No. 02-215

IN THE

Supreme Court of the United States

PACIFICARE HEALTH SYSTEMS, INC., *et al.*

Petitioners,

v.

JEFFREY BOOK, D.O., *et al.*

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

BRIEF OF *AMICUS CURIAE* TRIAL LAWYERS FOR PUBLIC JUSTICE IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Whether the Federal Arbitration Act, 9 U.S.C. §§ 1-16, requires federal and state courts to enforce arbitration clauses that expressly prohibit arbitrators from awarding statutory remedies to plaintiffs.

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INTEREST OF *AMICUS CURIAE*[1]

Trial Lawyers for Public Justice ("TLPJ") submits this brief as *amicus curiae* in support of Respondents, urging the Court to hold that federal law empowers courts, not arbitrators, to decide whether an arbitration clause that prohibits arbitrators from awarding statutory remedies is legal and enforceable.

TLPJ is a national public interest law firm that specializes in precedent-setting and socially significant civil litigation. In prosecuting cases throughout the federal and state courts, TLPJ seeks to advance consumers' and victims' rights, environmental protection, civil rights and civil liberties, workers' rights and workplace safety, the preservation and improvement of the civil justice system, and the protection of the poor and the powerless. Based on these goals, TLPJ has become concerned about a recent trend wherein some businesses are imposing abusive mandatory arbitration systems against their customers and individual employees as a means to evade liability for wrongdoing to these parties.

Five years ago, TLPJ established a Mandatory Arbitration Abuse Prevention Project to combat these abuses. During this time, we have been contacted repeatedly by consumers and workers, and by their lawyers, who wished to pursue claims through the civil justice system and have their cases heard by a jury of their peers, but could not do so because of mandatory arbitration systems imposed by businesses. While TLPJ supports alternative dispute

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[1] Pursuant to Rule 37.6 of the Rules of this Court, *amicus* state that no counsel for a party authored this brief in whole or in part, and no person or entity other than *amicus* and its counsel made a monetary contribution to the preparation or submission of the brief. Pursuant to Rule 37.3(a), letters of consent to file this brief from Petitioners and Respondents have been filed with the Clerk of the Court.

resolution when it is truly consensual between the parties, our research and investigation have convinced us that businesses very often impose binding arbitration requirements against consumers, workers, and other parties as a mandatory condition for entering into certain types of economic transactions. We recognize that these mandatory arbitration clauses are usually enforceable under general principles of contract law. In a smaller number of cases, however, we have seen corporations abuse their advantages in bargaining power and commercial sophistication by imposing restrictive arbitration schemes that strip claimants of remedies or create other barriers to a claimant's vindication of his or her statutory rights. Through its Mandatory Arbitration Abuse Prevention Project, TLPJ has devoted considerable time and effort to representing parties in fighting these corporate abuses of the power to compel arbitration.

The question presented is whether the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-16, requires a court or an arbitrator to determine whether an arbitration clause that prohibits arbitrators from awarding extra-contractual or punitive damages is illegal and unenforceable. TLPJ has a strong interest in the resolution of this question because pre-arbitration *judicial* review of the legality of arbitration clauses has long been critical in preventing corporations from using their control over forum selection under the FAA to take away statutory remedies from consumers and workers.

The corporations that engage in these abuses typically defend their restrictive arbitration schemes by invoking the FAA and the seemingly boundless "liberal" or "emphatic federal policy in favor of arbitral dispute resolution." *See* Petitioners' Brief at 8-9 and 20, quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625 and 631 (1985). These

corporations claim that the FAA allows them not only to keep claimants out of court, but also to diminish or eliminate altogether a claimant's access to statutory remedies. We believe that these efforts are misguided in that they seek to transform the FAA's endorsement of contractual forum selection into a license for "do it yourself civil justice reform."[2] We also believe that these efforts, if left unchecked by the Court, could undermine many federal and state laws that were enacted to protect consumers, workers, and other individuals against abuses of corporate power.

