that arbitration critics fear may result

150. *See id*. at 522–23.

151. *Id.*

152. *See id.*

153. Sternlight, *supra* note 103, at 7 (footnote omitted); *see also* EEOC Notice No. 915.002, *supra* note 30, n.18; Sternlight, *Panacea*, *supra* note 8, at 638.

> [T]he arbitration clauses are crucial in that they not only bar judicial relief but also may allow companies to select the arbitrators, set the arbitration in a location convenient for the company but not for the little guy, exclude certain recoveries such as punitive damages, shorten the statute of limitations, deny discovery and other procedural protections, and eliminate virtually any right of appeal.

Id. (footnote omitted); Sternlight, *supra* note 7, at 36–39; United States Department of Commerce & Federal Trade Commission, *Joint Workshop on Alternative Dispute Resolution for Online Consumer Transactions*, *available at* http://www.ftc.gov/bcp/altdisresolution/comments/index.htm (visited August 12, 2000) (comments of Joan Claybrook, Public Citizen, and F. Paul Bland, Jr., Trial Lawyers for Public Justice). For a doctrinal analysis of whether various "unfair" provisions in arbitration clauses are unconscionable, see Stephen J. Ware, *Arbitration and Unconscionability After* Doctor's Associates, Inc. v. Casarroto, 31 WAKE FOREST L. REV. 1001 (1996).

in a biased decision maker.[154] For example, in *Hooters of America, Inc. v. Phillips*,[155] the Fourth Circuit held that Hooters had breached its contract and the duty of good faith and fair dealing by adopting an arbitration procedure that, among other provisions,[156] required all arbitrators to be selected from a list put together by Hooters.[157] The court concluded that "[g]iven the unrestricted control that one party (Hooters) has over the panel, the selection of an impartial decision maker would be a surprising result."[158] By comparison, the Ninth Circuit in *Woods v. Saturn Distribution Corp.*[159] refused to find "evident partiality" in an arbitration by a panel of two Saturn dealers and two Saturn employees.[160] The court rejected a dealer's argument that the panel was "composed of persons so closely tied to and dependent upon Saturn that any reasonable person would conclude he is not likely to receive a fair hearing."[161] It concluded that the dealer provided no evidence that the other dealers would benefit from ruling in favor of Saturn, such as by receiving an increased allocation of cars, and found no support for the dealer's assertion that Saturn employees would be biased against him.[162]

154. *See* Sternlight, *supra* note 7, at 6; Sternlight, *Panacea*, *supra* note 8, at 637–39.

155. 173 F.3d 933 (4th Cir. 1999).

156. *See id.* at 938–39. Other provisions found objectionable by the court include that (1) Hooters was not required to provide any notice of its defenses but the employee was required to provide notice of his or her claims; (2) Hooters, but not the employee, could expand the scope of the arbitration; (3) Hooters, but not the employee, could seek summary disposition; (4) Hooters, but not the employee, could record the arbitration proceeding; (5) Hooters, but not the employee, could seek to vacate any award on showing by a preponderance of the evidence that the arbitration panel exceeded its authority; and (6) Hooters, but not the employee, was permitted to cancel the arbitration agreement on 30 days notice. *See id.* at 939. The court held that "[b]y creating a sham system unworthy even of the name of arbitration, Hooters completely failed in performing its contractual duty" to establish a system of arbitration—"a system whereby disputes are fairly resolved by an impartial third party." *Id.* at 940.

157. *See id*. at 938. The court explained the arbitrator selection procedure as follows:

> The employee and Hooters each select an arbitrator, and the two arbitrators in turn select a third. Good enough, except that the employee's arbitrator and the third arbitrator must be selected from a list of arbitrators created exclusively by Hooters. This gives Hooters control over the entire panel and places no limits whatsoever on whom Hooters can put on the list. Under the rules, Hooters is free to devise lists of partial arbitrators who have existing relationships, financial or familial, with Hooters and its management. In fact, the rules do not even prohibit Hooters from placing its managers themselves on the list. Further, nothing in the rules restricts Hooters from punishing arbitrators against the company by removing them from the list.

Id. at 938–39.

158. *Id.* (describing arbitrator selection mechanism as "crafted to ensure a biased decision maker"); *see also* Cheng-Canindin v. Renaissance Hotel Assocs., 57 Cal. Rptr. 2d 867, 869 (Cal. Ct. App. 1997) (arbitration chaired by manager of hotel, with other members of hotel management as arbitrators); Ditto v. RE/MAX Preferred Props., Inc., 861 P.2d 1000 (Okla. Ct. App. 1993) (all three arbitrators selected by realty company from pool of its realtors).

159. 78 F.3d 424 (9th Cir. 1996).

160. *See id.* at 426. The arbitrators were selected at random from a pool of volunteers and received training in Saturn's dispute-resolution process. *See id.*

161. *Id.*

162. *See id.* at 428–29. The employees' jobs might not be jeopardized by ruling against Saturn, the court suggested, because they may have "an employment contract that specifies their salary and tenure." *Id.* at 429.

An arbitration clause also may specify the location where the arbitration proceeding is to be held, such as the principal place of business of the corporation. For corporations operating nationwide, such a clause may require an individual to travel a substantial distance to arbitrate a claim.[163] Such provisions face strong criticisms that they unfairly increase dispute resolution costs for individuals.[164] Indeed, proposed franchisee-protection legislation in Congress would outlaw such clauses.[165] In *Keystone, Inc. v. Triad Systems Corp.*,[166] the Montana Supreme Court invalidated a contract clause requiring a Montana corporation to arbitrate in California, relying on a Montana statute mandating that arbitration take place in the state.[167] The court found that the statute was not preempted under *Southland*[168] and *Doctor's Associates*[169] because the statute did not "nullif[y] either party's obligation to arbitrate their dispute" and because Montana had a similar statutory requirement for forum-selection clauses.[170] Other courts have upheld arbitration clauses specifying distant

163. *See* Carrington & Haagen, *supra* note 8, at 387. *Cf.* Edward A. Purcell, Jr., *Geography as a Litigation Weapon: Consumers, Forum-Selection Clauses, and the Rehnquist Court*, 40 UCLA L. REV. 423, 445–49 (1992) (forum selection clauses).

164. *See* Carrington & Haagen, *supra* note 8, at 387 (clause requiring Montana franchisees to arbitrate in Connecticut "was massively inconvenient for [the franchisees], so inconvenient that it effectively extinguished their right to the promised location if such a promise was made"); Sternlight, *supra* note 7, at 37; Vail, *supra* note 100, at 70 ("A purchase of XYZ electronic equipment can mean submitting disputes to XYZ's affiliated arbitrator in Jefferson, Wyoming—surely a tactic meant to discourage consumers from filing grievances"); *see also* Keith J. Kanouse & H. Stephen Brown, *AAFD's "Fair Franchising Standards": The Case For*, FRANCHISE L.J., Fall 1996, at 59, 59; *cf.* Lee Goldman, *My Way and the Highway: The Law and Economics of Choice of Forum Clauses in Consumer Form Contracts*, 86 NW. U. L. REV. 700, 722 (1992) (forum selection clauses). For example, the American Franchisee Association lists "provisions requiring arbitration in the franchisor's home state as among the worst franchise agreement provisions, noting that . . . the venue provision can be a costly prospect to a franchisee." *Franchise Agreement Arbitration Clauses Are Here to Stay . . . Or Are They?*, 7 WORLD ARB. & MEDIATION REP. 172 (1996).

165. *See* Small Business Franchise Act of 1999, H.R. 3308, 106th Cong. § 6(c) (1999).

> No stipulation or provision of a franchise agreement, or of an agreement ancillary or collateral to a franchise, shall . . . deprive a franchisee of the right to commence an action (or, if the franchise provides for arbitration, initiate an arbitration) against the franchisor for violation of this Act, or for breach of the franchise agreement, or of any agreement or stipulation ancillary or collateral to the franchise, in a court (or arbitration forum) *in the State of the franchisee's principal place of business*.

Id. (emphasis added); *see also* Carrington, *supra* note 8, at 231 app. (setting out text of proposed statute). A number of states also have statutes or regulations that invalidate clauses in franchise agreements providing for out-of-state arbitration, although courts have held those provisions preempted by the FAA. *See* Benjamin A. Levin & Richard S. Morrison, Kubis *and the Changing Landscape of Forum Selection Clauses*, FRANCHISE L.J., Winter 1997, at 97, 116–18 (1997); *see also infra* text accompanying note 172.

166. 971 P.2d 1240 (Mont. 1998).

167. *See id.* at 1243–44. The Montana statute provided as follows:

> No agreement concerning venue involving a resident of this state is valid unless the agreement requires that arbitration occur within the state of Montana. This requirement may only be waived upon the advice of counsel as evidenced by counsel's signature thereto.

MONT. CODE ANN. § 27-5-323, *quoted in Keystone*, 971 P.2d at 1244.

168. Southland Corp. v. Keating, 465 U.S. 1 (1984).

169. Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681 (1996).

170. *Keystone*, 971 P.2d at 1245 (citing MONT. CODE ANN. § 28-2-708); *cf.* Patterson v. ITT Consumer Fin. Corp., 18 Cal. Rptr. 2d 563, 565–67 (Cal. Ct. App. 1993) (holding arbitration clause unconscionable in part on ground that it required California consumers to arbitrate in Minnesota).

locations against allegations that they were unconscionable[171] and concluded that state statutes invalidating such clauses were preempted by the FAA.[172]

Third, arbitration clauses may contain provisions altering the rights and remedies of one or both of the parties in ways that arbitration critics argue are unfair. Those provisions may define the allocation of litigation costs—either providing for the prevailing party to recover its attorneys' fees[173] or requiring each party to bear all of its own costs. They may limit the amount of time in which the parties can make a claim, effectively shortening the statute of limitations that otherwise would apply.[174] Also, they may restrict the authority of arbitrators to award punitive damages or contain an express waiver of any right to punitive damages.[175]

In *Graham Oil Co. v. ARCO Products Co.*,[176] the Ninth Circuit invalidated an arbitration clause containing all three of these types of provisions as contrary to the Petroleum Marketing Practices Act (PMPA).[177] The PMPA is a federal statute designed to "'protect[] franchisees'"[178] owning gasoline-distribution franchises because of their "'continuing vulnerability . . . to the demands and actions of the franchisors.'"[179] It creates a federal cause of action for termination or nonrenewal of such a franchise in violation of statutory requirements.[180] The PMPA further provides that under appropriate circumstances the franchisee may recover punitive damages and reasonable attorneys' fees.[181] The statute also contains a one-year statute of limitations.[182] The franchise agreement between ARCO and its franchisees provided: (1) "Each party shall pay its own costs and expenses, including attorneys' fees related to such

171. *E.g.*, Doctor's Assocs., Inc. v. Stuart, 85 F.3d 975, 980 (2d Cir. 1996).

172. *E.g.*, KKW Enters., Inc. v. Gloria Jean's Gourmet Coffees Franchising Group, 184 F.3d 42, 50–52 (1st Cir. 1999) (holding that Rhode Island statute invalidating clauses in franchise agreements selecting out-of-state forum preempted as applied to arbitration clause); Doctor's Assocs., Inc. v. Hamilton, 150 F.3d 157, 163 (2d Cir. 1998) (holding that New Jersey Franchise Practices Act invalidating arbitral forum selection clauses in franchise agreements preempted by the FAA), *cert. denied*, 525 U.S. 1103 (1999); Management Recruiters Int'l v. Bloor, 129 F.3d 851, 856 (6th Cir. 1997) (dicta) (suggesting that if Washington Franchise Investment Protection Act imposed an absolute requirement of in-state arbitration despite parties' agreement to the contrary, it would be preempted by FAA); M.C. Constr. Corp. v. Gray Co., 17 F. Supp. 2d 541, 547–49 (W.D. Va. 1998) (holding preempted a Virginia statute requiring arbitration under construction contract to be held in-state); Alphagraphics Franchising, Inc. v. Whaler Graphics, Inc., 840 F. Supp. 708, 710 (D. Ariz. 1993) (holding that a Michigan statute invalidating clauses in franchise agreements selecting out-of-state arbitral forum is preempted).

173. Fee-shifting clauses seem to have been relatively uncontroversial. Indeed, the American Association of Franchisees and Dealers recommends such a provision in its Fair Franchising Standards. *See* Kanouse & Brown, *supra* note 164, at 65.

174. *E.g.*, Sternlight, *supra* note 7, at 38; Kanouse & Brown, *supra* note 164, at 65.

175. *E.g.*, Sternlight, *supra* note 7, at 37; Kanouse & Brown, *supra* note 164, at 64.

176. 43 F.3d 1244 (9th Cir. 1994).

177. 15 U.S.C. §§ 2801–2806 (1994).

178. *See Graham Oil*, 43 F.3d at 1246 (quoting Khorenian v. Union Oil Co., 761 F.2d 533, 535 (9th Cir. 1985)).

179. *Id.* (quoting S. REP. NO. 95-731 (1978), *reprinted in* 1978 U.S.C.C.A.N. 873, 876).

180. *See* 15 U.S.C. § 2805(a) (1994).

181. *See id.* § 2805(d)(1)(B) & (C).

182. *See id.* § 2805(a).

arbitration"; (2) "The arbitrator(s) may not assess punitive or exemplary damages"; and (3) "The party waives the right to seek any relief or pursue any claim not included in an arbitration demand filed and served within 90 days following the date the party knew or should have known of the facts giving rise to the claim."[183] The court of appeals held that these three provisions were contrary to statutory rights "important to the effectuation of the PMPA's policies" and thus "violate[d] federal law."[184] Because the arbitration clause was "a highly integrated unit containing three different illegal provisions," the court concluded that the provisions were not severable and the entire arbitration clause was invalid.[185]

Finally, arbitration clauses may permit the corporation, but not the individual, to proceed to court for certain types of claims. Some clauses give the corporation the option to go to court;[186] others simply exclude certain types of claims from arbitration altogether.[187] These clauses have been criticized on the ground that if litigation is best for the corporation, the individual should be able to go to court too.[188] The West Virginia

183. *Graham Oil*, 43 F.3d at 1249–50.

184. *Id.* at 1248.

185. *Id.* at 1248; *see also* Armendariz v. Foundation Health Psychcare Servs., Inc., 6 P.3d 669, 691–94 (Cal. 2000) (damages limitation and nonmutual arbitration clause); Degaetano v. Smith Barney, Inc., 983 F. Supp. 459, 464–65 (S.D.N.Y. 1997) (arbitration clause void "to the extent that it prevents prevailing plaintiffs from obtaining an award of attorney's fees in employment discrimination cases"); Johnson v. Hubbard Broad., Inc., 940 F. Supp. 1447, 1459–62 (D. Minn. 1996) (allowing arbitrator to decide validity of provisions; but if arbitrator interprets arbitration agreement as waiving right to attorneys' fees or punitive damages or as reducing statute of limitations, "the agreement would contravene federally established remedial measures, possibly rendering the agreement unenforceable as unconscionable") (claim based on federal and state civil rights laws); Stirlen v. Supercuts, Inc., 60 Cal. Rptr. 2d 138, 150–51 (Cal. Ct. App. 1997) (finding restriction on remedies, including punitive damages, unconscionable). *But see* Wright v. Circuit City Stores, Inc., 82 F. Supp. 2d 1279 (N.D. Ala. 2000); Morrison v. Circuit City Stores, Inc., 70 F. Supp. 2d 815 (S.D. Ohio 1999). *See generally* Edward Wood Dunham, *Enforcing Contract Terms Designed to Manage Franchisor Risk*, FRANCHISE L.J., Winter 2000, at 91, 97–98 (discussing enforceability of damage caps in franchise agreements). For other approaches to similar issues, see Paladino v. Avnet Computer Techs., Inc., 134 F.3d 1054, 1057–58 (11th Cir. 1998) (Hatchett, C.J.) (holding that arbitrator authorized to award "damages for breach of contract only"; court construed "as a gloss explaining the types of claims that the parties intended to submit to arbitration, rather than as a potentially unlawful limitation of statutory remedies"); Great Western Mortgage Corp. v. Peacock, 110 F.3d 222, 231–32 (3d Cir. 1997) (holding that challenges to provisions in arbitration agreement allegedly waiving attorneys' fees and punitive damages and providing a shortened statute of limitations were for the arbitrator to decide) (claim based on a state anti-discrimination law).

186. *See generally* Marco E. Schnabl, *The Growing Use of Options to Arbitrate*, N.Y. L.J., Feb. 4, 1993, at 5 (discussing options to arbitrate commonly found in commercial contracts).

187. Such clauses have been referred to as "carve-outs" because they carve out certain disputes from the obligation to arbitrate. Donald Lee Rome, *Preserving Rights—and ADR—by Knowing When to Use a 'Carve Out'*, ALTERNATIVES TO HIGH COST LITIG., Jan. 1998, at 6, 6; Terry L. Trantina, *An Attorney's Guide to Alternative Dispute Resolution (ADR)*, *in* ARBITRATION OF CONSUMER FINANCIAL DISPUTES 29, 43–45 (PLI Corp. Law Practice Course, Handbook Series No. 1102, 1999) (citing advantages).

188. *E.g.*, Michael D. Donovan & David A. Searles, *Preserving Judicial Recourse for Consumers: How to Combat Overreaching Arbitration Clauses*, 10 LOY. CONSUMER L. REV. 269, 282 (1998) ("While such a clause binds unsophisticated, trusting consumers and commits them to an irrevocable waiver of their day in court, it leaves powerful and more sophisticated businesses completely free to choose a judicial forum for the enforcement of the contracts."); Sternlight, *supra* note 7, at 38–39.

Supreme Court of Appeals in *Arnold v. United Companies Lending Corp.*[189] held unconscionable a clause in a consumer-loan contract requiring the consumer to arbitrate any disputes but permitting the lender to go to court to foreclose on the property or recover money due from the consumer.[190] In *Iwen v. U.S. West Direct*,[191] the Montana Supreme Court refused to enforce an arbitration clause that required an advertiser in the yellow pages to arbitrate all disputes but permitted the publisher to go to court to collect amounts due,[192] concluding that the arbitration clause "lack[ed] mutuality" and was unconscionable.[193] The majority of courts, however, have rejected challenges to similar arbitration clauses, regardless of whether the challenge was based on grounds of unconscionability or lack of mutuality.[194]

III. HOW COMMON ARE "UNFAIR" ARBITRATION CLAUSES?

There is little published empirical evidence on the use and nature of arbitration clauses.[195] Contracts ordinarily are private, not public, docu-

189. 511 S.E.2d 854 (W. Va. 1998).

190. *See id.* at 858. The arbitration clause provided:

> [T]his Agreement to . . . arbitrate shall not apply with respect to either (i) the Lender's right . . . to submit and to pursue in a court of law any actions related to the collection of the debt; (ii) foreclosure proceedings . . . , proceedings pursuant to which Lender seeks a deficiency judgment, or any comparable procedures allowed under applicable law pursuant to which a lien holder may acquire title to the Property which is security for this loan and any related personal property . . . upon a default by the Borrower under the mortgage loan documents; or (iii) an application by or on behalf of the Borrower for relief under the federal bankruptcy laws of [sic] any other similar laws of general application for the relief of debtors.

Id.

191. 977 P.2d 989 (Mont. 1999).

192. The clause provided in part that "[a]ny controversy or claim arising out of or relating to this Agreement, or breach thereof, *other than an action by Publisher for the collection of amounts due under this Agreement*, shall be settled by binding arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association . . . ." *Id.* at 993. The advertiser was a lawyer; the yellow-pages ad as published had omitted his toll-free phone number. *See id.* at 991.

193. *See id.* at 996; *see also* Armendariz v. Foundation Health Psychcare Servs., Inc., 6 P.3d 669, 691–94 (Cal. 2000) (holding damages limitations and nonmutual nature of arbitration made arbitration clause unconscionable); Lopez v. Plaza Finance Corp., 1996 WL 210073, at *4 (N.D. Ill. April 25, 1996) ("Where only one party is bound to arbitrate, the agreement is unenforceable.").

194. *E.g.*, Harris v. Green Tree Fin. Corp., 183 F.3d 173, 179–81 (3d Cir. 1999); We Care Hair Dev., Inc. v. Engen, 180 F.3d 838, 842–43 (7th Cir. 1999); Barker v. Golf U.S.A., Inc., 154 F.3d 788, 791–94 (8th Cir. 1998), *cert. denied*, 525 U.S. 1068 (1999); Doctor's Assocs., Inc. v. Distajo, 66 F.3d 438, 453 (2d Cir. 1995) ("where the agreement to arbitrate is integrated into a larger unitary contract, the consideration for the contract as a whole covers the arbitration clause as well" (quoting W.L. Jorden & Co. v. Blythe Indus., 702 F. Supp. 282, 284 (N.D. Ga. 1988)); Wilson Elec. Contractors, Inc. v. Minnotte Contracting Corp., 878 F.2d 167, 168–69 (6th Cir. 1989); Brown v. Surety Fin. Serv., Inc., 2000 WL 528631 (N.D. Ill. Mar. 24, 2000); Thompson v. Ill. Title Loans, Inc., 2000 WL 45493 (N.D. Ill. Jan. 11, 2000); Wright v. Circuit City Stores, Inc., 82 F. Supp. 2d 1279 (N.D. Ala. 2000); Pridgen v. Green Tree Fin. Serv. Corp., 88 F. Supp. 2d 655 (S.D. Miss. 2000); Smith v. Sanderson Group, Inc., 736 So. 2d 604 (Ala. 1999); *ex parte* Parker v. Green Tree Fin. Corp., 730 So. 2d 168 (Ala. 1999); Ishmael v. Dutch Housing Inc., 1997 Ohio App. LEXIS 3974, at *4–6 (Ohio Ct. App. 1997); Munoz v. Green Tree Fin. Corp., 2001 S.C. LEXIS 16 (S.C. Sup. Ct. Jan. 22, 2001); Lackey v. Green Tree Fin. Corp., 498 S.E.2d 898, 904 (S.C. Ct. App. 1998).

195. For rare exceptions, see Mei L. Bickner et al., *Developments in Employment Arbitration: Analysis of a New Survey of Employment Arbitration Programs*, DISP. RESOL. J., Jan. 1997, at 8, 15,

ments, and so are not readily available for study. Although institutions frequently publish their arbitration rules, which operate as standard terms that parties can incorporate by reference into their contracts, no direct evidence is available of the number of contracts incorporating those rules.[196] The only evidence of the frequency with which those rules are used is the number of demands for arbitration filed with each institution, which may or may not reflect the number of contracts incorporating the rules.[197] More importantly, because institutional rules are merely standard forms, they can be and are changed by the parties in their contracts.[198] Merely examining the institutional rules does not reveal how the parties themselves changed the rules.

As a result, criticisms of arbitration clauses as "unfair" generally rely on anecdotal reports of the terms of arbitration clauses—in particular clauses that have given rise to litigation—rather than any systematic study of those terms.[199] To the extent that the criticism is simply that unfair provisions can be added to arbitration agreements and sometimes are, then anecdotal reports may be useful. But a more systematic examination of dispute-resolution clauses is necessary to determine (1) the extent to which parties have choices other than arbitration for dispute resolution; (2) whether the use of "unfair" provisions in arbitration clauses is widespread or isolated; and (3) how the frequency of "unfair" provisions in arbitration clauses compares to the frequency in other dispute-resolution clauses, particularly forum-selection clauses.

This part offers empirical evidence on the use of "unfair" arbitration clauses in a sample of franchise agreements. Franchise agreements, unlike most other contracts, are publicly available in some states, which require franchisors to register before selling franchises in the state.[200]

78–83 (survey of thirty-six employers on arbitration procedures in employment contracts); Stephen R. Bond, *How to Draft an Arbitration Clause (Revisited)*, ICC INT'L CT. ARB. BULL., Dec. 1990, at 14 (analyzing arbitration clauses in arbitrations filed in 1987 and 1989 with the International Court of Arbitration of the International Chamber of Commerce); Stephen R. Bond, *How to Draft an Arbitration Clause*, J. INT'L ARB., June 1989, at 65 (same for 1987). Much of the empirical work on the use of arbitration is in the form of surveys of corporate officials, which provide no information on the terms of arbitration agreements. *E.g.*, David B. Lipsky & Donald L. Seeber, *Patterns of ADR Use in Corporate Disputes*, DISP. RESOL. J., Feb. 1999, at 66; Catherine Cronin-Harris & Peter H. Kaskell, *How ADR Finds a Home in Corporate Law Departments*, ALTERNATIVES TO HIGH COST LITIG., Dec. 1997, at 158.

