

MODEL STATE CONSUMER & EMPLOYMENT JUSTICE ENFORCEMENT ACT

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ABOUT THE NATIONAL CONSUMER LAW CENTER

Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness.

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INTRODUCTION

Much attention is now being paid to the expanded use of forced arbitration clauses in employment and consumer contracts, the attendant harms to consumers and employees, and the possibility of federal intervention.¹ Recent media attention has highlighted the harms that arbitration inflicts on Americans every single day.² And a flurry of federal activity (both congressional and regulatory) has sought to chip away at many of these harms.³

Perhaps because of a concern that their efforts would be preempted by federal law, however, states have not yet fully examined the tools available to them to minimize forced arbitration's harms and to protect consumers and employees from some of the harmful effects of forced arbitration that are not shielded by federal law as it currently stands.

This introduction explains the harmful effects of “forced arbitration” clauses in employment and consumer contracts, not just for a state’s residents, but also for the state’s own interests in state law enforcement and in the efficient procurement of goods and services. The introduction also details ten areas where state legislation is *not* preempted by the Federal Arbitration Act, and where states can address some of these harms *now*.

In 2016, NCLC released a Model State Consumer and Employee Justice Enforcement Act, and bills based on that model have been introduced in several states. Since then NCLC has developed model language on two additional topics— the effect in standard form contracts of opt-out provisions and the appropriate remedy where a standard form contract contains illegal or unconscionable terms. This 2017 version of the model act includes these two additional topics as Titles IX and X.

The Model State Consumer and Employee Justice Enforcement Act provides model statutory language to implement these ten possible state interventions. Titles I and II of the Model Act seek to protect the state’s interests both in enforcing laws consumer and employment laws and in ensuring efficient contracting and procurement. Titles III through X seek to protect employees’ and consumers’ access to justice without running afoul of federal law.

A. Background: The Harms of “Forced Arbitration” & Federal Attention to the Issue

1. Forced Arbitration and its Harms

“Forced arbitration” clauses are fine-print terms included in contracts of adhesion—often contracts between an employee and her employer or a consumer and a merchant—that, in the case of consumer and employment contracts in non-unionized workplaces, require the

¹ See, e.g., Public Citizen, *Righting a Financial Wrong* (Feb. 27, 2014), available at www.citizen.org

² See Jessica Silver-Greenberg & Robert Gebeloff, *Arbitration Everywhere, Stacking the Deck of Justice*, *The N.Y. Times*, Oct. 31, 2015, available at www.nytimes.com.

³ Outlined below.

consumer or employee to give up her constitutional right to assert claims against the merchant or employer in court as a condition of obtaining or keeping her job or using the consumer good or service.⁴ These clauses are prevalent in a number of types of contracts including, among others, cellphone contracts, credit agreements, auto loans, school enrollment forms, nursing home contracts, and employment contracts in non-union workplaces.

These clauses purport to provide employees and consumers with a private forum to resolve their claims against the company instead of the public forum—whether judicial or administrative—that is generally available for such claims. But in practice many consumers and employees are never able to access this alternative, private forum. As explained further below, most forced arbitration clauses require the employee or consumer to pursue her claims individually, without the benefit of class or collective action procedures that many consumers and employees rely on to assert their rights. Moreover, some clauses require the consumer or employee to pay exorbitant arbitration fees or even to arbitrate in a far-off forum. And, finally, some businesses are now adept at manipulating the procedures of the arbitration provider to prolong the duration of the arbitration.⁵

Even when the employee or consumer can pursue her claims in arbitration, she often finds that the deck is stacked against her. The arbitration process is secret, and arbitrators are often subject to “repeat player” bias in favor of the business and against the employee or consumer—the business, after all, is the entity appearing in front of the arbitrator most frequently and is the one paying the arbitrator’s salary.⁶ What is more, under federal law, the

⁴ Through the collective bargaining process, unionized workers have the advantage of negotiating over an arbitration agreement.

⁵ In June 2015, the Yale Law School scholar Judith Resnik summarized the problem:

The result [of recent Supreme Court decisions] has been the mass production of arbitration clauses without a mass of arbitrations. Although hundreds of millions of consumers and employees are obliged to use arbitration as their remedy, almost none do so—rendering arbitration not a vindication but an unconstitutional evisceration of statutory and common law rights. The diffusion of disputes to a range of private, unknowable alternative adjudicators also violates the constitutional protections accorded to the public—endowed with the right to observe state-empowered decision makers as they impose binding outcomes on disputants. Closed processes preclude the public from assessing the qualities of what gains the force of law and debating what law ought to require. The cumulative effect of the Supreme Court's jurisprudence on arbitration has been to produce an unconstitutional system that undermines both the legitimacy of arbitration and the functions of courts. It should be noted that mediation, another form of ADR, differs substantially from arbitration. A mediator attempts to facilitate an agreement between the parties, while an arbitrator actually decides the case. Mediation does not prevent the consumer from bringing an action in court.

Judith Resnik, *Diffusing Disputes: The Public in the Private of Arbitration, the Private in Courts, and the Erasure of Rights*, 124 Yale L.J. 2804 (2015)

⁶ David Horton & Andrea Cann Chandrasekher, *After the Revolution: An Empirical Study of Consumer Arbitration*, Georgetown L. J. Vol. 104 (forthcoming), available at <http://papers.ssrn.com>.

right to appeal an arbitrator’s decision is extremely limited. A consumer or employee cannot obtain relief on an appeal from an arbitrator’s decision even when the arbitrator is clearly wrong on the facts or the law.⁷

For the most part, businesses are allowed to write their contracts this way because of the Supreme Court’s recent interpretations of the Federal Arbitration Act (FAA),⁸ a law that has been on the books since the 1920s. Although Congress’s purpose in enacting the FAA was to allow companies, bargaining at arms-length, to settle on an alternative dispute resolution forum, a series of recent Supreme Court decisions has expanded the Act’s reach to cover almost all employment and consumer contracts, whether or not the parties actually bargained over the term.⁹

2. Federal Action

In recognition of the harms caused by forced arbitration, as of 2017, the federal government had taken a number of positive steps to address the issue. The extent of these steps reflects a growing consensus that forced arbitration is often unfair, but these measures nonetheless fall far short of fully protecting all consumers and employees, and many of them have been withdrawn or have been substantially weakened under the Trump Administration.

- The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) prohibits the use of forced arbitration clauses in mortgage loan and manufactured home loan agreements;¹⁰
- The Military Lending Act prohibits arbitration in most forms of credit other than mortgage and purchase money loans extended to military service members and dependents;¹¹
- Department of Education Rules now in effect prohibit arbitration of most claims involving disputes with schools participating in the federal Direct Loan Program.¹²
- Federal Trade Commission recently has reaffirmed its position that binding arbitration agreements do not apply to disputes related to written warranties,¹³

⁷ *Hall Street Assoc. LLC v. Mattel, Inc.*, 552 U.S. 576 (2008).

⁸ 9 U.S.C. § 2

⁹ *See generally* Imre Szalai, *Outsourcing Justice* (2013); *see also* Paul Bland, Public Justice, *Important New Book Proves Federal Arbitration Act Badly Distorted by Supreme Court* (Mar. 31, 2014), *available at* www.publicjustice.net (reviewing Professor Szalai’s book).

¹⁰ 15 U.S.C. § 1639c(e).

¹¹ 32 C.F.R. § 232.8.

¹² 34 CFR § 685.300.

¹³ Final Action Concerning Review of Interpretations of Magnuson-Moss Warranty Act; Rule Governing Disclosure of Written Consumer Product Warranty Terms and Conditions; Rule Governing Pre-Sale Availability of Written

- The Department of Health and Human Services proposed severe restrictions on long-term care facilities' use of arbitration agreements, including prohibiting these facilities from making assent to such an agreement a condition of entering a long-term care facility.¹⁴ (Though that proposal was withdrawn by the Trump Administration.)
- President Obama in 2014 signed the Fair Pay and Safe Workplaces Executive Order,¹⁵ which prohibited pre-dispute, binding arbitration agreements covering discrimination, assault, and sexual harassment claims in contracts between large federal contractors and their employees. (The order has since been rescinded by President Trump.)

The Dodd-Frank Act provides express authorization for the Consumer Financial Protection Bureau (CFPB) to promulgate regulations prohibiting or limiting arbitration agreements involving consumer financial products, after first conducting a study on the issue.¹⁶

In March 2015, the CFPB published the final results of its study, which includes a thorough, empirical analysis stretching over 700 pages. The report details many of the harms that forced arbitration clauses cause consumers of financial products, noting in particular that forced arbitration prevents many consumers from ever being able to assert claims or obtain redress arising from corporate wrongdoing.¹⁷ In July, 2017 the CFPB issued a final rule prohibiting the use of arbitration to prevent class actions in court and adding other provisions dealing with mandatory arbitration.¹⁸ By one vote Congress rescinded the regulation under the Congressional Review Act.¹⁹

Warranty Terms; Rule Governing Informal Dispute Settlement Procedures; and Guides for the Advertising of Warranties and Guarantees, available at www.ftc.gov.

¹⁴ Medicare and Medicaid Programs; Reform of Requirements for Long-Term Care Facilities, 80 FR 42168-01. A court has enjoined the rule from going into effect.

¹⁵ See Exec. Order No. 13,673 (2014), available at www.whitehouse.gov.

¹⁶ 12 U.S.C. § 5518.

¹⁷ CFPB Arbitration Study at §§ 1.4.3 & 1.4.7 (For example, in 2010 and 2011, consumers of credit cards, checking accounts/debit cards, payday loans, prepaid cards, private student loans, and auto loans obtained less than \$400,000 in affirmative relief from the American Arbitration Association (AAA), notwithstanding the prevalence of arbitration clauses in these industries. By comparison, between 2008 and 2012, the average annual payout for consumers from class action settlements covering financial services products—in cases where the defendants could not insulate themselves from liability with forced arbitration clauses—was more than \$2 billion in cash relief, including fees and expenses, and \$600 million in in-kind relief (such as debt forgiveness)).

¹⁸ 12 CFR 1040.4(a).

¹⁹ Pub. L. No. 115-74 (2017).

B. Need for State Action

1. *Why Federal Actions Do Not Solve the Problem*

Forced arbitration of consumer and employment disputes is a scourge on the American justice system that calls for action at every level of government. Moreover, despite these recent and important federal actions, there is a continuing need for state action concerning forced arbitration.

First, a number of these recent federal enactments did not go into effect—most notably the CFPB Rule and the HHS Rule covering long-term care facilities. Other regulations only apply to certain transactions, such as mortgage loans or credit involving military personnel.

Thus, states should see recent federal attention to the issue as a call to action. While federal regulators consider the problem, states should act quickly to do their part too. Forced arbitration harms not only consumers and employees but also the states themselves, and states have the authority to protect against these harms to state interests, notwithstanding federal law. Additionally, federal law, even as it is currently interpreted, leaves considerably more room for states to protect consumers and employees than many states may have realized.

2. *How Forced Arbitration Harms States*

a. The Need for Private Enforcement

On November 19, 2014, sixteen state attorneys general submitted a joint letter to the Consumer Financial Protection Bureau (CFPB) urging the CFPB to exercise its statutory authority to regulate the use of forced arbitration clauses in consumer agreements for financial products and services. The letter recognized that unfair forced arbitration clauses not only create problems for individual consumers, but that the pervasiveness of these clauses results in a “systematic failure to hold accountable those companies that abuse the trust placed in them by consumers.” In other words, forced arbitration has harmful ripple effects throughout the entire marketplace because enforcement officials like these state attorneys general cannot, on their own, protect consumers from abusive practices.

Public enforcement agencies suffer from at least three systematic limitations that inhibit their capability to enforce the law adequately: (1) limited resources, (2) “informational disadvantages” that make it difficult for them to discover wrongdoing, even when it is apparent to its victims, and (3) the possibility of “capture” by wealthy and powerful interests.²⁰ To fill the enforcement void, the American legal system—at both the federal and state level—explicitly encourages private civil litigation.²¹ Every state in the country provides

²⁰ J. Maria Glover, *The Structural Role of Private Enforcement*, 53 Wm. & Mary L. Rev. 1137, 1155 (2012).

²¹ Richard B. Stewart & Cass Sunstein, *Public Programs & Private Rights*, 95 Harv. L. Rev. 1193, 1214 (1982) (“Public enforcement is, however, frequently inadequate because of budget constraints.”); see also Lauren K. Saunders, National Consumer Law Center, *Hold Wrongdoers Accountable to the Individuals They Harm*, NCLC Issue Brief

consumers with a private cause of action under its unfair and deceptive practices law, and the vast majority allow for the full recovery of actual damages and litigation costs and attorney fees, with the aim of deterring wrongful conduct and encouraging private enforcement.²²

Relying on private causes of action and fee-shifting provisions, private enforcement has historically played a critical role in helping to police the marketplace. In the employment context, for example, commentators writing before the proliferation of arbitration clauses and class and collective action bans reported that private enforcement actions recovered approximately \$1 billion per year in lost wages for victims of wage-and-hour violations.²³

In many ways the need for private enforcement of state protections has only increased in recent years. Economic pressures on state budgets have shrunk state public enforcement capacity. At the same time the pervasiveness and sophistication of wrongdoing has exacerbated the “informational” divide between public enforcement officers and employees and consumers. For example, “wage theft”—the practice of failing to pay workers for wages owed to them—has become increasingly prevalent, yet it is often difficult to detect by public enforcement officers who may not, for example, recognize that employees are being asked to work “off the clock.”²⁴

The CFPB’s study also highlights the importance of private civil litigation in enforcing the law. Section 9 of the study discusses the “relationship between public enforcement and consumer financial class actions.” One finding sticks out: In cases where the CFPB found “overlapping” enforcement activity by “government entities and private class action lawyers”—which would occur in the relatively rare instances where corporate wrongdoing involving a consumer financial product or service was not shielded by an arbitration clause and class waiver — “public enforcement activity was *preceded* by private activity seventy-one percent of the time.”²⁵

States have never needed private enforcement more. And yet the proliferation of forced arbitration has dramatically undermined state laws encouraging private enforcement. On its face, arbitration would not seem to bear on a consumer’s or worker’s ability to enforce state law, but merely to alter the forum in which such laws are enforced. According to the Supreme Court, after all, the Federal Arbitration Act embodies nothing more than a federal interest in encouraging alternative dispute resolution mechanisms that are “efficient and

(Nov. 2009), *available at* www.nclc.org

²² National Consumer Law Center, *Unfair and Deceptive Acts and Practices* § 12.2 (8th ed. 2012), *updated at* www.nclc.org/library.

²³ Michael Orey, *Wage Wars*, *Bloomberg Businessweek* (Sept. 30, 2007), *available at* <http://www.businessweek.com/stories/2007-09-30/wage-wars>.

²⁴ National Employment Law Project, *Winning Wage Justice: An Advocate’s Guide to State and City Policies to Fight Wage Theft* (Jan. 2011), *available at* <https://s27147.pcdn.co/wp-content/uploads/2015/03/WinningWageJustice2011.pdf>

²⁵ CFPB Arbitration Study at § 9.1 (emphasis added).

speedy.”²⁶ In practice, however, forced arbitration prevents most consumers and employees from bringing private enforcement actions against their employers and merchants in any forum.

As explained above, recent data highlights the extent of the “claim suppression” consequences of forced arbitration. The CFPB concluded that from 2010 to 2012 consumers of credit cards, checking accounts/debit cards, payday loans, prepaid cards, private student loans, and auto loans filed, on average, only 411 cases with the American Arbitration Association per year—this figure notwithstanding the prevalence of arbitration clauses in consumer financial agreements governing these contracts and the number of consumers using these products.²⁷ The preliminary results of the CFPB’s study noted that “[p]lainly, the number of arbitrations [during the 2010 to 2012 period] was low relative to the total populations using these products.”²⁸

The dearth of consumer claims arises in part from the pervasiveness of “class action waivers” that prevent consumers and employees from aggregating claims. According to the CFPB’s report, over ninety percent of arbitration clauses in contracts for most kinds of financial services include class waivers.²⁹ Since 2011, when the Supreme Court endorsed the enforceability of these provisions, class action waivers have effectively squelched hundreds of viable consumer and employment class actions—often in cases that are impossible or very difficult to bring on an individual basis.³⁰

Class action waivers suppress claims—and thus interfere with public enforcement of important state laws—in a number of ways. First, they interfere with consumers’ and employees’ ability to seek redress for “small dollar” claims, even when the consumer or employee knows she has been wronged. According to the CFPB report, a survey of credit card consumers revealed that just over two percent of credit card consumers would consider seeking legal redress against a credit card company for a wrongful fee. The majority of consumers responded that they would instead simply cancel their credit card.³¹ In the aggregate, the failure to seek private redress for these wrongs dramatically undermines the effective enforcement of state law.

²⁶ *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 221 (1985).

²⁷ CFPB Arbitration Study at § 1.4.3.

²⁸ Consumer Financial Protection Bureau, Arbitration Study Preliminary Results: Section 1028(a) Study Results to Date (Dec. 12, 2013), available at <http://files.consumerfinance.gov>.

²⁹ CFPB Arbitration Study at § 2.5.5.

³⁰ National Association of Consumer Advocates & Public Citizen, Cases That Would Have Been: Three Years After *AT&T v. Concepcion*, Cases of Corporate Wrongdoing Continue to Pile Up (May 1, 2014), available at www.issueab.org.

³¹ CFPB Arbitration Study at § 3.1.

Second, the possibility of class or collective litigation is important in cases where not all consumers or employees understand that their rights have been violated, or where they might be intimidated or lack the initiative to come forward on their own.³² Class actions allow a few named plaintiffs to represent a broader group of consumers or employees who do not know that they have been harmed or who want to remain anonymous.

Finally, arbitration agreements frequently make individual arbitration more burdensome and costly than filing in court—thus suppressing individual claims as well—by, among other things, requiring consumers or employees to pay thousands of dollars in arbitration costs, prohibiting the award of remedies that would otherwise be available, dramatically limiting discovery, requiring consumers or employees to arbitrate in far-off forums, and shortening the statutes of limitation applicable to consumer and employment claims. Although these features of arbitration clauses may, in some cases, render the clauses in which they appear unconscionable and unenforceable, many consumers and employees never have an opportunity to challenge these clauses in court because these unfair provisions deter consumers and employees from bringing claims. And, even when consumers or employees do file claims, many of the most unfair arbitration agreements “delegate” the question of enforceability to an arbitrator, preventing consumers and employees from accessing a judicial forum to establish that the arbitration agreement is unconscionable.³³

Even arbitration agreements that appear fair by requiring the business to bear the costs of arbitration suppress individual consumer and employment claims. Increasingly, businesses require their consumers and employees to arbitrate disputes but then refuse to pay the arbitration costs, putting the consumer or employee in the difficult position of having to front the business’s costs or convince a court to hear her claims notwithstanding the arbitration agreement.³⁴

States are unlikely to be able to offset the reduction in private enforcement caused by these trends by increasing their budgets for public enforcement. One response to this problem is to allow private attorneys general to assist in the enforcement of state law. This approach would fill the gap caused by the reduction in private litigation, because such actions on behalf of the state are not subject to arbitration agreements. Model language for such an approach is set out in the Model State Consumer and Employee Justice Enforcement Act, Title I.

³² *Haynes v. Logan Furniture Mart, Inc.*, 503 F.2d 1161, 1165 (7th Cir. 1974) (noting that it is proper for a court, in deciding the “best” available method for prosecution of a claim, to consider the “inability of the poor or uninformed to enforce their rights, and the improbability that large numbers of class members would possess the initiative to litigate individually”).

³³ *See Rent-A-Center West, Inc. v. Jackson*, 561 U.S. 63 (2010) (parties can delegate questions of validity to the arbitrator); *see also Duran v. J. Hass Grp., L.L.C.*, 531 F. Appx. 146, 147 (2d Cir. 2013) (summary order; in case against debt settlement company, compelling New York plaintiff to arbitrate in Arizona her argument that the arbitration clause’s requirement that she arbitrate in Arizona was unconscionable).

³⁴ Paul Bland, Public Justice, Bait and Switch (Mar. 24, 2014), available at www.publicjustice.net.

b. The Secrecy of Forced Arbitration Proceedings Hinders State Procurement and Contracting

The secret nature of forced arbitration obscures essential information on which states rely in making informed and efficient decisions about the procurement of goods and services and in overseeing private contractors after entering into a contractual relationship.

Arbitration clauses exacerbate the difficulties states might ordinarily have gathering information about potential recipients of state funds.

Many arbitration clauses contain “confidentiality provisions” expressly prohibiting the parties from disclosing information about cases brought through arbitration.³⁵ Even when the clause does not prohibit the parties from publicizing their case, the public (including states) rarely finds out about arbitration awards or claims in arbitration because, unlike judicial decisions and publicly filed complaints, arbitration filings are generally not provided in a publicly accessible database.

During the initial stages of the public contracting process, public agencies usually rely on open bidding processes to select government contractors. Although public bidding may help the government identify the costs of a contract, it will not, on its own, reveal whether a potential contractor is involved in legal disputes with consumers or employees. The government will have difficulty identifying whether the contractor provides the services it claims to provide unless the contractor or other business resolves its disputes with consumers and employees publicly.

For example, consider a for-profit college that receives state funds to train state employees on the use of software used by various state agencies. Without having the opportunity to review claims brought against the school by former students alleging that they did not receive the promised education, the state will not be able to effectively evaluate whether the services provided by the school merit the state selecting that school to train its employees. In other words, transparent dispute resolution is critical to evaluating the quality of the goods or services offered by a business before entering into a contractual relationship.