STATEMENT OF CASE

Respondents, a group of doctors, filed suit on behalf of themselves and others similarly situated alleging that several Health Maintenance Organizations' ("HMOs'") automated claims processing systems deprived them of payments they were owed for services performed. The Federal Judicial Panel on Multi-District Litigation consolidated the cases and transferred them to the United States District Court for the Southern District of Florida. Respondents then filed an amended complaint, asserting state contract law claims and claims under state and federal statutes, including the Racketeer Influenced and Corrupt Organizations Act ("RICO), 18 U.S.C. §§ 1961 *et seq*.

In response to the amended complaint, Petitioners and other defendant HMOs moved to compel arbitration of Respondents' claims based on arbitration clauses in various of the HMOs'

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[2] *See* Interview, "Do An LRA: Implement Your Own Civil Justice Reform Program NOW," The Metropolitan Corporate Counsel at 30 (Aug. 2001) (interview with Managing Director of the National Arbitration Forum, an ostensibly neutral arbitration service provider).

contracts with individual doctors. Several of these arbitration clauses contain exculpatory provisions limiting the authority of arbitrators to hear certain claims or to award specific types of relief to Respondents and other claimants. For example, one of the arbitration clauses used by Petitioners UnitedHealthcare, Inc. and UnitedHealth Group Incorporated (collectively, "United") provides that "arbitrators . . . *shall have no authority to award extra contractual damages of any kind, including punitive or exemplary damages*, and shall be bound by controlling law." (J.A. 168) (emphasis added). This arbitration clause further provides that "in no event may arbitration be initiated more than one year following the sending of written notice of the dispute." (J.A. 168).[3] The clause also expressly prohibits the arbitrators from disregarding these limitations on their authority, even if they conclude that the limitations are unlawful: "The arbitrators may construe or interpret but shall not vary or ignore the terms of this Agreement[.]" (J.A. 168).[4]

Petitioners PacifiCare Health Systems, Inc. and Pacifi-Care Operations, Inc. (collectively, "PacifiCare") imposed similar arbitration clauses providing that an "arbitrator shall have the power to grant all legal and equitable remedies and award compensatory damages provided by [state] law, *but shall not have the power to*

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[3] The statutory limitations period for Respondents' RICO claims ordinarily would be four years. *See Agency Holding Corp. v. Malley-Duff Associates, Inc.*, 483 U.S. 143, 156 (1987).

[4] Another of United's arbitration clauses likewise provides that "arbitrators. . .shall have no authority to award any punitive or exemplary damages," and includes identical provisions imposing a one-year filing requirement and prohibiting arbitrators from varying or ignoring the terms of the agreement. (J.A. 212).

award punitive damages." (J.A. 84, 106-07, 146-47) (emphasis added). One of PacifiCare's arbitration clauses also declares that "the courts shall not have the authority to review or grant any request or demand for damages." (J.A. 147).

The district court issued a comprehensive opinion granting Petitioners' and the other HMOs' motions to compel arbitration in part and denying the motions in part. The court examined the claims by different plaintiffs against different defendants and ordered arbitration of claims between contracting parties wherever there was an enforceable arbitration clause. For example, the court ordered arbitration of claims against defendant WellPoint Health Networks, Inc. ("WellPoint") after concluding that a plaintiff's contract with WellPoint contained an arbitration clause and that the clause imposed no impediment to the plaintiff's access to statutory remedies. *See In re Managed Care Litigation*, 132 F. Supp. 2d 989, 1002-03 (S.D. Fla. 2000). The court similarly ordered arbitration of claims by contracting plaintiffs against defendants Foundation Health Systems, Inc. ("Foundation"), Prudential Insurance Company of America ("Prudential"), and CIGNA Corporation ("CIGNA"). *Id*. at 1001-05. With regard to claims against Foundation, the court observed that one of Foundation's arbitration clauses impermissibly shortened the limitations period for filing claims to six months and prohibited awards of punitive damages, but nevertheless ordered arbitration of all covered claims because two other applicable arbitration clauses did not contain these infirmities. *Id*. at 1001-02.