196. Many institutional rules are available on the Internet. For a collection of both domestic and international arbitration rules, see Commercial Arbitration Resource Collection, *Institutional Rules*, *at* http://lawstudy.law.ukans.edu/arbitrate/rulestext.html (visited Feb. 28, 2001) (copy on file with *University of Illinois Law Review*).

197. Presumably there is some relationship, although not a precise one. For other difficulties with data from arbitration institutions, see Christopher R. Drahozal, *Commercial Norms, Commercial Codes, and International Commercial Arbitration*, 33 VAND. J. TRANSNAT'L L. 79, 114 n.168 (2000).

198. *See infra* text accompanying notes 231–32; *see also* Mark E. Budnitz, *Arbitration of Disputes Between Consumers and Financial Institutions: A Serious Threat to Consumer Protection*, 10 OHIO ST. J. ON DISP. RESOL. 267, 273–77 (1995) (describing terms of arbitration clauses used by four financial institutions).

199. *E.g.*, Haagen, *supra* note 8, at 1056–57; Sternlight, *supra* note 7, at 7–9.

200. *See infra* text accompanying notes 203–06.

Arbitration critics commonly group franchisees with consumers and employees as parties needing protection from "unfair" arbitration clauses.[201] If so, the empirical evidence presented in this part of the article may provide some indication of the frequency of "unfair" arbitration clauses in consumer contracts generally.[202] The evidence reveals that (1) a majority of franchise agreements do not provide for arbitration, instead relying on a judicial forum for resolving disputes; (2) some "unfair" provisions are common in the arbitration clauses studied, but others are very rare; and (3) forum-selection clauses contain many of the same "unfair" provisions as well.

A. Sample

The sample consists of franchise agreements from seventy-five leading franchisors that had franchise agreements on file with the Minnesota Department of Commerce in the summer of 1999. Minnesota is one of thirteen states that requires franchisors to register before selling franchises in the state.[203] Franchisors register by filing a Uniform Franchise Offering Circular (UFOC),[204] a copy of the franchise agreement,[205] and other materials with the Minnesota Department of Commerce. The materials filed, including both the UFOC and the franchise agreement, are available for public review. The UFOC is a form promulgated by the North American Securities Administrators' Association, Inc. (NASAA) "to facilitate compliance with disclosure requirements under state franchise investment laws."[206] Item 9 of the UFOC requires franchisors to

201. *See supra* note 9.

202. I argue later that franchisors in fact require no special protection. *See infra* text accompanying notes 445–55. If so, then conclusions from the evidence presented in this section would not necessarily apply to consumer contracts generally.

203. MINN. STAT. ANN. § 80C.02 (West 1999); *see* Federal Trade Commission, *State Agencies Administering Franchise Disclosure Laws*, *at* http://www.ftc.gov/bcp/franchise/netdiscl.htm (last updated Sept. 3, 1999) (identifying states requiring filing as California, Hawaii, Illinois, Indiana, Maryland, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin) (on file with *University of Illinois Law Review*).

204. *See* MINN. R. 2860.3800 (1999) ("The commissioner may accept as application for registration the Uniform Franchise Registration Application adopted by the North American Securities Administrators Association; however, the commissioner reserves the right to require alterations in the Uniform Franchise Offering Circular as necessary.").

205. *See* MINN. STAT. ANN. § 80C.04(h) (West 1999); MINN. R. 2860.3500(15) (1999). Other agreements required by the franchisor, such as site-development agreements or software-licensing agreements, also are included in the filing. For consistency, the dispute-resolution clauses studied here were those in the franchise agreement (sometimes called a license agreement), rather than these other agreements. This limitation may, however, result in some provisions of arbitration clauses, particularly exceptions to arbitration, being undercounted. The Doctor's Associates, Inc. Franchise Agreement (Subway), for example, does not exclude foreclosure actions from arbitration. *See* Doctor's Assocs., Inc. v. Jabush, 89 F.3d 109, 111 (2d Cir. 1996). But Subway's sublease agreement with franchisees does not contain an arbitration clause and provides that default under the franchise agreement also constitutes default under the sublease, thus permitting Subway to go to court to evict the franchisee. *See id.* at 111–13.

206. North American Securities Administrators Association, *Uniform Franchise Offering Circular Guidelines*, General Instructions ¶ 90, *available at* http://nasaa.org/nasaa/corpfin/ufoc.doc (last visited

disclose the franchisee's obligations as to "dispute resolution,"[207] and section 17 requires disclosure of provisions in the franchise agreement concerning "[d]ispute resolution by arbitration or mediation" and "[c]hoice of forum."[208] The items provided a starting point for locating the relevant provisions in the franchise agreement itself, which was the most recent version of the franchise agreement used in Minnesota.[209] Minnesota requires a separate registration whenever the franchisor offers or sells a franchise with terms that "vary substantially" from the agreement on file,[210] discouraging, at least in Minnesota, individually negotiated changes in the franchise agreement.

The franchises studied include almost all of the highest ranking franchise opportunities listed in *Entrepreneur Magazine*'s Franchise 500,[211] a self-described ranking of "the best opportunities for entrepre-

Nov. 6, 2000); *see* Patrick J. Carter, *The New Uniform Franchise Offering Circular: The Franchisee Perspective*, FRANCHISE L.J., Fall 1994, at 27 (describing development of revised UFOC).

207. *See* North American Securities Administrators Association, *Requirements for Preparation of a Uniform Franchise Offering Circular*, Item 9: Franchisee's Obligations ii(x), *available at* http://nasaa.org/nasaa/corpfin/ufoc.doc (last visited Nov. 6, 2000).

208. North American Securities Administrators Association, *Requirements for Preparation of a Uniform Franchise Offering Circular*, Item 17: Renewal, Termination, Transfer and Dispute Resolution v(u) & v(v), *available at* http://nasaa.org/nasaa/corpfin/ufoc.doc (last visited Nov 6, 2000). In addition, if applicable the following language must appear on the cover of the UFOC:

> THE FRANCHISE AGREEMENT PERMITS THE FRANCHISEE (TO SUE) (TO ARBITRATE WITH) ______ ONLY IN ______. OUT OF STATE (ARBITRATION) (LITIGATION) MAY FORCE YOU TO ACCEPT A LESS FAVORABLE SETTLEMENT FOR DISPUTES. IT MAY ALSO COST MORE (TO SUE) (TO ARBITRATE WITH) ______ IN ______ THAN IN YOUR HOME STATE.

North American Securities Administrators Association, *Requirements for Preparation of a Uniform Franchise Offering Circular*, Cover Page Instruction (iv), *available at* http://nasaa.org/nasaa/corpfin/ufoc.doc (last visited Nov. 6, 2000).

209. Most, but not all, franchisors use a standard franchise agreement with addenda that contain variations as required by a particular state's law. Some franchisors, however, file in Minnesota a version of the franchise agreement for use only in Minnesota. Presumably, these franchisors may use a somewhat different version of the franchise agreement in other states. This raises the possibility of some bias due to the provisions of Minnesota franchise law. Thus, Minnesota regulations provide that it is an "unfair and inequitable" practice to "require a franchisee to waive his or her rights to a jury trial or to waive rights to any procedure, forum, or remedies provided for by the laws of the jurisdiction, or to consent to liquidated damages, termination penalties, or judgment notes; provided that this part shall not bar an exclusive arbitration clause." MINN. R. 2860.4400(j) (1999). Because of Minnesota franchise law, a franchisor might include an arbitration clause in its Minnesota contract when it would prefer a court trial without a jury, which might result in some bias in favor of arbitration in the sample. Or punitive damages waivers may be understated.

210. *See* MINN. R. 2860.1100(1) (1999). A "substantial variation in the contract or agreement" is one that "relate[s] to different products, services, fees charged, duties imposed, obligations incurred, or investments required to be made by the contract or agreement," but does not include "variation of terms or provisions within a contract or agreement designed to recognize individual differences in time, geography, market, volume, size, or costs for goods, materials, and supplies incurred by the franchisor." *Id.* at 2860.1100(2).

211. *See Entrepreneur Magazine's 20th Annual Franchise 500*, ENTREPRENEUR MAGAZINE ONLINE, *at* http://www.entrepreneurmag.com/franchise500/franchise_ranks.hts (visited June 1, 1999). The seventy-five franchises studied are not the seventy-five highest-ranked franchises listed in the Franchise 500 because nine of the top seventy-five were not registered (or seeking to be registered) in Minnesota at the time the data was collected. Instead, the sample includes those of the top eighty-four franchises for which registration filings were available.

neurs."[212] The ranking itself is not a part of the quantitative analysis; instead, it simply provides assurance that the franchises studied are viable franchise opportunities.[213] The franchises included in the sample are listed in Appendix I.

Tables 1 through 3 summarize some basic characteristics of the franchises in the sample. Table 1 lists the products or services produced by the franchises studied. Those products and services are widely varied. The most common type of franchise studied is fast food and other restaurants (25 of 75). But the sample also includes a number of retail franchises (10), as well as franchises providing business and accounting services (9), cleaning services (6), auto-care services (6), travel services (6), hair-care services (4), and various others.

Table 2 summarizes the year in which the franchisors began franchising, as reported by *Entrepreneur Magazine*.[214] It illustrates that the franchisors studied are long-standing, well-established franchisors. All but seven franchisors have been franchising for more than ten years. The newest franchisor in the sample is Curves for Women, a franchisor of fitness and weight-loss centers for women, which began franchising in 1995.[215] The oldest franchisor in the sample is A&W Restaurants, Inc., which began franchising in 1925.[216] The 1980s was the most common decade for the franchisors in the sample to begin franchising, with twenty-nine franchisors, followed by the 1970s with seventeen and the 1960s with twelve.

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212. *See* Marcia Anton et al., *Franchise 500*, ENTREPRENEUR, Jan. 1999, at 210, 210. Entrepreneur Magazine describes its methodology as follows:

> In our ranking, we consider numerous factors, some of which are weighed more heavily than others. The most important ones include financial strength and stability, growth rate, and size of the system. We also consider the number of years a company has been in business, the length of time it's been franchising, start-up costs, litigation history, percentage of franchise terminations, and whether the company provides financing. Financial data was audited by an independent CPA firm.
>
> These factors are objective, quantifiable measures of a franchise operation. We do not measure subjective elements such as franchisee satisfaction or management style, since these are judgements only you can make based on your own needs and experiences. All companies, regardless of size, are judged by the same criteria.

Id.

213. For another use of data from the Entrepreneur Magazine Franchise 500, see Bruce H. Kobayashi & Larry E. Ribstein, *Contract and Jurisdictional Freedom*, *in* THE FALL AND RISE OF FREEDOM OF CONTRACT 325, 344 (F.H. Buckley ed., 1999).

214. The year the franchisor began franchising is not necessarily the same as the year the franchisor began doing business. For example, Carlson Wagonlit Travel began doing business in 1888 and did not begin franchising until 1984. *See Entrepreneur Magazine's 20th Annual Franchise 500*, *supra* note 211.

215. *See* Appendix I.

216. *See id.*

TABLE 1
PRODUCT OR SERVICE PROVIDED

Food Service & Restaurants	25
Various Retail	10
Business & Accounting Services	9
Cleaning Services	6
Automobile Services	6
Travel Services	6
Hair Care Services	4
Real Estate	3
Fitness Center	2
Training Services	2
Other	2

TABLE 2
YEAR BEGAN FRANCHISING

1990s	7
1980s	29
1970s	17
1960s	12
1950s	6
1940s	2
1930s	1
1920s	1

Table 3 summarizes the number of franchised units for the franchisors in the sample. The number of franchises ranged from 162 for Q Lube, the smallest system in the sample, to 19,667 for Kumon Math & Reading Centers, the largest.[217] Roughly one-quarter of the sample have

217. *See id.*

between 500 and 1000 franchises, and another one-quarter have between 1000 and 2000 franchises. Again, these data suggest that the franchisors in the sample are relatively large, well-established franchisors with extensive franchise operations.[218]

TABLE 3
NUMBER OF FRANCHISES (1998)

<500	16
500–1000	18
1000–2000	18
2000–3000	5
3000–4000	4
4000–5000	8
5000–10,000	3
>10,000	3

B. Results

Overall, eighty-nine percent of the franchise agreements studied contained some form of dispute-resolution clause, either an arbitration clause or a forum-selection clause. This finding is broadly consistent with other recent reports on the use of dispute-resolution clauses in franchise agreements.[219] Table 4 presents details of the results. The most common form of dispute-resolution clause in the franchise agreements studied was a clause providing for arbitration of disputes: forty-five percent of the

218. Note that there may be many different franchise agreements in effect between a particular franchisor and its franchisees at any given time. For example, Dairy Queen argued against class certification in a class action brought by a group of its franchisees on the ground that there were "more than 500 different types of franchise agreements existing among the franchisees who are members" of the class. Collins v. Int'l Dairy Queen, Inc., 168 F.R.D. 668, 676 (M.D. Ga. 1996), *modified*, 169 F.R.D. 690 (M.D. Ga. 1997). Thus, the fact that *Entrepreneur Magazine* shows Dairy Queen as having 5800 franchisees in 1998, *see* Appendix I, and that the Dairy Queen franchise agreement on file with the Minnesota Department of Commerce contains an arbitration clause, does not mean that all 5800 franchisees are parties to a Dairy Queen franchise agreement that contains an arbitration clause. *See* Appendix I.

219. *See* Robert W. Emerson, *Franchise Contract Clauses and the Franchisor's Duty of Care Toward Its Franchisees*, 72 N.C. L. REV. 905, 966 app., 973 app. (1994) (93% of one hundred food service franchise agreements studied contained dispute resolution clauses). For discussions of the use of arbitration clauses in franchise agreements in the United Kingdom, see ANTONY W. DNES, FRANCHISING: A CASE-STUDY APPROACH 298–99 (1992); Antony W. Dnes, *A Case-Study Analysis of Franchise Contracts*, 22 J. LEGAL STUD. 367, 373 n.15 (1993).

agreements (34 of 75)[220] contained such a clause.[221] This compares with thirty-one percent reported by Emerson in 1993,[222] and twenty-three percent reported by the Senate Small Business Committee in 1971.[223] Because of differences in the samples used by these sources, it is difficult to reach any definitive conclusions. But the evidence at least suggests a growing use of arbitration clauses in franchise agreements, although still less than a majority contain such clauses. Thirty-nine percent of the agreements (29 of 75) contained clauses providing for an exclusive judicial forum,[224] and five percent of the agreements (4 of 75) included clauses providing for a nonexclusive judicial forum.[225] The remaining eleven percent of the franchise agreements (8 of 75) contained no dispute-resolution clause.[226]

TABLE 4
DISPUTE-RESOLUTION CLAUSES IN FRANCHISE AGREEMENTS

	1999	Emerson 1993	Senate Report 1971
Arbitration	45%	31%	23%
Forum Selection	44%	62%	27%
Exclusive	(39%)		
Nonexclusive	(5%)		
Total	89%	93%	50%

In every franchise agreement with an arbitration clause, arbitration was "mandatory" for the franchisee in the sense that the franchisee could not wait until after the dispute arose to decide whether to arbitrate. One

220. One franchise agreement provided for arbitration to determine the value of the premises should the franchisor seek to acquire the premises from the franchisee. For all other disputes, the agreement contained an exclusive forum selection clause. Because most disputes would be resolved in court rather than in arbitration, I classified this agreement as one containing a forum-selection clause rather than an arbitration clause.

221. Sample provisions from a variety of arbitration clauses appear in Appendix II.

222. *See* Emerson, *supra* note 219, at 973 app.

223. *See* SENATE SELECT COMM. ON SMALL BUSINESS, 92D CONG., 1ST SESS., REPORT PREPARED FOR THE SMALL BUSINESS ADMINISTRATION: THE ECONOMIC EFFECTS OF FRANCHISING (1971).

224. *E.g.*, Jani-King Associate Franchise Agreement, *infra* Appendix III.

225. *E.g.*, Ramada Franchise Systems, Inc. License Agreement, *infra* Appendix III.

226. Interestingly, 20% of the franchise agreements (15 of 75) provided for some form of mediation, either together with or instead of other forms of dispute resolution. This is a dramatic increase from the 3% in 1991, reported by Emerson. *See* Emerson, *supra* note 219, at 973 app. An additional twelve franchisors in the sample (as well as five franchisors that included a mediation clause in their franchise agreement) participate in the National Franchise Mediation Program administered by the Center for Public Resources (CPR). *See* CENTER FOR PUBLIC RESOURCES, ADR IN INDUSTRY AND PRACTICE AREAS, *at* http://www.cpradr.org/industry-franchise.htm (visited Oct. 30, 2000) (listing participating franchisors); *see also* David J. Kaufman, *A New Mediation Program*, N.Y. L.J., Apr. 28, 1999, at 3; Margaret A. Jacobs, *Industry Giants Join Movement to Mediate*, WALL ST. J., July 2, 1997, at B1. Thus, at least 36% (27 of 75) of the franchises studied provide for disputes with franchisees to be subject to some form of mediation.

clause permitted the franchisor to elect to arbitrate any dispute arising out of the franchise agreement, with

> [the election to] be made at any time prior to the commencement of a judicial proceeding by Franchisor, or in the event of a judicial proceeding instituted by you at any time prior to the date on which an Answer and/or Response is due to a Summons and/or Complaint served by you.[227]

Otherwise, the dispute was to be resolved in either state or federal court in New York, the franchisor's home state.[228] As discussed below, a number of clauses permitted either the franchisor, the franchisee, or both to proceed to court instead of arbitration for certain types of disputes.[229]

Of the arbitration clauses studied, virtually all (33 of 34 or 97%) selected the American Arbitration Association (AAA) to administer the arbitration, with the Commercial Arbitration Rules of the AAA generally chosen to govern the conduct of the arbitration.[230] All of the arbitration clauses went beyond the simple form of the AAA's recommended arbitration clause[231] to address other matters in the clause.[232] By contrast, the forum-selection clauses in the sample often, although not always, were much simpler.[233] Key features of arbitration under the AAA rules in effect at the time[234] are as follows, subject to the arbitrator(s)' discretion to interpret and apply procedural rules[235] and the parties' ability to agree to different procedures:

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227. Yogen Fruz USA Franchise Company, Inc. Franchise Agreement, *infra* Appendix II.

228. *Id.*

229. *See infra* text accompanying notes 312–19.

230. One arbitration clause required use of the "least expensive procedure" of the AAA, one clause provided for the AAA's expedited arbitration procedures to govern, and two clauses provided that "[a]ctions to enforce an express obligation to pay moneys may be brought" under the AAA's expedited arbitration procedures. Indeed, the AAA Commercial Arbitration Rules provide that the Expedited Procedures generally "shall be applied in any case where no disclosed claim or counterclaim exceeds $75,000, exclusive of interest and arbitration costs," and adds that "[p]arties may also agree to use the Expedited Procedures in cases involving claims in excess of $75,000." 2000 AAA RULES, *supra* note 110, Rule R-7; *see id.* Rules E-1 to E-10 (setting out Expedited Procedures).

231. *See* 2000 AAA RULES, *supra* note 110. The AAA's sample arbitration clause reads as follows:

> Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration administered by the American Arbitration Association under its Commercial Arbitration Rules, and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

Id.

232. For examples of some of the provisions included in the arbitration clauses in the sample, see Appendix II.

233. *E.g.*, Jani-King Associate Franchise Agreement, *infra* Appendix III (exclusive forum-selection clause); Ramada Franchise Systems, Inc. License Agreement, *infra* Appendix III (nonexclusive forum-selection clause).

234. The rules described in the text are the AAA rules effective as amended January 1, 1999, which were in effect during the period of the study. *See* AMERICAN ARBITRATION ASSOCIATION, COMMERCIAL DISPUTE RESOLUTION PROCEDURES (as amended Jan. 1, 1999), *available at* http://www.adr.org/rules/archives/commercial_rules.html (last visited Feb. 27, 2001) [hereinafter 1999 AAA RULES]. The AAA amended its rules effective September 1, 2000. *See* 2000 AAA RULES, *supra* note 110.

235. *See* 1999 AAA RULES, *supra* note 234, Rule R-55. The rule states:

- Arbitration is initiated by the claimant "giv[ing] to the other party" a demand for arbitration "within the time period, if any, specified in the contract(s)."[236] The claimant also must file with any AAA office two copies of the demand and two copies of the arbitration clause in the contract, plus the appropriate filing fee.[237] Under the rules in effect in 1999, the filing fee ranged from $500 for a claim of up to $10,000, to $7000 for a claim of $1,000,000 to $5,000,000, with the fee for claims of over $5,000,000 negotiable.[238] The AAA may reduce or defer payment of the filing fee "in the event of extreme hardship on the part of any party. . . ."[239]
- The respondent may file and serve an answering statement, which may include a counterclaim. If the respondent includes a counterclaim, it must pay the appropriate filing fee.[240]
- If the parties agree on a method for appointing an arbitrator, that method will be followed.[241] If the parties do not agree on a method for appointing an arbitrator, the AAA will send both parties an identical list of prospective arbitrators from an AAA panel. If the parties cannot agree on one of the names, the parties can strike names to which they object and are to rank the remaining names. The AAA will pick an arbitrator from the names remaining on both lists, "in accordance with the designated order of mutual preference."[242] Unless the parties agree otherwise or the AAA "in its discretion" directs otherwise, one arbitrator will be chosen.
- The AAA rules do not provide for class arbitration.[243] Indeed, the rules do not provide even for consolidation of separate arbitration proceedings into one, and the AAA's practice is not to

> The arbitrator shall interpret and apply these rules insofar as they relate to the arbitrator's powers and duties. When there is more than one arbitrator and a difference arises among them concerning the meaning or application of these rules, it shall be decided by a majority vote. If that is not possible, either an arbitrator or a party may refer the question to the AAA for final decision. All other rules shall be interpreted and applied by the AAA.

Id.

236. *Id.* Rule R-4(a)(i).

237. *See id.* Rule R-4(a)(ii).

238. *See id.* Filing Fees. In addition, the AAA charged hearing fees and postponement/cancellation fees. *See id.* Hearing Fees, Postponement/Cancellation Fees. Effective September 1, 2000, the AAA amended its rules to increase many of its filing fees and to replace the fees for hearings and postponement with a Case Service Fee. *See* 2000 AAA RULES, *supra* note 110, Fees.

239. 1999 AAA RULES, *supra* note 234, Rule R-51.

240. *See id.* Rule R-4(b).

241. *See id.* Rule R-13(a).

242. *See id.* Rule R-13(a)–(b).

243. *See* Miller, *supra* note 97, at 304. *But see* Kaplinsky, *supra* note 128, at 714–15 (stating that at least one "renegade arbitrator" has certified a class in arbitration, apparently relying on the arbitral discretion over procedural matters); Smit, *supra* note 141, at 170 n.27 ("To the extent institutional rules permit arbitrators to formulate rules of procedure, they may be regarded as authorized to permit, and provide rules for processing, class actions.").

consolidate unless expressly authorized by the parties or ordered by a court.[244]

- The arbitrator may direct the parties to produce "documents and other information" and identify any witnesses to be called at the hearing "consistent with the expedited nature of arbitration."[245] At least five business days before the hearing, the parties must exchange copies of all exhibits they will seek to introduce at the hearing.[246] In addition, if authorized by law, the arbitrator may subpoena witnesses or documents independently or at a party's request.[247]
- The arbitration hearing is to be private;[248] the parties may be represented by counsel if they give appropriate notice.[249] The order of presenting evidence is within the control of the arbitrator so long as "the parties are treated with equality and . . . each party has the right to be heard and is given a fair opportunity to present its case."[250] The parties may introduce "relevant and material" evidence.[251] The arbitrator is authorized to exclude evidence that is irrelevant or cumulative, but "[c]onformity to legal rules of evidence shall not be necessary."[252]
- Unless the parties agree otherwise, the arbitrator must make his or her award within thirty days after the hearing is closed.[253] In the award, the arbitrator "may grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement of the parties, including, but not limited to, specific performance of a contract."[254] The arbitrator is to assess the costs of arbitration, including the AAA's administrative fees and the arbitrator's fees, "among the parties in such amounts as the arbitrator determines is appropriate"[255] and may award attorneys' fees if authorized by the parties or by the applicable law.[256]

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244. *See* Michael F. Hoellering, *Consolidated Arbitration: Will It Result in Increased Efficiency or an Affront to Party Autonomy?*, DISP. RESOL. J., Jan. 1997, at 41, 46. The AAA Rules contain a default rule governing selection of arbitrators in the event the parties agree to multiparty arbitration. 1999 AAA RULES, *supra* note 234, Rule R-13(c). But the rule does not authorize either the arbitrator or a court to consolidate arbitration proceedings in the absence of agreement of the parties.