The state’s interest in transparent dispute resolution among its contractors does not end, however, at the time the state enters into a contract. Transparent dispute resolution during the course of the contract’s performance helps the state evaluate whether the contractor is effectively performing its obligations. Without being able to examine employee and consumer claims against the contractor, the state might have difficulty determining whether the contractor is breaching its contractual obligations, which would justify termination of the

³⁵ See National Consumer Law Center, *Consumer Arbitration Agreements* Ch. 6 (7th ed. 2015), *updated at* www.nclc.org/library.

contract. For example, if a state is paying a contractor to provide meals to low-income consumers, the state might learn that those meals are tainted only if one of the meal's recipients is able to bring suit in a public forum.

Additionally, transparent resolution of consumer and employment disputes prevents the contractor from concealing chronic problems that might interfere with the quality of the goods or services provided to the state, even if the contractor does not breach the contract. A recent scandal involving sexual harassment problems at the clothing manufacturer and retail store American Apparel illustrates the problem.

For decades, American Apparel's chief executive officer had been the subject of sexual harassment claims and accusations on the part of employees, but he remained in control of the company until 2014. An article in *The New York Times* noted that forced arbitration clauses in employment contracts had helped to insulate his practices from public scrutiny and thus injured shareholders and customers. "If American Apparel hadn't been able to use arbitration and confidentiality clauses to keep investors and the public in the dark over those accusations, [the CEO] would most likely have been shown the exit some years earlier."³⁶ As *The Times* further explained, "A board can use [arbitration clauses] to hide a pattern of bad conduct. Either employees will be deterred from bringing claims or, if they do, the claims will be buried in the silence of arbitration."³⁷

A large government contractor could similarly use arbitration clauses to conceal pervasive and chronic wrongdoing and harm the state's financial interests in any number of ways during the performance of the contract. For example, as in the situation with American Apparel, a contractor might use forced arbitration clauses in employment contracts to conceal and insulate from public scrutiny ongoing legal violations, which, when allowed to persist outside the public eye, interfere with the quality of the goods and services provided. Alternatively, a large contractor might be able to conceal consumer claims brought in arbitration that allege illegal charges to individual consumers. Without being able to track these claims, the state might not identify ways in which it too is illegally overcharged by government contractors, perhaps in violation of the contract.

To the extent that the state—acting as a market participant and not as a regulator—determines that companies utilizing arbitration clauses in employment or consumer contracts adversely affect the state's procurement activities, the state can choose not to contract with those companies. Model language for such an approach is set out in the Model State Consumer and Employee Justice Enforcement Act, Title II, which allows states to use their "market participant" powers to ensure that their contractors resolve consumer and employment disputes transparently.

³⁶ Steve David Solomon, *Arbitration Clauses Let American Apparel Conceal Misconduct*, *The N.Y. Times*, July 15, 2014, available at <http://dealbook.nytimes.com>.

³⁷ *Id.*

3. *Forced Arbitration Only Other Harmful Effects That Call for State Action*

Forced arbitration has a number of other harmful effects on consumers and workers. Many of these aspects of forced arbitration are entirely unrelated to federal law regarding arbitration, and therefore are susceptible to state intervention. The following list sets out a number of these problems and the corresponding title in the model act that is designed to address the harm without conflicting with federal law.

- Notwithstanding the number of rights that forced arbitration agreements often require consumers and employees to waive, these terms are often buried in long form contracts or employment manuals that consumers and workers rarely have the time to read and understand. *See* Title III, *infra*.
- The Federal Arbitration Act purports to protect arbitration as an alternative dispute resolution mechanism that is faster and cheaper than litigation in court. In practice, however, many arbitration clauses contain unfair terms that are entirely inconsistent with even the most arbitration-friendly understandings of federal law, including terms that require consumers and employees to waive important rights and remedies, to arbitrate in a far-off venue, or to pay extraordinary arbitration fees. *See* Title IV, *infra*.
- Express and implied limitations on the scope of the Federal Arbitration Act provide states with fairly broad authority to prohibit arbitration contracts in certain contexts, including in employment contracts for transportation workers and any contract for insurance. Additionally, state law governs when the contract containing the arbitration clause does not affect interstate commerce or when the parties agree that state law governs. Too often, states fail to utilize this authority. *See* Title V, *infra*.
- Private arbitrations are administered by private organizations that have been susceptible to bias in the past and that tend to administer disputes opaquely. *See* Title VI, *infra*.
- Disputes regarding arbitration prolong litigation and often make it difficult for employees and consumers to have their day in court even when a judge determines that they are *not* bound to arbitrate their dispute. *See* Title VII, *infra*.
- Even when consumers or employees do bring claims in arbitration, they often face difficulty having their case heard by an arbitrator. When the arbitral forum requires the employer or business to pay the arbitration fees, the employer or business can stall the arbitration process by refusing to make a payment. In theory, arbitrators should formally refuse to administer the arbitration, making the forum unavailable and allowing the consumer or employee to pursue her claims in court. In practice, however, it is often difficult and time consuming to obtain this result. *See* Title VIII, *infra*.

C. Overview of Federal Preemption

Notwithstanding the ways in which arbitration of consumer and employment disputes harms states, consumers, and employees, little state legislation has been enacted to address these problems. In large part, this is because of a fear that the Federal Arbitration Act (FAA) preempts any state law that limits forced arbitration. Although federal law does protect arbitration agreements from some state laws that might otherwise limit their enforceability, this Model Act provides a number of possible avenues for state action that do not conflict with or obstruct federal law.

The FAA provides that a written agreement to settle a dispute by arbitration “shall be valid, irrevocable, and enforceable, save upon such grounds that exist at law or in equity for the revocation of any contract.” 9 U.S.C. § 2. In a number of contexts, courts have stated that this language embodies a “liberal federal policy favoring arbitration.”³⁸ At the same time, however, the Act’s express language preserves general state contract rules and other rules that do not conflict with that policy. The challenge for states is identifying measures that protect states themselves, along with the state’s consumers, and employees from forced arbitration’s harmful effects without conflicting with the FAA’s purposes.

The United States Supreme Court’s FAA preemption jurisprudence, culminating in its 2011 decision in *AT&T Mobility L.L.C. v. Concepcion*,³⁹ suggests that there are two ways in which a state law or rule of decision can be preempted by the Federal Arbitration Act.

First, a state rule is clearly preempted if it singles out arbitration clauses for disfavor relative to other contractual terms or singles out private dispute resolution for disfavor relative to judicial or administrative dispute resolution.⁴⁰ Rules requiring that certain kinds of disputes or claims be resolved through litigation as opposed to arbitration and rules requiring that arbitration clauses take a particular form fall into this category.⁴¹

Second, the FAA preempts state rules of decision that interfere with the “fundamental attributes of arbitration.” According to the Court, the FAA “encourage[s] efficient and speedy dispute resolution.”⁴² The aspects of arbitration that facilitate this idealized notion of arbitration are “fundamental” to arbitration, and rules that interfere with these fundamental attributes are preempted. For example, in *Concepcion*, the Court held that a California rule

³⁸ *Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983); *Chelsea Family Pharmacy, P.L.L.C. v. Medco Health Solutions, Inc.*, 567 F.3d 1191, 1199 (10th Cir. 2009).

³⁹ *AT&T Mobility L.L.C. v. Concepcion*, 131 S. Ct. 1740 (2011).

⁴⁰ *THI of New Mexico at Hobbs Ctr., L.L.C. v. Patton*, 741 F.3d 1162, 1169 (10th Cir. 2014); see generally *AT&T Mobility L.L.C. v. Concepcion*, 131 S. Ct. 1740, 1746 (2011).

⁴¹ See, e.g., *Ferguson v. Corinthian Colleges, Inc.*, 733 F.3d 928, 934 (9th Cir. 2013).

⁴² *Concepcion*, 131 S. Ct. at 1749 (internal quotation marks omitted) (quoting H.R. Rep. No. 68-96, at 2 (1924)).

prohibiting some arbitration clauses which required that disputes be arbitrated only on an individual, not classwide, basis was preempted because bilateral dispute resolution is *fundamental* to arbitration.⁴³

Mindful of these constraints, the proposals that follow provide states with opportunities to protect themselves from the harms of forced arbitration without interfering with private parties' right, embodied in the FAA, to enter into agreements to resolve disputes efficiently and expeditiously. These proposals are guided by the following principles, some specific to FAA preemption but others relating to states' powers more generally.

Although the FAA preempts some state laws regulating private agreements to arbitrate, it cannot prevent states from using their public enforcement and procurement powers to protect their own financial and enforcement interests. One of a state's primary responsibilities is regulating private businesses and entities, but this is not the state's sole function. In addition to being a regulator, the state is also an enforcer of state laws and a large consumer of and investor in goods and services in the private marketplace. In these latter arenas, the state is considerably less encumbered by federal law from mitigating the harms of forced arbitration to state interests. *See* Title I & Title II, *infra*.

The FAA leaves considerably more leeway for state action addressing the *formation* of arbitration agreements than the *enforcement* of arbitration agreements. As the Supreme Court made clear in *Concepcion*, one of the FAA's primary goals is the enforcement of arbitration clauses pursuant to the parties' private, consensual agreement. But when there is no private, consensual agreement, the FAA's presumption in favor of arbitrability does not apply. For this reason, state laws focusing on the formation of arbitration agreements are more likely to survive challenge than state laws focusing on the enforcement of arbitration agreements. *See* Title III, *infra*.

The FAA does not require the enforcement of arbitration clauses that are unconscionable and unfair, as long as what renders such clauses unfair is not a "fundamental" attribute of arbitration. As explained above, the Supreme Court has held that some aspects of forced arbitration clauses, including the requirement that consumers and workers arbitrate their disputes on an individual basis, are so "fundamental" to arbitration that they are protected by the FAA and cannot be defeated by general state contract defenses. But the FAA does not protect arbitration clauses from generally applicable state-law challenges, including unconscionability, if they call for an inefficient, prolonged, or costly arbitration forum. States should act to clarify that certain terms included in some arbitration clauses are presumptively unconscionable. *See* Titles IV, IX, and X, *infra*.

⁴³ *Id.*; *Sec. Indus. Ass'n v. Connolly*, 883 F.2d 1114, 1117 (1st Cir. 1989) (finding Massachusetts regulations preempted by the FAA because the "[r]egulations not only regulate; they do so in a manner patently inhospitable to arbitration. They (i) bar firms from requiring individuals to enter PDAs as a nonnegotiable condition precedent to account relationships; (ii) order the prohibition brought "conspicuously" to the attention of prospective customers; and (iii) demand full written disclosure of "the legal effect of the pre-dispute arbitration contract or clause" (internal citations omitted)).

Federal law provides an exception to the FAA for insurance contracts and contracts regarding transportation workers, and the FAA does not apply to contracts that do not involve interstate commerce or when the parties agree that state law applies. In these contexts, states have the authority to prohibit the formation and enforcement of forced arbitration agreements. *See* Title V, *infra*.

The FAA does not regulate the private companies that administer arbitrations. Federal law may prevent states from adopting certain regulations related to the enforcement of private agreements to arbitrate, but the FAA does not prevent the states from regulating the private arbitration administrators that arbitration agreements often designate to resolve disputes. *See* Titles VI & VII, *infra*.

The FAA does not govern the procedures by which private parties must litigate questions about arbitration in state court. Pursuant to black-letter principles of civil procedure, state procedural law applies to cases brought in state court, even where those cases raise issues of federal law, like the scope of the Federal Arbitration Act. *See* Title VII, *infra*.

MODEL STATE CONSUMER AND EMPLOYEE JUSTICE ENFORCEMENT ACT

Summary of Act

The Model State Employee and Consumer Justice Enforcement Act includes eight separate titles that protect against different harms related to forced arbitration of consumer and employment disputes. Although they are presented as a single Act, these subparts also stand alone. Thus, states can enact any or all of the titles. A definitions section applies to terms used throughout all eight titles, and each title is followed by notes and analysis.

Definitions of Terms—The model act invites states to use their existing definitions for a number of terms that appear throughout the model act and to replace terms included in these model provisions with language that is more appropriate for the state’s legislative scheme. However, the model act does define “forced arbitration agreement” and “employee.” The definition of “forced arbitration agreement” is designed to cover all situations where a consumer or employee cannot meaningfully understand and assent to an arbitration agreement because it is a condition of entering into a relationship with the business or would be considered by a reasonable person to be a condition of entering into the relationship. The definition of “employee” is designed also to cover disputes where plaintiffs argue that a business has “misclassified” them as something other than an “employee.”

Title I: Delegation of State Public Enforcement Authority—To preserve public resources while ensuring adequate enforcement of state worker and consumer protection laws, Title I embodies a delegation to private attorneys general of the authority to enforce these laws on behalf of the state. Consistent with age-old *qui tam* doctrine, the law allows the private attorney general to recoup an incentive award capped at a percentage of the recovery remitted to the state. The state maintains control over the litigation by preserving the state’s opportunity to intervene in the action for the purposes of dismissing it with prejudice, settling it, or pursuing it on the state’s own behalf.

Title II: Conditions on Persons Doing Business with the State—Pursuant to their market participant powers, states can prohibit the entities with which they do business from forming or enforcing forced arbitration clauses in employment and consumer contracts. As explained above, forced arbitration obscures information that is often essential to government contracting and procurement, and states have an interest as market participants in ensuring that the entities with which they do business do not use arbitration clauses to obscure claims that might reveal something about the quality of their products or services. Title II requires that any entity seeking to do business with the state notify its consumers and employees that it will cease enforcing forced arbitration clauses in employment and consumer contracts. Importantly, the Title covers all of the entity’s employment and consumer contracts, not just those contracts directly tied to the government contract or project.

Title III: Clear Notice and Single Document Rule—For a set of contracts identified by the state, Title III requires that merchants and employers provide clear notice of all material terms in language that the consumer or employee can understand. For consumer contracts, Title III also requires that material terms be included in a single document. Such “material terms” include, among others, forced arbitration clauses.

Title IV: Unconscionable Terms in Standard Form Contracts—Title IV sets out types of contractual terms related to dispute resolution found in form contracts between an individual and the drafter of the contract that are presumptively unconscionable, including, among others, terms requiring the individual to waive substantive rights or to resolve her dispute in a far-off forum. Title IV also seeks to deter employers and merchants from inserting unconscionable terms that would chill consumer and employee claims. The Title creates a presumption that such terms are not severable from the arbitration agreement and by making the inclusion of such terms in a standard form contract an unfair and deceptive practice under state law.

Title V: Prohibition of Forced Arbitration Clauses under State Law—Title V amounts to a catch-all provision that prohibits the enforcement of forced arbitration clauses in employment and consumer contracts that are not covered by the Federal Arbitration Act, including in contracts for insurance and in employment contracts for transportation workers.

Title VI: Data Disclosure Requirements for Arbitration Providers—Title VI does not regulate private arbitration agreements but instead the private companies that administer arbitrations. It requires that these companies comply with certain data disclosure requirements. For example, arbitration administrators must disclose how many consumer and employment arbitrations are conducted during specified time periods, the arbitrator conducting the arbitration, and the award.

Title VII: Appellate Jurisdiction—Title VII removes the jurisdiction of appellate courts to consider appeals from denials of motions to compel arbitration. In this way, it ensures that employers and merchants are not able to force a plaintiff through costly and prolonged litigation regarding the applicability of an arbitration clause that a court has declined to enforce.

Title VIII: Preventing Respondents from Improperly Delaying the Arbitration Proceeding—Like Title VI, Title VIII does not regulate arbitration agreements, *per se*, but rather arbitration providers that administer a minimum number of disputes brought by consumers or employees. Title VIII provides that if a respondent in an arbitration brought by a consumer or employee fails to pay arbitration fees, the administrator must either administer the arbitration or promptly refuse to move forward with the arbitration and notify the parties in writing of that refusal.

Title IX: Effect of Opt-Out Provisions—Title IX deals with corporations' attempt to legitimize unconscionable standard form contract provisions by technically giving consumers the right to opt out of the provisions within a certain number of days. In reality, consumers rarely even understand their right to opt-out and virtually never do so. Title IX provides that there is a rebuttable presumption that the right to opt out of a standard form contract does not bear on whether the contract is procedurally conscionable. As with Titles III and IV, there is no federal preemption because the provision applies to any standard form contract and thus does not discriminate against arbitration agreements. The title provides a uniform interpretation of state contract law.

Title X: Remedy for Drafter Overreach in Standard Form Contracts—Title X deals with the problems that drafters have little incentive to keep unenforceable provisions out of standard form agreements. Often the only consequence of adding clearly unconscionable provisions is that, in the rare cases that those provisions are subject to litigation, the provision is merely struck and the rest of the agreement is enforced. This results in agreements containing clearly unenforceable provisions that deter consumers and employees from exercising their rights. Title X sets out factors for courts to consider in determining whether to strike only an unenforceable provision or the whole agreement. As with Title IX, Title X applies to all standard form contracts and does not prevent courts from interpreting state law in a uniform fashion. As such there is no federal preemption.

DEFINITION OF TERMS

[*Note:* States will likely need to define other terms used throughout the Act (including, for example, “consumer”), but because many states already include such definitions in their employee and consumer protection statutes, the Model Act does not provide such definitions here. Furthermore, some terms used throughout the Act will be inappropriate for certain states’ statutory schemes. As just one example, the term “civil penalties” might not be appropriate in some states that impose “fines” or “sanctions.”]

Forced arbitration agreement is an agreement to subject disputes between the parties to a binding dispute resolution procedure separate from federal or state judicial or administrative process if such agreement (1) is a condition of entering into a relationship with the party that presented the agreement or is presented in such a way that a reasonable person would consider it to be a condition of entering into a relationship with the party that presented it; and (2) was not negotiated by a labor union through collective bargaining; pursuant to this definition, for a consumer and employment contract an arbitration agreement is a “condition of entering into a relationship” with a business if the business retaliates against the consumer or employee for failing to assent to the agreement or if the consumer or employee reasonably fears that the business would retaliate against the consumer or employee for failing to assent to the agreement. The right to “opt-out” of the agreement at a later time does not affect or alter the agreement’s status as a “forced arbitration agreement.”

Employee is, for the purpose of this Act, any person employed by another as defined by state law, and any person who is not classified by a business as an employee but who claims to be an employee and whose claims against the purported employer relate to this alleged misclassification.

Notes

Definition of forced arbitration. The definition of “forced arbitration agreement” stretches broadly to cover any agreement that a consumer or employee enters into as a condition of her relationship with a business. The definition also applies to arbitration agreements that are in actuality “forced,” even when the employer or business attempts to hide that forced nature. Under this definition an arbitration agreement is “forced” if a reasonable consumer or employee would think that it is a condition of entering into the relationship. Furthermore, a business cannot remove an arbitration agreement from the ambit of this definition by including an opt-out clause.⁴⁴

⁴⁴ The opportunity to “opt out” of an arbitration clause is not a meaningful one. The CFPB has found that “[c]onsumers are generally unaware of any arbitration clause opt-out opportunities they may have been offered.” CFPB Arbitration Study at § 1.4.2. Similarly, in assessing whether the presence of an opt-out clause precludes a finding that an arbitration agreement is procedurally unconscionable, many courts have refused to give weight to opt-out provisions which are often burdened by limitations and conditions, or which do not provide consumers with sufficient data to make an informed choice about whether to opt out..

Definition of “employee.” “Employee” is defined as anyone falling with the state’s definition of an employee and also, for the purpose of this Act, anyone who claims that she is an “employee” but that her employer has “misclassified” her as something else—like a franchise or an independent contractor—to avoid following wage-and-hour laws. If “employee” were not defined in this manner, and instead shared the definition of “employee” used in the state’s wage-and-hour protections, then a court would have been placed in the awkward position of first having to result the merits of the misclassification claim before addressing the preliminary issue as to whether the arbitration clause applied.⁴⁵

TITLE I: DELEGATION OF STATE ENFORCEMENT AUTHORITY

Section 1. Findings.

Limits on the availability of public enforcement resources have deleterious effects on the marketplace by allowing abuses targeting consumers and workers to persist unprosecuted. To ensure the robust enforcement of [*designated State consumer and worker protection statutes*], while simultaneously minimizing the outlay of scarce State funds, this Title provides for private attorneys general to represent the State’s enforcement interests in certain contexts in which the State does not have the means to enforce fully state consumer and worker protections.

Section 2. Civil penalties.

Unless State law provides a different amount as the civil penalty recoverable by the State for violations of [*designated State consumer and worker protection statutes*], a person who commits a violation of such State consumer or worker protection laws shall be subject to a civil penalty not to exceed \$5,000 per violation.

Section 3. Private attorney general suits:

- (a) A person may initiate on behalf of the State an action alleging violations of [*designated State consumer and worker protection statutes*] to recover civil penalties on behalf of the State and to seek injunctive, declaratory, or other equitable relief that the State would itself be entitled to seek;
- (b) In initiating an action under this Title, a person may allege multiple violations that have affected different consumers or employees, as long as those violations are of a sufficiently similar kind that they can be efficiently managed in a single action;

⁴⁵ Much litigation has resulted from an analogous situation where a plaintiff resists a motion to compel arbitration of a misclassification claim because she argues that the FAA does not apply to her dispute because the arbitration agreement is contained within a “contract of employment of” a transportation worker, which is excluded from the Federal Arbitration Act. 9 U.S.C. § 1; *see also* Title V, *infra*. The definition of employee avoids such unnecessary litigation.