The district court also granted in part and denied in part the motions by Petitioners United and PacifiCare to compel arbitration. With regard to claims against United, the court found that the provisions of United's arbitration clause prohibiting awards of extra-

contractual damages and imposing a one-year limitations period would raise "grave concerns that Dr. Porth's statutory claims will not be adjudicated properly in an arbitration forum." *Id*. at 1000. The court held that Respondents' statutory claims against United could not be subject to arbitration because of these remedial limitations, but also held that Respondents' contract claims were subject to arbitration because the damages restriction would not apply and the abridged limitations period alone was not sufficient to prevent enforcement. *Id*. at 1001. With regard to claims against PacifiCare, the court held that all covered contractual and non-RICO statutory claims must be arbitrated, but that Respondents' RICO claims would not be subject to arbitration because PacifiCare's arbitration clause prohibited arbitrators from awarding punitive damages that were available to Respondents under the Act. *Id*. at 1005.

The Eleventh Circuit affirmed the district court's opinion in its entirety. The court of appeals described the district court's holdings regarding Petitioners' arbitration clauses and their restrictions on the remedies available to Respondents, then affirmed these holdings for the reasons given by the district court without further comment. *See In re Humana Inc. Managed Care Litigation*, 285 F.3d 971, 973-74 (11th Cir. 2002).

SUMMARY OF ARGUMENT

The courts below correctly found that the FAA empowers courts to determine whether arbitration clauses that prohibit arbitrators from awarding statutory remedies to claimants are illegal and unenforceable in particular cases. This Court's decisions interpreting and applying the FAA establish both that arbitration clauses should not be enforced where they would deprive claimants of statutory remedies, and that courts—not arbitrators—are the proper authority to make this determination.

First, an arbitration clause (like any other contract) must form a legal and valid agreement in order to be enforced. The question of whether an arbitration clause violates federal or state statutes is decisive as to whether the clause is enforceable. This Court has held repeatedly that parties must have the same statutory remedies in arbitration that they would have in court. In light of this baseline requirement, the Court has also made clear that an arbitration clause should not be enforced if it would operate to deny statutory remedies to a party. *See, e.g.*, *Mitsubishi*, 473 U.S. at 637 n.19. Thus, to the extent that terms of Petitioners' arbitration clauses prohibiting awards of extra-contractual or punitive damages are contrary to federal or state law, these restrictions would support a determination that the clauses are illegal and unenforceable.[5]

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[5] A necessary part of the holdings below was that the prohibitions on extra-contractual and punitive damages in Petitioners' arbitration clauses would take away statutory remedies that Respondents are seeking in their RICO claims. *Amicus* does not address herein whether RICO's damages remedies are properly characterized as "extra-contractual" or "punitive" in nature, or whether these remedies can ever be waived by contract. Rather, this brief focuses on the question of who should decide the threshold inquiry as to the legality of the arbitration agreement. Accordingly, the brief

Second, courts—not arbitrators—must make these determinations. This Court has held that questions of arbitrability concerning whether or not parties are bound by an enforceable agreement to arbitrate are for courts to decide under the FAA. *See, e.g., Howsam v. Dean Witter Reynolds, Inc.*, 123 S. Ct. 588, 592 (2002). A court is the *only* body that can make the determinations required here because an arbitrator could never disregard contractual restrictions on his or her own authority. As this Court has often recognized, arbitration under the FAA is strictly a matter of contract. Accordingly, the terms of an arbitration clause define the outer bounds of a party's duty to arbitrate and of an arbitrator's authority to award relief. *See First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995) ("[arbitration] is a way to resolve those disputes—but only those disputes—that the parties have agreed to submit to arbitration.") Since any arbitrators would be bound by the terms of Petitioners' arbitration clauses prohibiting them from awarding extra-contractual or punitive damages, only a court could ever make the determination that these restrictions are illegal and unenforceable, and then proceed to award such remedies as may be provided by statute.

Consistent with these principles, numerous federal and state courts have rejected corporate attempts to rely on the FAA and the "liberal federal policy favoring arbitration" as bases for eliminating or diminishing claimants' access to statutory remedies. These courts have prevented corporations from distorting the FAA's underlying purposes by erasing the critical distinction between contractual *forum selection* and contractual *exculpation*. The FAA allows parties to contract to resolve disputes in a forum outside of court,

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proceeds on the assumption that the terms of the arbitration clause do, in fact, restrict an arbitrator's authority to award statutory remedies.

but it does not allow corporations to take away from individuals the substantive legal protections that are secured by federal and state statutes. In light of the critical role that courts have played in countering corporate abuses of the opportunity for arbitration, the Court should hold that the FAA empowers courts—not arbitrators— to determine whether arbitration clauses that restrict a party's access to statutory remedies are legal and enforceable.