245. 1999 AAA RULES, *supra* note 234, Rule R-23(a).

246. *Id.* Rule R-23(b).

247. *Id.* Rule R-33(d). The Federal Arbitration Act authorizes arbitrators to "summon in writing any person to attend before them or any of them as a witness and in a proper case to bring with him or them any book, record, document, or paper which may be deemed material as evidence in the case." 9 U.S.C. § 7 (1994).

248. *See* 1999 AAA RULES, *supra* note 234, Rule R-25.

249. *See id.* Rule R-26.

250. *Id.* Rule R-32(a), (b).

251. *Id.* Rule R-33(a).

252. *Id.* Rule R-33(a), (b).

253. *See id.* Rule R-43.

254. *Id.* Rule R-45(a).

255. *Id.* Rule R-45(c); *see also id.* Rule R-52 ("The expenses of witnesses for either side shall be paid by the party producing such witnesses. All other expenses of the arbitration, including required

- No appeals process is provided for in the AAA rules.

Occasionally, arbitration clauses in the franchise agreements studied changed these rules to make arbitration more (or less) closely resemble litigation.[257] Overriding the standard AAA rule,[258] three clauses adopted the Federal Rules of Evidence to govern the arbitration hearing.[259] Two clauses provided for the Federal Rules of Civil Procedure to govern discovery in arbitration,[260] a significant change from usual arbitral practice.[261] Three clauses specified precise procedures for and limits on the extent of discovery available in arbitration.[262] Two clauses provided for de novo hearings in court if the damages awarded by the arbitrator exceeded a specified amount (either $100,000 or $150,000).[263] Two other clauses effectively provided for judicial review of errors of law by making legal errors beyond the scope of the arbitrator's jurisdiction.[264] No clauses provided for an arbitral appeals panel. Two clauses provided for limited class arbitration,[265] and one provided for limited consolidation of related arbitrations but gave a party to a claim "properly the subject of a class action" the choice between pursuing an individual claim in arbitration and the class action in court.[266] Many more clauses (18 of 34 or 53%) precluded class relief,[267] either expressly (8),[268] by precluding consolida-

travel and other expenses of the arbitrator, AAA representatives, and any witness and the cost of any proof produced at the direct request of the arbitrator, shall be borne equally by the parties, unless they agree otherwise or unless the arbitrator in the award assesses such expenses or any part thereof against any specified party or parties.").

256. *See id.* Rule R-45(d).

257. Conversely, forum-selection clauses often included waivers of jury trial rights, effectively making the judicial forum more like arbitration. *E.g.*, Quizno's Corporation Franchise Agreement, *infra* Appendix III.

258. *See supra* text accompanying notes 251–52.

259. *E.g.*, Medicine Shoppe International, Inc. License Agreement, *infra* Appendix II.

260. *E.g.*, *id.*

261. *See supra* text accompanying notes 120–22; *see also* 3 MACNEIL ET AL., *supra* note 34, § 34.1 at 34:2 ("Limitations on discovery . . . remain one of the hallmarks of American commercial arbitration, including arbitration under the FAA. Avoidance of the delay and expense associated with discovery is still one of the reasons parties choose to arbitrate.") (footnotes omitted). For a description of discovery rules in employment arbitration programs, see Bickner et al., *supra* note 195, at 80.

262. *E.g.*, Yogen Fruz USA Franchise Company, Inc. Franchise Agreement, *infra* Appendix II.

263. *E.g.*, Servicemaster Franchise Agreement, *infra* Appendix II.

264. *See* Century Small Business Solutions, Inc. Franchise Agreement, *infra* Appendix II; Mail Boxes Etc. Franchise Agreement, *infra* Appendix II.

265. *E.g*., Allied-Domecq Retailing USA Franchise Agreement (Baskin-Robbins), *infra* Appendix II (permitting class-wide arbitration of franchisees' claim "limited exclusively to alleged misappropriation of moneys from the Fund of any System authorized by this Agreement").

266. *See* Taco John's International, Inc. Restaurant Franchise Agreement, *infra* Appendix II (requiring that claims "present issues of fact or law in common" but providing that "the total number of Taco John's Restaurants owned by the claimants in the arbitration may not exceed fifteen percent (15%) of the total number of franchised Taco John's Restaurants in operation").

> If a claim which is subject to arbitration under this Agreement is properly the subject of a class action, then the party making that claim may, in its discretion, elect either to assert it as a single-party claim (as opposed to a claim on behalf of a class) in the arbitration, or to file it as a class action in a court of competent jurisdiction, pursuant to the laws and rules applicable to that court.

Id.

267. Several (4 of 33 or 12%) of the forum-selection clauses studied contained provisions seeking to preclude class actions in litigation. *E.g.*, Coldwell Banker Commercial Franchise Agreement, *infra*

tion (2),[269] by precluding both class relief and consolidation (3),[270] or by limiting the arbitration to claims involving the franchisee (5).[271] Overall, the vast majority of clauses maintained the standard characteristics of arbitration unchanged.

Every arbitration clause—indeed, virtually every franchise agreement—contained at least some provisions of the sort arbitration critics have identified as unfair.[272] "Unfair" provisions appeared both in franchise agreements with arbitration clauses and in franchise agreements with forum-selection clauses (and on occasion in those with neither). Some of the "unfair" provisions were common, although others were rare.

1. Selection of Arbitrators

More than half (19 of 34 or 56%) of the arbitration clauses in the sample contained some provision on the selection of arbitrators, as summarized in Table 5. Of the clauses with a provision on arbitrator selection, forty-seven percent (9 of 19) required a single arbitrator,[273] and fifty-three percent (10 of 19) specified a panel of three arbitrators.[274] The clauses providing for three arbitrators generally directed each party to appoint one arbitrator and then the party-appointed arbitrators to appoint the third, presiding arbitrator.[275] Thirty-seven percent of the clauses with provisions on arbitrator selection (7 of 19) established qualifications for the arbitrator or arbitrators. One of the clauses specified that arbitrators must be lawyers or former judges;[276] four others required experience in "franchising or distribution law."[277] The other two did not require legal experience but instead experience either in franchise arbitration or the franchise industry.[278]

Appendix III (waiver of right to bring class action); Jackson Hewitt Franchise Agreement, *infra* Appendix III (franchisee agrees not to bring or join class action, explaining that "for our Network to function properly, we cannot be burdened with the costs of litigating network-wide disputes"); Wendy's International, Inc. Unit Franchise Agreement, *infra* Appendix III (no class action or consolidation).

268. *E.g.*, Fantastic Sams Conventional License Agreement, *infra* Appendix II.

269. *E.g.*, Orion Franchise Agreement, *infra* Appendix II.

270. *E.g.*, Papa John's Franchise Agreement Single Location Franchise, *infra* Appendix II.

271. *E.g.*, CD Warehouse, Inc. Franchise Agreement, *infra* Appendix II.

272. *See* discussion *supra* Part II.B.3.

273. *E.g.*, Century Small Business Solutions, Inc. Franchise Agreement, *infra* Appendix II.

274. *E.g.*, Auntie Anne's, Inc. Franchise Agreement, *infra* Appendix II.

275. *E.g.*, *id.*; Schlotzsky's Inc. Franchise Agreement, *infra* Appendix II. The Auntie Anne's, Inc. Franchise Agreement is unusual, however, in that it provides for all decisions to be made by the third arbitrator, rather than by the panel of arbitrators. *See* Auntie Anne's Franchise Agreement, *infra* Appendix II.

276. *E.g.*, Century Small Business Solutions, Inc. Franchise Agreement, *infra* Appendix II.

277. *E.g.*, Play It Again Sports Franchise Agreement, *infra* Appendix II.

278. *E.g.*, Schlotzsky's Inc. Franchise Agreement, *infra* Appendix II.

TABLE 5
PROVISIONS ON ARBITRATOR SELECTION

One arbitrator	15%
One arbitrator plus qualifications	12%
Three arbitrators	21%
Three arbitrators plus qualifications	9%
No provision	44%

The Schlotzsky's, Inc. Franchise Agreement requires some qualifications worth further discussion. The Schlotzsky's, Inc. Franchise Agreement requires all arbitrators to be "qualified," which it defines to mean (1) at least forty years old; (2) with three-years experience in a "Qualified Food Service Position"; and (3) having worked in a "Qualified Food Service Position" within the last year.[279] A "Qualified Food Service Position" is a "Corporate Officer or Area Supervisor (or equivalent) for a multi-unit, quick service (including fast food) restaurant or chain (exclusive of drive-in and chains specializing in chicken), having annual system wide gross sales in excess of Two Hundred Million Dollars ($200,000,000.00)."[280] In other words, only corporate officials recently employed by large, fast-food companies can serve as arbitrators under the Schlotzsky's, Inc. Franchise Agreement. Although the provision ensures that arbitrators are familiar with the business side of the fast-food industry, it invites a challenge of bias that might invalidate the arbitration provision.[281] The Schlotzsky's, Inc. Franchise Agreement was the only one in the sample that contained this sort of qualification provision.[282]

2. Site of Arbitral Proceedings

Table 6 summarizes the sites where the dispute-resolution clauses in the sample required proceedings to be held. The vast majority of arbitration clauses (28 of 34 or 82%) required that arbitration take place at the franchisor's home, either by naming the city or by specifying that arbitration be held at the franchisor's principal place of business.[283] Two of these clauses, although providing for a default location of the franchisor's home city, apparently made the choice of location negotiable by provid-

279. *Id.*
280. *Id.*
281. *See supra* text accompanying notes 155–58.
282. *Cf.* Bickner et al., *supra* note 195, at 80 (among thirty-six employers surveyed, almost 85% provided for "joint selection" while "[s]omewhat less than 15% provided for employer selection").
283. *E.g.*, American Fastsigns, Inc. Franchise Agreement, *infra* Appendix II.

ing a line in the contract for the parties to select some other location.[284] Whether in fact other locations are chosen cannot be determined from the sample. A handful of clauses specified other locations: the franchisee's home state,[285] the home of the respondent in the arbitration,[286] a neutral location,[287] or a location to be determined by the arbitrator.

TABLE 6
LOCATIONS SPECIFIED IN DISPUTE-RESOLUTION CLAUSES

	Arbitration Clause	Exclusive Forum-Selection Clause
Franchisor's Home	82%	72%
Option for Franchisor		21%
Franchisee's Home	3%	3%
Respondent's Home	6%	3%
Neutral Location	3%	
Determined by Arbitrator	3%	
No Location	3%	

By comparison, seventy-two percent (21 of 29) of the exclusive forum-selection clauses in the sample required all litigation to be filed at the franchisor's home.[288] Another twenty-one percent (6 of 29) required the franchisee to file suit in the franchisor's home, but permitted the franchisor a choice of locations, including the franchisor's home.[289] All four of the nonexclusive forum-selection clauses authorized suit at the franchisor's home as the selected forum.

284. *E.g.*, Allied-Domecq Retailing USA Franchise Agreement (Dunkin' Donuts), *infra* Appendix II.

285. *See* Snap-On Tools Dealer Franchise Agreement, *infra* Appendix II.

286. *E.g.*, Orion Franchise Agreement, *infra* Appendix II. Thus, if the franchisee initiates the arbitration, the arbitration is held at the franchisor's home; if the franchisor initiates the arbitration, the arbitration is held at the franchisee's home.

287. *See* Taco John's International, Inc. Restaurant Franchise Agreement ("a neutral location chosen by the American Arbitration Association which does not unduly favor or prejudice either party"), *infra* Appendix II.

288. *E.g.*, A&W Restaurants, Inc. License Agreement, *infra* Appendix III.

289. *E.g.*, Arby's Inc. License Agreement, *infra* Appendix III.

3. Allocation of Litigation Costs

The franchise agreements in the sample contained two types of provisions allocating litigation costs.[290] One type is a fee-shifting provision, which provides that the prevailing party,[291] or the franchisor as prevailing party,[292] can recover his or her litigation costs, including attorneys' fees, from the other party. Such a provision attempts to change, by contract, the prevailing "American Rule" whereby parties are responsible for their own costs in litigation even if they prevail.[293] This type of provision appears in contracts with an arbitration clause, contracts with a forum-selection clause, and even contracts with no dispute-resolution clause. The other type of provision allocates the costs of arbitration,[294] changing (or reaffirming) the AAA rule that the arbitrator has the authority to assess the costs of arbitration.[295] This type of provision appears only in arbitration clauses.

As shown in Table 7, fifty percent (17 of 34) of the franchise agreements with arbitration clauses and forty-five percent (13 of 34) of the franchise agreements with exclusive forum-selection clauses contained fee-shifting provisions.[296] A slightly higher percentage of contracts with exclusive forum-selection clauses (3 of 29 or 10%) contained one-sided, fee-shifting clauses—ones that operated only in favor of the franchisor, not the franchisee—than did contracts with arbitration clauses (2 of 34 or 6%). Interestingly, one hundred percent (4 of 4) of the franchise agreements with nonexclusive forum-selection clauses contained fee-shifting provisions, as did fifty percent (4 of 8) of the franchise agreements with neither an arbitration clause nor a forum-selection clause.

290. *Cf.* Bickner et al., *supra* note 195, at 81 ("About half of the [employment arbitration] plans called for the employer to pay arbitration fees, the other half providing for shared costs.").

291. *E.g.*, Great Clips Franchise Agreement, *infra* Appendix II; Curves International, Inc. Franchise Agreement, *infra* Appendix III.

292. *E.g.*, Harris Research, Inc. Franchise Agreement (Chem-Dry), *infra* Appendix II; Servpro Industries, Inc. Franchise License Agreement, *infra* Appendix III.

293. *See* Chambers v. NASCO, Inc., 501 U.S. 32, 45 (1991); *see also* Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240, 247 (1975).

294. *E.g.*, Mail Boxes Etc. Franchise Agreement, *infra* Appendix II; Blimpie International, Inc. Traditional Location Franchise Agreement, *infra* Appendix II.

295. *See supra* text accompanying notes 255–56.

296. These numbers may be understated to some extent. Fee-shifting provisions in franchise agreements are often treated as forms of indemnification clauses, and so may appear elsewhere in the contract than in the dispute resolution clause.

TABLE 7
PROVISIONS ALLOCATING LITIGATION COSTS

	Arbitration	Exclusive Forum Selection	Nonexclusive Forum Selection	No Clause
Prevailing Party	44%	35%	75%	37.5%
Franchisor as Prevailing Party	6%	10%	25%	12.5%
Bear Own Costs	15%			
Bear Own Costs; No Attorneys' Fees	3%			
Share Arbitration Costs	9%			
As Arbitrator Determines	3%			
No Provision	21%	55%		50%

Thirty percent (10 of 34) of arbitration clauses contained some provision specifying how arbitrators were to assess costs. Three percent (1 of 34) merely reiterated that the costs were to be assessed as the arbitrator determined. Nine percent (3 of 34) directed that the parties were to share the costs of arbitration, typically the administrative costs and the arbitrator's fees. Eighteen percent (6 of 34) provided that the parties were to bear their own costs of conducting the arbitration but splitting the administrative fees and the fees for the arbitrator's services.[297] One of these clauses added that "attorneys' fees may not be awarded by the arbitrator(s), and any such award shall not be enforceable or enforced in any court."[298] The court in *Graham Oil* concluded that a clause requiring parties to bear their costs of arbitration was an invalid attempt to circumvent fee-shifting statutes,[299] which authorize the prevailing party by statute to recover its attorneys' fees in certain types of litigation.[300]

297. *E.g.*, Mail Boxes Etc. Franchise Agreement, *infra* Appendix II.
298. *See* Blimpie International, Inc. Traditional Location Franchise Agreement, *infra* Appendix II.
299. *See* Graham Oil Co. v. ARCO Prods. Co., 43 F.3d 1244, 1249 (9th Cir. 1994); *see supra* text accompanying notes 176–85.
300. *E.g.*, 42 U.S.C.A. § 1988(b) (West Supp. 2000) (civil-rights laws).

4. *Time Limits for Filing Claims*

Thirty-eight percent (13 of 34) of the arbitration clauses in the sample and thirty-nine percent (11 of 29) of the exclusive forum-selection clauses limited the time for parties to file claims, as shown in Table 8. The time limits specified ranged from six months to three years, with one or two years the most common. A small number of clauses required notice of any claim to be given within thirty to sixty days, with the arbitration demand filed within one to two years.[301] The provisions sometimes contained different time limits for different claims. The Doctor's Associates, Inc. Franchise Agreement (Subway) is illustrative. It requires an arbitration proceeding or other action to be begun within one year of when the events occurred, except that the franchisor is given three years to bring a claim against the franchisee alleging under-reported sales.[302]

TABLE 8
TIME LIMITS FOR FILING CLAIMS

	Arbitration Clause	Exclusive Forum-Selection Clause
One Year	15%	17%
Two Years	9%	17%
Other Limit	15%	3%
No Provision	62%	62%

5. *Restrictions on Available Relief*

Table 9 summarizes provisions in the franchise agreements studied that sought to preclude recovery of punitive damages. Almost three-quarters of the arbitration clauses (25 of 34 or 74%) contained such provisions, which were of three types.[303] Three clauses denied the arbitrator authority to award punitive damages in the arbitration proceeding.[304] Such clauses are ambiguous as to whether they preclude recovery of pu-

301. *See* Auntie Anne's, Inc. Franchise Agreement, *infra* Appendix II; Prudential Real Estate Brokerage Franchise Agreement, *infra* Appendix III.

302. *See* Doctor's Associates Inc. Franchise Agreement (Subway), *infra* Appendix II; *see also* Prudential Real Estate Brokerage Franchise Agreement, *infra* Appendix III (requiring action to be commenced within two years from date cause of action accrues, except for claims arising out of franchisee's obligation to pay money to the franchisor).

303. Thus, it seems no longer true that "[m]any arbitration agreements . . . do not expressly address the question of whether punitive damages may be awarded." Stephen J. Ware, *Punitive Damages in Arbitration: Contracting Out of the Government's Role in Punishment and Federal Preemption of State Law*, 63 FORDHAM L. REV. 529, 536 (1994). For a description of remedy provisions in employment arbitration programs, see Bickner et al., *supra* note 195, at 81.

304. *E.g.*, Mail Boxes Etc. Franchise Agreement, *infra* Appendix II.

nitive damages in a judicial forum after the arbitration is completed.[305] Ten clauses contained express waivers of the right to recover punitive damages, sometimes excluding certain claims (such as claims against the franchisee for trademark infringement or misuse of confidential information) from the waiver.[306] The remaining twelve claims combined language denying the arbitrator authority to award punitive damages with a waiver of punitive damages recovery.

TABLE 9
RESTRICTIONS ON PUNITIVE DAMAGES

	Arbitration	Exclusive Forum Selection	Nonexclusive Forum Selection	No Clause
No Authority to Award	9%			
Waiver	29%	41%	50%	12.5%
No Authority & Waiver	35%			
No Provision	26%	59%	50%	87.5%

Forum-selection clauses also contained waivers of punitive damages, although less frequently than arbitration clauses. Punitive damage waivers were found in forty-one percent (12 of 29) of the franchise agreements with exclusive forum-selection clauses and fifty percent (2 of 4) of the franchise agreements with nonexclusive forum-selection clauses.[307] Indeed, one (of eight) of the franchise agreements with neither an arbitration clause nor a forum-selection clause nonetheless contained a waiver of punitive damages. Waivers in forum-selection clauses, like those in arbitration clauses, sometimes excluded franchisor claims against the franchisee for trademark infringement or misuse of confidential information, thus permitting the franchisor to recover punitive damages on such claims.[308]

One arbitration clause not only contained a waiver of punitive damages but also a cap on total damage recovery by either party. The Doctor's Associates, Inc. Franchise Agreement (Subway) restricted parties to recovering compensatory damages, including, at most, one year of lost

305. *Compare* Ware, *supra* note 303, at 540–42 (arguing that agreement denying arbitrator authority to award punitive damages waives altogether claim for punitive damages), *with* Stipanowich, *Punitive Damages*, *supra* note 87, at 35 (arguing that punitive damages remain available in litigation after arbitration proceeding is completed). *See also* Jonathan Solish, *Turning Your Arbitration Instrument into a Stradivarius*, 11 FRANCHISE L.J., 135, 132 (1992) (discussing "two schools of thought on the question").

306. *E.g.*, GNC Franchising Inc. Agreement, *infra* Appendix II.

307. *E.g.*, Coldwell Banker Commercial Franchise Agreement, *infra* Appendix III.

308. *See id.*

profits, and then "further limited" any party's "total liability for Disputes" to $80,000 (adjusted annually for inflation) or the minimum amount in controversy for federal diversity jurisdiction,[309] whichever is greater.[310] No other franchise agreement in the sample contained a similar cap on damages, although as noted earlier, two arbitration clauses did provide for a de novo judicial proceeding if the damages awarded in arbitration exceeded a certain amount.[311]

6. *Exceptions to Arbitration*

A substantial majority of arbitration clauses (32 of 34 or 94%) excluded some claims or remedies from arbitration, either categorically or at the option (almost always) of the franchisor. As described earlier,[312] one clause granted the franchisor the option to choose between arbitration or litigation for any claim.[313] Twenty-nine clauses (29 of 34 or 85%) provided for some sort of claim to be decided in court, either by excluding the claim from arbitration or granting a party (usually, although not always, the franchisor) the option to go to court.[314]

Table 10 lists the most common exceptions to arbitration, as a percentage of all of the arbitration clauses studied.[315] The most common exception was for trademark disputes, with sixty-eight percent of all arbitration clauses permitting the franchisor to go to court to protect its trademark. Other common exceptions were: (1) equitable relief sought by the franchisor (44%); (2) recovery of money due under the franchise agreement (32%); (3) immediate termination of the franchise agreement, such as from fraud or dishonesty of the franchisee (32%); (4) repossession of real or personal property, such as through ejectment or foreclosure on collateral (26%); and (5) enforcement of covenants not to compete (18%).[316]

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309. Currently, the required amount in controversy for diversity jurisdiction is $75,000. *See* 28 U.S.C. § 1332(a) (Supp. III 1997).

310. *See* Doctor's Associates, Inc. Franchise Agreement (Subway), *infra* Appendix II.

311. *See supra* text accompanying note 263.

312. *See supra* text accompanying notes 227–28.

313. *See* Yogen Fruz USA Franchise Company, Inc. Franchise Agreement, *infra* Appendix II.

314. Of the remaining five clauses, three permitted parties to seek interim relief in court. This provision was common in the other arbitration clauses in the sample as well.

315. Because many of the arbitration clauses include several exceptions to arbitration, the percentages total to well over 100%.

316. The Precision Tune Auto Care, Inc. Franchise Agreement, for example, contains three of these exceptions: trademark disputes, actions to obtain possession of the store premises, and actions for money due. *See* Appendix II. It also excludes antitrust actions from arbitration, as do two other clauses.

TABLE 10
COMMON EXCEPTIONS TO ARBITRATION

Exception	Percentage
Trademark Disputes	68%
Equitable Relief for Franchisor	44%
Money Due	32%
Immediate Termination of Franchise Agreement (e.g., for fraud, dishonesty)	32%
Repossession of Real or Personal Property	26%
Covenants Not to Compete	18%

Finally, two clauses, in addition to granting the franchisor the option to litigate in specified classes of cases, granted franchisees a conditional option to litigate in court as well.[317] However, these clauses conditioned the franchisee's option to litigate on the franchisee "expressly waiv[ing] the right to a trial by jury and any and all claim(s) for punitive, multiple, exemplary and/or consequential damages."[318] Otherwise, the franchisee's complaint is to be "dismissed without prejudice, leaving the parties to their arbitration remedies, if any."[319]

C. *Summary of Findings*

The key findings can be summarized as follows. First, not all franchise agreements require arbitration. Indeed, fewer than half of the franchise agreements studied (45%) contained arbitration clauses. Most of the other franchise agreements contained forum-selection clauses (44%), although a small number of those did not specify an exclusive forum. Overall, eleven percent of the franchise agreements in the sample contained neither an arbitration clause nor a forum-selection clause.