- (c) For the purpose of encouraging the enforcement of public protections, a court may award a person who initiates a claim under this Title an incentive award of up to twenty-five (25) percent of the total monetary recovery if that person pursues the action to final judgment as the prevailing party, or up to ten (10) percent of the total recovery if the state intervenes in the action and pursues it to final judgment as the prevailing party, including after settlement. In deciding an appropriate incentive award, a court shall consider the complexity of the case, the resources dedicated to prosecuting the case, whether the private attorney general obtained equitable relief on behalf of the state, and the extent of such relief, and the importance of the case as measured by the extent of actual damages caused by the wrongdoing to consumers or employees; and
- (d) When a private attorney general or the State prevails in an action originally brought under this Title, the private attorney general and the State each shall be entitled to attorney fees and costs, as reasonable based on their participation in the action.

Section 4. State’s opportunity to intervene and proceed with the action.

A person initiating an action under this Title shall serve a copy of the complaint and a letter describing the action on the State Attorney General, at which point the action shall be stayed for thirty (30) days. The State may intervene in the action and proceed with any and all claims in the action:

- (a) As of right within the thirty-day stay; or
- (b) For good cause, as determined by the court, after the expiration of the thirty-day stay.

Section 5. Discovery.

Whether or not the State proceeds with the action, upon a showing by the State that certain actions of discovery by the person initiating the action would interfere with the State’s investigation or prosecution of a criminal or civil matter arising out of the same facts, the court may stay such discovery for a period of not more than 60 days. Such a showing shall be conducted *in camera*. The court may extend the 60-day period upon a further showing in camera that the State has pursued the criminal or civil investigation or proceedings with reasonable diligence and any proposed discovery in the action will interfere with the ongoing criminal or civil investigation or proceedings

Section 6. Prohibition of duplicative actions.

No action may be brought by a private party acting pursuant to this Title for any violations already alleged as the basis for an action brought by the State, or by another private party pursuant to this Title, and no action may be brought by the State for any violations already alleged as the basis for an action brought by a private party pursuant to this Title.

Furthermore, when a person initiates an action under this Title, no person other than the State may intervene or bring a related action under this Title based on the facts underlying the pending action.

Section 7. Settlement.

The court in which the action is filed shall review and approve any proposed settlement of an action brought under this Title to ensure that the settlement provisions are reasonable in light of State law. The court shall also ensure that any incentive fees and attorney fees or costs included in a settlement are reasonable and that the private attorney general does not recover, as an incentive payment, more than twenty-five (25) percent of the recovery remitted to the State under the proposed settlement. The proposed settlement shall be submitted to the State Attorney General at the same time that it is submitted to the court. If the State Attorney General opposes the settlement and expresses such opposition by filing a motion with the Court, the Court must decline approval of the settlement.

Section 8. Limitations on State actions initiated by a private party.

- (a) The State may dismiss any action in which it decides to intervene under Section 4 of this Title notwithstanding the objections of the person who initiated the action.
- (b) The State may settle any action in which it decides to intervene under Section 4 of this Title notwithstanding the objections of the person who initiated the action.

Section 9. Res judicata.

Notwithstanding any other provision of law, an action initiated by a private person under this Title shall not bar that person or any other individual from filing a private action based on the same nucleus of operative facts, nor shall a prior private action based on the same nucleus of operative facts bar an action under this Title.

Section 10. Relationship to forced arbitration.

Actions under this Title are prosecuted on behalf of the State and not an individual, and forced arbitration agreements between private parties do not apply to actions under this Title. No contract shall waive or limit a private party's right to act as a private attorney general under this Title by waiving that party's right to bring such an action in a public forum or by preventing the party from being able to bring an action alleging multiple violations committed against multiple consumers or employees pursuant to Section 3(b) of this Title.

Section 11. Severability.

If any provision of this Title or the application thereof to any person or circumstance is held invalid, such invalidity shall not affect other provisions or applications of the Title that can be given effect without the invalid provision or application, and to this end the provisions of this Title are declared to be severable.

Notes

Section 2—Rules relating to civil penalties for violations of consumer and worker protection laws. Depending on whether preexisting law already provides for civil penalties for violating state consumer or worker protections, a state enacting Title I may not need to provide such penalties separately. States should ensure, however, that this Title expressly identifies that its purpose is to provide for public enforcement capabilities for private parties, not to provide a private cause of action to consumers and workers.

Section 3—Delegation of public enforcement powers. Some of the provisions of this Title are based on the *qui tam* provisions of the California Private Attorneys General Act,

California Labor Code §§ 2698 to 2699.5 (West) (“PAGA”),⁴⁶ and some are based on the federal False Claims Act, 31 U.S.C. § 3130.

Title I includes the essential characteristics of a *qui tam* action as identified by Blackstone: (1) the prohibition of conduct as being contrary to the interests of the sovereign; (2) a penalty or forfeiture imposed for violations; (3) allowance of civil enforcement actions pursued by private parties for conduct that may not have directly affected that party; (4) provision of an incentive for private parties bringing actions under the statute; and (5) a provision binding the government to the outcome of the private parties’ enforcement actions.⁴⁷

Section 3(a)—Claims seeking injunctive or other equitable relief. Because much of the most important relief available to the state in enforcement actions brought under consumer or worker statutes is injunctive (for example, debt relief for debtors), Title I allows the state to delegate enforcement actions seeking that type of relief in addition to claims seeking monetary relief. Whether a private attorney general under this Title obtains injunctive relief for consumers or workers is one consideration a court may take into account in deciding an appropriate incentive payment, but note that obtaining injunctive relief does not increase the twenty-five (25) percent incentive payment limit in cases brought to final judgment.

Sections 3(a) & (b)—Representative actions by any member of the public. Like the federal False Claims Act, but unlike the *qui tam* provisions in California’s PAGA, Title I does not require that a party bringing an action on behalf of the state be “aggrieved” by the conduct of which the public enforcement action complains. California’s requirement has confused some courts and commentators who have misapprehended that PAGA’s purpose is to provide a remedy to aggrieved employees instead of to enforce state law on behalf of the state.⁴⁸ Title I avoids the possibility of this confusion.

⁴⁶ PAGA is further described in Professor Janet Cooper Alexander’s 2013 article, *To Skin a Cat: Qui Tam Actions As a State Legislative Response to Concepcion*, 26 U. Mich. J. L. Reform 1203 (2013), which advocates that states enact a provision similar to the model statute’s Title I.

⁴⁷ J. Randy Beck, *The False Claims Act and the English Eradication of Qui Tam Legislation*, 78 N.C. L. Rev. 539, 552 (2000).

⁴⁸ See, e.g., *Nanavati v. Adecco USA, Inc.*, No. 14-CV-04145-BLF, 2015 WL 1738152, at *8 (N.D. Cal. Apr. 13, 2015) (“As a dispute that is, at its core, between private parties, the terms of their arbitration agreement control.”).

The virtue of narrowing the set of persons who can bring *qui tam* claims to aggrieved persons, however, is not that it allows injured parties to seek redress. The California law is clearly intended to allow private parties to enforce the state’s right on behalf of the state. But by limiting the universe of potential relators to “aggrieved” parties, PAGA guards against the possibility of a multitude of frivolous lawsuits brought by private attorneys general from out of state or who are otherwise entirely disconnected from the alleged wrong.

While Title I does not require that the private attorney general be aggrieved, it protects against frivolous lawsuits through other means. Title I gives courts wide discretion to award incentive payments, but restricts that discretion to issues related to the complexity of the case, the outlay of resources used in prosecuting the case, and the extent of *actual* damages to consumers or workers. In this way, courts are entitled to award minimal incentive payments in uncomplicated cases involving minor violations.

Furthermore, Title I contains two other built-in checks against extensive frivolous litigation: First, if a case is truly frivolous, the State Attorney General may intervene and dismiss the case, resolving the matter quickly, and preventing the private attorney general from recovering any incentive payment. Second, under Title I, the private attorney general’s recovery is capped at a percentage of the state’s recovery. In this way, the private attorney general will not be able to recover unless the state recovers, and if the state recovers little, the private attorney general will also recover little.

If a state adopts Title I but limits private attorneys general to aggrieved parties, it should make it crystal clear through legislative findings and statutory language that the private attorney general is still allowed to proceed only on behalf of the state, and not on her own behalf and that the state will have the right to control the litigation completely.

Section 3(c)—Actions protecting a number of consumers or employees. In the interests of the efficient administration of justice, Title I allows private attorneys general to bring in a single action claims related to a number of different violations committed against multiple consumers or employees. Although the aggregate nature of these actions mimics some of the procedural benefits of a class action, actions brought under Title I differ from class actions in important ways. First, the private attorney general represents the interests of the state, not the interests of private individuals harmed by the consumer or worker abuses. Second, unlike class actions, which preclude members of the class from bringing individual claims for the same misconduct, claims brought under this Title do not alter the rights of the consumers or employees affected by the alleged wrongdoing to bring individual claims for the same misconduct. Because the private attorney general brings claims on behalf of the state, not to seek redress for the wrongs done to her or others, the private attorney general suit does not affect the private attorney general’s or any other person’s right to bring a separate private suit.⁴⁹

⁴⁹ Notwithstanding the “representative” nature of PAGA actions, they are not “class actions” subject to federal jurisdiction under the Class Action Fairness Act (“CAFA”), 28 U.S.C. § 1332(d)(2)–(A), because, among other things, they do not bind “absent,” “represented” employees with respect to their right to seek other remedies available under federal or state law. *See Bauman v. Chase Inv. Services Corp.*, 747 F.3d 1117 (9th Cir. 2014), *cert. denied*,

Section 4—State’s opportunity to intervene and proceed with the action. Because claims under this section belong to the state and are subject to the state’s control, the state has the opportunity to take over the conduct of any action brought under this Title. PAGA and the federal False Claims Act similarly allow for such government action. Unlike PAGA and the False Claims Act, however, Title I allows the state an opportunity to intervene at *any* point in a private attorney general suit under this Title, even after the initial thirty-day stay as long as the state shows good cause for the delay. In this way, the state can ensure that its interests are protected during a private attorney general suit under this provision.

Section 5—Discovery. This provision is modeled on a provision of the federal False Claims Act that similarly allows the United States Government to move for stays of discovery in actions brought by relators, even where the government has declined to intervene in the action. 31 U.S.C. § 3730(c)(4). In the context of Title I—where the state may intervene at any point, upon a showing of good cause—this provision allows the state to have some control over discovery that might be harmful to the state’s public enforcement interests without requiring the State to intervene in the action.

Section 6—Limitation on duplicative actions. Actions brought under this Title are public enforcement actions brought on behalf of the state with the state as the real party in interest. Therefore, a merchant or employer cannot be subject to two actions on behalf of the state seeking to enforce the same worker or consumer protection laws concerning the exact same conduct, even if one of those actions is brought under this Title and another of those actions is brought by the state in its own capacity.

Section 7—Settlement. Because claims brought under this Title are brought on behalf of the state and designed to protect the state’s interests, the state has the authority to review and reject any settlement, just as the federal government has the authority to review and veto a settlement of any claim brought by a relator under the False Claims Act. 31 U.S.C. § 3730(b)(1). Importantly, this Section also caps the amount that private attorneys general can recover personally, through an incentive payment after settlement, at twenty-five (25) percent of the amount remitted to the state through the settlement. By expressly limiting settlements in this way, even when the State does not veto the settlement, Title I protects against “sweetheart” settlements through which defendants “buy off” private attorneys general who may not have an incentive to protect the State’s public enforcement interests.⁵⁰

Section 8—State’s control over the action. Because claims brought under this Title belong to the state, once the state decides to intervene in an action brought under this Title, the private person who initially filed the action immediately relinquishes all control over the litigation to the state.

135 S. Ct. 870 (2014).

⁵⁰ *U.S. ex rel. Summit v. Michael Baker Corp.*, 40 F. Supp. 2d 772, 774 (E.D. Va. 1999) (“[T]he danger of granting the relator the power to decide settlements in a qui tam case is that the case may present a relator who manipulates the settlements in ways that unfairly enrich them and reduce the benefits of the Government.”).

Section 9—*Res judicata*. Actions brought under this Title belong to the state and preclude subsequent state enforcement efforts, whether brought by the state or a private attorney general under this Title. Conversely, actions under this Title are not duplicative of private actions related to the same issues or touching the same nucleus of operative facts. Therefore, an action brought under this Title does not have any preclusive effect on private actions addressing similar wrongdoing.

Section 10—Relation to forced arbitration. As explained below, courts have concluded that *qui tam* actions are not covered by arbitration agreements between the individual bringing the action and the defendant. In line with this precedent, Title I expressly prohibits consumers and employees from waiving their right to bring an action under this Title on behalf of the state or from waiving either their right to bring such an action in a public forum or their right to bring a *qui tam* action alleging multiple violations committed against multiple consumers or employees.

By contrast, some courts have interpreted PAGA to allow businesses and employees to “agree” that “representative” PAGA action must be brought in arbitration. *See, e.g., Sakkeab v. Luxottica Retail N. Am., Inc.*, 803 F.3d 425, 440 (9th Cir. 2015). This makes little sense, particularly in the context of Title I, where any party—whether or not she has a contractual relationship with the defendant—may bring an action on behalf of the state. Furthermore, allowing private contracts to dictate the forum in which these fundamentally *public* claims can be brought undermines the argument that private attorney general claims belong to the state and not to any private party.

Analysis of Title I

I) State Precedent for *Qui Tam* Actions to Enforce State Consumer or Worker Protections

In broad strokes, *qui tam* statutes (named for the Latin phrase “*qui tam pro domino rege quam pro se ipso in hac parte sequitur*,” or “he who sues in this matter for the king as well as for himself”) allow private individuals to sue to enforce essentially public rights. By far the most notable extant mechanism for *qui tam* enforcement in American law is the False Claims Act,⁵¹ which, among other things, allows for private “whistleblower” actions brought on behalf of the government alleging that the defendant has committed fraud against the government.

California’s PAGA is one example of an alternative type of *qui tam* statute. Under PAGA, an “aggrieved employee” is authorized to bring a civil action “on behalf of himself or herself and other current or former employees” to recover “civil penalties.”⁵² In light of the decline

⁵¹ 31 U.S.C. §§ 3729–3733.

⁵² Cal. Lab. Code § 2699(a) (West).

in “[s]taffing levels for state labor law enforcement,” the legislature crafted PAGA to “deputize[] an aggrieved employee to sue for civil penalties . . . as an alternative to [public] enforcement.”⁵³

Title I begins from the premise that *qui tam* actions, insofar as they are brought by private parties on behalf of the state, are not covered by the private contractual relationship that often exists between employees and employers and consumers and merchants. This is consistent with the cases discussing the issue in the False Claims Act context.⁵⁴

This position was endorsed by the California Supreme Court in *Iskanian v. CLS Transportation Los Angeles, L.L.C.*⁵⁵ The court concluded that “aggrieved” employees under PAGA could bring claims in court on behalf of the state asserting violations of California Labor Law notwithstanding the presence of enforceable arbitration clauses that prevented them from bringing claims in court in their own capacity.

While some California federal courts initially refused to follow *Iskanian*,⁵⁶ the *Iskanian* defendant’s petition for *certiorari* in the United States Supreme Court was rejected,⁵⁷ and the Ninth Circuit recently sided with the California Supreme Court in *Sakkab* in deciding that the FAA does not preempt a rule prohibiting the waiver of private attorneys’ general right to bring “representative” actions under PAGA.⁵⁸ Whether or not the Supreme Court ultimately considers this issue, Title I takes extra precautions, not found in PAGA, to ensure that it sits comfortably alongside the Federal Arbitration Act. Title I, therefore, is even less susceptible to challenge than PAGA.

First, PAGA’s requirement that a party be an “aggrieved” employee in order to bring a *qui tam* action detracts somewhat from the argument that it is a true *qui tam* statute. For example, the dissent in *Sakkab* placed considerable emphasis on the ways in which the *Iskanian* rule interfered with the “parties’ freedom to limit their arbitration only to those claims arising between the contracting parties,” a freedom endorsed by the United States Supreme Court in *Concepcion*.⁵⁹ Title I does not limit its application only to aggrieved parties

⁵³ *Iskanian v. CLS Transp. Los Angeles, L.L.C.*, 206 Cal. App. 4th 949 (2012), *aff’d*, 327 P.3d 129 (Cal. 2014).

⁵⁴ See Section B of the Title I analysis.

⁵⁵ 327 P.3d 129 (Cal. 2014).

⁵⁶ See, e.g., *Chico v. Hilton Worldwide, Inc.*, 2014 WL 5088240, at *12 (C.D. Cal. Oct. 7, 2014); *Ortiz v. Hobby Lobby Stores, Inc.*, 2014 WL 4961126 (E.D. Cal. Oct. 1, 2014); *Fardig v. Hobby Lobby Stores Inc.*, 2014 WL 2810025 (C.D. Cal. June 13, 2014). But see *Hernandez v. DMSI Staffing, L.L.C.*, 2015 WL 458083, at *1 (N.D. Cal. Feb. 3, 2015) (agreeing with *Iskanian*’s approach).

⁵⁷ *CLS Transp. Los Angeles, L.L.C. v. Iskanian*, 2015 WL 231976 (U.S. Jan. 20, 2015); see also Petition for Writ of *Certiorari, CLS Transp. Los Angeles, L.L.C. v. Iskanian*, No. 14-1341 (U.S. Sept. 22, 2014) .

⁵⁸ *Sakkab v. Luxottica Retail N. Am., Inc.*, 803 F.3d 425 (9th Cir. 2015).

⁵⁹ *Sakkab*. 803 F.3d at 444 (9th Cir. 2015) (Smith, J. dissenting).

who necessarily have a contractual relationship with the defendant. Therefore, Title I does not directly implicate private agreements or private parties' right to agree to an "efficient and speedy" dispute resolution mechanism.

Second, Title I allows the state considerably more control over a private attorney general action than PAGA and even more than the federal government retains over False Claims Act actions. Like the federal government in FCA actions, the state maintains some control over discovery in private attorney general actions under Title I and can veto any settlement of a private attorney general action. Furthermore, unlike either California's powers with respect to PAGA actions or the federal government's powers with respect to FCA actions, under Title I, the state has the right to intervene in a private attorney general action at any point during the litigation, as long as the state can show good cause for its delay in intervening. After intervening, the state can dismiss the action, settle it, or prosecute it to final judgment. In this way, the state maintains substantially greater control over a private attorney general action under Title I than California maintains over a PAGA action.

II) Arbitration Clauses Do Not Bind Private Attorneys General under Title I

Because any individual can act as a private attorney general under Title I, in some cases that individual may not have agreed to mandatory arbitration, and in those cases it should be clear that dispute is not subject to an arbitration agreement. But even when an individual's private action against a defendant would be subject to an arbitration clause—because, for example, that individual is a customer or employee of the defendant—that individual's private attorney general suit under Title I is not subject to the arbitration agreement, and this outcome is entirely consistent with the FAA.

The California Supreme Court's decision in *Iskanian* provides a useful framework for analyzing Title I as a true *qui tam* statute. There, the court first concluded that even though PAGA was silent as to whether "representative" actions could be waived by agreement, separate provisions of the California Civil Code dictated that the right to bring such claims is not waivable.⁶⁰ Second, the court addressed whether the holding that an employee could *not* waive this right was preempted by the FAA (just as California's rule prohibiting class action waivers had been deemed preempted in *Concepcion*).⁶¹ In addressing this question, the court began its analysis by noting that the FAA is focused on *private* disputes arising out of the "contract or transaction" that includes the arbitration agreement.⁶² The court acknowledged

⁶⁰ *Iskanian v. CLS Transp. Los Angeles, L.L.C.*, 327 P.3d 129, 148 (Cal. 2014) (citing Cal. Civ. Code § 3513 (West) ("[A] law established for a public reason cannot be contravened by private agreement.")).

⁶¹ *Id.* at 148–152.

⁶² *Id.* at 150 (internal quotation marks omitted) (quoting 9 U.S.C. § 2).

that this language extends to cover private enforcement of statutory rights (even when those rights serve a public purpose)⁶³ but held that it does not encompass public *enforcement* efforts brought by the state.

For support, the court pointed to *Equal Employment Opportunity Commission v. Waffle House, Inc.*,⁶⁴ in which the United States Supreme Court concluded that an arbitration clause in the contract between Waffle House and one of its employees did not require the Equal Employment Opportunity Commission to arbitrate its enforcement action against Waffle House to obtain relief for that employee, even though the EEOC sought victim-specific relief. In that case the Supreme Court noted that despite an employer's or merchant's intention to shield itself from judicial actions seeking redress for wrongs committed against an employee or consumer covered by an arbitration clause, the contractual relationship between the parties is dispositive: "Because the FAA is at bottom a policy guaranteeing the enforcement of private contractual relationships, we look first to whether the parties agreed to arbitrate a dispute, not to general policy goals, to determine [whether a party is bound to arbitrate a dispute]."⁶⁵ As the EEOC was not a party to the contract, it had not agreed to the arbitration clause and could bring suit in court.