ARGUMENT

The FAA Empowers Courts—Not Arbitrators—to Invalidate Arbitration Clauses That Prohibit Arbitrators from Awarding Statutory Remedies to Claimants.

A. Arbitration Clauses Must Allow Parties to Seek the Same Statutory Remedies They Could Recover in Court.

The FAA's policy goals concerning contractual forum selection do not allow corporations to take away federal and state statutory remedies from individual claimants. To the contrary, this Court has many times interpreted the FAA to permit private arbitration of statutory claims on the theory that "by agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum." *Mitsubishi*, 473 U.S. at 628.[6] In light of this baseline presumption that arbitration is just

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[6] *See also Equal Employment Opportunity Comm'n v. Waffle House, Inc.*, 534 U.S. 279, 296 n.10 (2002) (quoting *Mitsubishi*); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991) (same); *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 481 (1989) (same).

another forum, the Court has rejected "generalized attacks on arbitration that rest on 'suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be complainants.'" *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 89-90 (2000) (quoting *Rodriguez de Quijas*, 490 U.S. at 481). The FAA therefore provides no support for Petitioners to use their arbitration clauses to take away statutory remedies from Respondents and other claimants.

The issue presented here is not whether arbitration *generally* prevents parties from vindicating statutory rights, but whether the *particular terms* of Petitioners' arbitration clauses would prevent Respondents from vindicating statutory claims that they have in this case.[7] Petitioners mistakenly assume that the FAA allows them to enforce exculpatory provisions in an arbitration clause that would rewrite the statutes that provide substantive remedies for claimants. In fact, this Court's decisions go a long way towards prohibiting this practice. The Court has repeatedly held that a party's ability to effectively vindicate his or her statutory rights is a threshold requirement for enforcement of an arbitration clause

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[7] The proposition that this is a case-specific challenge to *Petitioners'* arbitration clauses, not a generalized attack on all arbitration, finds further support from evidence showing that most consumer arbitration clauses do not, in fact, contain such remedy-stripping provisions. Counsel for *amicus* have published a comprehensive manual on consumer arbitration law that includes an appendix compiling 160 arbitration clauses used by corporations in consumer transactions. The vast majority of these clauses do not attempt to limit the legal remedies available to consumers. *See* F. PAUL BLAND, JR. ET. AL., CONSUMER ARBITRATION AGREEMENTS: ENFORCEABILITY AND OTHER TOPICS (2d ed. 2002) (CD-Rom Link entitled "Arbitration Agreements").

that purports to cover statutory claims: "[S]o long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function." *Mitsubishi*, 473 U.S. at 637.[8]

The Court thus has declared that it would strike down any arbitration clause that purports to waive a party's statutory rights: "[I]n the event the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a party's right to pursue statutory remedies for antitrust violations, *we would have little hesitation in condemning the agreement as against public policy*." *Id*. at 637 n.19 (emphasis added). The Court recently reiterated this declaration, rejecting a lower court's holding that an arbitration clause prospectively waived an employee's statutory right to seek relief through the EEOC:

> To the extent the Court of Appeals construed an employee's agreement to submit his claims to an arbitral forum as a waiver of the substantive statutory prerogative of the EEOC to enforce those claims for whatever relief and in whatever forum the EEOC sees fit, the court obscured this crucial distinction [between forum selection and exculpation] and ran afoul of our precedent.

EEOC v. Waffle House, 534 U.S. at 295 n.10.

These decisions demonstrate that the FAA does not bind claimants to arbitration clauses that would strip them of the

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[8] *See also Randolph*, 531 U.S. at 90 (quoting *Mitsubishi*); *Gilmer*, 500 U.S. at 28 (same).

statutory remedies they could claim in court. Instead, these types of restrictions establish a basis for courts to strike down the clauses as illegal and against public policy under the statutes giving rise to claims in particular cases.