Second, the "unfair" provisions identified by arbitration critics ranged from common to very rare in the arbitration clauses studied. Only one arbitration clause in the sample contained a questionable provision governing the selection of arbitrators. The rest generally followed the arbitrator selection procedures in the Commercial Arbitration Rules of the American Arbitration Association, sometimes specifying the number of arbitrators or requiring the arbitrators to have legal training or franchising experience. Over eighty percent of the arbitration clauses

317. *E.g.*, Allied-Domecq Retailing USA Franchise Agreement (Baskin-Robbins), *infra* Appendix II.
318. *Id.*
319. *Id.* If the franchisee seeks to file a counterclaim in any litigation brought by the franchisor, a similar waiver is required or the counterclaim must be submitted to arbitration. *See id.*

required arbitration to take place at the franchisor's home, although a handful specified other locations. Seventy-nine percent contained some sort of provision allocating litigation costs and seventy-four percent restricted the award of punitive damages. Only thirty-eight percent established a time limit for bringing a claim. Finally, almost all (94%) excluded some claims or remedies from arbitration, sometimes categorically and sometimes at the franchisor's (or even the franchisee's) option. The most common exclusion was for trademark disputes, although claims for various forms of equitable relief also frequently were excluded.

Third, "unfair" provisions were included not only in arbitration clauses but also in franchise agreements with forum-selection clauses. Indeed, some franchise agreements with neither an arbitration clause nor a forum-selection clause nonetheless contained provisions arbitration critics have identified as unfair. Provisions selecting the franchisor's home as the location for resolving disputes (or giving the franchisor the option to so choose) were more common in forum-selection clauses than in arbitration clauses, although provisions setting out a time limit for bringing a claim were equally common. Provisions allocating litigation costs and waiving punitive damages, by comparison, were more common in arbitration clauses than in forum-selection clauses.

IV. ARE "UNFAIR" ARBITRATION CLAUSES ALWAYS UNFAIR?

Critics of predispute arbitration clauses cite a variety of ways in which they argue corporations take advantage of individuals by incorporating arbitration clauses into their standard form contracts.[320] This part of the article aims to demonstrate that the presence of an arbitration clause, and more importantly, even the presence of "unfair" provisions in an arbitration clause, does not necessarily mean that individuals have been taken advantage of. Instead, this part presents plausible circumstances in which arbitration—even if "unfair"—in the aggregate benefits the parties to the transaction. Individuals may be willing to trade the ability to bring rare, high-dollar claims before a jury for the ability to bring more common, low-dollar claims in arbitration. Or individuals may be better off agreeing even to one-sided arbitration clauses instead of retaining their right to go to court, if the resulting cost savings are passed on to consumers through reductions in the price of goods and services, to employees through higher wages, or to franchisees through lower franchise fees.[321]

I recognize that arbitration critics strenuously reject the possibility that corporations pass on the benefits of arbitration to their customers, instead arguing that any cost savings "go straight to [the corporation's]

320. *See* discussion *supra* Parts II.B.1 to II.B.3.
321. *See* Ware, *supra* note 1, at 212 & n.95.

bottom line."[322] I also recognize that there is little or nothing I can say that will change anyone's mind on the underlying question here, which is whether one has more faith in government (in which case one will favor more regulation of predispute arbitration agreements by courts or legislatures) or in the market (in which case one will favor less regulation).[323] Instead, my goals are more modest: first, to demonstrate that the mere fact that arbitration clauses appear unfair does not, in itself, mean that corporations are taking advantage of individuals; second, to show that greater regulation of predispute arbitration agreements is not costless—to make informed choices about whether to increase government regulation of such agreements we must be aware of the costs, and not just the benefits, of regulation; and, third, to identify market mechanisms that will tend to constrain corporate abuses of arbitration, which, at least in some circumstances, will reduce any need there might otherwise be for government intervention.

This part first presents a basic model of the decision whether to arbitrate or litigate. Next, it applies that model to explain why even fully informed individuals might agree to "unfair" characteristics of arbitration and "unfair" provisions in arbitration clauses. Finally, it examines the roles of reputation and arbitration institutions in controlling corporate opportunism through the use of predispute arbitration agreements.

A. *Agreeing to Arbitrate: A Basic Model*

This section describes a basic model of the decision to arbitrate versus litigate.[324] It begins by analyzing why parties enter into postdispute arbitration agreements. It then extends the analysis to predispute arbitration agreements. The model predicts that fully informed individuals will enter into a predispute arbitration agreement when (1) arbitration on net benefits the parties vis-à-vis litigation, through some combination of reduced dispute-resolution costs and increased benefits from deterring wrongful behavior; and (2) if the individual is made worse off by arbitration, the corporation makes a transfer payment to the individual that equals or exceeds any net detriment.

The actors in the model are a corporation and an individual, who either have a contractual relationship or are considering entering into one. The individual is assumed to be the prospective claimant in arbitration (or plaintiff in litigation), and the corporation the prospective respondent (defendant). The model is based on several assumptions. First, it assumes that both parties can reasonably estimate the expected costs and

322. Carrington & Haagen, *supra* note 8, at 355–56.
323. *See* Sternlight, *Class Action*, *supra* note 8, at 123 n.493; Sternlight, *supra* note 9, at 46.
324. The discussion that follows draws from Hylton, *supra* note 32, and, to a lesser degree, from Shavell, *supra* note 32, with my own modifications and simplifications.

benefits of changing the dispute-resolution forum.[325] In other words, it assumes that both the corporation and individual are sophisticated parties. This assumption is discussed further in part IV.E. Second, it assumes that once a dispute arises, the parties' relationship is at an end, either because it is a one-time transaction or because the dispute is sufficiently serious that it ends any future relationship. This assumption is the basis of one reason parties might prefer predispute arbitration agreements to postdispute arbitration agreements—their effect on contract performance.[326] Third, it assumes no transaction-cost barriers to reaching an agreement to arbitrate.[327] The implications of relaxing this assumption are considered later in this section as providing another reason parties might prefer a predispute arbitration agreement.

When a dispute arises, the parties have a choice. They can agree to arbitrate their dispute or they can go to court. Litigation is the default method of dispute resolution—if the parties do not agree to arbitrate, the dispute will be decided in court.[328] The parties will agree to arbitrate if the marginal benefits of arbitration exceed the marginal costs of arbitration. What are the possible benefits and costs of arbitration as compared to going to court? One possible difference between arbitration and litigation is cost. Arbitration is touted as less expensive than litigation.[329] However, that may not be the case.[330] Indeed, certain types of arbitration, such as international commercial arbitration, likely are as costly as or more costly than litigation.[331]

A second possible difference between arbitration and litigation is the expected outcome. The individual may expect to be more (or less) likely to prevail in arbitration than in court, and may expect to recover more (or less) in damages. Conversely, the corporation may expect to be more (or less) likely to prevail in arbitration than in court, and may ex-

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325. *See* Hylton, *supra* note 32, at 235, 259–63. For behavioral challenges to this sort of rationality assumption, see, for example, BEHAVIORAL LAW AND ECONOMICS (Cass R. Sunstein ed. 2000); Christine Jolls et al., *A Behavioral Approach to Law & Economics*, 50 STAN. L. REV. 1471 (1998); Cass Sunstein, *Behavioral Law & Economics: A Progress Report*, 1 AM. L. & ECON. REV. 115 (1999); Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law & Economics*, 88 CAL. L. REV. 1051 (2000). *But see* Richard A. Posner, *Rational Choice, Behavioral Economics and the Law*, 50 STAN. L. REV. 1551 (1998).

326. One reason commonly given for the use of arbitration is that parties may be better able to preserve their business relationships while arbitrating than while litigating. If, in fact, litigation is more damaging to parties' relationships than arbitration, then at least in that respect the dispute-resolution costs of litigation would be greater than the costs of arbitration.

327. *See* Shavell, *supra* note 32, at 11; *see* Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 15–19 (1960).

328. *See* Hylton, *supra* note 32, at 213.

329. *See supra* text accompanying note 140.

330. *See* Walt, *supra* note 113, at 406 ("The little impressionistic empirical evidence available suggests that commercial arbitration costs are no lower systematically than litigation costs.").

331. *See* BORN, *supra* note 111, at 8–9; Charles N. Brower & Abby Cohen Smutny, *Arbitration Agreements Versus Forum Selection Clauses: Legal and Practical Considerations*, *in* INTERNATIONAL DISPUTE RESOLUTION: THE REGULATION OF FORUM SELECTION 37, 41–43 (Jack L. Goldsmith ed., 1997).

pect to pay more (or less) in damages. If the parties have the same expectations about the likely change in outcome, the expected increase (or decrease) in compensation received by the individual will be matched by the expected increase (or decrease) in compensation paid by the corporation. Because the dispute already has arisen, and by assumption the parties' relationship is at an end, the expected resolution of the dispute will have no effect on the parties' behavior under their contract. All that is to be decided is compensation.

The simplest case in which parties will agree to arbitration after a dispute arises is if arbitration reduces both parties' dispute-resolution costs while having no effect on the expected outcome. If each party will save $1,000 in dispute-resolution costs from arbitrating instead of litigating, for example, they will agree to submit their dispute to arbitration.[332]

If the cost savings from arbitration are one-sided, the parties will still agree to arbitrate if arbitration reduces their combined dispute-resolution costs. Assume, for example, that arbitration increases the individual's dispute-resolution costs by $1,000 but decreases the corporation's dispute-resolution costs by $2,000, with no change in expected outcome. The individual will agree to arbitrate only if the corporation is willing to pay more than $1,000 for arbitration. Because the corporation is willing to pay up to $2,000 for arbitration, the parties will agree to arbitrate in exchange for the corporation paying the individual some amount between $1,000 and $2,000. Both parties are better off as a result. If the numbers are reversed, so that arbitration reduces the corporation's costs by $1,000 while increasing the individual's costs by $2,000, the parties will not agree to arbitrate. The corporation will only be willing to pay up to $1,000 for arbitration, while the individual will demand at least $2,000.

If the parties expect arbitration to change the outcome, the party benefiting from the change in outcome similarly will need to make a transfer payment to induce the other party to agree to arbitrate. For example, assume that arbitration reduces the individual's expected recovery by $5,000, and reduces the corporation's expected liability by $5,000. If the parties would benefit on net by arbitration (for example, the corporation's dispute-resolution costs go down by $2,000 while the individual's go up by $1,000), the parties still will be better off by arbitrating: the individual is $6,000 worse off while the corporation is $7,000 better off. The corporation will pay the individual some amount greater than $6,000 but less than $7,000 in exchange for the individual agreeing to arbitrate.

In sum, under this basic model, parties will enter into postdispute arbitration agreements rather than litigating in court when arbitration on net reduces their dispute-resolution costs.[333] If the reduction in dispute-

332. *See* Shavell, *supra* note 32, at 5.

333. I simplified Professor Hylton's model by disregarding that the parties might have different expectations about how arbitration would affect the outcome of the proceeding. *See* Hylton, *supra*

resolution costs is one-sided, or the parties expect arbitration to change the outcome of the case, the party made better off by arbitration will make a sufficient transfer payment to the other party to induce that party to agree to arbitrate.

The parties instead could enter into a predispute arbitration agreement, agreeing to arbitrate all future disputes, rather than waiting for a dispute to arise. Again, arbitration may have different dispute-resolution costs than litigation and may have a different expected outcome. Thus, the basic analysis from above provides the starting point here as well. But because contract performance has not yet taken place, a change in expected outcome from agreeing to arbitrate does more than simply change the compensation the parties expect to pay or receive. The change in expected outcome also may alter the parties' incentives to perform under the contract.[334] For example, if the corporation expects that it will more likely prevail on a breach-of-contract claim in arbitration than in litigation, it may be more likely to breach a contract containing an arbitration clause than one without. Changing the forum thus may increase or decrease the extent to which legal sanctions deter wrongful conduct, i.e., may have increased or decreased deterrence benefits.[335]

In deciding whether to enter a predispute arbitration agreement instead of going to court, the parties will consider not only whether arbitration increases or decreases dispute-resolution costs, but also whether it increases or decreases deterrence benefits. The parties will prefer arbitration to litigation so long as arbitration on net is beneficial, if, for example, arbitration (1) reduces dispute-resolution costs and increases deterrence benefits; (2) reduces dispute-resolution costs by more than it reduces deterrence benefits; or (3) increases deterrence benefits by more than it increases dispute-resolution costs.[336] To the extent the benefits are one-sided, and to the extent of any change in the compensation paid or received, transfer payments will be required to achieve agreement.[337]

For example, assume that the corporation is more likely to prevail in arbitration than in litigation, and expects to pay $1,000 less in compensation to the individual. Assume also that the individual expects to receive $1,000 less in compensation. But, unlike the case of a postdispute arbitration agreement, the change in expected outcome from arbitration also may reduce the net deterrence benefits to the parties as well, say, by $500.[338] Will these parties agree to arbitrate? It depends on whether the

note 32, at 227. If the parties' expectations differ, they might refuse to arbitrate even when their net dispute resolution costs would be lower in arbitration, or they might agree to arbitrate when their net dispute resolution costs would be higher in arbitration.

334. *See* Shavell, *supra* note 32, at 6–7.

335. *See* Hylton, *supra* note 32, at 213, 218–19.

336. *See id.* at 225. Note that Hylton concludes that not only are the parties to the arbitration agreement better off, but that society as a whole is better off as well. *See id.* at 245–46.

337. *See id.* at 228.

338. The net deterrence benefits here will be the benefits to the individual of proper contract performance of $1,000, less $500, the costs to the corporation of performing.

parties' dispute-resolution costs are enough lower under arbitration to offset the reduced deterrence benefits. If arbitration reduces the parties' dispute-resolution costs on net by more than $500, they will still be better off arbitrating than litigating in court and will agree to arbitrate, provided that the party benefiting from arbitration (here likely the corporation) makes the necessary transfer payment.

In this example, although the parties are better off agreeing to a predispute arbitration agreement than going to court, they would be even better off waiting until a dispute arises and then agreeing to arbitrate. Because by assumption a postdispute arbitration agreement does not affect the parties' incentives to perform under the contract, deterrence benefits will be $500 greater with a postdispute arbitration agreement than with a predispute arbitration agreement. Similarly, if the parties expect the same outcome in arbitration as in litigation, so that the only benefit of arbitration is reduced dispute-resolution costs, in this basic model they are no better off agreeing to arbitrate before a dispute arises than after.[339] Thus, only if a predispute arbitration agreement is likely to increase deterrence benefits will the parties enter into a predispute arbitration agreement under this model.

But predispute arbitration agreements differ from postdispute arbitration agreements in other respects that become important once the assumption of no transactions costs is relaxed. Transactions costs are likely to be lower for parties entering into predispute arbitration agreements than those entering into postdispute arbitration agreements. First, predispute arbitration agreements provide greater opportunities for making transfer payments than do postdispute arbitration agreements. Because no dispute has yet arisen, the parties can consider the range of possible disputes that might arise in agreeing on a dispute resolution forum. Parties may be uncertain whether they will be claimant or respondent in arbitration (versus plaintiff or defendant in litigation). Similarly, the parties may be uncertain about the type of dispute that will arise—for example, a low-value dispute (a part is broken on an appliance) or a high-value dispute (the appliance causes serious personal injury). Parties may have different preferences for dispute-resolution fora for different types of disputes, which may make possible exchanges between the parties within the arbitration agreement.

For example, arbitration is common in international commercial contracts; the vast majority of international economic contracts (90% by some estimates) contain arbitration clauses.[340] Parties agree to arbitrate international commercial disputes in large measure to avoid "hometown

339. *See* Shavell, *supra* note 32, at 5.

340. *See* KLAUS PETER BERGER, INTERNATIONAL ECONOMIC ARBITRATION 8 n.62 (1993) (citing ALBERT JAN VAN DEN BERG ET AL., ARBITRAGERECHT 134 (1988)).

justice";[341] neither party wants to have disputes resolved in the other party's home court.[342] At the time of contract formation, both parties are uncertain about which one will initiate litigation and thus benefit by being able to choose its home forum. As a result, they are able to compromise—each gives up its right to initiate litigation in its home forum, and instead they agree to arbitration in a neutral forum.[343]

Second, predispute arbitration agreements avoid the bilateral monopoly problem that arises once the parties have entered into a contract. Before contracting, each party has other options—each can choose to enter into a contract with another party or not enter into any contract at all. Once they enter into a contract and a dispute arises they can deal only with each other, making bargaining failure more likely.[344] This is a possible explanation for complaints by some arbitration advocates, who blame attorneys representing individuals for refusing to arbitrate once a claim has arisen.[345]

Third, once a dispute arises, the costs of agreeing to arbitrate combined with a transfer payment may be greater than simply settling the case altogether. If both parties benefit from arbitration, they can agree to arbitrate without having to put a dollar value on those benefits. If the arbitration clause is one-sided, however, so that the corporation gains and the individual loses from arbitration, the corporation will have to make a transfer payment to induce the individual to agree to arbitrate. For the individual to determine how much to demand, the individual will have to value his or her losses, including the possibility of a reduced recovery in arbitration. Once the individual makes that determination, however, it is only marginally more costly to settle the claim altogether, and avoid the further uncertainty of going to arbitration. In other words, submission agreements combined with transfer payments may well face much higher transactions costs, at least as compared with simply settling the claim.

341. *See* William W. Park, *Arbitration Avoids 'Hometown Justice' Overseas*, NAT'L L.J., May 4, 1998, at C18.

342. *See* Charles N. Brower, *Introduction* to INTERNATIONAL ARBITRATION IN THE 21ST CENTURY: TOWARDS "JUDICIALIZATION" AND UNIFORMITY?, at ix, x (Richard B. Lillich & Charles N. Brower eds., 1994).

343. Arbitration also avoids the possibility of parallel proceedings in the courts of both countries. *See* GARY B. BORN & DAVID WESTIN, INTERNATIONAL CIVIL LITIGATION IN UNITED STATES COURTS 319–41 (2d ed. 1992). But the parties could avoid parallel proceedings by agreeing to resolve all disputes in the courts of one party, with that party making a transfer payment to the other reflecting the benefit it expects to receive from home court bias in its favor. The parties can avoid the necessity for such a transfer payment, and thus save the associated transactions costs, by agreeing to arbitrate in a neutral forum. Moreover, agreeing to litigate in the courts of one party might reduce deterrence benefits to such a degree that arbitration is preferable, even with a transfer payment.

344. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 608 (5th ed. 1998) ("Settlement negotiations are a classic example of bilateral monopoly.").

345. *See* Patricia Sturdevant & Dwight Golann, *Should Binding Arbitration Clauses Be Prohibited in Consumer Contracts?*, DISP. RESOL. MAG., Summer 1994, at 4, 6. Another possible explanation, of course, is that arbitration would not make the parties on net better off, and, once represented by counsel, the individual realizes that.

In sum, one would expect well-informed individuals to agree to arbitrate rather than litigate when either they benefit from agreeing to arbitrate (through reduced dispute-resolution costs or increased deterrence benefits) or, even if made worse off by arbitration, so long as the corporation compensates them for their expected detriment, including any reduction in compensation received. Predispute arbitration agreements will be preferred to postdispute arbitration agreements when arbitration will increase deterrence benefits and when the transactions costs of postdispute agreements are too high. The following three sections use this model to explain plausible circumstances under which well-informed individuals will agree to "unfair" arbitration clauses.

B. *Unfairness and Mandatory Arbitration*

Arbitration critics mean two different things when they call arbitration "mandatory." The first meaning is that individuals have no choice but to agree to arbitration because the arbitration agreement is presented to them in a standard form contract on a take-it-or-leave-it basis, in what is commonly called a "contract of adhesion."[346] This issue is discussed in part IV.E. The second meaning is that individuals would prefer to litigate in court rather than arbitrate once a dispute arises, but a predispute arbitration agreement either mandates or compels them to arbitrate. Arbitration critics use this preference for litigation as evidence that arbitration is unfair to the individuals who now seek to go to court.

This criticism proves too much. Even arbitration critics agree that arbitration is an appropriate means of resolving disputes between sophisticated commercial parties and that predispute arbitration agreements, such as ones in international commercial contracts, should be enforced.[347] Yet international arbitration is likely to be "mandatory" or "compelled" as arbitration critics use those terms. For example, David Schwartz uses the phrase "'compelled arbitration' [to] refer to situations in which a party has agreed to arbitrate future disputes but, once the dispute arises, would prefer to litigate rather than arbitrate."[348] Parties to international contracts containing arbitration clauses often will meet this definition. Once a dispute arises, both parties to the international arbitration agreement will prefer to be in court, each in the court of its home country. Sometimes the parties initiate such litigation but a court order compels them to arbitrate. Much of the time they proceed to arbitration without court intervention, compelled either by the contract language, the belief that a court likely would specifically enforce the contract if asked, or their own business reputation.[349] Nonetheless, if the arbitration

346. *See supra* text accompanying notes 96–99.

347. *E.g.*, Haagen, *supra* note 8, at 1060 n.116.

348. Schwartz, *supra* note 8, at 37 n.10.

349. *See* Schwartz, *supra* note 8, at 37 n.10 ("The key definitional feature is the perception of being compelled—whether by the contract language itself, the belief the language will be specifically en-

agreement were revocable, the party with the weakest position on the merits would have a strong incentive to revoke and seek to litigate the dispute in its home court.[350]

Even in "consumerized" arbitration, that an individual who agreed to arbitrate before a dispute arose changes his or her mind does not necessarily mean that enforcing the predispute arbitration agreement is unfair. The individual may have been willing to give up the right to bring high-dollar but rare claims before a jury in exchange for the ability to pursue low-dollar but more common claims in arbitration.[351] Such a deal is possible only before a dispute arises, when there is uncertainty as to what type of claim (if any) will materialize. Once the individual knows what type of claim he or she has (either high-value or low-value), either the individual may be unwilling to arbitrate (if it is a high-value claim) or the corporation may be unwilling to arbitrate (if it is a low-value claim that could not economically be brought in court). By entering into a predispute arbitration agreement in such circumstances, the parties can enter into a deal that makes both of them better off. Permitting the individual (or the corporation for that matter) later to avoid arbitration would effectively preclude such deals from being made, making the parties worse off.[352] Enforcement of the predispute arbitration agreement in this sort of case would be the fair, not the unfair, approach.

Similarly, if the arbitration clause is one-sided in favor of the corporation, the individual will prefer to litigate in court rather than proceed with arbitration. Arbitration may be more expensive than litigation for the individual, or may result in less compensation being paid to the individual. Moreover, when agreeing to arbitrate, the individual faces only a probability of a dispute arising, and is compensated accordingly. When deciding whether to abide by the arbitration agreement, however, the individual now faces the certainty of a dispute, no longer just a probability.

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forced if tested, or an actual order—to arbitrate notwithstanding one's better judgment at the time the dispute arises.").

350. *See* Landes & Posner, *supra* note 35, at 236.

351. *E.g.*, Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 281 (1995) (discussing alleged consumer-protection benefits of proposed test for interstate commerce nexus).

> Sometimes, of course, it would permit, say, a consumer with potentially large damage claims, to disavow a contract's arbitration provision and proceed in court. But, if so, it would equally permit, say, local business entities to disavow a contract's arbitration provisions, thereby leaving the typical consumer who has only a small damages claim (who seeks, say, the value of only a defective refrigerator or television set) without any remedy but a court remedy, the costs and delays of which could eat up the value of an eventual small recovery.

Id.; *cf.* Lewis L. Maltby, *Private Justice: Employment Arbitration and Civil Rights*, *in* ARBITRATION NOW 1, 18, 25–26 (Paul H. Haagen ed., 1999) (presenting empirical evidence that employees with low-dollar claims may do better in arbitration and arguing that high cost of court litigation may preclude deserving claimants from getting to court).

352. The problem is one of adverse selection: if the individual can choose after the dispute arises whether to litigate or arbitrate, consumers with high-value claims will want to litigate but ones with low-value claims will want to arbitrate. The corporation gets the worst of both worlds. Its rational response is simply to stop agreeing to arbitration at all, with the result that what is assumed to be a beneficial exchange for both parties ex ante does not take place.

The transfer payment that was based on a probability will not be enough to compensate the individual for suffering a disadvantage in resolving a certain dispute. As a result, it is not surprising that the individual will prefer to litigate rather than to arbitrate after the dispute arises.

But enforcing such a one-sided arbitration clause is not "unfair" if the individual—who is assumed to be sophisticated and well informed—already has been compensated for agreeing to the clause. As discussed above, an individual will agree to a one-sided arbitration clause if the corporation makes up for the expected detriment in another part of the contract—i.e., the corporation makes some sort of transfer payment to the individual.[353] If the individual already has been compensated for agreeing to a one-sided arbitration clause, the agreement to arbitrate should be enforced. Otherwise, individuals who are parties to existing contracts will get a windfall—individuals will get the benefits from their original deal without bearing the expected costs.