Because, according to the court in *Iskanian*, a private party's claim under PAGA is nothing more than a mechanism for enforcing "the *state's* interest in penalizing and deterring employers who violate California's labor laws," PAGA's *qui tam* provisions "do[] not interfere with the FAA's policy goals."⁶⁶ Therefore, the FAA does not preempt the rule that the right to bring PAGA actions in a public forum cannot be waived by agreement.⁶⁷

The underpinnings of *qui tam* law support the *Iskanian* court's finding. While acknowledging that *qui tam* enforcement is unique in the law, the Supreme Court has confirmed that *qui tam* plaintiffs have Article III standing to bring actions on behalf of the government, whether or not they have themselves experienced a constitutional injury-in-fact, because they are the assignees of claims that could be brought by the government. Through this lens, a *qui tam*

⁶³ See, e.g., *Ferguson v. Corinthian Colleges, Inc.*, 733 F.3d 928, 936 (9th Cir. 2013) ("States cannot require a procedure that is inconsistent with the FAA, even if it is desirable for unrelated reasons." (internal quotation marks omitted)).

⁶⁴ 534 U.S. 279 (2002).

⁶⁵ *Waffle House*, 534 U.S. at 294.

⁶⁶ *Iskanian*, 327 P.3d at 150.

⁶⁷ The California Supreme Court also contended with the argument that PAGA violates state separation-of-powers laws by authorizing "financially interested private citizens to prosecute claims on the state's behalf without governmental supervision." *Iskanian*, 327 P.3d at 153. The Court rejected this argument, reasoning that the rule prohibiting government contingent-fee arrangements with private attorneys in narrow sets of circumstances simply requires government entities to supervise the attorneys they choose to hire to pursue actions. By contrast, a rule disallowing *qui tam* actions would significantly interfere with a legitimate exercise of legislative authority aimed at accomplishing the important public purpose of augmenting scarce government resources for civil prosecutions. *Id.* at 154.

plaintiff's incentive payment is not an award to redress a statutorily defined injury, but rather a portion of the monetary judgment assigned to the "relator" as compensation for her efforts.⁶⁸

This understanding is also consistent with the approach most courts have taken in deciding whether False Claims Act *qui tam* claims can be arbitrated. A federal district court has found, for example, that as a matter of contract interpretation, a whistleblower's *qui tam* claims are not subject to the arbitration clause in an employment contract:

[P]laintiff's *qui tam* claims in no way impinge on her employee status. Even if plaintiff had never been employed by defendants, assuming other conditions were met, she would still be able to bring a suit against them for presenting false claims to the government. Moreover, as a relator plaintiff stands as a private representative of the government, participating in any recovery to which the government may be entitled.⁶⁹

In other words, *qui tam* claims are not subject to private arbitration agreements because they are not private claims and, for this same reason, state rules creating unarbitrable *qui tam* claims are not preempted by the FAA.

Moreover, not only are actions brought under Title I brought on behalf of the state, they are also controlled by the state in important ways. In *Waffle House*, the Court noted that the EEOC had "exclusive authority over the choice of forum and the prayer for relief once a charge has been filed."⁷⁰ By allowing the state to intervene as of right within the first thirty days and at any point in the litigation as long as it demonstrates good cause, Title I gives the state a similar ability to control the litigation as the EEOC had, and considerably more than the state has under PAGA.

Furthermore, in a similar manner to the federal False Claims Act, Title I allows the state considerable authority and control over private attorney general actions even when it does not intervene. The state may, for example, move to stay discovery that interferes with public enforcement efforts and veto a private attorney general settlement.⁷¹

⁶⁸ *Vermont Agency of Natural Resources v. United States ex rel. Stevens*, 529 U.S. 765, 774 (2000).

⁶⁹ *Mikes v. Strauss*, 889 F. Supp. 746, 754 (S.D.N.Y. 1995). Many courts hold that employee-whistleblowers' FCA retaliation claims (*i.e.*, claims brought by the employee against the employer for retaliating against the employee for serving as a whistleblower under the FCA) are subject to arbitration clauses in employment agreements. *See, e.g.*, *United States ex rel. Conyers v. Kellogg, Brown & Root, Inc.*, No. 412CV04095SLDJEH, 2015 WL 1510544, at *13 (C.D. Ill. Mar. 30, 2015). In contrast to public FCA claims brought on behalf of the federal government, however, these claims are private claims brought by the employee in her individual capacity to redress a private wrong.

⁷⁰ *Waffle House*, 534 U.S. at 298.

⁷¹ *See, e.g., Nanavati v. Adecco USA, Inc.*, No. 14-CV-04145-BLF, 2015 WL 1738152, at *8 (N.D. Cal. Apr. 13, 2015) (citing the absence of these features in PAGA as a reason to conclude that California does not control PAGA litigation).

Although a private attorney general bringing an action under Title I would initially determine the forum and demands for relief, the state has the ability to intervene and take complete control over these and all other decisions regarding the litigation. Ultimately, an action brought under Title I belongs to the state and is the state's to prosecute (or dismiss).

Finally, unlike PAGA, where only “aggrieved” employees can bring actions under the statute, the private attorney general's status does not derive from any relationship with the defendant, let alone a contractual relationship that includes an arbitration clause. Under Title I, any private party can bring a claim on behalf of the state and prosecute that action as long as the state declines to intervene and drop or settle the matter, or bring the action on its own.⁷² In the context of a Title I action, the private attorney general is akin to a government contractor, performing the state's enforcement duties in exchange for compensation.

In this sense, actions brought under Title I are reminiscent of actions brought under state attorneys general contingency arrangements with private attorneys—arrangements that have consistently been upheld by courts.⁷³ Although contingency-fee arrangements have been the subject of some political criticism,⁷⁴ there is little question about the state's legal *authority* to contract out enforcement duties to private lawyers. Moreover, Title I avoids many of the critiques normally leveled against contingency-fee arrangements. Unlike contingency-fee arrangements, which are sometimes negotiated behind closed doors, under Title I a proposed private attorney general suit is filed publicly. The attorney general's perspective on a proposed private attorney general suit is transparent and demonstrated by its public actions—intervention and dismissal demonstrates the attorney general's view that the case is frivolous; intervention and prosecution of the case reflects the attorney general's determination that the case is important but that it is not a good candidate for a private attorney general suit; and a decision not to intervene, but to allow the private attorney general suit to move forward, reflects a determination that the case has merit but is appropriately brought by a private attorney general under Title I.

⁷² PAGA's requirement that a party be an “aggrieved” employee in order to bring an action is one of the bases upon which the respondent and *amici* urged review by the Supreme Court. Brief of the Employers Group & Cal. Employment Law Council as *Amici Curiae* in Support of the Petition for Writ of *Certiorari*, *CLS Transp. Los Angeles, L.L.C. v. Iskanian*, No. 14-1341 (U.S. Sept. 22, 2014).

⁷³ See generally David B. Wilkins, *Rethinking the Public-Private Distinction in Legal Ethics: The Case of "Substitute" Attorneys General*, 2010 Mich. St. L. Rev. 423, 428. Many state courts and legislatures have expressly endorsed this practice. See *id.* at 434–435.

⁷⁴ See Eric Lipton, *Lawyers Create Big Paydays by Coaxing Attorneys General to Sue*, N.Y. Times, Dec. 18, 2014, available at www.nytimes.com.

III) A Note about the FAA and the Procedures Governing Multi-Employee or Multi-Consumer Actions under Title I

Much of the litigation surrounding the viability of the *Iskanian* rule has focused on the procedures for bringing a “representative action” under PAGA. In many ways, this focus flows naturally from the Supreme Court’s analysis in *Concepcion*, where the Court concluded that “the switch from bilateral to class arbitration sacrifices the principal advantage of arbitration—its informality—and makes the process slower, more costly, and more likely to generate procedural morass than final judgment.”⁷⁵ In *Sakkab*, the Ninth Circuit reasoned that the *Iskanian* rule is consistent with *Concepcion* largely based on its conclusion that “[b]ecause representative PAGA claims do not require any special procedures, prohibiting waiver of such claims does not diminish parties’ freedom to select the arbitration procedures that best suit their needs.”⁷⁶

Like a “representative” action under PAGA, a suit under Title I that “allege[s] multiple violations that have affected different consumers or employees” does not require nearly the same procedural formality as a class action. Because it does not waive or limit “absent” consumers’ or employees’ rights to bring private actions on their own, there is no notice requirement and no requirement that the private attorney general or her counsel be “adequate.”⁷⁷

However, the procedural differences between a class action and a private attorney general action under Title I are not the sole—or even the most important—justification for the conclusion that Title I is not preempted by the FAA. After all, some courts, like the dissent in *Sakkab* may conclude that multi-employee or multi-consumer actions under Title I are “more likely to make the process slower, substantially more costly, and more likely to generate procedural morass than non-representative, individual arbitration.”⁷⁸ More importantly, however, the informality of the procedures governing actions under Title I is only relevant to the preemption analysis if such actions could ever be arbitrated. But allowing such actions to be subject to private arbitration agreements, even while prohibiting waiver of the right to bring multi-employee or multi-consumer actions, would suggest that those actions *belong* to private parties and would undermine the state’s argument that Title I actions belong to the state and are controlled by the state. In this sense, Title I escapes FAA preemption not because its procedures are consistent with “speedy and efficient” dispute resolution, but because it involves *public* enforcement actions that do not implicate *private* agreements to arbitrate.

⁷⁵ *Concepcion*, 131 S. Ct. at 1751.

⁷⁶ *Sakkab*, 803 F.3d at 436.

⁷⁷ *See id.* (noting the same differences between PAGA and class claims under Federal Rule of Civil Procedure 23).

⁷⁸ *Id.* at 446 (Smith, J. dissenting).

TITLE II: CONDITIONS ON PERSONS DOING BUSINESS WITH THE STATE

Section 1. Findings.

To ensure that the State spends its limited funds in the most efficient manner possible, this Title prohibits the State from doing business with persons that form or enforce forced arbitration agreements with their consumers or employees. The secret nature of forced arbitration agreements between persons doing business with the State and their consumers or employees undermines the efficient management of State funds in the following ways:

- (a) It prevents the State from learning whether goods or services provided by persons doing business with the State are the subject of consumer grievances concerning the quality of the good or service or whether the employees producing such goods or providing such services complain of unfair and illegal treatment that might interfere with the quality of the good or service;
- (b) It obscures the extent to which persons doing business with the State violate the legal rights of their consumers or employees, and therefore whether such persons are breaching their obligations to the State or concealing from public scrutiny conduct that interferes with the quality of a good or service provided to the State; and
- (c) It obscures the extent to which persons doing business with the State might be destabilized by the person's conduct as to consumers or its employees—such destabilization increases the likelihood that such person will defraud the State or be unable to perform under a contract with the State.

Section 2. Definition of “doing business with the State.”

A person “does business with the State” when it or any of its subsidiaries or parent entities receives State funds exceeding \$100,000 in exchange for goods or services provided to the State or a third party. Persons “doing business with the State” include but are not limited to persons performing public work on State contracts, merchants of goods or services purchased by the State, and persons providing services to third parties in exchange for funds provided directly from the State.

Section 3. Prohibition against the State doing business with persons that form or enforce forced arbitration agreements.

- (a) The State shall not do business with any person or any of its parent entities or subsidiaries if that person includes forced arbitration clauses in any of its contracts with consumers or employees, unless one-hundred-eighty (180) days before doing business with the State, the person or its parent entity or subsidiary provides reasonable notice to its consumers or employees that it will cease enforcing arbitration clauses in consumer or employment contracts if such clauses exist in consumer or employment contracts.

- (b) The State shall not do business with any person or any of its parent entities or subsidiaries if that person or any of its parent entities or subsidiaries enforces forced arbitration agreements against any of its employees or consumers.

Section 4. Enforcement.

- (a) Before doing business with any person, the State agency representing the State in the business relationship shall confirm that such person, its parent entities, and its subsidiaries do not form or enforce forced arbitration agreements with consumers or employees and shall ensure, when appropriate, that a contract between the State and the person includes a provision prohibiting that person, its parent entities, and its subsidiaries from forming or enforcing forced arbitration agreements. Under this provision, a person or its parent entities or subsidiaries forms forced arbitration clauses in its contracts with consumers or employees if current contracts with consumers or employees include forced arbitration clauses, unless, one-hundred-eighty (180) days before doing business with the State, the person or its parent entity or subsidiary provides reasonable notice to its consumers or employees that it will cease enforcing arbitration clauses in consumer or employment contracts.
- (b) If the State Attorney General, after giving a person doing business with the State notice and an opportunity to be heard, concludes that such person has violated the provisions of Section 3, the State Attorney General shall notify all State agencies doing business with the person about the violation and can seek actual damages owed to the State caused by such violation.
- (c) If a State agency receives notice from the State Attorney General that a person with whom the agency does business has violated the provisions of Section 3, the agency shall terminate its business dealings with such person as soon as practical.

Section 5. Severability.

If any provision of this Title or the application thereof to any person or circumstance is held invalid, such invalidity shall not affect other provisions or applications of the Title that can be given effect without the invalid provision or application, and to this end the provisions of this Title are declared to be severable.

Notes

Section 1—Findings. This section makes clear that the purpose of Title II is to protect the state’s procurement interests by ensuring that the state has access to accurate information about any legal claims asserted by employees or consumers against persons doing business with the state.

Section 2—Broad definition of “person doing business with the State.” The broad definition of “person doing business with the State” covers, among others, persons who sell goods and services to the state or who provide those services to third parties in exchange for

state funds, but only when such funds are provided directly by the state and not a third party. In other words, a for-profit school is covered by Title II if it receives state funds in exchange for providing training to students, whether or not those students are employed by the state, but the school is not covered by the definition if it receives tuition payments from students, even if those payments originated in state grants. The definition is intended to extend the meaning of “person doing business with the State” to the full limits of the state’s “market participant” authority.

Section 3—Application. Title II covers both the formation of new forced arbitration agreements and the enforcement of arbitration clauses that pre-exist the enactment of Title II. Businesses that have already entered into contracts with consumers or employees that include forced arbitration clauses are not barred from doing business with the state, as long as they have ceased enforcement of those clauses and so informed their consumers or employees sufficiently before contracting with the state so that the state has a public record on which to evaluate the contractor.

Analysis of Title II

The FAA preempts states from enacting laws that prohibit private parties from entering into forced arbitration agreements or that prohibits the enforcement of such agreements in private civil litigation. The FAA may also preempt state laws conditioning private persons’ receipt of state funds on the requirement that they refrain from entering into arbitration agreements.⁷⁹ However, when the state acts like a private actor in the marketplace, it may affect the formation and enforcement of arbitration agreements pursuant to its “market participant” authority, described below.⁸⁰

I) Federal Precedent for Title II

In 2014, the White House acted to protect its own financial interests in procurement matters from the dangers of opaque dispute resolution. On July 31, 2014, President Obama signed the Fair Pay and Safe Workplaces Executive Order.⁸¹ Under a section titled “Complaint and Dispute Transparency,” the order prohibits pre-dispute, binding arbitration agreements covering discrimination, assault, and sexual harassment claims in contracts between large federal contractors and their employees. Importantly, the executive order covers all of these contractors’ employment agreements, even those with employees who do not work on federal contracts.

⁷⁹ See, e.g., *Wisconsin Dep’t of Indus., Labor & Human Relations v. Gould Inc.*, 475 U.S. 282, 290 (1986) (concluding that a state cannot avoid federal labor law preemption merely by virtue of acting pursuant to its spending as opposed to its regulatory powers); cf. *Dolan v. City of Tigard*, 512 U.S. 374, 386 (1994) (explaining that the government can only impose an otherwise unconstitutional condition on the receipt of government funds when there is an “essential nexus” between the government interest in this condition and the government’s expense of the funds).

⁸⁰ *White v. Mass. Council of Constr. Employers*, 460 U.S. 204 (1983).

⁸¹ See Exec. Order No. 13,673 (2014), available at www.whitehouse.gov.

The Fair Pay and Safe Workplaces Executive Order provides an important precedent for states. Executive orders, like state laws, cannot conflict with federal statutes. Although the Federal Arbitration Act allows parties to agree to arbitrate discrimination and sexual harassment claims, the President has the authority to trump this general rule based on the “market participant” rule, which authorizes him to require that federal contractors resolve their disputes transparently, and which would allow states to enact similar requirements.⁸²

II) “Market Participant” Authority Explained

The origin of the “market participant” rule lies in the centuries-old “government-proprietary” distinction,⁸³ under which governmental bodies are protected by sovereign immunity when acting pursuant to their governmental functions but are treated like any other private actor when acting pursuant to proprietary interests.⁸⁴ States acting like private actors—so the reasoning goes—should not benefit from a privilege derived from the special status of sovereign authority. Over the past several decades, courts have applied the distinction to support a different proposition: just as states cannot benefit from their governmental status (via sovereign immunity) when acting like private parties in the marketplace, they should also not be “punished” for their governmental status when acting pursuant to their proprietary interests and authority. In other words, a state should be able to set the same kinds of policies as private actors when it comes to the state’s private activities. This is the “market participant” rule.

The “market participant” rule applies when a government agency requires an entity with which it does business (generally in a contracting relationship) to take certain actions that the agency could not normally require the entity to take because of limitations on the agency’s authority as a governmental actor, but that a private market participant could require the entity to take as a condition of its business relationship with the entity. As long as the governmental agency acts as a “market participant,” the requirement is not subject to federal preemption or other normal limitations on the agency’s regulatory authority. But if the agency’s purpose is *actually* to regulate the entity with which it does business, then the requirement is subject to the same constraints as other kinds of regulations.

Litigation concerning the “market participant” rule has arisen frequently in two categories of cases: first, in cases involving governmental action favoring in-state residents, which might violate the Dormant Commerce Clause;⁸⁵ and, second, in cases involving governmental

⁸² *Bldg. & Constr. Trades Dep’t, AFL-CIO v. Allbaugh*, 295 F.3d 28, 31 (D.C. Cir. 2002).

⁸³ See generally Michael Burger, *It Ain’t Easy Being Green*, 78 U. Cin. L. Rev. 835 (2010).

⁸⁴ *Hillerby v. Town of Colchester*, 167 Vt. 270, 272 (1997) (explaining the doctrine and noting that many states have replaced it with governmental “tort claims” acts).

⁸⁵ As explained by the Supreme Court, the “market participant” exception to the Dormant Commerce Clause allows for states to “operate freely in the free market.” For example, in *White v. Massachusetts Council of Construction Employers, Inc.*, the Supreme Court upheld an executive order of the Mayor of Boston that required all construction projects funded by the city to employ a workforce made up of at least half Boston residents. 460 U.S. 204 (1983). Although the city would otherwise be unable to require private construction firms to hire mainly city residents, the Court reasoned that Boston was free to discriminate against non-residents with regard to the makeup of employees

action that pressures private companies to depart from the default labor-management practices prescribed by federal labor law, which might contravene the implied preemption doctrine derived from the National Labor Relations Act.⁸⁶ In these contexts, when applying the “market participant” rule, Supreme Court and lower court decisions accommodate “a complex range of competing constitutional values”⁸⁷ to determine whether the state or locality is acting as a regulator or a private market participant.

First, courts examine whether the governmental expenditure takes the *form* of private action. In other words, to act like a “market participant,” the state’s conduct must look like the conduct of a “market participant.”

Second, courts examine whether the governmental purpose is proprietary or regulatory.⁸⁸ Courts consider a wide range of sources, including the legislative history of the state enactment, the expressed legislative findings supporting the enactment, and whether the

working on projects funded by the city, as such conduct constituted “direct state participation in the market,” and amounted, effectively, to a decision on the part of the city regarding the makeup of its own employees. *Id.* at 207 (internal quotation marks omitted).

⁸⁶ In the labor law context, the seminal case on the issue is *Building & Construction Trades Council of Metropolitan District v. Associated Builders & Contractors of Massachusetts/Rhode Island, Inc.* (“*Boston Harbor*”), 507 U.S. 218 (1993), where the Supreme Court concluded that Massachusetts could require contractors working on the Boston Harbor project to enter into pre-recognition labor-management agreements. Although a state requirement that private parties enter into these agreements with each other would clearly be preempted, Massachusetts could enact the rule as a “market participant” because it had a legitimate interest in ensuring labor peace on government construction projects. *Id.* at 230.

Subsequent cases have clarified this exception. In *Chamber of Commerce of U.S. v. Brown*, the Supreme Court confronted a California statute that prohibited employers from using funds received by the government to assist or deter union organizing—a normally common practice in the lead-up to a union certification election. Notwithstanding that the law solely affected the use of government funds, the Court deemed it preempted. To survive preemption under the “market participant” exception, the Court stated, state action had to be “specifically tailored to one particular job,” and aimed “to ensure an efficient project that would be completed as quickly and effectively as possible at the lowest cost.” 554 U.S. 60, 70 (2008) (internal quotation marks omitted).

The Supreme Court has also examined whether the “market participant” rule protects a state’s decision to refuse to do business with companies that have repeatedly violated federal labor law, finding that the provision was preempted because its purpose was to amplify the punishment already provided under federal law for violating the National Labor Relations Act. *Wisconsin Dep’t of Indus., Labor & Human Relations v. Gould, Inc.*, 475 U.S. 282 (1986). Nonetheless, the Clean Air Act did not preempt California provisions directing state and local governments to procure vehicles that exceeded its standards. *Engine Mfrs. Ass’n v. S. Coast Air Quality Mgmt. Dist.*, 498 F.3d 1031 (9th Cir. 2007) (California “provisions directing state and local governments to purchase, procure, lease, and contract for use of vehicles meeting certain criteria [exceeding the Clean Air Act] [amounted to] proprietary state action because they essentially reflect[ed] California’s own interest in its efficient procurement of needed goods and services”). See also *Johnson v. Rancho Santiago Cmty. Coll. Dist.*, 623 F.3d 1011, 1025–1026 (9th Cir. 2010) (school district’s “Project Stabilization Agreement” was permissible market participant conduct that, therefore, was not preempted by ERISA or the NLRA).