B. Only Courts Can Decide Questions Concerning the Legality of Contractual Restrictions on an Arbitrator's Authority.

Courts must decide whether an arbitration clause is legal and enforceable, just as they must decide any other question relating to whether parties are bound by an agreement to arbitrate. The FAA's text and more than three decades of precedent applying the Act demonstrate that arbitration is strictly a matter of contract and that parties cannot be forced to arbitrate claims where there is no enforceable agreement for them to do so. The FAA provides that written arbitration agreements shall be enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. The Act further states that a federal court may order a party to arbitrate only "upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue." 9 U.S.C. § 4. Consistent with these provisions, the Court has held that issues going to the making of an agreement to arbitrate must be decided by courts, not arbitrators, because the FAA "makes arbitration agreements as enforceable as other contracts, *but not more so*." *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 403-04 and 404 n.12 (1967) (emphasis added).

The Court's recent decision in *Howsam v. Dean Witter Reynolds, Inc.*, 123 S. Ct. 588 (2002), reiterates that courts must decide such threshold or "gateway" questions as whether parties are

bound by a legal and enforceable arbitration agreement. In *Howsam*, the Court held that an arbitrator, not a court, should apply an arbitration service's rule giving parties six years to submit claims to arbitration because satisfaction of this limitations period "seems an aspect of the controversy which called the grievance procedures into play," such that parties would expect an arbitrator to decide the issue. *Id*. at 593 (citation omitted). *Howsam* was careful to distinguish, however, between this type of merits-based question involving *application* of a contractual limitations period whose legality was not disputed, and the types of questions at issue here. Regarding the latter, the Court concluded that: "[A] gateway dispute about whether the parties are bound by a given arbitration clause raises a 'question of arbitrability' for a court to decide." *Id*. at 592 (citing *First Options*, 514 U.S. at 943-46; *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543, 546-47 (1964)). Respondents are raising arbitrability questions here because their challenge to the legality of contractual restrictions on the arbitrators' authority to award statutory damages goes to whether or not they are bound by these arbitration clauses.[9]

While a court's power to decide arbitrability questions is well-established, an arbitrator could never resolve the arbitrability disputes at issue here. Respondents are challenging the legality of Petitioners' arbitration clauses based on the restrictions they place

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[9] Petitioners erroneously claim that a court's ruling on the lawfulness of contractual restrictions on an arbitrator's authority would "usurp the arbitrator's role in performing the merits review." (Brief at 25.) The courts below did not award extra-contractual or punitive damages to Respondents, nor did they examine any evidence that would support such awards. Instead, the courts focused solely on whether Respondents were bound by arbitration clauses that limited arbitrators' authority to award them statutory remedies. *Howsam* clearly reserves these questions for courts.

on the authority of arbitrators themselves to award extra-contractual or punitive damages. An arbitrator has no power to set aside or ignore contractual restrictions on his or her own authority because, as this Court has recognized, "arbitration is strictly a matter of contract between the parties; it is a way to resolve those disputes, *but only those disputes*—that the parties have agreed to submit to arbitration." *First Options*, 514 U.S. at 943. Thus, under the FAA, only courts can determine the legality of contractual restrictions on an arbitrator's authority to award statutory remedies.

A court's power to address the lawfulness of contractual restrictions on an arbitrator's authority to award statutory remedies is perfectly consistent with federal arbitration policy. Petitioners assert that "[a]llowing district courts to evaluate such provisions in the first instance not only usurps the role of the arbitrator, but also exhibits a strong distrust of the arbitral process. . ." (Brief at 6-7). To the contrary, the call for a court to invalidate these restrictions is a challenge not to the *competence* of arbitrators, but to the *authority* of arbitrators in light of the contractual restrictions that Petitioners imposed on them. *Cf*. *Mitsubishi*, 473 U.S. at 626-27 ("we are well past the time when judicial suspicion of the . . . competence of arbitration tribunals inhibited the development of arbitration as an alternative means of dispute resolution.")

The only parties that showed "suspicion" or "distrust" towards arbitrators in this case were *Petitioners* themselves by drafting their arbitration clauses to prohibit arbitrators from awarding the statutory damages remedies that Respondents could recover in court. If Petitioners truly wanted the "efficiency and cost-effectiveness that were part of the arbitration bargain" (Brief at 20), rather than the chance to strip Respondents of statutory remedies, they could easily have drafted an arbitration clause that

did not disturb an arbitrator's authority to award those remedies. Their failure to do so should not be rewarded through an unwarranted reinterpretation of the FAA and its policies regarding contractual forum selection.