Permitting individuals to go to court after a dispute has arisen, as some pending legislation proposes,[354] will not result in a windfall to individuals under future contracts—the parties simply will adjust the terms of the deal. If the benefits of arbitration were one-sided, the parties would not include a predispute arbitration agreement in their contract because that agreement would not be enforceable—even if the corporation were willing to compensate the individual to induce him or her to arbitrate, and even if arbitration on net would benefit the parties.[355] As a result, individuals without disputes will be worse off—either from being denied the ability to make beneficial exchanges or from paying higher prices (or receiving lower wages)—for the benefit of those individuals who ultimately have a dispute with the corporation.[356] Whether those costs are worth paying is a political decision; but they are costs that should not be overlooked in making the political decision.

353. *See supra* text accompanying notes 333–37.

354. *See supra* text accompanying notes 104–05.

355. In addition, making predispute arbitration agreements revocable, or otherwise unenforceable, also might interfere with the use of arbitration to provide increased deterrence benefits—such as when the expertise of the arbitrator will give a more accurate outcome. The parties could not make a legally enforceable predispute arbitration agreement, and postdispute arbitration agreements do not affect the parties' incentives to perform under the contract. *See* Shavell, *supra* note 32, at 6 ("ADR that improves incentives must be agreed to ex ante because the parties would not obtain joint benefits from an ADR agreement ex post."). But this concern would be significant only in cases in which the threat of legal sanction deters individuals, rather than corporations, because generally it is individuals who are given the ability to revoke the arbitration agreement. Moreover, the corporation likely will be more concerned with its business reputation than an individual, and may abide by a predispute arbitration agreement even if not legally required to do so.

356. *See* Ware, *supra* note 1, at 213 (enforcing predispute arbitration agreements "empowers all consumers, not just those with a dispute, to get consideration for the right to government adjudication"). Some of the costs may be borne by others as well. For example, increased costs from restrictions on employment arbitration may be borne, in part, by consumers, in the form of higher prices, or by employers, in the form of lower profits. *Cf.* Christine Jolls, *Accommodation Mandates*, 53 STAN L. REV. 223 (2000).

C. *Unfairness and the Arbitral Process*

Arbitration critics also argue that standard characteristics of arbitration are unfair to individuals. But each of the unfair characteristics that critics identify—ability to select the arbitrator, limited discovery, lack of an appeals process, unavailability of class relief, and fee-based dispute resolution—are characteristics that even informed individuals might agree to, at least in exchange for a transfer payment.

The parties may prefer arbitrators that they select to decision making by a jury or by appointed or elected judges.[357] Because arbitrators get paid only when selected by the parties, they have an incentive to decide cases so as to make the parties better off.[358] An arbitrator also may have greater expertise in the subject matter of the dispute, making his or her decision making more accurate. The greater accuracy may increase the deterrence benefits over those provided by litigation—either before a jury or a judge.[359]

Given the assumption that individuals are fully informed about the arbitral process, the concern that arbitrators will favor repeat players is unfounded. If the corporation tries to select an arbitrator who has made biased decisions in the past, the individual will not agree to that selection. Moreover, arbitrators considering whether to make a decision favoring the corporation in order to attract more business in the future will be discouraged from doing so by the awareness that individuals will know about the favoritism and reject the arbitrator in future disputes. As a result, bias in favor of repeat players will not be a profitable strategy for arbitrators.

Even for individuals who are not fully informed—i.e., in the real world—repeat-player bias may be less of a problem than some critics suggest. Although individuals are not repeat players, their attorneys may well be. Plaintiffs' attorneys may represent numerous employees, franchisees, or consumers against corporate defendants, effectively becoming repeat players.[360] Their better information will discourage arbitrators who might otherwise show favoritism toward corporations.[361]

357. The issue of arbitration clauses that create one-sided selection mechanisms is discussed *infra* Part IV.D.1.

358. *See supra* text accompanying notes 140–42.

359. *See* Shavell, *supra* note 32, at 5–6. In addition, if arbitration "would lower the risks attending disputes (because, for instance, exposure to unreliable jury verdicts could be avoided), the parties would tend to find ADR mutually beneficial if one or the other is risk averse." *Id.* at 5.

360. *See* Estreicher, *supra* note 8, at 1355; Oppenheimer & Johnstone, *supra* note 114, at 23; Dick Youngblood, *Entrepreneurial Attorney Is Fighting for Franchisees*, STAR TRIB. (Minneapolis-St. Paul), April 13, 1997, at 3D (discussing attorney who represents only franchisees); *see also JAMS/Endispute Clarifies Position on Mandatory Employment Arbitration*, 7 WORLD ARB. & MEDIATION REP. 51 (1996) (explaining that JAMS principles for fairness in employment arbitration are "at least in part" a response to threat of boycott of JAMS by plaintiffs' employment bar). *But see* Lisa B. Bingham, *Employment Arbitration: The Repeat Player Effect*, 1 EMPLOYEE RIGHTS & EMP. POL'Y J., 189, 198–99 (1997) (plaintiffs' employment bar not yet serving as repeat players, and "there is reason to believe

In addition, as discussed in more detail later,[362] the repeat-player argument ignores the incentives of arbitration institutions to avoid even the appearance of bias by their arbitrators. An institution that develops a reputation for unfairness or biased arbitrators risks losing credibility, which courts rely on to recognize and enforce arbitral awards.[363] The enforceability of awards rendered by arbitrators is essential to the institution's attractiveness to corporations. Arbitration awards that courts ultimately do not enforce increase dispute-resolution costs for the parties. An arbitration institution that develops a reputation for biased arbitrators risks losing business as courts vacate awards in favor of corporations. It also risks triggering legislation that restricts the market for its services by increasing the regulation of arbitration. Accordingly, one would expect arbitration institutions to develop mechanisms for selecting arbitrators that avoid problems of bias. Rules requiring arbitrators to disclose any past relationship with a party are one example.[364]

Plausible explanations for individuals' willingness to agree to less discovery and a limited right to appeal require less discussion. Discovery provides greater information to both parties, and may enable individual claimants to prove claims they otherwise could not prove. As a result, it may well increase the accuracy of litigation and resulting deterrence benefits. But discovery is costly. If the savings in dispute-resolution

that most individual members of the plaintiff's bar may never successfully emerge as repeat players in employment arbitration").

361. One study examined a sample of employment arbitrations administered by the AAA for arbitrator bias in favor of repeat players. *See* Bingham, *supra* note 118, at 236. Using a "macrojustice assessment"—meaning "the study examine[d] the overall pattern of outcomes . . . without controlling for the merits of the individual case"—Professor Bingham found that repeat players are likely to win more often in arbitration and recover a higher percentage of damages claimed than nonrepeat players. *Id.* at 236, 238–39. However, the results as to outcome may be due to a selection effect, as Bingham recognizes. *See id.* at 241; Lisa B. Bingham, *Unequal Bargaining Power: An Alternative Account for the Repeat Player Effect in Employment Arbitration*, INDUS. REL. RES. ASS'N 50TH ANN. PROC. 33, 39–40 (1999) (explaining that differing outcomes for repeat players "largely correspond with differences in the nature of the basis for the arbitration"). Similarly, the results as to recovery may merely reflect a repeat player's more realistic demands. Thus, as Stephen Walt concludes, the empirical evidence on bias is "inconclusive." *See* Walt, *supra* note 113, at 418 & n.149; *see also* Rau, *supra* note 118, at 517–18 (no evidence of systematic bias in medical or attorney fee arbitration). Lewis Maltby compared Professor Bingham's aggregate data on outcomes in employment arbitration to publicly available data on employment litigation in federal courts. He found that although "the small fraction of employees who take their disputes to court and win a jury verdict do better on average than employees who are successful in arbitration," overall "far more employees win in arbitration than in court" and "employees who take their disputes to arbitration collect more than those who go to court." Lewis Maltby, *Employment Arbitration: Is It Really Second Class Justice?*, DISP. RESOL. MAG., Fall 1999, at 23, 24; Maltby, *supra* note 351, at 18. For an analysis of methodological issues in empirical studies of outcomes in arbitration, see Stephen J. Ware, *The Effect of* Gilmer*: Empirical and Other Approaches to the Study of Employment Arbitration*, 16 OHIO ST. J. ON DISP. RESOL. (forthcoming 2001).

362. *See infra* text accompanying notes 466–68.

363. *See* Eric A. Posner, *Arbitration and the Harmonization of International Commercial Law: A Defense of Mitsubishi*, 39 VA. J. INT'L L. 647, 664 (1999); Cole v. Burns Int'l Security Servs., 105 F.3d 1465, 1485 (D.C. Cir. 1997).

364. *See* 2000 AAA RULES, *supra* note 110, Rule R-19(a). *But see* Rau, *supra* note 118, at 525–26 (arbitrator disclosure of prior dealings with parties insufficient).

costs from limiting discovery exceed the reduced deterrence benefits, and the individual is compensated for any reduction in expected compensation, the individual will be better off agreeing to arbitration. Indeed, corporations regularly agree to arbitrate disputes among themselves, suggesting that for those disputes the cost savings from limiting discovery exceed the value of any reduction in accuracy.

Similarly, sophisticated individuals also may be willing to agree to arbitration with no right to appeal instead of litigation with a right to appeal; again, corporations do it almost every time they agree to arbitration. The right to appeal is costly: parties must pay lawyers to handle the appeal, plus the appeal delays ultimate resolution of the dispute. The trade-off again is between these sorts of costs and the deterrence benefits from greater accuracy with an appeals process. Appeals courts may correct errors.[365] But, as William Landes and Richard Posner argue, the benefits of an appeals process may derive less from error correction than from lawmaking—the precedent established by appellate courts.[366] These lawmaking benefits, however, are largely external to the parties to the dispute.[367] Thus, an individual may be better off agreeing to do without a right to appeal in arbitration rather than preserving a right to appeal in court.[368]

Individuals also rationally may be willing to give up the right to class relief. In theory, class actions provide important benefits to prospective plaintiffs. First, class actions may provide significant economies of scale. By combining many similar actions into one, parties (and the judiciary) save the costs of adjudicating the same issues over and over again.[369] Second, class actions may permit plaintiffs to bring suit as a class when no plaintiff individually would have the incentive to sue. If all plaintiffs have very small claims, no individual plaintiffs would be willing to undertake the legal expenses necessary to bring suit. But when many small individual claims are aggregated in a class action, bringing suit may no longer be prohibitively costly.[370] Without a class action, small, individual harms may go uncompensated and deterrence would be less effective.[371]

365. *See* Shavell, *supra* note 32, at 381.

366. *See* Landes & Posner, *supra* note 35, at 238.

367. The appeals process also serves the function of aligning the incentives of trial courts and appellate courts. *See* Drahozal, *supra* note 59, at 491–97. Because the incentives of arbitrators, who compete for cases, differ significantly from the incentives of public-court judges, *see id.* at 501–02, parties to an arbitration agreement ordinarily will not need to provide a right to appeal for incentives reasons.

368. Arbitration critics rely on this fact to argue that extensive use of arbitration for resolving disputes may result in too little lawmaking by public courts, an argument that is beyond the scope of this paper.

369. *See* Roger Bernstein, *Judicial Economy and Class Actions*, 7 J. LEGAL STUD. 349 (1978); Geoffrey P. Miller, *Class Actions*, *in* 1 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 257, 257 (Peter Newman ed., 1998).

370. *See* POSNER, *supra* note 344, at 626; Miller, *supra* note 369, at 257.

371. *See supra* text accompanying note 370.

In practice, however, class actions too often may not achieve their theoretical benefits. One problem is conflicts of interest within the class.[372] Even more problematic is the now well-recognized conflict of interest between class members and the attorneys representing the class.[373] Precisely because class members frequently have small claims that do not give them much incentive to participate actively in the case, class actions tend to be run by, and for the benefit of, the plaintiffs' attorneys. Settlements can be too low and come too early, and legal fees can be too high. Additionally, the prospect of immense class liability may create an "intense pressure to settle" on defendants, resulting in what some have called "blackmail settlements."[374] In either case, the parties, on net, may be better off with no class relief, with individuals giving up some deterrence benefits in exchange for reduced dispute-resolution costs (including attorneys' fees) or reduced overdeterrence.[375]

Finally, unlike litigation, which generally requires payment only of a small filing fee in order to bring suit, in arbitration the parties must pay all the costs of arbitration, including a potentially significant up-front filing fee and all the arbitrator's fees and expenses. As *Brower v. Gateway 2000, Inc.*[376] illustrates, the filing fee alone may exceed the entire value of an individual's claim.[377] Arbitration critics argue that the fact that parties must pay for arbitration will discourage individuals with meritorious claims from even bringing an action.

372. *E.g.*, Broussard v. Meineke Discount Muffler Shops, Inc., 155 F.3d 331, 337–39 (4th Cir. 1998); Herbert Hovenkamp, *Tying Arrangements and Class Actions*, 36 VAND. L. REV. 213, 244–52 (1983).

373. *See* John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 COLUM. L. REV. 1343, 1417–21 (1995); John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. CHI. L. REV. 877, 883–89 (1987); John C. Coffee Jr., *Rethinking the Class Action: A Policy Primer on Reform*, 62 IND. L.J. 625, 628–34 (1986); John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 677–84 (1986); John C. Coffee, Jr., *The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation*, 48 L. & CONTEMP. PROBS., Summer 1985, at 5, 23–26 (1985); Susan P. Koniak, *Feasting While the Widows Weep:* Georgine v. Amchem Prods., Inc., 80 CORNELL L. REV. 1045, 1055–56 (1995); Susan P. Koniak & George M. Cohen, *Under Cloak of Settlement*, 82 VA. L. REV. 1051, 1053–57 (1996); Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 12–27 (1991); *see also* John C. Coffee, Jr., *Conflicts, Consent, and Allocation After Amchem Products—Or, Why Attorneys Still Need Consent to Give Away Their Clients' Money*, 84 VA. L. REV. 1541, 1544–46 (1998) (describing how conflict of interest may continue at allocation stage). *See generally* Miller, *supra* note 369, at 258–59 (describing economics of class actions).

374. *In re* Rhone-Poulenc Rorer, Inc., 51 F.3d 1293, 1298 (7th Cir. 1995) (quoting HENRY J. FRIENDLY, FEDERAL JURISDICTION: A GENERAL VIEW 120 (1973)).

375. For a skeptical view of both of these types of settlements, see Bruce Hay & David Rosenberg, *"Sweetheart" and "Blackmail" Settlements in Class Actions: Reality and Remedy*, 75 N.D. L. REV. 1277 (2000). *See generally* DEBORAH R. HENSLER ET AL., CLASS ACTION DILEMMAS 424–45 (2000) (analyzing costs and benefits of selected class actions).

376. 676 N.Y.S.2d 569 (App. Div. 1998).

377. *See id.* at 571, 574–75; *see also supra* text accompanying notes 237–40.

First, if true, from a societal perspective that may not be a bad result. The government subsidizes litigation.[378] Precisely because the parties do not pay for the time of judges and the costs of court administration, one would expect lawsuits to be brought even if the total costs of the litigation exceed its benefits. There may be reasons to provide such a subsidy to litigation, such as a desire to encourage the production of legal precedents.[379] But it is useful to keep in mind that the starting points are not balanced.

Second, the costs of consumer arbitration have come down, as arbitration institutions compete to provide low-cost arbitration services.[380] Both the National Arbitration Forum and the American Arbitration Association now offer low-cost consumer arbitration, with fees that are roughly the same as court filing fees.[381] The availability of consumer arbitration at increasingly low cost weakens this criticism of consumer arbitration. At the same time, it makes more plausible the view that consumers benefit from arbitration by being able to bring claims they otherwise could not afford to bring.[382]

Third, even when the up-front costs in arbitration may be higher than in court, institutional arbitration rules generally permit a prevailing party to recover the administrative fee and the arbitrator's fees from the other side at the end of the arbitration proceeding.[383] Thus, if an individual prevails, he or she may not only be able to recover any damages sought but also the costs of arbitration.[384] The effect of this sort of fee-shifting rule (as well as contract provisions that preclude fee shifting) are discussed in the next section.[385] But the presence of higher up-front costs does not necessarily mean that a claimant will not be able to bring a claim.

Fourth, the effect of high up-front arbitration costs will disproportionately affect small claimants (with the fee-shifting caveat noted above). If arbitration costs are, in fact, higher than court costs, those costs will tend to discourage individuals from bringing small claims. However, a fully informed individual reasonably could agree to arbitrate small claims, even if actually arbitrating the small claim is cost-

378. *See* POSNER, *supra* note 344, at 639–40 (arguing for higher court filing fees); Shavell, *supra* note 32, at 8.

379. *See* POSNER, *supra* note 344, at 640.

380. Corporations presumably are demanding such lower-cost arbitration, either for reputational reasons or to make it more likely that courts will enforce arbitration agreements and awards to which they are a party.

381. *See infra* text accompanying notes 469–72.

382. *See supra* text accompanying notes 351–52.

383. *See supra* text accompanying notes 255–56.

384. In addition, some arbitral institutions require their arbitrators to serve pro bono in adjudicating small claims, and at least one may waive fees altogether for indigent claimants. *See supra* note 141.

385. *See infra* text accompanying notes 406–13.

prohibitive. One could plausibly believe that the cost of litigating such a claim might exceed any deterrence benefits.[386]

D. Unfairness and One-Sided Arbitration Clauses

Arbitration critics challenge not only the default characteristics of arbitration, as reflected in usual arbitration practices or rules, but also provisions added to arbitration clauses by the drafting party, usually, if not always, the corporation. Those provisions, on their face, disadvantage the individual at the expense of the corporation. If, however, the corporation's benefit from arbitration exceeds the individual's loss, and the corporation compensates the individual for the disadvantage suffered, both parties can be made better off by such provisions.

1. Selection of Arbitrators

As described above, some arbitration agreements seemingly "stack the deck" in favor of one party by providing for arbitrators that may be biased in favor of that party. The *Hooters* court certainly thought so.[387] However, fully informed individuals may be made better off under some circumstances by agreeing to arbitration panels that appear biased.

Initially, corporations will not inevitably provide for panels biased in their favor—indeed, the opposite may be true. Gordon Tullock uses the example of the returns desk at a department store.[388] The employees who decide whether to give refunds when goods are brought back to the store are like arbitrators—they decide whether to grant the party's claim for a refund.[389] Moreover, they are employees of the store, whose compensation comes solely from the store. Yet, if anything, employees at return desks are "biased" in favor of the customer—"the customer is always right."[390]

Moreover, the vast majority of arbitration clauses in the franchise agreements studied provide for arbitrations to be administered by an arbitral institution; indeed, only one arbitration clause in the entire sample provided for an arbitrator-selection mechanism that poses any unusual risk of bias.[391] Arbitral institutions have strong incentives to avoid biased

386. *See infra* text accompanying notes 400–02.

387. *See* Hooters of Am., Inc. v. Phillips, 173 F.3d 933, 938–39 (4th Cir. 1999); *see supra* text accompanying notes 155–58.

388. TULLOCK, *supra* note 113, at 128.

389. A returns desk is like an arbitrator with limited authority to give a remedy—it cannot award either compensatory or punitive damages; its only remedy is a refund of the price or replacement of the defective goods.

390. Another example might be securities arbitration. *See* Carrington & Haagen, *supra* note 8, at 368 (arguing that if the theory that the securities industry has large stake in controlling fraud is true, "then brokers accused of committing fraud on their clients may have even more to fear from arbitration than from trial by jury").

391. *See supra* text accompanying notes 279–82.

arbitrators.[392] Accordingly, the problem of arbitration clauses providing for biased arbitrators appears limited in franchise contracts.[393]

Finally, arbitration clauses providing for biased decision makers may ultimately be an attempt to enter into an otherwise unenforceable agreement waiving the individual's claims.[394] Keith Hylton has suggested that the arbitration clause in the *Hooters* case was precisely such an agreement.[395] Arbitration critics argue that such uses of arbitration to circumvent legal requirements are precisely why commercial arbitration is problematic as a form of dispute resolution.[396] In fact, a fully informed individual could rationally decide to waive a claim in advance. Statutes do not adapt to individual circumstances, so that even statutes that, on the whole, are beneficial may be detrimental to certain parties under certain circumstances. And some statutes may not be beneficial on the whole. If so, then waivers in theory would make the parties better off.

I do not advocate permitting parties to waive statutory (or other claims) that by law are nonwaivable, either through a biased arbitration agreement or otherwise. One of the costs of a democracy is having to live within its laws even if parties might be better off by contracting around them. The point here is simply to note that there are such costs, which may result from refusing to enforce arbitration clauses that provide biased selection mechanisms.

2. *Site of Arbitral Proceedings*

A common provision in arbitration agreements is that arbitration is to take place at a location close to the franchisor's home. Over eighty percent of the franchise agreements studied so provided.[397] If the franchisor operates only local franchises, this provision will be relatively innocuous; it will operate essentially the same as if the provision required arbitration at the franchisee's home. The franchisor's home and the franchisee's home are the same.

But none of the franchises studied here are local franchises. To the contrary, they are nationwide or even worldwide franchises. For some franchisees—those in the same state as the franchisor, for example—

392. *See supra* text accompanying notes 362–64.

393. One survey found that fifteen percent of the employment arbitration procedures studied provided for the employer unilaterally to select the arbitrator. *See* Bickner et al., *supra* note 195, at 80.

394. *See* Shavell, *supra* note 32, at 7 (explaining that parties can use predispute arbitration agreements to reduce frequency of claims, which would be beneficial when, "given the applicable law, too many actions would be brought in the sense that they would absorb resources in the form of dispute resolution costs but not produce any (or, more generally, much) benefit in behavior").

395. *See* Hylton, *supra* note 32, at 235.

396. *E.g.*, Schwartz, *supra* note 8, at 62 (corporations using predispute arbitration agreements are "engaged in a measure of 'self deregulation'"). *See generally* Stephen J. Ware, *Default Rules from Mandatory Rules: Privatizing Law Through Arbitration*, 83 MINN. L. REV. 703 (1999).

397. *See supra* text accompanying notes 283–88. Almost eighty percent of exclusive forum-selection clauses provided for litigation to take place at the franchisor's home.

there is nothing inconvenient about this clause. But for distant franchisees, it is a different matter. Distant franchisees will face additional costs of arbitrating at a distant site, such as travel expenses for the franchisee and his or her attorney.[398]

Conversely, having all arbitration take place at a single location will reduce the corporation's dispute-resolution costs.[399] The reduction in the franchisor's costs may exceed the increase in the franchisee's costs. If more witnesses are located at the franchisor's offices than at the franchisee's location, which is a possibility given that the franchisor is likely to have more employees than the franchisee, requiring arbitration to take place at the franchisor's home will reduce the parties' overall dispute-resolution costs. Moreover, the franchisor, unlike the franchisee, is likely to have disputes with multiple franchisees going on at the same time. Requiring all the arbitrations to take place at the same location may result in economies of scale in dispute resolution for the franchisor, again reducing the parties' overall costs. Finally, by increasing the likelihood that a single state's substantive law will apply to all arbitrations involving the franchise agreement, dispute-resolution costs as well as the costs resulting from uncertainty about the applicable law may be significantly reduced.

Another possible explanation is that such provisions discourage franchisees from pursuing small claims. Requiring franchisees to travel to the franchisor's place of business will increase the franchisee's dispute-resolution costs for both large claims and small claims. Those increased costs would not ordinarily be shifted to the franchisor if the franchisee prevails in the arbitration, because under standard institutional arbitration rules only the administrative fee and the arbitrator's fees can be allocated by the arbitrator in the absence of agreement by the parties.[400] As a result, although the costs of pursuing large claims increases, the proportional increase in the cost of pursuing small claims increases significantly more. In other words, a provision requiring arbitration to occur at the franchisor's home may have the effect of discouraging franchisees from pursuing small claims against the franchisor.

That individuals are discouraged from bringing small claims nonetheless may be consistent with the conclusion that arbitration benefits the parties on net. Although it is plausible that reduced dispute-resolution costs from arbitration may permit parties to litigate disputes they other-

398. *Cf.* Purcell, *supra* note 163, at 445–49 (cataloging the costs of distant litigation for individuals).

399. *E.g.*, Carrington & Haagen, *supra* note 8, at 386–87 (noting that single location for arbitration was "marvelously convenient for [the franchisor] for it enabled them to resolve all their disputes with franchisees across the continent most efficiently, using a single law firm intimately familiar with its affairs and without need of consultation on the law of any other jurisdiction"; but concluding that "the arbitration clause was massively inconvenient for [the franchisee]").