⁸⁷ Dan T. Coenen, *Untangling the Market-Participant Exemption to the Dormant Commerce Clause*, 88 Mich. L. Rev. 395, 398 (1989)

⁸⁸ *Id.*

enactment, considered as whole, is fully congruent with the putative proprietary interest.⁸⁹ However, courts do not perform a “factual investigation into the particular subjective motives of the relevant government [policymaker].”⁹⁰

Third, depending on the analysis under the second prong, courts examine whether the challenged action has a sufficiently “narrow scope [to] defeat an inference that its primary goal was to encourage a general policy rather than address a specific proprietary problem.”⁹¹ This prong of the inquiry assumes that private actors motivated by proprietary (as opposed to ethical or regulatory) interests are only concerned with how the actors with which they do business conduct themselves inside the business relationship, and not with these actors’ conduct outside of the proprietary relationship. Similarly, according to this view, a governmental agency generally acts with a regulatory purpose if it acts out of concern with a private party’s conduct outside of its relationship with the government.⁹²

III) Application of “Market Participant” Rule to Title II

Title II is a proper exercise of state “market participant” authority. Not only does it have a logical and defensible proprietary purpose, but its effects are targeted toward achieving these proprietary aims.

A) The State Acts As a Market Participant in Enacting Title II

Title II takes the form of “market participant” conduct. Title II does not govern all recipients of government expenditures, just those who are paid by the government for the provision of a good or service to the government or a third party. The state does not act like a “market participant” when it makes unconditional payments to private parties. The state does, however, act like a “market participant” when it makes payments with the expectation that recipients of such payments perform a service in return, and the state has a “market participant” interest in ensuring that it selects recipients that can perform that service efficiently.⁹³

⁸⁹ See, e.g., *New York Bankers Ass’n, Inc. v. City of New York*, 2015 WL 4726880, at *24 (S.D.N.Y. Aug. 7, 2015) (“What is obvious from the text is confirmed by the legislative history. The legislators who sponsored and who spoke in support of this bill did so with one voice: federal and state laws were seen as ineffectual in terms of both the collection of information and the influence over bank conduct regarding community reinvestment in New York City.”).

⁹⁰ *Hotel Employees & Restaurant Employees Union Local 57 v. Sage Hospitality Res., L.L.C.*, 390 F.3d 206, 216 (3d Cir. 2004).

⁹¹ *Cardinal Towing & Auto Repair, Inc. v. City of Bedford*, 180 F.3d 686, 693 (5th Cir. 1999); see also *Mich. Bldg. & Constr. Trades Council v. Snyder*, 729 F.3d 572 (8th Cir. 2013) (“[T]o be proprietary, the government action must be aimed to achieve a proprietary goal and must be limited to the furtherance of that goal.”).

⁹² Echoes of this approach can be traced back to the Supreme Court’s decision in *Boston Harbor*. What made that case different from *Gould*, according to the Court, was that the Massachusetts Bay Water Authority required its contractor to enter into a pre-certification agreement “to ensure an efficient project that would be completed as quickly and effectively as possible at the lowest cost,” and not to regulate the contractor’s conduct outside of the contracting relationship. *Boston Harbor*, 507 U.S. at 232.

⁹³ *Bldg. & Constr. Trades Dep’t, AFL-CIO v. Allbaugh*, 295 F.3d 28, 35 (D.C. Cir. 2002) (“[T]he Government

B) Title II Establishes a Valid “Market Participant” Purpose

The policies expressed in Section 1 of Title II describe strong reasons for prohibiting persons doing business with the government from entering into or enforcing forced arbitration clauses. As explained above, the state is at risk of experiencing financial harm if its contractors resolve their disputes privately, because the state will not be able to make informed contracting decisions or be confident that its contractors will be able to perform their obligations efficiently.

A state enacting Title II might be wrong about the net effect such a provision would have on public expenditures. It could be, for example, that arbitration decreases overall costs or that claim suppression results in a net-negative effect on the amount of funds the state must pay for the service or good at issue. These possibilities, however, “bear[] only on whether the [state] made a good business decision, not on whether it was pursuing regulatory, as opposed to proprietary, goals.”⁹⁴ The real inquiry, as applied by the Supreme Court is whether the statutory language or structure is consistent with a plausible, stated proprietary goal. Title II passes that test.

C) The “Scope” of Title II Is Appropriate

Title II is closely tied to the stated “market participant” purpose. Title II is designed to ensure that the state can access information about any legal claims made by employees or consumers against a potential government contractor or other person doing business with the state both before entering into a contracting relationship and after commencing such a relationship, to ensure that the entity is performing its obligations efficiently and as prescribed by the contract. Toward this end, the Title prohibits persons doing business with the state from entering into or enforcing forced arbitration agreements.

The fact that Title II might have broad effects does not mean that its scope is impermissibly broad. The Ninth Circuit has explained that courts should look first to the “*nature* of the [state] expenditure” to determine whether a “comprehensive state polic[y] with wide application” is, nonetheless, “essentially proprietary” or at least lacking the effect of “broad social regulation.” If so, the state action survives.⁹⁵

Furthermore, the D.C. Circuit has flatly rejected the argument that the government acts as a regulator when it pursues “blanket, across-the-board rules that prohibit certain actions on

unquestionably is the proprietor of its own funds, and when it acts to ensure the most effective use of those funds, it is acting in a proprietary capacity. Second, that the Government is a lender to or a benefactor of, rather than the owner of, a project is not inconsistent with its acting just as would a private entity; a private lender or benefactor also would be concerned that its financial backing be used efficiently. In sum, the distinction between federally owned and federally funded projects is not relevant here.”)

⁹⁴ *Johnson v. Rancho Santiago Cmty. Coll. Dist.*, 623 F.3d 623 F.3d 1011, 1025 (9th Cir. 2010).

⁹⁵ *Id.*; see also *Mich. Bldg. & Constr. Trade Council*, 729 F.3d at 580.

the part of its contractors and recipients of its financial assistance.”⁹⁶ The issue, according to the court, is not the breadth of the government action but the relationship between the conduct the government seeks to compel among recipients of government funds and the work these persons do for the government. On this last measure, although Title II proposes an “across-the-board” rule, there is a close connection—explained in the legislative findings—between the rule and government expenditures.

Moreover, the fact that Title II affects all of a potential contractor’s employment and consumer contracts, not just those contracts directly tied to the government project, is also logically and closely tied with its proprietary purposes. The state has an interest in ensuring that its private contractors and other parties with which it does business do not form or enforce forced arbitration agreements with consumers and employees because forced arbitration obscures the private dealings of government contractors (and other persons doing business with the state). In doing so, the contractor undermines the state’s ability to make informed and economical decisions as a market participant both before entering into a contract and while a contracting entity is performing under a contract, in order for the state to ensure that the contracting entity is performing its obligations effectively and efficiently.

The state’s interest in the transparency of its business partners’ dispute resolution processes is unique relative to other proprietary interests at stake in “market participant” cases because the interest is implicated by *all* of the business partners’ relationships with consumers and employees. The concerns against which Title II seeks to protect potentially would arise if any of a business partner’s consumers or employees filed claims against it. Any of these claims might provide valuable information to the state about the quality of goods or services provided to the state. And the financial costs and destabilizing effects of these disputes potentially would spill over into the entity’s business relationship with the state whether or not the disputes arose from consumer or employment relationships that were directly tied to the business relationship with the state. Therefore, although Title II would have a broad reach, its effects are precisely tailored to its stated purpose.

TITLE III: CLEAR NOTICE AND SINGLE DOCUMENT RULE

Section 1. Findings.

Obscure and overly complex language in consumer and employment contracts interferes with employees’ and consumers’ ability to provide meaningful assent to their consumer and employment contracts. To ensure that private parties comprehend the material terms of the consumer and employment contracts into which they enter, this Title requires that merchants and employers in designated forms of contracts adequately disclose terms and condition.

⁹⁶ *Allbaugh*, 295 F.3d at 33 (internal quotation marks and alterations omitted).

Section 2. Coverage.

This Title applies to contracts of the categories set out in Section 3 formed after this Title's effective date that meet any one of the following three criteria:

- (a) An employment or consumer contract not written in plain language that an average consumer or employee would understand;
- (b) An employment or consumer contract not written in the language in which the transaction was conducted, unless it can be proven that fewer than ten percent (10%) of the entity's transactions are conducted in that language; or
- (c) If a consumer contract, all of the material terms are not found in a single document.

Section 3. Categories of contracts covered.

[TO BE FILLED IN BY EACH STATE]

Section 4. Rights when a covered contract is non-conforming.

A consumer or employee may seek a court order reforming any contract covered by Section 2. Such reformed agreement shall reflect the understanding of the parties, and the court may exclude terms not written in plain English, not written in the language in which the transaction was conducted, or found in a separate document.

Section 5. Pre-existing rules.

This Title shall be applied in conjunction with pre-existing rules regarding contract formation, including rules regarding reasonable notice and the conduct a consumer or employee must manifest in order to assent to an agreement.

Notes

Section 1—Findings. This section makes clear that Title III is not concerned with the substance of contractual terms, nor with arbitration clauses in particular, but rather with providing consumers and employees the opportunity to truly assent to their contractual arrangements.

Section 2—Contracts that do not meet the Title's conditions are voidable. Title III does not automatically void contracts that do not meet the conditions set out here. Employees and consumers must affirmatively raise this defense if they seek to avoid a material obligation. In this way, consumers and employees may raise rights protected by a contract that does not meet the technical requirements of this Title.

Section 2(a)–(c)—Coverage. This Title does not apply especially to arbitration clauses, and this Title does not target arbitration clauses.

Section 3—Allowing states to identify the industries at issue. Because of the number of different considerations that might apply in each industry depending on the state, the Model Act allows states to identify the types of contracts to which this Title will apply.

Section 4—Allowing the court to reform a non-conforming contract. This Title allows the court the discretion to reform a non-conforming contract, consistent with the parties’ intent, with recognition of the criteria specifically identified in Section 2 that frequently characterize unclear and unfair contractual terms.

Section 5—Consistent with the common law. This Title provides additional rules regarding the provision of adequate notice of material terms to consumers and employees. The Title does not abrogate pre-existing common law rules regarding notice and assent. In other words, even if the material obligations of a contract are clearly set out in the manner prescribed by this Title, the consumer or employee is not bound by those terms unless she manifests assent to those terms by, for example, signing the agreement.

Analysis of Title III

Individuals rarely read the fine print in their form contracts, and even when they do read these contracts, they rarely understand their import.⁹⁷ Although states cannot prohibit employers and merchants from conditioning employment or provision of goods or services on a consumer’s or employee’s assent to an arbitration agreement, states can require that employees and consumers be on reasonable notice of the terms.

Because the “federal policy favoring arbitration” does not apply to questions of contract formation, and the parties cannot delegate the question of contract formation to an arbitrator, state courts (and federal courts applying state law) have an important role in policing arbitration agreements to ensure that consumers and employees are not bound by “forced” arbitration agreements unless they are on notice (either inquiry or actual) of the agreement and then assent to it through conduct that is sufficient to bind them. Since 2013, a number of state supreme courts—including the highest courts in Florida, Missouri, and West Virginia—have issued sweeping and important decisions governing the question of contract formation. These courts have concluded, in a variety of contexts, that businesses need to mount actual evidence to establish contract formation and that merely pointing to an arbitration clause in a form contract is not enough to bind a consumer to that clause.⁹⁸

⁹⁷ Jeff Sovern, *Arbitration Clauses Trap Consumers with Fine Print*, Am. Banker, Dec. 2, 2014, available at www.americanbanker.com.

⁹⁸ *Basulto v. Hiialeah Auto.*, 141 So. 3d 1145 (Fla. 2014) (trial court’s fact-bound inquiry finding that the parties never formed a contract because, *inter alia*, neither salespeople nor plaintiff understood arbitration clause was not clearly erroneous); *Baker v. Bristol Care, Inc.*, 2014 WL 4086378 (Mo. Aug. 19, 2014) (concluding, *inter alia*, that unilateral right to amend contract within thirty days rendered contract containing arbitration clause illusory); *State ex rel. U-Haul Co. of W. Va. v. Zakaib*, 752 S.E.2d 586 (W. Va. 2013) (reference to a contract addendum in a clickwrap agreement was insufficient to bind consumers to such addendum arriving in hard copy in a non-descript envelope).

These cases illustrate the important role of rigorous judicial analysis in determining whether parties have actually assented to arbitrate. There is less precedent regarding rules regulating the formation of arbitration agreements on an *ex ante* basis because rules that specifically target the mechanism of forming arbitration clauses, in particular, are likely preempted by the FAA.⁹⁹ Therefore, any law regulating the formation of arbitration agreements must speak to the formation of other kinds of contractual agreements as well. The most helpful precedent for rules like Title III, then, lies in state laws that regulate categories of contractual terms that include more than just arbitration clauses—for example, rules relating to the formation of agreements to waive statutory or constitutional rights,¹⁰⁰ or rules relating to assent to material terms.¹⁰¹

A state rule targeting all material terms, even when applied to arbitration clauses in specific cases, is unlikely preempted. For support, states can point to precedent concluding that stand-alone arbitration agreements entered into between car dealers and buyers are not enforceable when the relationship is covered by a “single document rule” requiring that all material terms be included in a single document.¹⁰²

It is important to note that Title III might be subject to a specific and narrow preemption argument. The FAA makes agreements to arbitrate “valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”¹⁰³ In the Ninth Circuit case *Ting v. AT&T*,¹⁰⁴ the court held that a California rule prohibiting class action waivers in consumer contracts was preempted by the FAA because the state rule did not apply to *any* contract, but only to consumer contracts.¹⁰⁵ The argument could be made here that because these rules do not apply to *any* type of contract, but only to those identified by the state, they are preempted by the FAA.

This argument should fail. As the Ninth Circuit recently explained: The Supreme Court has clarified that a state contract defense must be “generally applicable” to be preserved by [the FAA’s] saving clause. *Concepcion*, 131 S.Ct. at 1746. It is well established that the FAA

⁹⁹ As discussed above and at length in NCLC’s *Consumer Arbitration Agreements*, state laws regarding the mechanisms of contract formation generally survive FAA preemption as long as they do not specifically target arbitration. National Consumer Law Center, *Consumer Arbitration Agreements* Ch. 5 (7th ed. 2015), updated at www.nclc.org/library. For example, although a state rule providing that “[n]otice that a contract is subject to arbitration . . . shall be typed in underlined capital letters on the first page of the contract” applies to the question of contract formation, it is preempted by the FAA. *Doctor’s Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996).

¹⁰⁰ *Altalese v. U.S. Legal Servs. Grp., L.P.*, 2014 WL 4689318 (N.J. Sept. 23, 2014).

¹⁰¹ *Larkin v. New Century Auto Sales Inc.*, 2014 WL 29119 (E.D. Mich. Jan. 3, 2014).

¹⁰² See, e.g., *id.*

¹⁰³ 9 U.S.C. § 2.

¹⁰⁴ 319 F.3d 1126, 1147 (9th Cir. 2003).

¹⁰⁵ *Id.* at 1149.

preempts state laws that single out arbitration agreements for special treatment. At minimum, then, [the savings clause’s] “any contract” language requires that a state contract defense place arbitration agreements on equal footing with non-arbitration agreements. . . . Some of our cases can be read to suggest that the phrase “any contract” in [the FAA’s] saving clause requires that a defense apply generally to all types of contracts, in addition to requiring that the defense apply equally to arbitration and non-arbitration agreements. *See Ting v. AT & T*, 319 F.3d 1126, 1147–48 (9th Cir. 2003). However, the Court’s decision in *AT & T Mobility, LLC v. Concepcion* cuts against this construction of the saving clause. The Court in *Concepcion* held that the FAA preempted California law providing that class action waivers in certain consumer contracts of adhesion were unconscionable and unenforceable. 131 S.Ct. at 1748–53. Even though the state-law rule at issue only applied to a narrow class of consumer contracts, the Court strongly implied that the rule was a “generally applicable contract defense[.]” *See id.* at 1748.¹⁰⁶

In other words, the FAA protects against differential treatment of arbitration agreements as compared to other agreements, but it has no bearing on state contract rules that do not single out arbitration agreements for disfavor but that do treat some kinds of contracts differently than others. As explained above, then, Title III escapes FAA preemption because it applies to all material terms, not just arbitration clauses; it is not relevant to this analysis that the state may choose to apply Title III to some types of contracts and not others.

TITLE IV: UNCONSCIONABLE TERMS IN STANDARD FORM CONTRACTS

Section 1. Findings.

The inclusion of unconscionable terms in standard form contracts regarding dispute resolution is unfair not only because any resulting dispute resolution proceeding is unfair to the party forced to agree to the unconscionable terms, but also because the unconscionable terms discourage valid claims. Furthermore, when the provisions are challenged, courts may simply strike the unconscionable terms but enforce the remainder of the agreement regarding dispute resolution. As a result, businesses have little incentive not to include these terms. Furthermore, because this Title governs form contracts, it is unlikely that there is any meeting of the minds over a dispute-resolution agreement that does not include severed unconscionable terms.

Section 2. Unconscionable terms.

There is a rebuttable presumption that the following contractual terms are substantively unconscionable when included in a standard form contract to which only one of the parties to the contract is an individual and that individual does not draft the contract:

- (a) A requirement that resolution of legal claims take place in an inconvenient venue. An inconvenient venue is defined for State law claims as a place other than the

¹⁰⁶ *Sakkab v. Luxottica Retail N. Am., Inc.*, 803 F.3d 425, 432-33 (9th Cir. 2015) (some internal citations omitted).

county where the individual resides or the contract was consummated, and for federal law claims as a place other than the federal judicial district where the individual resides or the contract was consummated;

- (b) A waiver of the individual's right to assert claims or seek remedies provided by State or federal statute;
- (c) A waiver of the individual's right to seek punitive damages as provided by law;
- (d) A requirement that the individual bring an action prior to the expiration of the applicable statute of limitations;
- (e) A requirement that the individual pay fees and costs to bring a legal claim substantially in excess of the fees and costs that this State's courts require to bring such a State law claim or that federal courts require to bring such a federal law claim.

Section 3. Relation to common law and the Uniform Commercial Code.

In determining whether the terms described in Section 2 are unenforceable, a court shall consider the principles that normally guide courts in this State in determining whether unconscionable terms are enforceable. Additionally, the common law and Uniform Commercial Code shall guide courts in determining the enforceability of unfair terms not specifically identified in Section 2.

Section 4. Severability.

There is a rebuttable presumption that unconscionable terms in form contracts are not severable from the agreements in which they are situated, thus rendering the entire agreement unenforceable. In determining whether this presumption has been rebutted courts should consider general state law principles regarding the severability of unenforceable terms.

Section 5. Unfair and deceptive act and practice.

It is an unfair and deceptive practice in violation of [*the State deceptive practices statute*] to include one of the presumptively-unconscionable terms identified in Section 2 in a standard form contract to which only one of the parties to the contract is an individual and that individual does not draft the contract. Notwithstanding any other state laws to the contrary, a party who prevails in a claim under this Section shall be entitled to \$1,000 in statutory damages per violation. Additionally, such an action may be maintained by an employee against her employer whether or not [*the State deceptive practices statute*] otherwise allows for such claims.

Notes

Section 2—Unconscionable terms. This Title expresses legislative findings that there is a presumption that certain contractual terms are substantively unconscionable. The state's courts should be guided by this provision in determining whether a particular contractual

term is unconscionable based on all the factors involved in such an analysis under state law. This Title, however, shifts the burden to the party seeking to enforce the contract to show that, given all the factors involved, an enumerated provision is *not* unconscionable.

Section 3—Relation to the common law and the UCC. Section 2 of Title IV should be considered a codification of general common law and Uniform Commercial Code rules regarding the unconscionability of unfair terms. Section 3 clarifies that this Title does not alter the normal factors dictating whether unconscionable terms are unenforceable. In most states, one of those factors, in addition to the unfairly one-sided nature of the contract terms in question, is whether the manner in which the contract was formed was “procedurally” unconscionable.¹⁰⁷ Section 3 also clarifies that the enforceability of unfair terms not expressly listed in Section 2 turns on the principles that normally guide courts in deciding whether such terms are enforceable, and that the absence of an unfair term from Section 2 does not create any presumption that such term is *not* unconscionable.

Section 4—Severability. Section 4 prescribes that the inclusion of an unconscionable term in a standard form contract renders the entire agreement in which it is situated presumptively unenforceable. Courts often conclude that unconscionable terms should be severed from arbitration agreements and the agreements enforced without the offending clause.¹⁰⁸ This approach, however, has the consequence of creating perverse incentives. In the arbitration context, in particular, numerous courts have explained that “courts should not sever unconscionable provisions of arbitration clauses while leaving the rest intact, because doing so creates an incentive to get away with as many ‘bad’ arbitration provisions as possible.”¹⁰⁹ Unless courts completely refuse to enforce arbitration agreements containing illegal terms, the drafters of these contracts will continue to pack agreements with unconscionable terms, like those at issue here. Otherwise, drafters will know that the worst that can happen is that their most abusive terms are stricken, and even then only after a battle through expensive motion practice. To make clear that this is a rule of general applicability, it applies to all unconscionable terms in standard form contracts.