Petitioners' arguments relying on federal arbitration policy to overcome the terms of their own arbitration clauses are analogous to arguments that the Court rejected in *Waffle House*. The question presented in *Waffle House* was whether the EEOC's discrimination claims filed on behalf of an individual employee were subject to arbitration under the defendant employer's arbitration clause that the employee had signed. *Waffle House*, 534 U.S. at 282. The defendants and the lower court sought to compel arbitration of these claims by balancing the policy goals of the FAA and the statute giving rise to the EEOC's claims, without regard to whether the agency was ever bound by the defendant's arbitration clause. *Id*. at 293. This Court squarely rejected that argument, holding instead that "we look first to whether the parties agreed to arbitrate a dispute, not to general policy goals, to determine the scope of the agreement," and that "we do not override the clear intent of the parties, or reach a result inconsistent with the plain text of the contract, simply because the policy favoring arbitration is implicated." *Id*. at 294. In light of *Waffle House's* holding, federal arbitration policy provides no support for Petitioners' attempt to compel arbitration regarding the availability of statutory remedies that their arbitration clauses expressly prohibit arbitrators from awarding.

Finally, Petitioners argue that questions relating to contractual restrictions on an arbitrator's authority can be arbitrated because they will later be subject to post-arbitration review by courts. (Petitioners' Brief at 23-24). In fact, the FAA's provisions

concerning judicial review of arbitral awards do not transfer from a court to an arbitrator the power to decide "in the first instance" whether restrictions on the arbitrator's authority to award statutory remedies are illegal and unenforceable. Instead, these provisions further demonstrate that arbitrators would be *prohibited* from disregarding contractual restrictions on their authority to award statutory remedies to Respondents and other claimants.

The FAA enumerates specific grounds on which federal courts may confirm, vacate, or modify an arbitrator's award to a party. *See* 9 U.S.C. §§ 9-11. The grounds for judicial vacature listed in Section 10 are limited to situations where an arbitration award was procured by fraud or undue means, there was evident partiality or corruption by an arbitrator, an arbitrator's misconduct caused prejudice to a party, or where "*the arbitrators exceeded their powers*." 9 U.S.C. § 10(a) (emphasis added). Thus, instead of ensuring that Respondents' statutory rights would be protected, the FAA's post-arbitration review provisions guarantee that any arbitrators' award of extra-contractual or punitive damages would be subject to automatic vacature under Section 10(a)(4) for exceeding the powers granted to the arbitrators under Petitioners' arbitration clauses.

While a court would be obligated to vacate any arbitral award of extra-contractual or punitive damages because of the restrictive terms of Petitioners' arbitration clauses, it is doubtful that a court could protect Respondents' statutory rights by vacating an arbitrator's decision *enforcing* these restrictions. Courts have sometimes recognized a form of merits-based review of an arbitrator's award where there is a "manifest disregard of the law," *First Options*, 514 U.S. at 942 (citation omitted), but the typical formulation of this review makes clear that it is "severely limited,"

requiring a court to find that "the arbitrators knew of a governing legal principle yet refused to apply it," and that the law the arbitrator ignored was "well defined, explict, and clearly applicable to the case." *Halligan v. Piper Jaffray, Inc.*, 148 F.3d 197 (2d Cir. 1998). Indeed, this Court has held in the related context of review of a labor arbitrator's award that "[c]ourts are *not* authorized to review the arbitrator's decision on the merits . . . ," so that "improvident, even silly, factfinding does not provide a basis for a reviewing court to enforce the award." *Major League Baseball Players Ass'n v. Garvey*, 532 U.S. 504, 509 (2001) (citation omitted) (emphasis added). Absent any clear authority for a court to protect a party's right to seek punitive damages at the post-arbitration review stage, Petitioners' argument for an arbitrator's decision on this question "in the first instance" would let these restrictive arbitration clauses trump Respondents' statutory rights in the first *and last* instances.[10]

Since only courts have authority under the FAA to overrule illegal terms in an arbitration clause, the two lower courts correctly found that disputes over the lawfulness of restrictions on an