400. *See* 2000 AAA RULES, *supra* note 110, Rules R-45(c), R-52. These costs may be shifted by contract provisions of the type discussed in the next section or by fee-shifting statutes. *See* discussion *infra* Part IV.D.3.

wise would not—and thus achieve increased deterrence benefits[401]—it also is plausible that arbitrating small claims would have minimal deterrence benefits that were exceeded by the costs of the arbitration proceeding.[402]

3. Allocation of Litigation Costs

The American rule on allocating litigation costs is that each party bears its own attorneys' fees. The English rule permits the prevailing party to recover its own fees from the other party.[403] The basic rule in arbitration is that parties bear their own attorneys' fees, but that the arbitrator can allocate the administrative and arbitrator's fees between the parties as he or she determines.[404] In the arbitration clauses studied, forty-four percent provide that the prevailing party can recover its attorneys' fees from the other party, adopting the English rule by contract.[405] A minority of clauses—fifteen percent—sought to override the usual fee-shifting provided in arbitration by requiring the parties to bear their own arbitration expenses and to share the administrative and arbitrators' fees. One clause expressly precluded any award of attorneys' fees by the arbitrator.

Whether parties benefit on net from fee-shifting rules is uncertain.[406] Holding litigation spending constant, the English rule encourages claimants with strong claims to go forward with their claims and discourages claimants with weak claims from going forward.[407] But because the English rule increases the amounts at stake—a prevailing claimant not only recovers damages but also its dispute-resolution costs—parties are likely to spend more on litigation.[408] The increased expenditures may discourage even some claimants with strong claims from going forward,[409] par-

401. *See* Hylton, *supra* note 32, at 233.

402. *See supra* text accompanying note 386.

403. *E.g.*, James W. Hughes & Edward A. Snyder, *Allocation of Litigation Costs: American and English Rules*, *in* 1 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 51, 51 (Peter Newman ed., 1998).

404. *See supra* text accompanying notes 290–95.

405. *See supra* text accompanying notes 296–97. Many forum-selection clauses likewise adopted the English rule by providing for prevailing parties to recover their attorneys' fees.

406. For a useful overview, see Hughes & Snyder, *supra* note 403, at 51–56.

407. *See* Steven Shavell, *Suit, Settlement and Trial: A Theoretical Analysis Under Alternative Methods for the Allocation of Legal Costs*, 11 J. LEGAL STUD. 55, 59 (1982); David Rosenberg & Steven Shavell, *A Model in Which Suits Are Brought for Their Nuisance Value*, 5 INT'L REV. L. & ECON. 3, 5 (1985); *see also* Lucian A. Bebchuk, *Suing Solely to Extract a Settlement Offer*, 17 J. LEGAL STUD. 437 (1988) (arguing that the English rule will discourage nuisance suits).

408. *See* Ronald Braeutigam et al., *An Economic Analysis of Alternative Fee Shifting Systems*, 47 L. & CONTEMP. PROBS. 173, 181 (1984); John C. Hause, *Indemnity, Settlement, and Litigation, or I'll Be Suing You*, 18 J. LEGAL STUD. 157, 158 (1989); Avery Katz, *Measuring the Demand for Litigation: Is the English Rule Really Cheaper?*, 3 J.L. ECON. & ORG. 143, 159–61, 171 (1987) (using simulations to estimate that "a switch from the pure American rule to the pure English rule could result in an increase in expenditure of over 100 percent in the typical case").

409. *See* Edward A. Snyder & James W. Hughes, *The English Rule for Allocating Legal Costs: Evidence Confronts Theory*, 6 J.L. ECON. & ORG. 345, 351–53 (1990).

ticularly if claimants are risk averse.[410] The available empirical evidence suggests that litigation costs per claim do go up under the English rule, but also that the quality of claims increases.[411] The increased expenditures and higher quality claims may lead to more accurate decision making and increased deterrence benefits, but at the expense of higher dispute-resolution costs.[412] Plus, fee-shifting rules, at least ones providing for recovery of reasonable attorneys' fees, increase the amount of satellite litigation over the amount of fees, further increasing dispute-resolution costs.[413] Parties plausibly could conclude that the American rule is or is not preferable to the English rule; thus, the diversity of contractual approaches to fee-shifting is perhaps not surprising.

4. *Time Limits for Filing Claims*

Some arbitration clauses (and some forum-selection clauses) restrict the time in which one or both parties can file a claim.[414] If given effect, these provisions effectively modify the statute of limitations, usually reducing the limit provided by statute. Restricting the time in which claims can be filed can result in some cases in which a meritorious claim fails because it was filed too late. In such a case, the individual receives reduced compensation, and the corporation pays reduced compensation. For this reason, arbitration critics contend that such provisions are unfair to the individual.[415]

However, the parties as a whole may be better off by agreeing to reduce the amount of time in which a claim can be filed. Statutes of limitation, particularly for breach-of-contract actions, are quite long.[416] The longer after a dispute arises that a claim may be filed in court, the less the deterrent value of the litigation. Plus, the trier of fact is more likely to make a mistake, because memories will fail and documents may have been lost or destroyed. Similarly, older claims are likely to be more expensive to litigate than newer claims. Witnesses may be harder to locate and the relevant evidence may be more costly to collect. Thus, it is plausible that the savings in dispute-resolution costs from shifting from a court with a long statute of limitations to an arbitration proceeding with

410. *See* James W. Hughes & G.R. Woglom, *Risk Aversion and the Allocation of Legal Costs*, *in* DISPUTE RESOLUTION: BRIDGING THE SETTLEMENT GAP 167, 186 (David A. Anderson ed., 1996).

411. *See* James W. Hughes & Edward A. Snyder, *Litigation and Settlement Under the English and American Rules: Theory and Evidence*, 38 J.L. & ECON. 225, 248 (1995); Snyder & Hughes, *supra* note 403, at 370–75 (defense expenditures increased between 61.3% and 108.1% for litigated claims and 46.6% and 150.7% for settled claims).

412. *See* POSNER, *supra* note 344, at 631.

413. *See id.* at 629.

414. *See supra* text accompanying notes 301–02. Note that Article 2 of the Uniform Commercial Code expressly authorizes the parties to reduce the statute of limitations for breach of a sales contract to not less than one year. *See* UCC § 2-725(1) (1994).

415. *See supra* text accompanying notes 172–74.

416. *See* UCC § 2-725(1) (1994) (four-year statute of limitations for breach of sales contract); KAN. STAT. ANN. § 60-511(1) (1994) (five-year statute of limitations for breach of written contract).

a short statute of limitations may exceed any deterrence benefits of permitting old claims to be litigated.

Moreover, presumably the shorter statute of limitations gives claimants incentive to file their claims sooner. Claims that may not have been filed for three or four years after a dispute has arisen may now be filed in one or two years. Those claims that are filed earlier (for which a meritorious claimant will receive compensation) will be both less costly to litigate—because the evidence is fresher—and have a greater deterrent benefit. Thus, the parties on net might be made better off.

5. *Restrictions on Available Relief*

The arbitration clauses studied commonly excluded recovery of punitive damages, either by waiving recovery altogether, denying the arbitrator authority to award punitive damages, or both.[417] Forum-selection clauses, somewhat less frequently, also contained waivers of punitive damages.

Punitive damages may be necessary for optimal deterrence of wrongful conduct when the party may escape liability, such as when the conduct is difficult to detect, or when "the injurer's gains are not counted in social welfare," such as when he or she acts out of spite.[418] Because compensatory damages are based on the actual harm caused, if a party is likely to escape detection, merely awarding compensatory damages will result in underdeterrence of the wrongful conduct.[419] When a party acts out of spite, he or she gains pleasure from causing harm itself. As a result, no level of deterrence is too high—"the act should be deterred completely because it produces no social gain, only harm."[420] If punitive

417. *See supra* text accompanying notes 303–11.

418. *See* Robert D. Cooter, *Punitive Damages for Deterrence: When and How Much?*, 40 ALA. L. REV. 1143, 1149–66 (1989); Dorsey D. Ellis, Jr., *Fairness and Efficiency in the Law of Punitive Damages*, 56 S. CAL. L. REV. 1, 23–33 (1982); A. Mitchell Polinsky & Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 HARV. L. REV. 869, 887–91, 908–10 (1998) [hereinafter Polinsky & Shavell, *Economic Analysis*]; *see also* A. Mitchell Polinsky & Steven Shavell, *Punitive Damages*, *in* 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 192, 193–95 (Peter Newman ed., 1998); Paul H. Rubin et al., BMW v. Gore: *Mitigating the Punitive Economics of Punitive Damages*, 5 SUP. CT. ECON. REV. 179, 181–99 (1997). *But see* Jonathan M. Karpoff & John R. Lott, Jr., *On the Determinants and Importance of Punitive Damage Awards*, 42 J.L. & ECON. 527, 531 (1999) ("In most contractual relationships, punitive awards are unnecessary to encourage optimal contractual performance.").

419. *See* Polinsky & Shavell, *Economic Analysis*, *supra* note 418, at 887 ("*If a defendant can sometimes escape liability for the harm for which he is responsible, the proper magnitude of damages is the harm the defendant has caused, multiplied by a factor reflecting the probability of his escaping liability*."). The economic argument for punitive damages in breach-of-contract cases is similar. *See id.* at 936–39.

420. *Id.* at 909–10 (limiting this rationale to individual and not corporate defendants). A further, seemingly related rationale for punitive damages is to encourage parties to engage in market transactions concerning property the other party might try and appropriate—by infringing on a copyright, for example. Polinsky & Shavell explain:

> If punitive damages are set so that total damages substantially exceed the value of the attractive property, a person who might otherwise simply take the property will instead bargain with its owner, because it would be cheaper to pay an agreed-on price than to pay damages. Conse-

damages are awarded in other cases, however, overdeterrence may result. Parties may engage in too little of the activity;[421] deterrence "benefits" become deterrence costs. Moreover, the availability of punitive damages may increase dispute-resolution and other costs, because of the extra evidence needed to determine the amount of punitive damages, the increase in litigation and expenditures on litigation that may result from the increased amount at stake, and the increased variance in possible outcomes.[422]

If, in fact, punitive damages result in overdeterrence, or if the deterrence benefits from the availability of such damages are less than the added dispute-resolution costs,[423] the parties will be better off waiving punitive damages. Again, although this is not the only possible result, it is a plausible one.

6. *Exceptions to Arbitration*

Almost all of the arbitration clauses studied exclude some type of claim or remedy from arbitration. The exclusion may be an absolute "carve-out" for certain types of claims, excluding them altogether from arbitration. Or it may be an option, giving one or both parties (but usually the franchisor) the option to go to court instead of arbitrating the claim.[424] Arbitration critics decry these carve-outs or options as unfair to the party (usually the individual) who must arbitrate instead of litigate.[425]

That certain types of disputes are better suited to litigation than arbitration follows from the basic model of the decision to arbitrate described above. For certain types of disputes, arbitration may be cheaper or more accurate. For other types of disputes, litigation may be cheaper or more accurate. As a result, it is not surprising that arbitration clauses

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> quently, property will be exchanged only if the buyer values it more than the property owner, and the incentive to take and protect property whose value might be underestimated by compensatory damages will be eliminated.

Id. at 947.

421. *See* Rubin et al., *supra* note 418, at 190; Karpoff & Lott, *supra* note 418, at 531; *see also* James Boyd & Daniel E. Ingberman, *Do Punitive Damages Promote Deterrence?*, 19 INT'L REV. L. & ECON. 47, 61 (1999) ("Punitive damages reduce deterrence in precisely those cases where improvement is most necessary.").

422. *See* A. Mitchell Polinsky, *Are Punitive Damages Really Insignificant, Predictable, and Rational? A Comment on Eisenberg et al.*, 26 J. LEGAL STUD. 663, 668 (1997); George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L.J. 1521, 1588–89 (1987).

423. Thus, one study has found that the availability of punitive damages had no deterrent effect on a range of environmental and safety torts. *See* W. Kip Viscusi, *The Social Costs of Punitive Damages Against Corporations in Environmental and Safety Torts*, 87 GEO. L.J. 285, 289–96, 335 (1998) (proposing that "punitive damage awards be eliminated for corporate risk and environmental decisions"). *But see* Theodore Eisenberg, *Measuring the Deterrent Effect of Punitive Damages*, 87 GEO. L.J. 347 (1998) (criticizing Viscusi's analysis); David Luban, *A Flawed Case Against Punitive Damages*, 87 GEO. L.J. 359 (1998) (same). For Viscusi's response, see W. Kip Viscusi, *Why There Is No Defense of Punitive Damages*, 87 GEO. L.J. 381 (1998).

424. *See supra* text accompanying notes 312–16.

425. *See supra* text accompanying notes 188–93.

provide for some disputes to be arbitrated and others to be decided in court.

The sorts of disputes most commonly excluded from arbitration can readily be understood within this model. Intellectual-property disputes, in which the franchisor seeks to enjoin the franchisee's use of its trademark (the most common exception in the franchise agreements studied) is better suited for litigation than arbitration. First, the cost of a mistake is high; franchisors may prefer litigation with an appeals process to a largely unreviewable arbitration award.[426] Second, temporary injunctive relief to prevent further degradation of the trademark can be an important remedy, essential for adequate deterrence.[427] Although provisional remedies generally are available in arbitration,[428] arbitration is ill-suited for the grant of such relief. Arbitrators cannot order provisional relief until they are appointed, and a party that seeks to avoid provisional relief can defeat much of the purpose of the remedy by delaying the appointment of arbitrators.[429] Thus, the studied arbitration clauses commonly authorized the parties to go to court to obtain provisional relief.[430] However, provisional relief of this sort may require at least some preliminary inquiry into the merits of the case, and it may be less costly to have both aspects of that inquiry done by a court rather than splitting it between the court and an arbitration panel. Therefore, permitting a party to go to court rather than arbitrate intellectual-property disputes may reduce dispute-resolution costs and increase the accuracy of the dispute-resolution process.

Another common exception is claims for money owed to the other party.[431] Here, it may be that the certainty and accuracy of courts provides greater deterrence benefits to the parties.[432] Alternatively, litigation may have lower dispute-resolution costs. To enforce an arbitration award, a party will need to get it reduced to a court judgment, not a

426. *See* Eileen Davis, *ADR Well-Suited to Handle Franchise Cases*, 10 ALT. TO HIGH COST LITIG. 131, 131 (1992) ("The most common exceptions [to arbitration] are disputes involving the franchisor's trademark, which is the lifeblood of the business. Given the lack of appeal in most arbitrations, the risk that an arbitrator might wrongly determine the mark to be generic or invalid is too high.").

427. *See id.*; Schnabl, *supra* note 186, at 6.

428. *E.g.*, 2000 AAA RULES, *supra* note 110, Rule R-36; 3 MACNEIL ET AL., *supra* note 34, § 36.6.1.

429. *E.g.*, BORN, *supra* note 111, at 726, 769–70; Rome, *supra* note 187, at 6 (advocating carve-outs for certain claims when "timely exercise of the rights to be preserved" is important, "since selecting an arbitrator, as well as the process itself, can take substantial time").

430. *See supra* note 314.

431. *See supra* text accompanying notes 315–16.

432. *Cf.* Hylton, *supra* note 32, at 231 (banks litigate rather than arbitrate loan defaults because banks may "perceive a substantial loss in deterrence benefits" in using arbitration: "Most loan contracts are relatively clear, and courts have a great deal of experience with them. An arbitration regime would risk diluting this predictability, which could, in turn, reduce deterrence benefits.") (footnote omitted); Norbert Horn, *The Development of Arbitration in International Finance Transactions*, 16 ARB. INT'L 279, 284 (2000); William W. Park, *Arbitration in Banking and Finance*, 17 ANN. REV. BANKING L. 213, 215–16 (1998).

complicated requirement but an additional step nonetheless, before it can recover on the judgment. In simple disputes over money due it may be cheaper to skip that intermediate step by having a court enter judgment for the amount owed. Similar arguments may explain why foreclosure and eviction actions commonly are excluded from arbitration.[433]

One clause in the sample granted the franchisor the option to litigate or arbitrate, although requiring the franchisee to arbitrate.[434] Why should the franchisor have that option and not the franchisee? One answer is discussed further in the next section: the corporation, which has repeat dealings with other franchisees, likely is subject to a greater reputational constraint on opportunistic uses of its option than is an individual.[435]

E. Unfairness and Adhesion Contracts

As the preceding sections explain, fully informed individuals may find it beneficial to enter into predispute arbitration agreements, even those labeled "unfair" by arbitration critics. Arbitration can provide net benefits to the transacting parties, which they can share between themselves by means of adjustments in wages or in the prices of goods and services. Whether uninformed consumers—as opposed to fully informed ones—in fact benefit from one-sided arbitration clauses depends on how effectively the market causes corporations to adjust prices and wages to reflect benefits of arbitration. If the market is ineffective, arbitration not only may not benefit individuals, it actually may make the parties worse off overall: the corporation's gain from arbitration may be more than offset by the individual's loss.

The degree to which savings from arbitration is passed on to consumers ultimately is an empirical question. I am aware of no empirical attempts to measure the relationship between the use of arbitration clauses and either the price of goods and services or employees' wages.[436]

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433. *See* Horn, *supra* note 432, at 284; Solish, *supra* note 305, at 135 ("Courts are better suited to the summary ejection of a defaulting franchisee and will be constrained by statute to move expeditiously."); Trantina, *supra* note 187, at 48.

> There are some areas of the law that are so uniform, results so certain and rapid in application by the courts (e.g., the real estate mortgage foreclosure area) that attorneys and their clients are unwilling to give up the benefits available from the courts because they outweigh any other advantages that might accrue from arbitration.

Id.

434. *See supra* text accompanying notes 227–28.

435. *See* Benjamin Klein, *Transaction Cost Determinants of "Unfair" Contractual Arrangements*, 70 AM. ECON. REV. 356, 360 (1980) ("Explicit contractual restraints are often placed on the smaller, less well-established party (the franchisee), while an implicit brand name contract-enforcement mechanism is relied on to prevent cheating by the larger, more well-established party (the franchisor).").

436. Research in other areas suggests that government restrictions on parties' contracts do affect prices. *E.g.*, JAMES N. DERTOUZOS & LYNN A. KAROLY, LABOR-MARKET RESPONSES TO EMPLOYER LIABILITY (Rand Corp. 1992) (estimating that state wrongful-discharge laws are equivalent to a tax of 10% on wages).

One very anecdotal piece of evidence[437] is the arbitration clause at issue in *Stiles v. Home Cable Concepts, Inc.*[438] In *Stiles*, a finance company changed the terms of its revolving credit arrangement to include an arbitration clause and to reduce the annual percentage rate (APR) to 16.96%; if the customer objected to the change, he or she could retain the right to go to court and pay an APR of 18.96%.[439] The two-percentage-point difference in rates reflects the degree to which the customers shared in the cost savings the finance company expected to result from arbitration.[440] Whether that reduced rate sufficiently compensated customers for giving up the right to go to court cannot be determined from the case. Nor is there any indication from the case what fraction of the customers agreed to arbitration.

In the absence of empirical evidence, whether one believes that individuals benefit from arbitration through reduced prices and higher wages, or instead that corporations use arbitration to take advantage of individuals and avoid their legal obligations, depends largely on one's faith in the market as a means of allocating resources.[441] Those who believe that the market is a more effective constraint than courts will generally support the enforceability of predispute arbitration agreements.[442] On the other hand, those who believe that courts can constrain corporate opportunism better than markets are skeptical of the enforcement of arbitration clauses in standard form contracts.[443] As arbitration critics argue, individuals often will be poorly informed relative to corporations, which even economists agree weakens the efficiency case for enforcing contracts.[444] The model described above assumes that the parties know-

437. I acknowledge my previous veiled criticism of arbitration critics for relying on anecdotal evidence, *see supra* text accompanying note 199, and make no claims that this one reported case resolves the debate over the degree to which customers benefit from arbitration clauses. As stated, it is just an anecdote.

438. 994 F. Supp. 1410 (M.D. Ala. 1998).

439. *See id.* at 1412–13.

440. The leading arbitration treatise asserts that in *Stiles*, the finance company "subsidized customers whose claims arising under its contracts would be arbitrated." 2 MACNEIL ET AL., *supra* note 34, § 17.9, at 17:107 (rev. ed. 1999). It is perhaps more accurate to say that the finance company was seeking to induce customers to agree to arbitration by offering them a lower interest rate.

441. The Supreme Court evidently favors the market. *See* Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585, 594 (1991) ("It stands to reason that passengers who purchase tickets containing a forum selection clause like that at issue in this case benefit in the form of reduced fares reflecting the savings that the cruise line enjoys by limiting the fora in which it may be sued.").

442. *See* Hylton, *supra* note 32, at 213 ("presumption in favor of enforcement" of arbitration agreements); Shavell, *supra* note 32, at 3 ("ex ante ADR agreements should ordinarily be enforced by the legal system").

443. *See* Carrington & Haagen, *supra* note 8, at 388 (rejecting alleged reduction in price to franchisee from arbitration clause; "no person conscious of the practical realities of dispute resolution would be deceived by that academized theory"); Schwartz, *supra* note 8, at 107–09; Stempel, *supra* note 8, at 1397; Sternlight, *Panacea*, *supra* note 8, at 688–89 ("If the consumer is not aware of the existence or significance of the clause, the supplier is free to impose a term that benefits the supplier but significantly harms the consumer."); *cf.* Goldman, *supra* note 164, at 716–21 (consumers unaware of forum selection clauses).

444. *See* Hylton, *supra* note 32, at 15, 37–41 (but concluding that arbitration agreements should be enforced when reason for lack of information is "rational apathy"); Shavell, *supra* note 32, at 8 ("[I]t

ingly and voluntarily enter into the arbitration agreement with complete information. The greater the degree that is not true, the weaker the case for enforcing the agreement.

I cannot resolve that debate in this article. Instead, I will make three basic points, which arbitration critics tend to overlook in their arguments. First, franchisees are much closer to the sophisticated, well-informed individual assumed in the model than are consumers or employees, and should be treated accordingly. Second, a corporation's concern about its business reputation can constrain abusive use of predispute arbitration agreements; court and legislative efforts, if any, should focus on those cases in which reputation is least likely to be an effective constraint. Third, arbitration institutions have strong incentives to promote the fairness of the arbitral process, and may render further court or legislative intervention unnecessary.

First, franchise contracts should not be treated as adhesion contracts, as most (but not all) courts recognize.[445] Many franchisees are sophisticated business people who can and do shop around for franchise opportunities.[446] Indeed, some franchisees are large corporations.[447] Such franchisees will evaluate alternative franchise opportunities and search for the best combination of contract terms. In doing so, the sophisticated franchisees will protect less sophisticated ones.[448] State franchising laws discourage franchisors from discriminating between sophisticated and unsophisticated franchisees in contract terms: in at least some states all material variations in contract terms must be filed with a state regulator.[449] Thus, less sophisticated franchisees should benefit from the search activities of sophisticated ones. In addition, franchisees have access to significant information to help them evaluate dispute-resolution alternatives. The Uniform Franchise Offering Circular, which must be provided by franchisors to prospective franchisees, requires con-

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may be that a party to an agreement was not properly informed about relevant information—in the present context, information about the legal process or the character of ADR"—which "could provide grounds for not enforcing an ex ante ADR agreement.").

445. *See* James V. Jordan & Judith B. Gitterman, *Franchise Agreements: Contracts of Adhesion?*, FRANCHISE L.J., Summer 1996, at 1, 41–45. For a different view, see David Charny, *Nonlegal Sanctions in Commercial Relationships*, 104 HARV. L. REV. 373, 436–39 (1990); Sternlight, *supra* note 9, at 47–48.

446. *E.g.*, Broussard v. Meineke Discount Muffler Shops, Inc., 155 F.3d 331, 348 (4th Cir. 1998) ("By all lights, Meineke franchisees are independent, sophisticated, if sometimes small, businessmen who dealt with Meineke at arms' length and pursued their own business interests."); Doctor's Assocs., Inc. v. Jabush, 89 F.3d 109, 113 (2d Cir. 1996) (recognizing that franchisees "'[were] not vulnerable consumers or helpless workers. They [were] business people who bought a franchise'") (alteration in original) (quoting Original Great Am. Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd., 970 F.2d 273, 281 (7th Cir. 1992)).

447. *See supra* note 12.

448. *See* 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, 637–38 (1979). Although arbitration critics are skeptical of this argument, see Sternlight, *Panacea*, *supra* note 8, at 691 (calling it a "Pollyannaish defense"), it is particularly appropriate in the franchising context.