Section 5—UDAP violation. Section 5 provides that the inclusion of the specified terms in a form contract constitutes a violation of the state’s general statute prohibiting unfair or deceptive acts or practices (“UDAP” law). Section 5 thereby incorporates the state’s UDAP law, including any applicable procedural rules and remedies. Some state laws provide that the inclusion of unconscionable terms not only renders the contract unenforceable in certain

¹⁰⁷ See, e.g., Arthur Alan Leff, *Unconscionability and the Code—the Emperor’s New Clause*, 115 U. Pa. L. Rev. 485, 487 (1967) (describing the distinction between procedural and substantive unconscionability); see also National Consumer Law Center, *Consumer Arbitration Agreements* § 6.4 (7th ed. 2015), updated at www.nclc.org/library (describing the relationship between procedural and substantive unconscionability).

¹⁰⁸ See National Consumer Law Center, *Consumer Arbitration Agreements* § 6.8.3 (7th ed. 2015), updated at www.nclc.org/library.

¹⁰⁹ *Winston v. Academi Training Ctr., Inc.*, 2013 WL 989999, at *3 (E.D. Va. Mar. 13, 2013).

contexts, but that it also provides for a cause of action under state law.¹¹⁰ Explicitly making the inclusion of unconscionable terms in standard form contracts a UDAP violation will, like

Section 4, deter businesses from including unconscionable terms to chill claims. To ensure that it has the broad reach notwithstanding potentially contradictory principles under general state UDAP law, Section 5 also allows for the recovery of statutory damages,¹¹¹ and expressly allows for claims against brought by employees against employers.¹¹²

Analysis of Title IV

In practice, arbitration clauses in consumer and employment contracts not only provide an alternative forum for resolving disputes; because of the costs of arbitration, these clauses often prevent consumers and employees from being able to assert their rights in any forum. Some of the aspects of arbitration that are most likely to chill claims are insulated from state regulation by the FAA. For example, the Supreme Court has deemed bilateral dispute resolution to be so fundamental to the ideals of arbitration purportedly embodied in the FAA, that so-called “class action waivers” are effectively protected by the FAA from state-law based challenges.¹¹³

Many arbitration clauses, however, include terms that not only chill claims but that are inconsistent with the ideals of efficient, speedy, and cheap dispute resolution. Examples are terms calling for excessive costs and fees or requiring the consumer or employee to waive substantive rights or arbitrate in a far-off forum. These types of terms are not protected by the FAA from state-law based challenges and are frequently deemed unenforceable as a matter of state law.¹¹⁴

Section 2 of Title IV is merely a codification of common law principles that have already been adopted by courts in a number of states and, therefore, just as these common law rules are not preempted by the FAA, neither is Section 2. This analysis is not affected by the fact that this Title may appear to “target” arbitration in a way that generally applicable common

¹¹⁰ See generally National Consumer Law Center, *Unfair and Deceptive Acts and Practices Ch. 4* (8th ed. 2012), *updated at* www.nclc.org/library; see also *De la Torre v. CashCall, Inc.*, --- F.Supp.2d ----, 2014 WL 3752796, at *3 (N.D. Cal. July 30, 2014), *vacated on other grounds*, 2014 WL 5390259 (N.D. Cal. Oct. 21, 2014).

¹¹¹ *Felix v. Ganley Chevrolet, Inc.*, 2015-Ohio-3430, ¶ 31, 2015 WL 5039233 (Ohio Aug. 27, 2015) (concluding that UDAP claims based on unconscionable arbitration clause did not support award of damages to class because plaintiffs could not establish actual damages).

¹¹² *Harvard Translations, Inc. v. Heuberger*, No. CIV.A. 99-0682F, 1999 WL 967569, at *1 (Mass. Super. Sept. 9, 1999) (“Under Massachusetts case law, disputes between employers and employees are not actionable under [the Commonwealth’s UDAP protections].”).

¹¹³ *Concepcion*, 131 S. Ct. 1749 (2011).

¹¹⁴ For an extensive discussion of the doctrine, see National Consumer Law Center, *Consumer Arbitration Agreements Ch. 6* (7th ed. 2015), *updated at* www.nclc.org/library.

law rules do not. First, these provisions do not speak to *private* dispute resolution in particular. For example, this Title would likely render unconscionable a provision regarding suit in a distant *judicial* forum.

Furthermore, the distinction between the codified rules set out here and the common law principles that courts apply in specific cases does not have any legal relevance. If the FAA preempted legislatures from codifying specific guidance for courts on the enforceability of terms related to arbitration based on general legal principles like unconscionability, it would similarly preempt courts from applying general legal principles in specific cases related to arbitration. As the Supreme Court has recognized, however, *Concepcion* did not overthrow the common law contract defense of unconscionability.¹¹⁵

Moreover, not only does this Title not target “fundamental” attributes of arbitration for disfavor, which would be impermissible under *Concepcion*, but it also does not abrogate courts’ important role in determining whether—based on the facts of a particular case—certain provisions are unconscionable. In 2013, in *Sonic-Calabajas A, Inc. v. Moreno*,¹¹⁶ the California Supreme Court concluded that a *per se* rule prohibiting the enforcement of waivers of employees’ right to administrative hearings, known as “Berman” hearings, was preempted by the FAA because such a rule interfered with fundamental aspects of arbitration, including the possibility of more expeditious dispute resolution in the absence of a “Berman” hearing. The court explained, however, that the waiver of a “Berman” hearing is still relevant to a general unconscionability analysis:

[T]he waivability of a Berman hearing in favor of arbitration does not end the unconscionability inquiry. The Berman statutes include various features designed to lower the costs and risks for employees in pursuing wage claims, including procedural informality, assistance of a translator, use of an expert adjudicator who is authorized to help the parties by questioning witnesses and explaining issues and terms, and provisions on fee shifting, mandatory undertaking, and assistance of the Labor Commissioner as counsel to help employees defend and enforce any award on appeal. Waiver of these protections does not necessarily render an arbitration agreement unenforceable, nor does it render an arbitration agreement unconscionable *per se*. But waiver of these protections in the context of an agreement that does not provide an employee with an accessible and affordable arbitral forum for resolving wage disputes may support a finding of unconscionability. As with any contract, the unconscionability inquiry requires a court to examine the totality of the agreement's substantive terms as well as the circumstances of its formation to determine whether the overall bargain was unreasonably one-sided.¹¹⁷

¹¹⁵ *Marmet Health Care Ctr., Inc. v. Brown*, 132 S. Ct. 1201, 1204 (2012) (reaffirming, post-*Concepcion*, the viability of “state common law principles that are not specific to arbitration and pre-empted by the FAA”).

¹¹⁶ 311 P.3d 184 (Cal. 2013) *cert. denied*, 134 S. Ct. 2724 (2014).

¹¹⁷ *Id.* at 203.

Although its focus on aspects of arbitration that are not “fundamental” brings this Title outside the ambit of FAA preemption on its own, this Title goes one step further in ensuring its viability. Like general rules of unconscionability, the Title instructs courts that certain enumerated terms are presumptively unconscionable. Consistent with the fact-intensive nature of unconscionability analysis, the court should weigh all the facts involved in a case to determine unconscionability but, in enacting this Title, the legislature has determined that the likelihood of these enumerated terms being unconscionable is such that the burden should shift to the drafter to show why in the facts of a case the term is not unconscionable.

This same analysis should apply to Section 4, which creates a presumption that unconscionable terms in standard form contracts are not severable from the remainder of the contract. The United States Supreme Court recently granted *certiorari* in *MHN Gov’t Services Inc. v. Zaborowski* to consider whether California has an arbitration-specific severability doctrine, and, if so, whether that doctrine is preempted by the FAA.¹¹⁸ At this point, however, it is black-letter law that, like unconscionability, severability doctrine is a generally-applicable state law doctrine. It requires courts to examine whether there was a “meeting of the minds” on a cohesive agreement that does not include the unenforceable term.¹¹⁹ Based on the legislative findings expressed in Section 1, this Title appropriately extends the doctrine to protect against the perverse incentives that severing unconscionable terms sometimes creates for drafters. Section 1 also explains that this presumption is consistent with *general* rules regarding severability because there usually will not have been a genuine meeting of the minds over a dispute-resolution term in a form contract, let alone a term with unconscionable language excised. This Section further insulates itself from preemption both by applying to all form contracts and by creating only a presumption of non-severability and allowing courts to make the final determination based on all of the evidence and the state’s “general rules” regarding severability.

Finally, the provision expressly providing that inclusion of an unconscionable term enumerated in this Title constitutes an unfair and deceptive practice does not change the preemption analysis. A number of state laws, regulations, and cases hold that the inclusion of unconscionable terms in standard form contracts is unfair or deceptive. Applying this

¹¹⁸ See, e.g., *MHN Gov’t Servs. Inc. v. Zaborowski*, Pet. for Writ of *Certiorari*, No. 14-1458 (2015), available at www.scotusblog.com.

¹¹⁹ *Cordova v. World Fin. Corp. of N.M.*, 208 P.3d 901, 911 (N.M. 2009) (recognizing that courts cannot perform “judicial surgery” to excise an unenforceable term). The question of whether an unenforceable term within an arbitration clause is a question of state law that turns on the traditional factors that apply to the question whether an unenforceable term can be severed from an agreement. This question should not be confused, however, with the question whether an arbitration clause is severable from an unenforceable and illegal contract. The United States Supreme Court has concluded that the latter question is one of federal law. *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440 (2006) (arbitration clause is severable from illegal contract such that an attack on the legality of the contract as a whole does not bear on the enforceability of the arbitration clause in particular).

rule to arbitration clauses does not run afoul of the FAA, because the state law violation follows only from a finding that the provision is unconscionable and unenforceable based on considerations that are not preempted by the FAA.¹²⁰

TITLE V: PROHIBITION OF FORCED ARBITRATION CLAUSES UNDER STATE LAW

Section 1. Findings.

Forced arbitration agreements covering consumers and employees are contrary to the established public policy of this State. Because employees and consumers are forced to assent to these agreements as a condition of being an employee or consumer before any dispute has arisen with the employer or merchant, these agreements do not offer employees and consumers a meaningful choice about how to resolve their disputes with the employer or merchant. In addition, forced arbitration agreements prevent employees and consumers from effectively vindicating their rights under State law. For these reasons, except when inconsistent with federal law, the State prohibits the formation and enforcement of forced arbitration agreements in employment and consumer contracts.

Section 2. Prohibition of arbitration clauses in insurance agreements.

A forced arbitration agreement within or part of any written contract for insurance with a consumer or other written agreement involving the offering of insurance to a consumer is invalid, unenforceable, and void. Any such arbitration agreement shall be considered severable, and all other provisions of the contract for insurance shall remain in effect and given full force.

Section 3. Prohibition of arbitration clauses in employment contracts for workers exempted from the Federal Arbitration Act.

A forced arbitration agreement within or part of any written contract of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce is unenforceable and void. Any such arbitration agreement shall be considered severable, and all other provisions of the employment contract shall remain in effect and given full force.

Section 4. Prohibition of arbitration clauses that are not governed by federal law.

Any forced arbitration agreement, or portion thereof, in an employment or consumer contract is invalid, unenforceable, and void, when the enforceability of such arbitration agreement, or the portion at issue, is governed by State law. Any such arbitration agreement shall be considered severable, and all other provisions of the employment contract shall remain in effect and given full force.

¹²⁰ National Consumer Law Center, *Unfair and Deceptive Acts and Practices* Ch. 4 (8th ed. 2012), *updated at* www.nclc.org/library.

Section 5. Severability.

If any provision of this Title or the application thereof to any person or circumstance is held invalid, such invalidity shall not affect other provisions or applications of the Title that can be given effect without the invalid provision or application, and to this end the provisions of this Title are declared to be severable.

Notes

Section 2—Prohibition of arbitration clauses in insurance agreements. The federal McCarran-Ferguson Act allows states to regulate arbitration clauses in insurance contracts. Section 2 of this Title is limited to insurance contracts and declares arbitration requirements in such contracts to be void. Unlike Title III, which declares material terms *voidable* if the consumer or employee does not expressly assent to them—because of a concern that declaring all material terms void would have unintended consequences—this section declares arbitration clauses in insurance agreements *void*. It does not alter other terms of insurance agreements.

Section 3—Prohibition of arbitration clauses in employment contracts governing transportation workers. The Federal Arbitration Act includes an express exception for “contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce” that the Supreme Court has concluded removes “transportation workers” from the FAA’s reach.¹²¹ Title V expressly incorporates the federal legislative language to ensure that arbitration clauses in all contracts that fall within the federal exemption are void.

Section 4—“Catch all” prohibition. Title V also includes a “catch all” provision that renders void any forced arbitration clause in an employment or consumer contract when such arbitration clause is governed by state law and not the FAA. This provision would cover forced arbitration clauses in employment and consumer contracts that do not affect interstate commerce and forced arbitration clauses in employment and consumer contracts in which the parties agree that such arbitration clauses are covered by state and not federal law. It would also apply to the extent that Congress or the Supreme Court excludes other types of employment or consumer contracts from the FAA.

Analysis of Title V

Although state rules that limit the enforceability of arbitration are generally preempted by the Federal Arbitration Act,¹²² federal law provides various exceptions to this rule. This Title clarifies that when state and not federal law governs the enforceability of a forced arbitration clause in an employment or consumer contract, that arbitration clause is void as a matter of state law.

¹²¹ 9 U.S.C. § 1; *see also Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001).

¹²² *See, e.g., Ferguson v. Corinthian Colleges, Inc.*, 733 F.3d 928, 934 (9th Cir. 2013).

First, the federal McCarran-Ferguson Act includes a “reverse preemption” provision that “[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance... unless such Act specifically relates to the business of insurance.”¹²³ Because the FAA does not specifically relate to insurance, state insurance law can prohibit arbitration agreements in insurance transactions. A number of states either provide that arbitration clauses in insurance agreements are not enforceable or provide that arbitration agreements in certain lines of insurance are unenforceable.¹²⁴ Although these regulations would likely be preempted were it not for the McCarran-Ferguson Act, the FAA does not preempt such rules as long as they clearly identify that they are intended to regulate the “business of insurance.”¹²⁵ Section 2 of this Title specifically addresses the “business of insurance,” and thus is not preempted by the FAA.

Second, the FAA itself states that it does not govern “contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce.”¹²⁶ The United States Supreme Court has interpreted this language as removing from the FAA’s coverage “contracts of employment of transportation workers.”¹²⁷ Nonetheless, arbitration clauses included in contracts of employment of transportation workers can still be enforceable as a matter of state law.¹²⁸ By enacting this Title the state ensures that such agreements are void and unenforceable.

¹²³ 15 U.S.C. § 1012(b).

¹²⁴ See National Consumer Law Center, *Consumer Arbitration Agreements* § 3.3.4 (7th ed. 2015), *updated at* www.nclc.org/library.

¹²⁵ See, e.g., *Standard Sec. Life Ins. Co. of N.Y. v. West*, 267 F.3d 821 (8th Cir. 2001) (Missouri statute providing for enforceability of arbitration clauses in written contracts except for contracts of insurance was not preempted by the FAA); *Stephens v. Am. Int’l Ins. Co.*, 66 F.3d 41 (2d Cir. 1995) (FAA did not preempt Kentucky statute limiting enforceability of arbitration clauses in cases related to insurance premium delinquency actions); *Mut. Reinsurance Bureau v. Great Plains Mut. Ins. Co.*, 969 F.2d 931 (10th Cir. 1992) (FAA did not preempt aspect of Kansas Arbitration Act providing that arbitration clauses are enforceable other than those contained in contracts for insurance); *Balaban-Zilke v. Cigna Healthcare of Cal., Inc.*, 2003 WL 21228038 (Cal. Ct. App. May 28, 2003) (FAA did not preempt arbitration-related regulations involving contracts for health care service plans); *Allen v. Pacheco*, 2003 WL 21310267 (Colo. June 9, 2003) (FAA did not preempt specific disclosure requirements related to arbitration clauses in medical service agreements); *Cont’l Ins. Co. v. Equity Residential Properties Trust*, 565 S.E.2d 603 (Ga. App. 2002) (FAA did not preempt Georgia Arbitration Act provision providing for the enforcement of written arbitration clauses except for arbitration clauses in insurance agreements).

¹²⁶ 9 U.S.C. § 1.

¹²⁷ *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001).

¹²⁸ See, e.g., *Palcko v. Airborne Express, Inc.*, 372 F.3d 588, 597–598 (3d Cir. 2004).

Finally, the FAA does not govern arbitration clauses in contracts that the parties agree are governed exclusively by state law¹²⁹ or that do not involve interstate commerce.¹³⁰ This Title makes clear that in these circumstances, and any others in which federal law might not apply, forced arbitration clauses in consumer and employment contracts are void and unenforceable.

TITLE VI: DATA DISCLOSURE REQUIREMENTS FOR ARBITRATION ADMINISTRATORS

Section 1. Findings.

Unlike administrative or judicial proceedings, arbitration proceedings regarding consumer and employment claims are not public. The lack of public information regarding these proceedings interferes with the State’s ability to monitor arbitration administrators to ensure that they comply with basic principles of fairness and impartiality.

Section 2. Requirements.

- (a)** Any private company that administers five or more arbitrations a year in this State involving a consumer or employee shall collect and publish the following information about each of its arbitrations for at least five years after the arbitration has completed:
 - (i)** The names of the parties to the arbitration;
 - (ii)** The party that filed the arbitration claim;
 - (iii)** The type of dispute involved, including goods or services, insurance, credit, debt collection, or employment;
 - (iv)** The prevailing party;
 - (v)** Whether the consumer or employee was represented by an attorney;
 - (vi)** The date the company administering the arbitration received the demand for arbitration, the date the arbitrator was appointed, and the date of the arbitration’s disposition;
 - (vii)** Whether the arbitration resulted in an in-person hearing;
 - (viii)** Whether the parties provided each other with any pre-hearing discovery;

¹²⁹ See *Volt Info. Sciences, Inc. v. Bd. of Trustees*, 489 U.S. 468 (1989).

¹³⁰ See National Consumer Law Center, *Consumer Arbitration Agreements* § 3.3.2 (7th ed. 2015), *updated at* www.nclc.org/library.

- (ix) The amount of the claim, the amount of the award, and any other relief granted, if any;
 - (x) The name of the arbitrator, his or her total fee for the case, and the percentage of the arbitrator's fee paid by each party; and
 - (xi) The arbitrator's professional affiliations.
- (b) Information published pursuant to this title must be updated at least quarterly, and made available to the public in a computer-searchable format, which shall be accessible at the website of the private company administering the arbitrations, if any, and on paper upon request.
- (c) No private company shall have any liability for collecting, publishing, or distributing the information in accord with this section.

Section 3. Confidentiality.

This Title does not require disclosure of any information other than that set forth in Section 2.

Section 4. Enforcement.

Any private person and any public enforcement agency responsible for enforcing State law under this Title may bring suit for injunctive relief against an entity that violates these provisions, and may recover reasonable attorney fees and other costs if an injunction or equivalent relief is awarded. Injunctive relief is the only relief available in a suit arising from failure to comply with this Title.

Section 5. Severability.

Should a court decide that any provision of this act is unconstitutional, preempted, or otherwise invalid, that provision shall be severed, and such a decision shall not affect the validity of the act other than the part severed.

Notes

Section 2—Requirements. The requirements of this Title are designed to provide the state and the state's residents with an overall picture of how disputes within its borders are resolved by private arbitrators. This Title does not alter rules regarding arbitration agreements between parties or regarding the confirmation of arbitration awards.

Section 3—Confidentiality. Private information about a consumer or employee shall remain confidential unless the parties agree otherwise.

Section 4—Enforcement. This Title allows for *private* enforcement of its requirements. The only remedy available under this Title, however, is injunctive relief, meaning arbitration providers will not be held liable for money damages related to any failure to abide by this Title's disclosure requirements.

Analysis of Title VI

California currently regulates arbitration administrators in a similar fashion to Title VI.¹³¹ Like California law, Title VI requires arbitration administrators (not the individual arbitrators) to disclose information about individual cases and their outcome, how frequently a business uses the same arbitration service provider, how long arbitrations take, how much arbitrators are paid, and who pays them.

This provision would provide useful information to states considering adjusting their policies and enforcement efforts. Indeed, fairly recent events illustrate the importance of state oversight of private arbitration companies. In 2009, the Minnesota attorney general filed a lawsuit against a major national private arbitration provider, the National Arbitration Forum (NAF). The lawsuit arose from the close financial relationship between NAF and a large national debt collection law firm, along with NAF's subsequent administration of thousands of consumer debt collection arbitrations brought by the same law firm. The lawsuit alleged, among other things, that NAF engaged in unfair and deceptive practices by representing to the public that it provided an independent dispute resolution forum, when in fact NAF was financially intertwined with a party that had a substantial interest in many of its arbitrations, and NAF frequently advertised to corporations that it provided a favorable forum for collection arbitrations. The lawsuit resulted in a consent decree in which NAF agreed to terminate administering consumer arbitrations nationwide. Disclosures such as those required by this Title help to expose this type of corruption among arbitration administrators.

Title VI expressly authorizes public enforcement agencies and private parties seeking information under this Title to bring suit seeking injunctive relief.¹³² Even though Title VI serves a public purpose, states might not always know whether arbitration providers are actually meeting Title VI's requirements. Therefore, this Title extends enforcement authority to persons such as consumers and employees participating in arbitrations, and journalists or others who interested in accessing data subject to the disclosure requirements of this Title.

The FAA does not preempt reasonable state regulation of arbitration administrators like the American Arbitration Association as long as the regulation does not indirectly limit the enforceability of an arbitration provision. Businesses might argue that this Title interferes with their FAA-protected right to require consumers and employees to resolve disputes through confidential proceedings. However, this Title does not regulate arbitration *agreements*. The parties are permitted to arbitrate before the forum of their choice. Moreover, this requirement does not force the administrator to make public any materials

¹³¹ Cal. Code Civ. Proc. §§ 1281.9, 1281.92, 1281.96, 1284.3 (West).

¹³² Carolyn Said, *Affordable Legal Solution*, San. Fran. Chron., Jan. 12, 2014 (explaining the problems with the absence of such a provision in California's law).

that are the subject of that arbitration, or to otherwise implement procedures that would conflict with the “purposes of the FAA” as understood by the Supreme Court, but rather to provide data on the parties, the arbitrators, and the arbitration fee.

TITLE VII: APPELLATE JURISDICTION

Section 1. No jurisdiction over interlocutory appeals.

Appellate courts shall not have jurisdiction to review a trial court’s interlocutory order denying a motion to compel arbitration or otherwise concluding that an arbitration agreement is unenforceable or does not cover a particular claim. Appellate review of the denial of a motion to compel arbitration may be had after a final judgment has issued. An interlocutory appeal shall be allowed if the trial court orders arbitration and dismisses the suit, or orders arbitration and stays the litigation.

Notes

Section 1—No interlocutory appeal. Litigation about the enforceability of arbitration clauses is often expensive and prolonged. This Title provides that parties shall have no right to appeal the denial of a motion to compel arbitration or other order concluding that an arbitration agreement is unenforceable or does not govern a particular dispute or claim until after the court has issued a final judgment in the dispute. In doing so it prevents arbitration agreements from slowing employees’ or consumers’ efforts to enforce their rights under state law.

The defendant is not similarly prejudiced when an interlocutory appeal is taken from an order staying litigation pending arbitration, because it is the other party that is seeking relief. In addition, in many cases it is not practical for the consumer or employee to proceed through arbitration because of the costs of arbitrating or the inability to bring class or collective claims, so that it is necessary for the consumer or employee to be able to appeal the order on an interlocutory basis.

Analysis of Title VII

The FAA does not preempt state law regarding the procedures for litigating issues related to arbitration.¹³³ Thus, despite Section 16 of the FAA that allows parties to appeal decisions denying motions to compel arbitration, some states already limit the right of interlocutory appeal in state courts.¹³⁴ By limiting the appealability of denials of motions to compel arbitration, states can ensure that employees’ and consumers’ claims are resolved quickly as

¹³³ See *Volt Info. Sciences, Inc. v. Bd. of Trustees*, 489 U.S. 468 (1989).

¹³⁴ See *Wells v. Chery Chase Bank*, 768 A.2d 620, 627 (Md. 2001) (collecting cases and observing that “[m]ost state courts which have faced the issue of whether the FAA prevented appeal of an order compelling arbitration hold that their own procedural rules govern appeals, unless those rules undermine the goals and principles of the FAA, and then those courts find that their procedural rules do not impermissibly undermine the objectives of the FAA”); see also National Consumer Law Center, *Consumer Arbitration Agreements* § 2.6.4 (7th ed. 2015), *updated at* www.nclc.org/library.

opposed to being delayed by prolonged litigation regarding the enforceability of an arbitration clause.

TITLE VIII: PREVENTING RESPONDENTS FROM IMPROPERLY DELAYING THE ARBITRATION PROCEEDING

Section 1. Findings.

The United States Supreme Court has held that the Federal Arbitration Act generally protects parties' right to enter into private agreements to resolve their private disputes expeditiously. That goal is frustrated if a party imposes an arbitration requirement on consumers or employees but, then using the procedures of the arbitration administrator chosen by that party, prevents the arbitration proceeding from going forward in an expeditious manner. In particular, when the entity that requires arbitration refuses to pay its required share of the expenses of arbitration, too often the consumer or employee is prevented from going to court and also prevented from having a speedy arbitration hearing. This conduct amounts to a breach of the arbitration agreement and should be grounds for the consumer or employee to bring her claim in court. However, arbitration administrators are often slow to enforce their own rules. This Title regulates administrators to ensure that they arbitrate disputes efficiently and speedily.

Section 2. Covered arbitration administrators.

This Title applies to all arbitration administrators that have administered, in this State, three or more arbitrations brought by a consumer or employee over the past 12 months.

Section 3. Requirements to ensure expeditious dispute resolution.

This section applies if a forced arbitration agreement, whether expressly or through incorporation of the rules of the arbitration administrator, requires that in a case brought by an employer or consumer, the respondent must pay certain fees or costs before the arbitration proceeding can proceed. In that case, if those fees or costs are not paid within 7 days after those fees are due, the arbitration administrator must:

- (a) Begin administering the arbitration, by scheduling a hearing date, notwithstanding the respondent's failure to pay required fees; or
- (b) Within 10 after the fees are due, refuse to administer the arbitration, and provide the consumer or employee with a letter explaining that the administrator will not administer the arbitration, and expressly stating that the "arbitration forum designated by the parties is unavailable to resolve this dispute."

Section 4. Requirements to prevent pending cases from being improperly suspended.

This section applies if a forced arbitration agreement, whether expressly or through incorporation of the rules of the arbitration administrator, requires that in a case brought by an employer or consumer, the respondent must pay certain fees or costs during the pendency of an arbitration proceeding. In that case, if those fees or costs are not paid within 7 days after the fees are due, the arbitrator must:

- (a) Continue the administering the arbitration proceeding notwithstanding the respondent's failure to pay required fees; or
- (b) Within 10 days after the fees are due, issue a final award for the consumer or employee that provides all relief requested by the consumer or employee. If the consumer or employee has not expressly set out the amount of monetary damages demanded, the arbitrator may either issue an award on liability alone and allow a court enforcing the award to decide damages or may hold its own hearing on monetary damages within one week following the issuance of the final award concerning liability.

Section 5. Disclosure requirements.

Administrators covered by this Title shall publicly report the following, as applicable, and updated quarterly on the administrators publicly-accessible website for any arbitration demanded by a consumer or employee: when each arbitration demand was made, when each demand for payment of costs and fees is made, the date the respondent paid all fees and costs requested, when a hearing, either live or on the papers, was held, when the award was issued, when the arbitration administrator provided a letter indicating the arbitration would not proceed, and when an arbitration proceeding was terminated for lack of payment and an a resulting award is made to the consumer or employee.

Section 6. Enforcement.

The provisions of this Title shall be enforceable through an action seeking declaratory or injunctive relief by the Attorney General or any employee or consumer aggrieved by an administrator's failure to comply with this Title.

Section 7. Administrator's Right to Collect Fees.

Whenever an arbitration agreement or the arbitration administrator's rules incorporated into that agreement require that the respondent pay fees or costs to the arbitrator or arbitration administrator, the arbitrator and administrator are third-party beneficiaries of the agreement to pay fees or costs. If the administrator administers an arbitration and an arbitrator proceeds with an arbitration notwithstanding the respondent's failure to pay fees or costs pursuant to Section 3(a) or 4(a) of this Title, then the administrator may pursue a breach of contract action against the respondent under State law to collect those fees or costs.

Notes

Section 1—Legislative findings. The legislative findings for this Title identify “stalled” arbitration proceedings as one of the most serious impediments many consumers and employees face in achieving redress in individual arbitrations. However, consistent with the focus of this Title, which regulates arbitration administrators and not the respondents in

arbitration proceedings, the findings point out that at bottom prolonged dispute resolution in arbitration arises because arbitrators and arbitration providers fail to enforce their own rules.¹³⁵

Section 2—Covered arbitration administrators. Like Title VI, this Title does not cover *every* private arbitration administrator. In this way, the Title avoids the critique that it effectively imposes requirements on private arbitration *agreements*. In theory, there is nothing to prevent a business from designating an arbitration administrator that is not covered by this Title.

Sections 3 & 4—Requirements. Sections 3 and 4 provide arbitration administrators with two different options when a respondent fails to pay fees required by the administrator’s rules or demanded by the administrator. First, the administrator may administer the arbitration promptly and in accordance with its normal procedures. Second, under Section 3, the administrator may refuse to administer the arbitration and provide the employee or consumer with a letter stating that the forum is unavailable and thereby entitling the employee or consumer to file her claims in a public forum. Under Section 4, in the event the arbitration proceeding has already initiated, instead of asking the consumer or employee to start all over again in court, the provision provides that an award will be issued in the consumer’s or employee’s favor if the defendant fails to properly participate in the proceeding. Note that Section 3 addresses the common problem, particularly in AAA arbitrations, of respondents failing to pay or delaying in paying fees required to initiate the arbitration. Section 4 addresses a much less common problem, but a problem that could arise if arbitration administrators sought to evade the requirements of Section 3 by initiating the arbitration but then terminating it while it is pending before the arbitrator because of a failure to pay fees or costs.

¹³⁵ An attorney who represents consumers bringing claims against predatory auto dealers and lenders recounted the following story about the American Arbitration Association’s (AAA) failure to follow its own rules requiring the business to pay fees in a timely manner and refusing to administer an arbitration if the arbitration clause is not registered with AAA. See American Arbitration Association, Consumer Arbitration Rules, R-12, *available at* www.adr.org.

We filed a YoYo car sale case against a car dealer where dealer kept the down payment and repo’d the car. Car dealer hires a known automobile dealer defense firm who for the first time provides my client with a copy the arbitration agreement she signed right before discovery is due. I don’t think we can win against it, so I call the other attorney and we agree to file a joint motion to stay the case compel arbitration to save time rather than waiting two months for a hearing date that I know I will lose. It is with AAA, so I file under the consumer rules. AAA takes approximately 90 days before contacting the dealer. Car dealer has not had the arbitration agreement previously approved with AAA and does not pay the fees so case gets dismissed—another couple of months. We file a motion with the Court to lift the stay and deem arbitration waived. Court sets it for a hearing a month and a half out. Shortly before hearing, dealer pays the \$250.00 to get AAA to approve the Arbitration and gets a letter from them saying they will now agree to hear cases involving the dealer. Court denies our motion and makes us start over from the beginning after almost a Year has passed! Email to David Seligman, Oct. 29, 2015 (on file with author).

Section 5—Disclosure requirements. To ensure that administrators are following the requirements of Sections 3 and 4, and to provide the state with information relevant to enforcement proceedings under Section 6, arbitration administrators are required to provide public disclosures regarding their compliance with this Title.

Section 6—Enforcement. Like Title VI, this Title is enforceable either through a public enforcement action brought by the state or by an aggrieved consumer or employee.

Section 7—Administrator’s Right to Collect Fees. In recognition of the financial costs imposed on arbitration administrators that proceed with arbitrations even when the respondent does not pay fees, the Title creates a cause of action for administrators to recover fees. Not only does this section incentivize respondents to pay fees on time, but it also provides further support for the argument that this Title is not preempted. By allowing arbitration providers to recover fees, the Title implicitly signals its approval of arbitration proceedings and provides a mechanism to allow those proceedings to proceed according to the parties’ agreement and the ideals of efficient and speedy dispute resolution even when the respondent has not complied with payment terms.

Analysis of Title VIII

This Title avoids any potential conflict with the FAA by regulating arbitration administrators and not arbitration agreements. On its face, a rule targeting employers and other businesses that breach the terms of their arbitration agreements by failing to pay fees in a timely fashion—and thus delaying the arbitration proceeding—would not appear to be preempted by the FAA. After all, this conduct patently contravenes the ideals of “efficient and speedy” dispute resolution protected by the FAA as set out in *Concepcion*.

However, businesses might argue that such a rule would infringe the parties’ *federal* right to delegate questions regarding the conduct of the arbitration to the arbitrator.¹³⁶ In general, courts hold that even if an arbitration agreement does not expressly delegate this question to the arbitrator, it is presumptively delegated to the arbitrator. Thus, when it is not clear whether a party has actually violated the forum’s rules¹³⁷ or when it appears that the arbitrator has (or will) come to its own determination of whether the party has violated the rules and what the consequences of that violation should be,¹³⁸ the court will generally defer to the arbitrator.

¹³⁶ *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63 (2010).

¹³⁷ *See Pro Tech Indus., Inc. v. URS Corp.*, 377 F.3d 868, 872 (8th Cir. 2004) (whether party waived right to arbitrate by making an untimely request for arbitration under the arbitration agreement was for the arbitrator to decide, because “arbitrators are the experts about the meaning of their own rules, and are comparatively better able to interpret and apply them than courts”); *RMES Communications, Inc. v. Qwest Bus. Gov’t Services, Inc.*, 2006 WL 1183173 (D. Colo. May 2, 2006) (whether party’s pre-litigation activity waived right to arbitrate was for arbitrator to decide); *Omar v. Ralphs Grocery Co.*, 13 Cal. Rptr. 3d 562, 568 (Ct. App. 2004) (“[W]here the delay is unrelated to the litigation process, it is improper for the judge to decide this issue.” (citation omitted)).

¹³⁸ *Lifescan, Inc. v. Premier Diabetic Services, Inc.*, 363 F.3d 1010 (9th Cir. 2004).

This Title avoids this counterargument entirely because it regulates arbitration administrators to ensure that they enforce their own rules effectively. However, nothing in this Title requires businesses to designate arbitration administrators that are subject to this Title or to specify certain arbitral rules or procedures in the arbitration agreement. Furthermore, nothing in this Title requires arbitration administrators to alter their rules. All that this Title requires is that arbitration providers *enforce* their rules according to their terms.

Furthermore, consistent with the general principle of federal law that arbitrators presumptively have the discretion to rule on matters regarding arbitral procedures, the Title allows the arbitrator either to refuse to administer an arbitration *or* to move forward with the arbitration, and to facilitate the possibility of the latter choice, provides the administrator with a meaningful mechanism to recovering fees. In this way, Title VIII not only fosters arbitration proceedings that are “efficient and speedy,”¹³⁹ but also avoids treating arbitration proceedings with disfavor relative to judicial or administrative proceedings.¹⁴⁰

TITLE IX: EFFECT OF OPT-OUT PROVISIONS

Section 1. Findings.

Standard form contracts sometimes allow the party of weaker bargaining power the opportunity to opt out of the contract or one of its clauses, creating the illusion of meaningful assent to the contract or the clause containing the opt-out provision. In practice, however, opt-out provisions in standard form contracts do not significantly change the nature of a one-sided or oppressive contract, as the party of weaker bargaining power rarely understands or exercises these opt-out opportunities.

Section 2. Effect of opportunity to opt out.

For any standard form contract drafted by one party and presented to another party of weaker bargaining power, there is a rebuttable presumption that the offeree’s right to opt out of the contract or any of its provisions does not bear on whether the contract is procedurally conscionable.

Notes

Section 1—Findings. The findings declare the legislature’s determination that an opt-out provision in a standard form contract in most cases does not make that contract more voluntary or less one-sided than it would be without that provision. As described in the analysis below, courts frequently treat standard form contracts with opt-out provisions more

¹³⁹ *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 221 (1985).

¹⁴⁰ *AT&T Mobility L.L.C v. Concepcion*, 131 S. Ct. 1740 (2011).

favorably than those without them, even enforcing substantively unfair terms that would not be enforceable in contracts that did not allow the offeree an opportunity to opt out. That line of precedent is inconsistent with the experience of consumers, employees, and others. The legislature can correct it.

Section 2—Effect of right to opt out. In analyzing whether a contract provision is unconscionable, courts typically examine both how a contract (or clause within a contract) was negotiated (procedural unconscionability) and the fairness of its substantive terms (substantive unconscionability).

Section 2 does not alter pre-existing state law concerning the relationship between procedural and substantive unconscionability. It addresses only how an opt-out provision bears on the procedural unconscionability analysis. This provision states that the opportunity to opt out of any clause in a contract of adhesion is presumptively irrelevant to the court’s determination of whether the contract is procedurally unconscionable. The offeror may overcome this presumption in special circumstances, but standard opt-out provisions—like those giving the consumer or employee a certain amount of time to opt out of the contract—should not overcome the presumption.

Analysis of Title IX: Effect of Opt-Out Provisions

Clarifying Procedural Unconscionability Law

Standard form contracts frequently include terms that allow the party of weaker bargaining power the opportunity to opt out of the contract or one of its clauses. The Consumer Financial Protection Bureau’s recent study of forced arbitration agreements concluded that a significant percentage of arbitration clauses in consumer financial product contracts include such “opt out” provisions, which allow the consumer to opt out of the arbitration requirement, generally within a specified period.¹⁴¹ And a significant percentage of employment contracts also include arbitration clauses with opt-out provisions.¹⁴²

Giving a consumer or worker the right to opt out of an arbitration requirement may seem to provide a fair opportunity to reject the requirement voluntarily. But, in practice, few consumers and employees read or understand fine-print opt-out opportunities. The CFPB’s study found that 27.3% of credit card arbitration agreements include opt-out provisions, but when the Bureau interviewed 1,007 consumers about their credit card contracts, only three stated that they were given an opportunity to opt out of their arbitration agreements. None of those three had done so.¹⁴³

¹⁴¹ Consumer Fin. Protection Bureau, Arbitration Study: Report to Congress, pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a) at 2.5.1 (“CFPB Study”), *available at* <http://files.consumerfinance.gov>.

¹⁴² *See, e.g., Johnmohammadi v. Bloomingdale’s, Inc.*, 755 F.3d 1072, 1075 (9th Cir. 2014).

¹⁴³ CFPB Study at 3.4.3.

While opt-out opportunities in practice do not provide meaningful choice to individuals presented with one-sided clauses, the presence of an opportunity to opt out of the contract—even when buried in the fine print—often carries outsized legal significance. Most states require a showing of both procedural and substantive unconscionability to declare a contract unenforceable.¹⁴⁴ This means that before even getting to the question of whether the terms of an agreement are unfair or oppressive (substantive unconscionability), many courts will ask whether the clause was presented in an unfair way, without the offeree having a sufficient opportunity to accept or reject its terms (procedural unconscionability).¹⁴⁵

Standard form contracts, prepared by one party, to be signed by another party in a weaker position, are contracts of adhesion,¹⁴⁶ and that alone makes them procedurally unconscionable to at least some degree—whether or not they have an opt-out term.¹⁴⁷ Yet a number of courts have concluded that the presence of an opt-out term is relevant to the procedural unconscionability analysis, and even that in some circumstances the presence of an opt-out provision necessarily renders an agreement procedurally conscionable.¹⁴⁸

Drafters of standard form contracts thus often include opt-out terms not to provide consumers or employees with any meaningful choice about whether to enter into the agreements, but rather to insulate the agreements from substantive scrutiny. Tellingly, the CFPB found that the consumer financial product contracts whose arbitration agreements were most likely to include opt-out opportunities were products that often target low income consumers for abuse—storefront payday loans (83.7% of arbitration agreements included opt-outs) and private student loans (83.3% of arbitration agreements included opt-outs).¹⁴⁹ It is likely that the companies selling these products are more concerned with insulating themselves from liability with arbitration clauses and class waivers than they are concerned with offering their customers meaningful choice in contract negotiation.

¹⁴⁴ National Consumer Law Center, *Consumer Arbitration Agreements* § 6.5 (7th ed. 2015).

¹⁴⁵ *Id.*

¹⁴⁶ *Contract*, Black's Law Dictionary (10th ed. 2014).

¹⁴⁷ *Circuit City Stores, Inc. v. Adams*, 279 F.3d 889, 893 (9th Cir. 2002); *Davis v. Gazillion, Inc.*, 2010 WL 2740002 (N.D. Cal. July 12, 2010) (any adhesive contract is procedurally unconscionable under California law); *Delmore v. Ricoh Americas Corp.*, 667 F. Supp. 2d 1129, 1136 (N.D. Cal. 2009) (“A contract or clause is procedurally unconscionable if it is a contract of adhesion.”).

¹⁴⁸ *Mobamed v. Uber Techs., Inc.*, --- F.3d ---, 2016 WL 4651409, at *5 (9th Cir. Sept. 7, 2016); *Circuit City Stores, Inc. v. Ahmed*, 283 F.3d 1198, 1199 (9th Cir. 2002) (holding that an arbitration provision was not procedurally unconscionable based on a thirty-day opt out clause); *Nesbitt v. FCNH, Inc.*, 74 F. Supp. 3d 1366, 1372 (D. Colo. 2014); *Clerk v. ACE Cash Express, Inc.*, 2010 WL 364450, at *8-10 (E.D. Pa. Jan. 29, 2010); *Fluke v. Cashcall, Inc.*, 2009 WL 1437593, at *8 (E.D. Pa. May 21, 2009) (holding that an arbitration provision containing a sixty-day opt out clause was not unconscionable); *Guadagno v. E*Trade Bank*, 592 F. Supp. 2d 1263, 1270 (C.D. Cal. 2008) (same).

¹⁴⁹ CFPB Study at 2.5.1.

Too often there is a fundamental misconception that opt-out opportunities make standard form agreements meaningfully voluntary.¹⁵⁰ State legislatures should enact Title IX to correct that misconception and to ensure that the common law is grounded in a more accurate understanding of the actual experiences of consumers and employees.