449. *See supra* text accompanying note 210.

spicuous front-page notice when the franchise agreement contains an arbitration clause and when the location of arbitration is in the franchisor's home state.[450] Private sources of information advising franchisees on what to look for in a franchise agreement—and discussing dispute-resolution clauses—are readily available.[451] Moreover, the market for franchise opportunities is highly competitive,[452] forcing franchisors to compete in providing contract terms.[453] Indeed, the empirical evidence presented earlier indicates that prospective franchisees can readily choose not to arbitrate disputes. Less than half of franchise agreements studied contain arbitration clauses.[454] Even "unfair" provisions in arbitration clauses do not appear in every franchise contract, although the frequency varies.[455] In short, franchisees should not be grouped with employees and consumers in determining the enforceability of predispute arbitration agreements.

Second, arbitration critics overlook the role of business reputation in constraining corporate opportunism. A business that develops a reputation for sharp dealing, whether through low-quality goods, arbitrary dealings with employees, or unfair contract terms—including arbitration clauses—will suffer in the marketplace. A good reputation is valuable to a business. Individuals regularly consider reputation in deciding whether to contract with a corporation.[456] The individual need not have particu-

450. *See supra* text accompanying notes 204–08.

451. *See* Andrew A. Caffey, *Have No Fear*, ENTREPRENEUR MAG., Dec. 1998 (arbitration agreement in franchise contract "could mean some travel in your future: Many franchise agreements require arbitration to occur at the American Arbitration Association office closest to the franchisor's headquarters"), *available at* http://www.entrepreneur.com/Your_Business/YB_PrintArticle/0,2361—1-,00.html (on file with the *University of Illinois Law Review*); Walter Pocock, *What to Look for in a Franchisor*, ARIZ. REPUBLIC, Mar. 17, 1998, at E10 ("Be satisfied with provisions about settling disputes. Watch out for clauses requiring arbitration in the franchisor's home state, if different from yours. Your travel and hotel expenses could be substantial.").

452. *E.g.*, Benjamin Klein, *Market Power in Franchise Cases in the Wake of* Kodak: *Applying Post-Contract Hold-Up Analysis to Vertical Relationships*, 67 ANTITRUST L.J. 283, 286 (1999) ("Because potential franchisees have many choices available pre-contract, franchisors have no market power when negotiating franchise contracts."); Paul H. Rubin, *The Theory of the Firm and the Structure of the Franchise Contract*, 21 J.L. & ECON. 223, 232 (1978).

> No individual who wants to become a franchisee is forced to sign with any one franchisor; the market for franchise operations is competitive, with the only monopoly element being the trademark. Thus, it is difficult to see why the courts would want to interfere at all in the franchisee-franchisor relationship.

Id. The Franchise 500 itself suggests the volume of franchise opportunities available to franchisees. *See supra* text accompanying notes 211–13.

453. *See* POSNER, *supra* note 344, at 127 ("If one seller offers unattractive terms, a competing seller, wanting sales for himself, will offer more attractive terms. The process will continue until the terms are optimal.").

454. *See supra* text accompanying notes 220–26.

455. Indeed, the fact that forum-selection clauses frequently contain similar provisions suggests that business reasons other than the choice of an alternative forum may be at work.

456. *E.g.*, Fred S. McChesney, *Consumer Ignorance and Consumer Protection Law: Empirical Evidence from the FTC Funeral Rule*, 7 J.L. & POL. 1, 43 tab.10B (1990).

larized knowledge of the "fine print" in the contract if he or she can rely on the corporation's general reputation for fair dealing.[457]

Repeat dealings are central to development of a business's reputation.[458] When individuals have repeat dealings with corporations, each side develops a reputation with the other. But even individuals who have not dealt with a corporation before can learn of its reputation: from friends,[459] consumer publications,[460] even the Internet.[461] Reputation is important even to a seemingly one-time business like a funeral home:

> Even if some customers purchase only one funeral, providers do not necessarily view them as one-time customers. Each consumer, if satisfied, represents likely additional referral business from favorable recommendations to other families in the future, and from repeat business within the same family. This gives providers greater incentives to increase purchasers' satisfaction by delivering the price-quality combination of goods and services that consumers seek.[462]

Certainly reputation does not perfectly constrain corporations from cutting corners at times (or just making mistakes), but it is a constraint that arbitration critics frequently fail to consider.

Reputation is likely to be more effective when parties have repeat dealings with each other, such as in employment[463] and franchise con-

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457. *See* David Friedman, *In Defense of Private Orderings: Comments on Julie Cohen's "Copyright and the Jurisprudence of Self-Help",* 13 BERKELEY TECH. L.J. 1151, 1157–58 (1998).

> [M]ass market products are more likely to provide me the characteristics I want and believe I am getting than more idiosyncratic products. This is in part because the effect of reputational incentives on the producers of mass market products and economies of scale in the generation of consumer information more than outweigh any advantages of being able to represent my preferences in one-on-one bargaining.

Id. (including not only product characteristics but also terms of standard form contracts).

458. *See* Daniel B. Klein, *Trust for Hire: Voluntary Remedies for Quality and Safety*, *in* REPUTATION: STUDIES IN THE VOLUNTARY ELICITATION OF GOOD CONDUCT 97, 105 (Daniel B. Klein ed., 1997) ("Remaining on Main Street gives rise to the businessman's reputation—that is, general opinion of his trustworthiness. Continuance and repetition open up vast institutional possibilities and provide fertile grounds for trust.").

459. *See id.* at 107–08.

460. *See id.* at 112–18 (describing "independent knower organizations," such as Consumers Union and the Better Business Bureau). Indeed, such organizations provide information about contract terms—including arbitration clauses—directly to their members. *See Give Up Your Right to Sue?*, CONSUMER REP., May 2000, at 8, 18 ("If you're faced with a mandatory-arbitration clause, read it carefully. . . . Walk away from a deal if you don't like what you hear."); *The Arbitration Trap: How Consumers Pay for "Low-Cost" Justice*, CONSUMER REP., Aug. 1999, at 64, 65 (advising consumers to "arm yourself against surprise by reading through the contracts you receive to see what dispute-resolution procedures, if any, you'll be obligated to follow").

461. *See* Rachel Beck, *Cos. Hear Disgruntled Voices on Web*, AP ONLINE, May 4, 1999, *at* 1999 WL 17800107 ("The Internet is a very effective new weapon for the consumer. . . . Before the Internet, unless you had a lot of time or money, there wasn't any way to get the public's attention to a problem. Now, you can broadcast it to the entire world in an instant.") (quoting Patricia Sturdevant, general counsel to National Association of Consumer Advocates).

462. McChesney, *supra* note 456, at 12–13.

463. *See* POSNER, *supra* note 344, at 370 ("Reputation alone will ordinarily restrain employers."); Hylton, *supra* note 32, at 254 ("Employees typically deal with employers on a repeated basis.").

tracts.[464] Reputation is likely to be less effective in one-time consumer transactions, particularly if consumers are isolated and the seller can readily discriminate between sophisticated and unsophisticated buyers.[465] It is transactions such as these that have the greatest potential for abusive use of arbitration clauses (and abuses of other kinds), and are ones in which judicial or legislative intervention has the strongest justification.

Third, arbitration institutions play an important role in promoting the fairness of the arbitration process—not only in limiting arbitrator bias[466] but also more generally in promoting fairness in the practice and procedure of arbitration.[467] The livelihood of arbitration institutions—such as the American Arbitration Association, JAMS, and the National Arbitration Forum—depends on the continued acceptability and enforceability of arbitration clauses. From the parties' perspective, an enforceable arbitration award is the essential result of the arbitration process. There is little reason to use an institution whose awards are not enforced by the courts.

A perception by the courts that arbitration awards are unfair—such as made by a biased arbitrator—increases the likelihood that the courts will refuse to enforce an award once made. Thus, arbitration institutions have a strong incentive to enhance the fairness of the process in order to assure users that their arbitration awards will be enforceable.[468] In addition, unfairness in arbitration raises the possibility of increased government regulation of the arbitration process. Such regulation could take a variety of forms, but many would pose a serious threat to the business of arbitration institutions. As often happens, the threat of government regulation can spur the industry to self-regulate in an attempt to head off restrictive legislation.

For both of these reasons, it is not surprising that the leading arbitration institutions have begun extensive efforts to enhance the fairness of arbitration proceedings they administer—and, indeed, are competing with each other to do so. The National Arbitration Forum has promul-

464. *See* Broussard v. Meineke Discount Muffler Shops, Inc., 155 F.3d 331, 348 (4th Cir. 1998) ("The market imposes a further, overriding restraint on the franchisor. There exists a grapevine among franchisees and franchisors do earn reputations. A franchise system marred by bad franchisor-franchisee relations is unlikely to expand—or survive."); *see also* Klein, *supra* note 435, at 358–59; Benjamin Klein et al., *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297, 305–07 (1978).

465. *See* Avery Wiener Katz, *Standard Form Contracts*, *in* 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 502, 505 (Peter Newman ed., 1998).

466. *See supra* text accompanying notes 362–64.

467. Some have argued that not only arbitrators, but also arbitration institutions, may be biased in favor of their corporate clients. *E.g.*, Carrington & Haagen, *supra* note 8, at 346; Olson v. Am. Arbitration Ass'n, Inc., 876 F. Supp. 850 (N.D. Tex. 1995) (rejecting as unsupported allegations of bias on the ground that "the AAA receives substantial contributions from employers"). I disagree, for the reasons stated in the text.

468. *See* Posner, *supra* note 363, at 664–65; Cole v. Burns Int'l Sec. Servs., 105 F.3d 1465, 1485 (D.C. Cir. 1997).

gated an "Arbitration Bill of Rights"[469] and has reduced fees to make arbitration more affordable for consumers.[470] The American Arbitration Association has published a Consumer Due Process Protocol and a Due Process Protocol on Employment Disputes,[471] and has issued arbitration rules providing for low-cost consumer arbitration.[472] JAMS has set out Minimum Standards of Procedural Fairness in employment arbitration,[473] and enforces its standards by refusing to administer any arbitration that does not meet the Minimum Standards.[474]

There is no legal requirement that corporations use arbitration institutions to administer their arbitrations, although many do. Of the arbitration clauses studied here, ninety-seven percent required arbitration before the AAA.[475] This analysis suggests that courts might be more wary of arbitration clauses that do not provide for independent institutions—particularly institutions with reputations of their own to develop or protect—to administer arbitrations.[476]

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469. *See* NATIONAL ARBITRATION FORUM, ARBITRATION BILL OF RIGHTS, *available at* http://www.arb-forum.com/other/ (last visited Nov. 6, 2000). The Arbitration Bill of Rights provides, for example, that "[t]he arbitrators should be both skilled and neutral," "[t]he cost of an arbitration should be proportionate to the claim," "[i]nformation about arbitration should be reasonably accessible before the parties commit to an arbitration contract," and "the remedies resulting from an arbitration must conform to the law." *Id.*

470. *See* NATIONAL ARBITRATION FORUM, NATIONAL ARBITRATION FORUM REDUCES FEES, ARBITRATION NOW EVEN MORE ACCESSIBLE (Jan. 12, 1999), *available at* http://www.arb-forum.com/new/press011299.html (on file with the *University of Illinois Law Review*).

471. *E.g.*, AMERICAN ARBITRATION ASSOCIATION, CONSUMER DUE PROCESS PROTOCOL (Apr. 17, 1998) *available at* http://www.adr.org/education/education/consumer_protocol.html (last visited Nov. 6, 2000) (on file with the *University of Illinois Law Review*). The Consumer Due Process Protocol provides that "[a]ll parties are entitled to a Neutral who is independent and impartial," "the proceedings should be conducted at a location which is reasonably convenient to both parties," and "[t]he arbitrator should be empowered to grant whatever relief would be available in court under law or in equity." *Id.*

472. *See* AMERICAN ARBITRATION ASSOCIATION, ARBITRATION RULES FOR THE RESOLUTION OF CONSUMER-RELATED DISPUTES (effective Apr. 1, 2000), *available at* http://www.adr.org/rules/commercial/000411ab.htm (last visited Nov. 6, 2000) (on file with the *University of Illinois Law Review*).

473. *See* JAMS, POLICY ON EMPLOYMENT ARBITRATION, MINIMUM STANDARDS OF PROCEDURAL FAIRNESS, *available at* http://www.jamsadr.com/employmentArb_min_stds.asp (last visited Nov. 16, 2000) (on file with the *University of Illinois Law Review*). The Minimum Standards of Procedural Fairness require, for example, that "[a]ll remedies that would be available under the applicable law in a court proceeding, including attorneys fees and exemplary damages, must remain available in arbitration"; "[t]he arbitrator(s) must be neutral, and an employee must have the right to participate in the selection of the arbitrator(s)"; and "[a]n employee's access to arbitration must not be precluded by the employee's inability to pay any costs or by the location of the arbitration." *Id.*

474. *See id.* (If JAMS "becomes aware that an arbitration clause or procedure does not comply with the Minimum Standards, it will notify the employer of the Minimum Standards and inform the employer that the arbitration demand will not be accepted unless there is full compliance with those standards.").

475. *See supra* text accompanying notes 230–32.

476. For health-care service plans, California law now distinguishes between arbitration programs administered by a "professional dispute resolution organization" and those that are not. *See* CAL. HEALTH & SAFETY CODE §§ 1373.19 & 1373.20 (West 2000) (providing that in arbitration program not administered by professional dispute resolution organization, a delay of more than 30 days in selecting an arbitrator will result in a conclusive presumption that "the agreed method of arbitration has failed"). The legislation was in response to significant delays in appointing arbitrators in Kaiser Per-

V. CONCLUSION

"Unfair arbitration clauses provide great fodder for academics and journalists seeking to attack binding arbitration[.]"[477]

This article offers a view of "unfair" arbitration clauses that runs counter to this commonly held opinion. "Unfair" arbitration clauses are not necessarily unfair, just as the standard characteristics of arbitration are not necessarily unfair. Fully informed individuals plausibly can be made better off by agreeing to each of the "unfair" provisions identified by arbitration critics: provisions governing the selection of arbitrators, the site of arbitral proceedings, the allocation of litigation costs, time limits for filing claims, restrictions on available relief, and one-sided exceptions to arbitration.

Although a plausible case can be made for enforcing all of the "unfair" arbitration clauses studied, some are more problematic than others. The strongest case for enforcement, in my view, is for clauses containing exceptions to arbitration. Sound business reasons underlie the most common exceptions to arbitration, and refusing to enforce arbitration clauses with such provisions will force parties to use less beneficial means of dispute resolution. The weakest case for enforcement is for clauses containing biased arbitrator-selection mechanisms. Such clauses may be attempts to circumvent statutory prohibitions on predispute waivers of certain types of claims. The other "unfair" provisions fall somewhere in between these extremes.

Whether in fact individuals benefit from arbitration agreements containing such provisions likely depends on whether corporations adjust prices and wages to reflect the cost savings resulting from arbitration, because these provisions, even if not "unfair," often are one-sided. If corporations do share the benefits of arbitration with individuals, refusing to enforce arbitration clauses containing "unfair" provisions will give a windfall to individuals with disputes and impose costs on everyone else. If corporations do not share the benefits of arbitration with individuals, refusing to enforce such arbitration clauses may nonetheless impose costs on the parties. Or it may prevent corporate opportunism and actually make individuals better off.

Arbitration clauses are most problematic when market constraints on opportunistic behavior are least effective. The interest of businesses in protecting their reputations reduces the likelihood of corporate oppor-

manente's self-administered arbitration program. *See* Engalla v. Permanente Med. Group, Inc., 938 P.2d 903, 930 (Cal. 1997) (finding sufficient evidence to support claim of fraud against Kaiser). Kaiser has since hired an outside law firm to take over administration of its arbitration program. *See* Mitchel Benson, *Courts Are Arming Consumers in their Battles Against HMOs*, WALL ST. J., Oct. 21, 1998, at CA1.

477. Jean R. Sternlight, *Drafting a "Bulletproof" Consumer Arbitration Agreement: Is It Possible?*, *in* ARBITRATION OF CONSUMER FINANCIAL SERVICES DISPUTES 763, 793–94 (PLI Corp. Law Practice Course, Handbook Series No. 1102, 1999).

tunism, and arbitration institutions have strong incentives to promote the fairness of the arbitral process. When these constraints are weakest—in one-time consumer transactions and when arbitration agreements do not provide for administration by an independent arbitral institution—courts and legislatures may view more skeptically claims that arbitration clauses in consumer contracts are beneficial.

APPENDIX I:
FRANCHISES STUDIED

Name of Franchise	Year Beginning Franchising	No. of Franchises (1998)
A&W Restaurants, Inc.	1925	1347
AAMCO Transmissions Inc.	1963	713
Arby's Inc.	1965	3105
Auntie Anne's Inc.	1989	450
Baskin Robbins USA Co.	1948	4111
Blimpie Int'l, Inc.	1970	1982
Blockbuster Video	1986	1010
Budget Rent A Car	1960	2490
Carlson Wagonlit Travel	1984	1302
CD Warehouse Inc.	1992	275
Century Small Business Solutions	1965	721
Chem-Dry	1978	3912
Coldwell Banker Real Estate	1982	2954
Computer Renaissance	1993	205
Cost Cutters Family Hair Care	1982	790
Coverall Cleaning Concepts	1985	4419
Culligan Water Conditioning	1938	749
Curves for Women	1995	402
Dairy Queen	1944	5800
Denny's Inc.	1984	800
Dunkin' Donuts	1955	4813
Express Services Inc.	1985	377
Fantastic Sams	1976	1313
Fastsigns	1986	409
GNC Franchising Inc.	1988	1290
Golden Corral Franchising Systems Inc.	1987	292
Great Clips Inc.	1983	1098
Hungry Howie's Pizza & Subs	1982	390
Interim Personnel	1956	315
Jackson Hewitt Tax Service	1986	1836
Jani-King	1974	7038
Jazzercise, Inc.	1983	4909
Jiffy Lube International Inc.	1979	963
KFC	1952	6635
Kumon Math & Reading Centers	1958	19,667
Maaco Auto Painting & Bodyworks	1972	535
Mail Boxes Etc.	1980	3655

(*Continued on next page*)

APPENDIX I—*Continued*

Name of Franchise	Year Beginning Franchising	No. of Franchises (1998)
Management Recruiters/Sales Consultants	1965	677
Matco Tools	1993	1106
McDonalds	1955	16,319
Medicine Shoppe, The	1970	1249
Merle Norman Cosmetics	1989	2029
Merry Maids	1980	1128
Miracle Ear Hearing Systems	1983	1374
Orion Food Systems Inc.	1993	866
Padgett Business Services USA	1975	414
Papa John's Pizza	1986	1247
Papa Murphy's	1986	347
Pizza Inn Inc.	1963	504
Play It Again Sports	1988	663
Precision Tune Auto Care	1978	506
Prudential Real Estate Affiliates	1988	1450
QLube Inc.	1978	162
Quizno's Corp., The	1983	380
RadioShack	1968	1963
Ramada Franchise Systems, Inc.	1990	965
Re/Max Int'l, Inc.	1975	3109
Rent-A-Wreck	1977	551
Schlotzsky's Deli	1977	715
ServiceMaster	1952	4210
Servpro	1969	931
Signs Now Corp.	1986	299
Snap-on Tools	1991	4157
Subway	1974	13,395
Super 8 Motels, Inc.	1976	1715
Supercuts	1979	767
Sylvan Learning Centers	1980	643
Taco Bell Corp.	1964	2927
Taco John's Int'l Inc.	1969	441
TCBY Treats	1982	2913
Thrifty Rent-A-Car System Inc.	1962	1140
Tim Hortons	1965	1529
Valvoline Instant Oil Change	1988	179

(Continued on next page)

APPENDIX I—*Continued*

Name of Franchise	Year Beginning Franchising	No. of Franchises (1998)
Wendy's Int'l, Inc.	1971	4032
Yogen Fruz Worldwide	1987	4722

Source: *Entrepreneur Magazine's 20th Annual Franchise 500*, ENTREPRENEUR MAGAZINE ONLINE, at http://www.entrepreneurmag.com/franchise500/franchise_rank.hts (visited June 1, 1999).

APPENDIX II: SELECTED PROVISIONS FROM ARBITRATION CLAUSES[478]

A. Sample Provisions on Discovery & Rules of Evidence

Medicine Shoppe International, Inc. License Agreement

G. ARBITRATION. . . . Such arbitration proceedings shall be conducted in St. Louis, Missouri and, except as otherwise provided in this Agreement, such claims shall be heard by one arbitrator in accordance with the then current Commercial Arbitration Rules of the American Arbitration Association with the following exception, that the arbitrator shall apply the rules of evidence and discovery which are applicable to like controversies heard in the United States District Court for the Eastern District of Missouri, in St. Louis, Missouri. . . . We both further agree that, in connection with any such arbitration proceeding, we both shall be bound by (i) the provisions of Rule 13 of the Federal Rules of Civil Procedure with respect to compulsory counterclaims (as the same may be amended from time to time), provided any such compulsory counterclaim shall be filed within thirty (30) days from the filing of the original claim; (ii) the provisions of the Federal Rules of Civil Procedure relating to discovery; and (iii) the Federal Rules of Evidence.

Yogen Fruz USA Franchise Company, Inc. Franchise Agreement

B. . . . (ii) Franchisor and you may take testimony by oral deposition, pursuant to the Federal Rules of Civil Procedure, of two persons associated with the opposing party, and any or all of the third party witnesses designated by the opposing party to testify at the arbitration hearing. A forty-five (45) day period shall be provided for such discovery following the exchange of pre-hearing briefs and witness lists, with the arbitrator being vested with the power to resolve any and all discovery disputes relating thereto.

B. Sample Provisions on Judicial Review

Servicemaster Franchise Agreement

24.7 De Novo Action on the Merits. If the arbitrators award either party damages (including actual damages costs and attorneys' fees) in excess of $100,000 in any arbitration proceeding commenced pursuant to this Agreement, either party will have the right to a de novo action on the merits by commencing a court action in accordance with the provi-

478. The sources for the arbitration clauses quoted are franchise agreements filed with the Minnesota Department of Commerce and are on file with the *University of Illinois Law Review*. *See supra* text accompanying notes 203–10. Capitalization and bold-faced print appears as in the original contract.

sions of this Agreement. If either party commences such a court action, then neither party will have the right to introduce the arbitrators' decision or findings in any court action and the arbitrators' decision and findings will be of no force and effect and will not be final or binding on either party. If either party fails to commence a court action within (30) days after receiving the arbitrators' written award, then the arbitrators' findings, judgment, decision and award will be final and binding on the Franchisor, the Franchisee and all other parties and may be entered as a final decree and judgment in any court of competent jurisdiction by any party.

Century Small Business Solutions, Inc. Franchise Agreement
13. DISPUTE RESOLUTION

A. Agreement to Use Procedure. . . . Any controversy or claim arising out of or relating to this Franchise Agreement or the breach hereof shall be settled by arbitration in accordance with the rules of the American Arbitration Association then in effect. The decision of the arbitrator will, except for mistakes of law, be final and binding upon the parties hereto . . . .

Mail Boxes Etc. Franchise Agreement
21.2. Arbitration:

. . . .

d. . . . The arbitrator shall not have the authority to commit errors of law or errors of legal reasoning.

C. Sample Provisions on Class Relief

Allied-Domecq Retailing USA Franchise Agreement (Baskin-Robbins)
11.8 No Class Actions. No party shall initiate or participate in any class action litigation claim against any other party bound hereby, except that FRANCHISEE may initiate and participate in any class action arbitration claim by franchisees of FRANCHISOR against FRANCHISOR limited exclusively to alleged misappropriation of moneys from the Fund of any System authorized by this Agreement, which claim must be brought only in arbitration under the provisions of this Section 11.

CD Warehouse, Inc. Franchise Agreement
27. ARBITRATION.

A. . . . Only claims, controversies or disputes involving Franchisee and no claims for or on behalf of any other Franchisee, Franchisee or Supplier may be brought by Franchisee hereunder.

Fantastic Sams Conventional License Agreement
13. MEDIATION AND ARBITRATION.

. . . .

It is the intent of the parties that any arbitration between LICENSOR and LICENSEE shall be of LICENSEE'S individual claim and that the claim subject to arbitration shall not be arbitrated on a class-wide basis.

Orion Franchise Agreement

10.1 Arbitration. . . . Each claim or controversy will be arbitrated by Franchisee on an individual basis, and will not be consolidated in any arbitration action with the claim of any other franchisee.

Papa John's Franchise Agreement Single Location Franchise

23. ENFORCEMENT.

(a)ARBITRATION.

. . . .