FAA Preemption

The Federal Arbitration Act (FAA) does not preempt Title IX for largely the same reasons that it does not preempt Titles III and IV. The rules set out here are merely the codification of common law principles applying across contracts of adhesion. And as commentators and courts have observed, it is entirely within the bounds of the FAA—and arguably even complimentary to the FAA—for states to regulate contracts of adhesion generally.¹⁵¹

TITLE X: REMEDY FOR DRAFTER OVERREACH IN STANDARD FORM CONTRACTS

Section 1. Findings.

The remedies for illegal or unconscionable terms in standard form consumer and employment contracts are frequently insufficient to deter drafter overreach. In some cases, consumers and employees may not challenge enforcement of these terms because they do not understand their rights or because the terms threaten harsh consequences and exert an *in terrorem* effect. Even when a consumer or employee challenges the illegal unconscionable term, the court may decide to sever only that term and enforce the remainder of the agreement in its absence.

Section 2. Remedies for illegal or unconscionable terms in standard form contracts.

If a court finds that a standard form contract contains an illegal or unconscionable term, the court may

- (a) refuse to enforce the entire contract or the specific part, clause, or provision containing the term;
- (b) enforce the contract including the specific part, clause, or provision containing the term, while severing only the illegal or unconscionable term; or
- (c) so limit the application of the illegal or unconscionable term or the clause containing such term as to avoid any illegal or unconscionable result.

¹⁵⁰ *James v. Comcast Corp.*, 2016 WL 4269898, at *3 (N.D. Cal. Aug. 15, 2016).

¹⁵¹ See *Reed Elsevier, Inc. ex rel. LexisNexis Div. v. Crockett*, 734 F.3d 594, 600 (6th Cir. 2013); Richard Frankel, *Concepcion and Mis-Concepcion: Why Unconscionability Survives the Supreme Court's Arbitration Jurisprudence*, 17 J. Disp. Resol. 225, 242–250 (2014) (“[A]dhesion contracts, in which one party lacks meaningful choice over arbitration terms, are anathema to fundamental principles of arbitration and thus may be freely regulated by states without risking federal preemption.”).

Section 3. Factors relevant to determining an appropriate remedy.

In ordering a remedy for illegal or unconscionable terms in standard form contracts, a court shall consider the following factors:

- (a) whether severing the term and enforcing the contract in its absence creates an incentive for drafters to include illegal or unconscionable terms in standard form contracts;
- (b) whether severing the term and enforcing the contract in its absence removes, in whole or in part, the incentive to draft enforceable standard form contracts that do not include such terms;
- (c) whether the inclusion of such an illegal or unconscionable term might exert an *in terrorem* effect by deterring the non-drafting party from asserting his rights under the contract or by deterring the non-drafting party from challenging the enforcement of the illegal or unconscionable term;
- (d) whether the drafting party acted in bad faith, for example, by including a term that is illegal or unconscionable under established precedent; and
- (e) the parties' actual purposes.

Section 4. Severance provisions.

In deciding whether merely to sever unenforceable terms from a standard form contract, a court shall not consider a term in such contract stating that unenforceable terms shall be severed.

Notes

Section 1—Findings. These legislative findings observe that drafters of contracts of adhesion have an incentive to include illegal or unconscionable terms if the very worst that can happen is that those terms are severed and the rest of the clause or contract enforced in their absence.

Section 2—Remedies for illegal or unconscionable terms in standard form contracts.

This section describes the possible outcomes in a case where a court determines that a standard form contract includes an illegal or unconscionable term. The legislative language mirrors the Uniform Commercial Code's unconscionability provision, UCC § 2-302, and does not alter preexisting rules regarding judicial remedies in contract cases. The only addition here is the express instruction that, in cases where severance is inappropriate, courts may strike the clause containing the unconscionable term as opposed to declining to enforce the entire contract. While most courts understand that already, this language should allay concerns that this provision would require courts to deem unenforceable an entire consumer contract, allowing the consumer to keep the benefit of the bargain, where the contract

contained an unconscionable term. Instead, based on the factors described in Section 3, the court could strike the clause containing the unconscionable term, while leaving the rest of the contract intact.

Section 3—Factors relevant to determining an appropriate remedy. Section 3 reiterates that the choice of the proper remedy for an illegal or unconscionable term remains committed to the discretion of the trial court. But this section does not ask courts to look to the mutual purposes of the parties, which is not appropriate in cases involving standard form, take-it-or-leave-it contracts. Instead, the court is asked to consider such factors as whether severance would provide the right incentives for the drafter, whether the term might, in some cases, chill the weaker party from asserting his or her rights in court by exerting an *in terrorem* effect, and the extent to which existing precedent suggests that the drafter would likely have known the term was unenforceable. The provision also asks the court to consider the parties’ purposes, but only their *actual* purposes. For example, while the parties might have the mutual purposes of effecting a loan transaction, it is unlikely that the consumer would have had any actual purposes respecting an arbitration clause containing an unconscionable term within the loan contract. In that case, the court could decide to enforce the loan agreement but decline to enforce the entire arbitration clause, and not just the unconscionable term within the arbitration clause.

Section 4—Severance provisions. Consistent with the policy of considering drafter incentives, bad faith, and the parties’ actual purposes, Section 4 clarifies that irrelevant to the severance analysis set out in Section 3 are any “severance provisions.” Such provisions may be buried in form contracts to protect the drafter from a judicial decision to deny enforcement of the entire agreement or an entire clause within that agreement. One justification for severance provisions is to prevent an entire contract from being defeated by a minor drafting mistake. But Sections 2 and 3 give courts sufficient tools to avoid potentially harmful outcomes. For example, Section 3 asks courts to consider how clearly unenforceable the unconscionable term is. If the term was included as an honest mistake, the court simply can sever it.

Analysis of Title X: Remedy for Drafter Overreach in Standard Form Contracts

A. Background

Even when the law is clear that a particular contract term is unenforceable, many drafters continue to include that term in standard form contracts. For example, frequently arbitration clauses include terms that are unenforceable and clearly unprotected by the Federal Arbitration Act, such as clauses that limit the plaintiff’s ability to bring claims or seek remedies allowed by law,¹⁵² or the availability of attorney’s fees as provided by law;¹⁵³ clauses

¹⁵² See, e.g., *Roberts v. Blue World Pools, Inc.*, 2015 WL 5315213, at *4 (W.D. Ky. Sept. 11, 2015) (concluding that term in arbitration agreement with pool installation and financing company that prohibits arbitrator from awarding any damages besides pool repair is unconscionable); *Gorman v. S/W Tax Loans*, No. 14-civ-00089, ECF Doc. No. 55 (D.N.M. March 17, 2015) (in suit against tax refund anticipation lender, concluding that plaintiff could not “effectively vindicate” her rights under the Truth in Lending Act because the arbitration clause prevented her from

allowing either party to obtain a fee award if it prevails (“loser pays” provisions);¹⁵⁴ clauses that impose excessive fees or costs;¹⁵⁵ and even clauses that require the consumer or employee to arbitrate in a far off venue.¹⁵⁶

These terms continue to appear in consumer and employment contracts because even where a particularly unfair term is certain to be struck down, drafters have little incentive not to include it—or, put another way, they have little incentive to draft the agreement to be enforceable in all aspects. In many cases, the presence of an unenforceable term will exert a powerful chilling effect that may prevent the individual from pursuing her legal rights. After all, would a low-wage worker or low-income consumer, already skeptical that the law provides an avenue for the vindication of her rights, decide to pursue a claim after her attorney explains to her that her contract purports to waive those rights or includes term that requires her to pay the other side’s fees and costs if she loses? Even if the attorney explains that such a term is almost certainly unenforceable, the consumer or employee will frequently be chilled from taking the risk of challenging it.¹⁵⁷ Drafters thus may include the terms *in terrorem*—for the purpose of frightening the offeree without intending ever to seek enforcement of the unenforceable term.

recovering statutory damages and attorney’s fees provided under TILA); *Willis v. Nationwide Debt Settlement Group*, 878 F. Supp. 2d 1208 (D. Or. 2012) (concluding that term that bans punitive damages is unenforceable, violates public policy); *Newton v. Am. Debt Services, Inc.*, 854 F. Supp. 2d 712 (N.D. Cal. 2012) (concluding that limitation of liability provision stripping plaintiffs of statutory rights under Credit Repair Organizations Act was substantively unconscionable).

¹⁵³ See, e.g., *Nino v. Jewelry Exch., Inc.*, 609 F.3d 191, 203 (3d Cir. 2010) (“Provisions in arbitration clauses requiring parties to bear their own attorney’s fees, costs, and expenses work to the disadvantage of an employee needing to obtain legal assistance . . . [and] also undermine the legislative intent behind fee-shifting statutes like Title VII.”); *Sanchez v. CleanNet USA, Inc.*, 78 F. Supp. 3d 747, 757 (N.D. Ill. 2015).

¹⁵⁴ See, e.g., *Coronado v. D.N. W. Houston, Inc.*, 2015 WL 5781375, at *10 (S.D. Tex. Sept. 30, 2015); *Saravia v. Dynamex, Inc.*, 310 F.R.D. 412, 422 (N.D. Cal. 2015); *Valle v. ATM Nat., LLC*, 2015 WL 413449, at *6 (S.D.N.Y. Jan. 30, 2015) (involving arbitration clause stating that “[t]he losing party must pay the expense of the prevailing party’s attorneys, experts and witnesses”); *Brinkley v. Monterey Fin. Servs., Inc.*, 242 Cal. App. 4th 314, 323 (2015); *DeVito v. Autos Direct Online, Inc.*, 37 N.E.3d 194, 202 (Ohio Ct. App. 2015) (in case against auto dealer, stating that “the undisclosed, unlisted costs of the process under the loser-pays provision would result in prohibitive assessed costs for almost all vehicle buyers”); *Hedeen v. Autos Direct Online, Inc.*, 19 N.E.3d 957, 969 (Ohio Ct. App. 2014) (“[T]he loser-pay provision chills consumers from pursuing their statutory claims through arbitration.”).

¹⁵⁵ See, e.g., *Nesbitt v. FCNH, Inc.*, 811 F.3d 371 (10th Cir. 2016); *Chavarria v. Ralphs Grocery Co.*, 733 F.3d 916 (9th Cir. 2013); *Brownlee v. Lithia Motors, Inc.*, 49 F. Supp. 3d 875, 881 (D. Colo. 2014); *Mance v. Mercedes-Benz USA*, 901 F. Supp. 2d 1147, 1165 (N.D. Cal. 2012); *Simmons v. Morgan Stanley Smith Barney, L.L.C.*, 872 F. Supp. 2d 1002 (S.D. Cal. 2012); *James v. Conceptus, Inc.*, 851 F. Supp. 2d 1020 (S.D. Tex. 2012); *Antonelli v. Finish Line, Inc.*, 2012 WL 525538 (N.D. Cal. Feb. 16, 2012); *Wolf v. Nissan Motor Acceptance Corp.*, 2011 WL 2490939 (D.N.J. June 22, 2011).

¹⁵⁶ See, e.g., *Duran v. J. Hass Group, L.L.C.*, 531 Fed. App’x 146 (2d Cir. 2013) (summary order); *Sanchez v. Nitro Lift Techs., L.L.C.*, 91 F. Supp. 3d 1218, 1223 (E.D. Okla. 2015); *Whataburger Restaurants LLC v. Cardwell*, 446 S.W.3d 897, 911 (Tex. App. 2014).

¹⁵⁷ Charles A. Sullivan, *The Puzzling Persistence of Unenforceable Contract Terms*, 70 OHIO ST. L.J. 1127, 1175 (2009) (“[I]t seems likely that the low level of risk in insisting on invalid terms results in many thousands of contracts containing such terms, contracts that will have adverse real world effects on their signatories because of information asymmetries.”).

Even when the individual does challenge the enforceability of the term, a business may not face any serious consequences for including it. Particularly if the clause includes a “severance” provision, instructing the court to sever illegal terms and enforce the agreement as a whole in their absence, unenforceable terms are often merely struck from the agreement.¹⁵⁸ In this way, drafters can have their cake and eat it too—they can purposefully overreach in including unenforceable terms, knowing that those terms will chill most claims but confident that even if the terms are challenged, the very worst that can happen is that the arbitration agreement is enforced without them.

B. An Alternative Approach to Severance

Generally, the common law instructs courts to give effect to the intention of the parties when deciding whether to sever unenforceable terms from a contract. In line with this principle, courts frequently conclude that illegal terms should merely be severed from an agreement. For example, courts may sever an unconscionable provision from an arbitration clause while still enforcing the clause without the provision by concluding that the clause’s primary purpose appears to be bilateral arbitration, particularly where the agreement includes a severance clause providing that unenforceable terms should be severed.¹⁵⁹

That approach may make some sense when considering contracts negotiated between two sophisticated parties, but it makes little sense in the context of contracts of adhesion—particularly consumer and employment contracts—where the consumer or employee is unlikely to have even read the complete agreement, let alone to have entered into it with an intention to be bound by all of its provisions. Rather, in these contexts, when deciding whether to sever illegal terms, this legislation instructs courts to consider (1) whether severing would provide the drafter with an incentive to include such terms or remove the incentive *not* to include such terms, (2) whether the inclusion of these terms might exert an *in terrorem* effect on the offeree, and (3) whether the drafter has acted in bad faith.

This analysis is critical for at least two reasons. First, because of their own limitations, it is impossible for courts to police the legality of *all* contracts on a *post hoc* basis. Therefore, to protect against the purposeful subversion of contract-enforceability doctrines, the law must sufficiently deter the inclusion of illegal terms at the drafting stage.¹⁶⁰ Second, contract law must protect against the *in terrorem* effects of clearly unenforceable contract terms. As courts have recognized in a number of contexts—including when examining landlord-tenant agreements and covenants not to compete—courts should refuse to sever illegal terms where

¹⁵⁸ See, e.g., *Booker v. Robert Half Int'l, Inc.*, 413 F.3d 77, 79 (D.C. Cir. 2005); *Bynum v. Maplebear Inc.*, 160 F. Supp. 3d 527, 537 (E.D.N.Y. 2016); *McLaurin v. Russell Sigler, Inc.*, 155 F. Supp. 3d 1042, 1044 (C.D. Cal. 2016); *Pollard v. ETS PC, Inc.*, 2016 WL 2983530, at *9 (D. Colo. May 12, 2016); *Coronado v. D.N. W. Houston, Inc.*, 2015 WL 5781375, at *11 (S.D. Tex. Sept. 30, 2015).

¹⁵⁹ *Gannon v. Circuit City Stores, Inc.*, 262 F.3d 677, 680 (8th Cir. 2001).

¹⁶⁰ See generally, Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1288 (2003) (“[I]t is important for courts to provide sellers with the maximum incentive not only to attempt to draft efficient non-salient form terms, but also to invest time and resources in doing so.”).

the inclusion of those terms may prevent parties from asserting their legal rights or, perversely, from challenging the enforcement of the same illegal terms.¹⁶¹

C. FAA Preemption

Title X applies to all contracts and not just to arbitration agreements, but an issue sure to be raised is whether the Federal Arbitration Act (FAA) preempts Title X as it relates to arbitration agreements. Severance doctrine has received increased attention over the past year because of the possibility (now mooted) that the Supreme Court would consider that issue in *MHN Gov't Servs, Inc. v. Zaborowski*,¹⁶² a case where the lower court refused to merely sever multiple illegal terms found in an arbitration clause in an employment contract.¹⁶³ Instead the court refused to enforce the arbitration requirement. The defendant who drafted the contract argued that the court had applied a California rule of decision that (contrary to generally applicable contract law) disfavored severance in cases involving arbitration clauses.¹⁶⁴ The case settled before the Court could resolve the appeal.

The defendant in *Zaborowski* might be right that *if* California had a different rule for severance in arbitration agreements than in other form contracts, the arbitration-specific rule would be preempted. But, as long as the doctrine is not arbitration-specific—in other words, as long as it applies to other contracts in the same setting that do not involve arbitration—then it should not be preempted by the FAA.

To avoid FAA preemption, however, it is not enough for this legislation to merely fail to mention arbitration by name. Even state rules that do not mention arbitration are preempted if they are designed to target arbitration agreements as opposed to other types of contracts.¹⁶⁵

For example, the California doctrine that the Court was prepared to address in *Zaborowski* did not expressly mention arbitration, but critics (and, it seems, at least four members of the Supreme Court) were skeptical that it was a generally applicable rule. One problem, it seems,

¹⁶¹ *Summers v. Crestview Apartments*, 236 P.3d 586, 593 (Mont. 2010); *Baierl v. McTaggart*, 629 N.W.2d 277, 285 (Wis. 2001); Harlan M. Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 682 (1960) (“For every covenant [not to compete] that finds its way to court, there are thousands which exercise an in terrorem effect on employees who respect their contractual obligations and on competitors who fear legal complications if they employ a covenantor, or who are anxious to maintain gentlemanly relations with their competitors.”).

¹⁶² *MHN Gov't Servs., Inc. v. Zaborowski*, 136 S. Ct. 27 (2015).

¹⁶³ *MHN Gov't Servs., Inc. v. Zaborowski*, 136 S. Ct. 1539 (2016).

¹⁶⁴ Br. for Petitioners, *MHN v. Gov't Servs., Inc. v. Zaborowski*, 14-1458 (U.S. 2015), available at www.scotusblog.com (framing question presented as: “The Federal Arbitration Act (FAA) provides that an arbitration agreement shall be enforced ‘save upon such grounds as exist at law or in equity for the revocation of any contract,’ 9 U.S.C. § 2. California law applies one rule of contract severability to contracts in general, and a separate rule of contract severability to agreements to arbitrate. The arbitration-only rule disfavors arbitration and applies even when the agreement contains an express severability clause. Its application in this case conflicts with binding precedent of this Court and with opinions of four other courts of appeals”).

¹⁶⁵ *Mortensen v. Bresnan Commc'ns, LLC*, 722 F.3d 1151, 1159 (9th Cir. 2013).

was that many lower courts expressed the doctrine as involving the mere counting of unconscionable terms—if an arbitration agreement included “multiple” illegal terms, the court would deny enforcement of the entire arbitration agreement.¹⁶⁶ That mechanical analysis might strike some as conflicting with the traditional approach to severance that encourages courts to “engage in [an] equitable and fact specific analysis [of the purpose of the parties] with a liberal preference for severability.”¹⁶⁷ And because that analysis seems to diverge from general contract doctrine in this way, courts might be skeptical that it is actually a generally applicable rule.

To craft an effective severance rule that would survive preemption, states should strive to ground their severance doctrine in long-standing principles of contract law that apply outside of the arbitration context. Even before arbitration clauses became prevalent in consumer and employment contracts, scholars and judges grappled with whether a severance doctrine that examined the purposes of the parties made much sense when it came to adhesive contracts. They developed a set of principles specific to those contacts. The incentive-oriented analysis outlined here is rooted in such principles.

While commentators and courts have long discussed a preference for severance, they have frequently also acknowledged concern for drafter overreach—or the drafter having his cake and eating it too. As the notes to the Restatement (Second) of Contracts provide, “a court will not aid a party who has taken advantage of his dominant bargaining power to extract from the other party a promise that is clearly so broad as to offend public policy by redrafting the agreement so as to make a part of the promise enforceable.”¹⁶⁸ Indeed, since the beginning of the proliferation of contracts of adhesion there has been a concern that severing unenforceable terms in these contracts may create an incentive for drafters to include as many unfair terms as possible, without fear that the inclusion of these terms will prevent enforcement of the agreement as a whole.¹⁶⁹

Outside of the arbitration context, courts have considered drafter incentives and bad faith in deciding not to merely sever unconscionable terms. The issue has been particularly likely to arise in cases where drafters might have an incentive to overreach or chill the lawful behavior of the offeree, for example in landlord-tenant cases and in employment agreements containing covenants not to compete.¹⁷⁰

¹⁶⁶ See *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669, 695 (Cal. 2000).

¹⁶⁷ Br. of Chamber of Commerce of the U.S.A. as *Amicus Curiae* in Support of Petitioners, *MHN*, No. 14-1458 (Dec. 2014).

¹⁶⁸ Restatement (Second) of Contracts § 184, cmt. (b) (1981).

¹⁶⁹ See, e.g., Harlan M. Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 683 (1960) (“If severance is generally applied, employers can fashion truly ominous covenants with confidence that they will be pared down and enforced when the facts of a particular case are not unreasonable. This smacks of having one’s employee’s cake, and eating it too.”).

¹⁷⁰ *Summers v. Crestview Apartments*, 236 P.3d 586, 593 (Mont. 2010); *Baierl v. McTaggart*, 629 N.W.2d 277, 285 (Wis. 2001); Harlan M. Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 682 (1960) (“For every covenant [not to compete] that finds its way to court, there are thousands which exercise an *in terrorem* effect on employees

This approach, therefore, avoids the critique that it is arbitration focused. For all contracts of adhesion, it allows courts to continue to engage in the kind of equitable and fact-specific analysis that is commonly applied to the question whether to sever illegal terms. But unlike the severance analysis normally applied to negotiated contracts, it recognizes that parties to adhesive contracts will rarely have a mutual purpose that the court should attempt to preserve in crafting a remedy for unconscionable terms. Instead, for these contracts, courts should look to the drafter's aims and incentives and, to the extent they exist, the parties' *actual* understanding of the contract's purpose.

who respect their contractual obligations and on competitors who fear legal complications if they employ a covenantor, or who are anxious to maintain gentlemanly relations with their competitors.”).

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