WE AND YOU AGREE THAT ARBITRATION WILL BE CONDUCTED ON AN INDIVIDUAL, NOT A CLASS-WIDE BASIS, AND THAT AN ARBITRATION PROCEEDING BETWEEN US (INCLUDING OUR AFFILIATES, SHAREHOLDERS, OFFICERS, DIRECTORS, AGENTS OR EMPLOYEES) AND YOU (INCLUDING YOUR OWNERS, GUARANTORS, AFFILIATES AND EMPLOYEES, IF APPLICABLE) MAY NOT BE CONSOLIDATED WITH ANY OTHER ARBITRATION PROCEEDINGS BETWEEN US AND ANY OTHER PERSON, CORPORATION, LIMITED LIABILITY COMPANY OR PARTNERSHIP.

Taco John's International, Inc. Restaurant Franchise Agreement
17.10 Negotiation, Mediation and Arbitration.

. . . .

The parties agree that arbitration shall be conducted on an individual basis, except as specifically provided below. The parties agree further that arbitration shall not be conducted on a class-wide basis.

You may commence arbitration as a claimant together with other franchisees of Taco John's Restaurant franchisees as co-claimants, subject to the following conditions:

(1) the claims of the other franchisees must present issues of fact or law in common with your claims; and

(2) at any time during the conduct of the arbitration, the total number of Taco John's Restaurants owned by the claimants in the arbitration may not exceed fifteen percent (15%) of the total number of franchised Taco John's Restaurants in operation.

You may consolidate any arbitration in which you are the claimant with other arbitrations in which other Taco John's Restaurants franchisees are claimants, subject to the following conditions:

(3) the claims of the other franchisees in the other arbitrations must present issues of fact or law in common with your claims in your arbitration proceeding; and

(4) at any time during the conduct of the consolidated arbitration, the total number of Taco John's Restaurants owned by the claimants in the consolidated arbitration may not exceed fifteen percent (15%) of the total number of franchised Taco John's Restaurants in operation.

If a claim which is subject to arbitration under this Agreement is properly the subject of a class action, then the party making that claim may, in its discretion, elect either to assert it as a single-party claim (as opposed to a claim on behalf of a class) in the arbitration, or to file it as a class action in a court of competent jurisdiction, pursuant to the laws and rules applicable to that court. If the court refuses to allow the matter to proceed as a class action, whether by refusing to certify a class or otherwise, then the party asserting the claim may not pursue it further in court, and if that party wishes to assert the claim further, then the party must submit it to arbitration in accordance with the provisions of this Paragraph 17.10.

D. Sample Provisions on Selection of Arbitrators

Century Small Business Solutions, Inc. Franchise Agreement
DISPUTE RESOLUTION

A. Agreement to Use Procedure.

. . . .

There shall be a single arbitrator who shall be an existing or former judge of a court of record within the United States or an attorney in good standing admitted to practice for a period of at least ten (10) years within the United States.

Auntie Anne's, Inc. Franchise Agreement
XXIX. APPLICABLE LAW; DISPUTE RESOLUTION

. . . .

B. . . . Each party can appoint its own arbitrator (who may or may not be on AAA list of arbitrators, or an attorney), who together select a person from the AAA approved list to serve as the neutral arbitrator. Although the party-appointed arbitrators participate in the entire proceeding, all decisions and/or rulings are made by the neutral arbitrator.

Play It Again Sports Franchise Agreement
19. ARBITRATION; ENFORCEMENT

A. Arbitration Process. . . . The arbitrator will have a minimum of five (5) years experience in franchising or distribution law . . . .

Schlotzsky's, Inc. Franchise Agreement
17.4 Arbitration Procedures

(a) Selection of Panel. Each party shall select one (1) qualified arbitrator and the two (2) arbitrators shall select a third qualified arbitrator. Failing selection of an arbitrator by either party, or by the two (2) selected by the parties, the additional arbitrator(s) shall be selected by the American Arbitration Association or any successor thereof, or by an arbitration organization or body, experienced in the arbitration of disputes involving the "Quick Service Restaurant" industry (such as JAMS ENDISPUTE), or as agreed upon by the parties.

(b) Qualifications of Arbitrators. Each arbitrator must meet or exceed each of the following criteria:

(i) At least forty (40) years of age;

(ii) Three (3) years experience in "Qualified Food Service Position"; and

(iii) Employed in "Qualified Food Service Position" within the last twelve (12) months.

"Qualified Food Service Position" shall mean: Corporate Officer or Area Supervisor (or equivalent) for a multi-unit, quick service (including fast food) restaurant or chain (exclusive of drive-in and chains specializing in chicken), having annual systemwide gross sales in excess of Two Hundred Million Dollars ($200,000,000.00).

E. Sample Provisions on the Site of Arbitral Proceedings

American Fastsigns, Inc. Franchise Agreement

25. Arbitration; Applicable Law

. . . .

B. . . . Arbitration shall take place at Franchisor's Principal Place of Business in Dallas County, Texas.

Allied-Domecq Retailing USA Franchise Agreement (Dunkin' Donuts)

CONTRACT DATA SCHEDULE

. . . .

L. Arbitration under this Agreement shall be initiated in the city and state of __________.

. . . .

Section 11. Arbitration.

. . . .

11. 1 Eligibility and Procedures. . . . Arbitration shall be initiated as provided in the Rules of the AAA by the filing of a demand for arbitration with the regional office of the AAA located in the city and state inserted in Item "L" of the Contract Data Schedule of this agreement. If no location is inserted in Item "L" or if such insertion is incomplete or inaccurate, Boston, Massachusetts, shall be deemed to apply. The arbitration proceedings, including without limitation all conferences, preliminary and dispositive hearings shall be conducted in such city and state unless all parties agree to another venue.

Snap-On Tools Dealer Franchise Agreement

25. Dispute Resolution.

A. Arbitration.

. . . .

. . . The arbitration shall be held at the office of the American Arbitration Association nearest the Snap-On Branch Office to which Dealer was assigned prior to the dispute; provided, however, if such office is outside the state in which the Dealer resides, Dealer may cause the arbitration to be held within Dealer's state of residence at a place mutually convenient to the parties and the arbitrators.

Orion Franchise Agreement

10.1 Arbitration. Except as provided below, any dispute arising under or in relation to this Agreement shall be resolved by binding arbitration by the American Arbitration Association under its rules of expedited commercial arbitration, at the AAA office nearest the party who did not initiate arbitration (if your state franchise law does not allow out of state arbitration, then arbitration shall be at your state capital).

Taco John's International, Inc. Restaurant Franchise Agreement

17.10 Negotiation, Mediation and Arbitration.

. . . .

(d) (iii) Arbitration. All controversies, disputes or claims which are the subject to [sic] this Paragraph 17.10 shall be submitted for arbitration after the parties have unsuccessfully attempted to negotiate and/or mediate the controversy, dispute or claim. The arbitration will be administered by the American Arbitration Association on demand of either party. Such arbitration proceedings shall be conducted before a panel of three (3) neutral arbitrators at a neutral location chosen by the American Arbitration Association which does not unduly favor or prejudice either party. . . .

F. Sample Provisions Allocating Litigation Costs

Great Clips Franchise Agreement

10.3 Costs and Fees. The prevailing party in any arbitration or court proceeding shall recover its costs in obtaining relief under this Agreement, including its reasonable attorneys' fees.

Harris Research, Inc. Franchise Agreement (Chem-Dry)

E. COSTS AND ATTORNEYS' FEES.

If HRI incurs expenses in connection with FRANCHISEE's failure to pay when due amounts owing to HRI, to submit when due any reports, information or supporting records or otherwise to comply with this Agreement, FRANCHISEE shall reimburse HRI for any such costs and expenses which it incurs, including but not limited to reasonable legal, arbitrators', accounting and related fees.

Mail Boxes Etc. Franchise Agreement

21.2. Arbitration:

. . . .

c. . . . The costs of arbitration are to be shared equally by the parties. Each party shall be responsible for its own costs and attorneys' fees.

Blimpie International, Inc. Traditional Location Franchise Agreement

ARTICLE 21. DISPUTE RESOLUTION: ARBITRATION AND LEGAL PROCEEDINGS

21.4 . . . [A]ttorneys' fees may not be awarded by the arbitrator(s), and any such award shall not be enforceable or enforced in any court. Except as otherwise provided, each party shall bear its own attorneys' fees, expert witness fees and other court or arbitration costs incurred in connection with any legal action or arbitration between Franchisor and Operator.

. . . .

23.4 Except as otherwise provided, each party shall bear its own attorneys' fees, expert witness fees, and other court costs incurred in connection with any violation of this Agreement.

G. Sample Provisions Limiting the Time for Filing Claims

Auntie Anne's Inc. Franchise Agreement

XXIX. APPLICABLE LAW; DISPUTE RESOLUTION

. . . .

D. As a condition precedent to commencing an action for damages or for violation or breach of this Agreement, Franchisee shall give notice to Franchisor within thirty (30) days after the occurrence of the violation

or breach, and failure to timely give such notice shall preclude any claim for damages.

E. The parties further agree that no cause of action arising out of or under this Agreement may be maintained by either party against the other unless brought before the expiration of two (2) years after the act, transaction or occurrence upon which such action is based or the expiration of one (1) year after the complaining party becomes aware of facts or circumstances reasonably indicating that such party may have a claim against the other party hereunder, whichever occurs sooner, and that any action not brought within this period shall be barred as a claim, counterclaim, defense or setoff.

Doctor's Associates Inc. Franchise Agreement (Subway)

l. We or you must start the action permitted under this Paragraph 10 to resolve a Dispute, whether by giving notice of the dispute or filing for mediation, arbitration, litigation, or any other permitted proceeding, within one (1) year from the time the events occurred which give rise to the Dispute, or the claim will be barred, except we may bring a claim under Subparagraph 5.h for under-reported sales within three (3) years from the under-reporting. We or you may bring an action for indemnification within one (1) year after we or you have notice of the claim that gives rise to the indemnification claim. The parties recognize this Subparagraph may have shorter time limits than applicable law will permit.

H. Sample Provisions Restricting Available Remedies

Mail Boxes Etc. Franchise Agreement

21.2. Arbitration:

. . . .

d. . . . [T]he arbitrator shall have no power or authority to award punitive, consequential or incidental damages.

GNC Franchising, Inc. Agreement

XXVI. <u>APPLICABLE LAW AND DISPUTE RESOLUTION</u>

. . . .

E. . . . Except for actions for trademark, tradedress or tradename infringement or other infringement or misappropriation of Franchisor's proprietary rights to any trademark, tradedress, patent, copyright, trade secret or other proprietary information, Franchisor and Franchisee hereby waive to the fullest extent permitted by law, any right to or claim for multiple punitive or exemplary damages against the other and agree that in the event of an arbitration or action at law between them, no party shall seek multiple, punitive or exemplary damages with respect to any claim or cause of action against the other party, whether in arbitration or litigation, and each party shall be limited to the recovery of any

actual damages sustained by it and costs and expenses, including attorney's fees as otherwise provided herein.

Rent-A-Wreck Franchise Agreement

F. ARBITRATION.

. . . .

The arbitrator has the right to award or include in his or her award any relief which he or she deems proper in the circumstances, including, without limitation, money damages (with interest on unpaid amounts from the date due), specific performance, injunctive relief and attorneys' fees and costs, provided that the arbitrator may not declare any Mark generic or otherwise invalid or, except as Subsection G below otherwise provides, award exemplary or punitive damages.

. . . .

G. WAIVER OF PUNITIVE DAMAGES AND JURY TRIAL.

EXCEPT FOR CLAIMS COMPANY MAY BRING AGAINST FRANCHISEE FOR HIS UNAUTHORIZED USE OF THE MARKS OR UNAUTHORIZED USE OR DISCLOSURE OF ANY CONFIDENTIAL INFORMATION, COMPANY AND FRANCHISEE AND THEIR RESPECTIVE OWNERS WAIVE TO THE FULLEST EXTENT THE LAW PERMITS ANY RIGHT TO OR CLAIM FOR ANY PUNITIVE OR EXEMPLARY DAMAGES AGAINST THE OTHER AND AGREE THAT, IN THE EVENT OF A DISPUTE BETWEEN COMPANY AND FRANCHISEE, THE PARTY MAKING A CLAIM WILL BE LIMITED TO EQUITABLE RELIEF AND THE RECOVERY OF ANY ACTUAL DAMAGES IT SUSTAINS. HOWEVER, IF FRANCHISEE IS REQUIRED TO INDEMNIFY COMPANY FOR ANY CLAIM OR LIABILITY UNDER SECTION 10, FRANCHISEE SHALL INDEMNIFY COMPANY FOR THE FULL AMOUNT OF ANY SUCH CLAIM OR LIABILITY, INCLUDING ANY PUNITIVE DAMAGES.

Doctor's Associates, Inc. Franchise Agreement (Subway)

17. a. The parties agree that no party will be liable for special, incidental, consequential, or punitive damages, and no party will seek multiple forms of damages of any kind in any Dispute, except to the extent federal or state law prohibits this limitation of damages or this Agreement otherwise permits. Each party's liability will be limited to compensatory damages, including claims for actual damages or losses and for future earnings or profits. Any claim for lost future earnings or profits will be limited to a maximum period of one (1) year. The parties specifically agree the provisions of this Subparagraph 17.a. will apply even if applicable governing law or arbitration rule permits an award for the type of damages the parties agree will not be available under this Agreement.

b. The parties further agree that a party's total liability for Disputes, as limited in Subparagraph 17.a., is further limited to an amount not greater than (1) $80,000, as adjusted for inflation annually at the end of each full calendar year based upon the percentage change in the Consumer Price Index (United States City Average, All Urban Consumers, All Items), or a comparable substitute if no longer used, or (2) the minimum amount in controversy necessary for federal diversity jurisdiction under 28 United States Code Section 1332; whichever yields the larger amount.

I. Sample Provisions Providing for Exceptions to Arbitration

Yogen Fruz USA Franchise Company, Inc. Franchise Agreement

A. . . . You agree to submit to the personal and the exclusive jurisdiction of the courts (both federal and state) located in the State of New York for any action brought by Franchisor or you hereunder. There may be state laws which conflict with this provision, in which instance such state law shall prevail.

B. (i) Except as provided in subparagraph C of this paragraph XXVIII, you agree that any dispute of any kind, nature or description between the parties hereto with respect to, relating to, or arising out of, the provisions of this Agreement or the breach thereof, may be resolved by arbitration at Franchisor election, which election may be made at any time prior to the commencement of a judicial proceeding by Franchisor, or in the event of a judicial proceeding instituted by you at any time prior to the date on which an Answer and/or Response is due to a Summons and/or Complaint served by you.

. . . .

C. The foregoing notwithstanding, you recognize the unique value and secondary meaning attached to Franchisor system, its trademarks, standards of operation and the Proprietary Rights. It is agreed that any noncompliance therewith or unauthorized or improper use thereof will cause irreparable damage to Franchisor and its franchisees. You, therefore, agree that if he should engage in any such unauthorized or improper use, during or after the period of this franchise, Franchisor shall be entitled to both permanent and temporary injunctive relief in an action brought by Franchisor in the Federal District Court for the District of New York; and you agree to submit to the jurisdiction of that Court for any cause of actions based on Franchisor rights as aforesaid.

Precision Tune Auto Care, Inc. Franchise Agreement

23.3.1 Notwithstanding the above, the following shall not be subject to arbitration:

(i) Disputes and controversies arising from the Sherman Act, the Clayton Act or any other federal or state antitrust law;

(ii) Disputes and controversies based upon or arising under the Lanham Act, as now or hereafter amended, relating to the ownership or validity of the Marks;

(iii) Disputes and controversies relating to actions to obtain possession of the Location under lease or sublease; or

(iv) For monies due.

23.3.2 If Franchisor shall desire to seek specific performance or other extraordinary relief including, but not limited to, injunctive relief under this Agreement, and any amendments thereto, then any such action shall not be subject to arbitration and Franchisor shall have the right to bring such action as described in Section 27.1.

Allied-Domecq Retailing USA Franchise Agreement (Baskin-Robbins)

11.6 FRANCHISEE's Exceptions. FRANCHISEE shall have the option to litigate any cause of action otherwise eligible for arbitration hereunder and shall exercise said option solely by filing a complaint in any court of competent jurisdiction in which FRANCHISEE expressly waives the right to a trial by jury and any and all claim(s) for punitive, multiple, exemplary and/or consequential damages. If any such complaint fails to include such express waivers or if any such court of competent jurisdiction determines that all or any part of such waivers shall be ineffective or void for any reason whatsoever, then the parties agree that the action shall thereupon be dismissed without prejudice, leaving the parties to their arbitration remedies, if then available pursuant to this Section 11.

11.6.1 In the event FRANCHISOR litigates any cause of action pursuant to subsection 11.5 above, FRANCHISEE shall not file any counterclaim, cross-claim, offset claim or the like against FRANCHISOR in the litigation, unless FRANCHISEE expressly waives the right to a trail by jury and any and all claim(s) for punitive, multiple, exemplary and/or consequential damages. Otherwise, FRANCHISEE shall submit each such counterclaim/cross-claim, offset claim or the like to arbitration, if then available pursuant to this Section 11.

APPENDIX III: SELECTED PROVISIONS FROM FORUM-SELECTION CLAUSES[479]

A. Sample Exclusive Forum-Selection Clause

Jani-King Associate Franchise Agreement

11.10. . . . JURISDICTION AND VENUE IS DECLARED TO BE EXCLUSIVELY IN DALLAS COUNTY, IN THE STATE OF TEXAS.

B. Sample Nonexclusive Forum-Selection Clause

Ramada Franchise Systems, Inc. License Agreement

17.4 Remedies. . . . You consent and waive your objection to the non-exclusive personal jurisdiction of and venue in the New Jersey state courts situated in Morris County, New Jersey and the United States District Court for the District of New Jersey for all cases and controversies under this Agreement or between we [sic] and you.

C. Sample Jury Trial Waiver

Quizno's Corporation Franchise Agreement

21.2 Waiver of Jury Trial. Franchisor, Franchisee, and the Bound Parties each waive their right to a trial by jury. Franchisee, the Bound Parties, and Franchisor acknowledge that the parties' waiver of jury trial rights provides the parties with the mutual benefit of uniform interpretation of this Agreement and resolution of any dispute arising out of this Agreement or any aspect of the parties' relationship. Franchisee, the Bound Parties, and Franchisor further acknowledge the receipt and sufficiency of mutual consideration for such benefit.

D. Sample Provisions on Class Relief

Coldwell Banker Commercial Franchise Agreement

16.1 Limitations: Any judicial proceeding between two or more of the parties shall be governed by the following limitations:

(a) Such judicial proceeding will be considered unique as to its facts and may not be brought as a class action. Franchisee and each of its Owners waived any right to proceed against Franchisor by way of class action. The court will not be precluded from making its own independent determination of the issues in question, notwithstand-

479. The sources for the forum-selection clauses quoted are franchise agreements filed with the Minnesota Department of Commerce and are on file with the *University of Illinois Law Review*. *See supra* text accompanying notes 203–10. Capitalization and bold-faced print appears as in the original contract.

ing the similarity of issues in any other judicial or arbitration proceeding involving any other franchisee. Each party waives the right to claim that a prior disposition of the same or similar issues preclude such independent determination.

Jackson Hewitt Franchise Agreement
28.7. No Class Actions. You agree that for our Network to function properly, we cannot be burdened with the costs of litigating network-wide disputes. You agree that any dispute between You and Us is unique as to its facts, and You shall not institute, join or participate in any class action against us or our Affiliates.

Wendy's International, Inc. Unit Franchise Agreement
26.2. Section 20 of this Agreement provides for non-binding mediation of certain disputes between the parties hereto. Subject to Section 20, Franchisee and any Guarantor may pursue any claim they may assert against any of the Franchisor Entities in an individual action, which shall not be joined or combined in any manner with any other action or claim of any other franchisee against any of the Franchisor Entities. Neither Franchisee nor any Guarantor will join together with any other franchisee of Franchisor in bringing any litigation against any of the Franchisor Entities; nor will Franchisee or any Guarantor maintain any claim against any of the Franchisor Entities in a class action, whether as a representative or as a member of a class or purported class; nor will Franchisee or any Guarantor seek to consolidate, or consent to the consolidation of, all or any part of any litigation by either of them against any of the Franchisor Entities with any other litigation against any of the Franchisor Entities.

E. Sample Provisions on Site of Litigation

A&W Restaurants, Inc. License Agreement
18.1 . . . The parties agree that any action brought by either party against the other in any court, whether federal or state, shall be brought exclusively within the State of Michigan in the judicial circuit or district in which A&W Restaurants, Inc. has its principal place of business, and the parties do hereby waive all questions of personal jurisdiction or venue for the purposes of carrying out this provision. The parties agree this forum is the most convenient forum for both jurisdiction and venue. The parties agree that this is a mutually convenient forum for any trial concerning disputes under this Agreement. It is mandatory that this forum be exclusively used for all disputes and no other forum may be used.

Arby's Inc. License Agreement

21:3 CHOICE OF FORUM

The parties agree that to the extent any disputes arise that cannot be resolved directly between the parties, Licensee shall file any suit against Arby's only in the federal or state court having jurisdiction where Arby's principal office is then located. Arby's may file suit in the federal or state court located in the jurisdiction where Arby's principal office is located or in the jurisdiction where Licensee resides or does business, or where the Licensed Premises are or were located or where the claim arose.

F. Sample Provisions Allocating Litigation Costs

Curves International, Inc. Franchise Agreement

M. Attorney Fees. In the event that any legal action is filed in relation to this Agreement, the successful party in the action shall be entitled to recover its costs therein, including reasonable attorneys' fees.

Servpro Industries, Inc. Franchise License Agreement

14.8 Should FRANCHISOR institute an action that in any way arises out of this Agreement or any alleged breach thereof, FRANCHISOR, if it prevails, shall recover from OPERATOR, in addition to any other relief, its costs and reasonable attorney's fees incurred in prosecuting such action. Should OPERATOR, or any third party, institute an action against FRANCHISOR or any of FRANCHISOR's agents or employees for any claim arising out of or related to this agreement, FRANCHISOR (or its agents or employees), if it prevails, shall recover from OPERATOR its costs and reasonable attorney's fees incurred in defending such action.

G. Sample Provisions Limiting the Time for Filing Claims

Blockbuster Inc. Standard Franchise Agreement

I. LIMITATIONS OF CLAIMS

Except with regard to FRANCHISEE's obligations to make payments to COMPANY pursuant to this Agreement, any and all claims arising out of or relating to this Agreement or the relationship between FRANCHISEE and its Owners and COMPANY and its Affiliates arising out of, from or related to this Agreement shall be barred unless an action or proceeding is commenced within two (2) years from the date the cause of action accrues.

Prudential Real Estate Brokerage Franchise Agreement

12.03 Written Notice of Unresolved Disputes—"Notification of Dispute" Procedure

Except as provided in paragraph 12.02 above, all disputes shall be brought to the attention of Franchisor and Franchisee by delivering a written notice headed "Notification of Dispute." Delivery of such notice shall be made within 60 days of the date on which facts respecting the dispute first come to Franchisor's or Franchisee's attention.

. . . .

12.08 Limitation of Actions

Franchisor and Franchisee agree that no form of action or proceeding permitted hereby will be maintained by any party to enforce any liability or obligation of the other party, whether arising from this Agreement or otherwise, unless any Notification of Dispute required to be delivered under this Agreement has been delivered in accordance with paragraph 12.03 hereof and unless the proceeding is brought before the expiration of the earlier of (a) the end of the 60-day period specified in paragraph 12.06 of this Agreement for the initiation of proceedings following mediation, if applicable; or (b) one year after the date of discovery of the facts resulting in such alleged liability or obligation or (c) two years after the date of the first act or omission giving rise to such alleged liability or obligation. . . . Notwithstanding the foregoing, where state or federal law mandates or makes possible by notice or otherwise a shorter period, such shorter period shall apply in all cases, in lieu of the time specified in (a), (b) or (c) above.

H. Sample Provision Restricting Available Remedies

Coldwell Banker Commercial Franchise Agreement

16.0 JUDICIAL PROCEEDING:

16.1 Limitations: Any judicial proceeding between two or more of the parties shall be governed by the following limitations:

. . . .

c. Except with respect to obligations regarding use of the Coldwell Banker Commercial Marks (set forth in Sections 2.1, 6.6 and 15.2 and Article 9.0) and the Confidential Information (set forth in Sections 14.3, 15.1 and 15.2 of this Agreement), the parties waive, to the fullest extent permitted by law, any right to or claim for any punitive or exemplary damages against any other party and agree that the party making any claim directly or indirectly arising from or relating to this Agreement will be limited to recovery of actual and consequential damages sustained.