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[10] The use of post-arbitration review for deciding the legality of restrictions on an arbitrator's authority to award relief is not only unsupported by authority, but it also would thwart the goals of "efficiency and cost-effectiveness" (Brief at 20) trumpeted by Petitioners. Under this system, a party facing such restrictions would have to go through arbitration under the restrictive terms, then obtain a judicial ruling striking down the restrictions, and then go back to arbitration for further proceedings involving new evidence related to the previously prohibited claims. By contrast, where courts make the initial determination, parties can then proceed on the merits of their claims with a clear understanding as to the decision-maker's authority to award relief.

arbitrator's authority to award statutory remedies are matters for judicial, not arbitral, resolution.

C. Lower Court Case Law Demonstrates that Pre-Arbitration Judicial Review Is Critical to Ensuring Fairness in Dispute Resolution Between Corporations and Individuals.

The power of courts to strike down arbitration clauses that restrict a party's statutory remedies has been of enormous significance in combating some of the worst abuses carried out under the banner of the FAA and federal arbitration policy. Although federal and state courts across the country routinely enforce valid arbitration clauses, a number of courts have refused to enforce particular clauses whose express terms would prevent parties from effectively vindicating their statutory rights in arbitration. A survey of these cases demonstrates that courts play a critical role in preventing the parties that draft these clauses from abusing their right to private dispute resolution under the FAA.

A number of these cases involve arbitration clauses that, like those at issue here, attempt to strip parties of substantive rights by imposing restrictions on the arbitrators' authority to award relief. In *Carll v. Terminix Int'l Co.*, 793 A.2d 921 (Pa. Super. Ct. 2002), for example, the plaintiffs were a married couple and their four children who claimed that they had suffered "numerous severe and permanent injuries as a result of [Terminix's] negligent application of pesticides in and around their home." *Id*. at 922. The defendant moved for arbitration under a clause providing that "the arbitrator shall not have the power or authority to hold Terminix responsible for . . . direct indirect, special, incidental, consequential, exemplary or punitive damages." *Id*. Against the backdrop of generally applicable state law involving exculpatory contracts, the court had little difficulty in finding that this arbitration clause was counter to law

and refused to enforce it. *Id*. at 925.[11] Yet, under Petitioners' and their *amici's* approach, these injury victims would have been forced into arbitration to find out what remedies they might claim from a decision-maker who was contractually barred from awarding the only relief they sought.

Another type of challenge that has required judicial intervention involves arbitration clauses imposing "Loser Pays" rules that force any individual consumer who does not prevail on claims against a business to pay the attorneys' fees of the defendant. While most arbitration clauses do not impose this type of rule, at least one national arbitration service has boasted in communications to in-house counsel for corporations that it applies such a rule to consumer claims with the goal of making it more risky for individuals to bring claims against businesses. *See* Interview, *"Do an LRA: Implement Your Own Civil Justice Reform Program NOW,"* The Metropolitan Corporate Counsel at 30 (Aug. 2001) (quoting Managing Director of the National Arbitration Forum). A "Loser Pays" rule is fundamentally at odds with the attorneys' fees provisions set forth in nearly every civil rights and consumer protection statute in effect in the United States.[12] This Court has

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[11] Similarly, in *Parrett v. City of Connersville, Ind*., 737 F.2d 690, 697 (7th Cir. 1984) (Posner, J.), the Court was faced with an arbitration system that did not permit the arbitrator to award the full common law damages that a plaintiff might suffer, and that did not permit the arbitrator to prevent harm to a constructively discharged plaintiff before it occurred. The Seventh Circuit held that, in light of these sharp limitations, the arbitration system established by a City for claims by police officers offended due process.

[12] These statutes typically provide that a prevailing plaintiff shall recover her or his attorneys' fees, but a defendant shall only recover attorneys' fees if the plaintiffs' claims were frivolous. *See* Alba Conte, 1

enunciated the simple and sensible reason for this rule: Requiring individuals to pay a defendant's attorneys' fees merely because they do not prevail would discourage plaintiffs from seeking protection of the law. "To take the further step of assessing attorney's fees against plaintiffs simply because they do not finally prevail would substantially add to the risks inhering in most litigation and would undercut the efforts of Congress to promote the vigorous enforcement of the provisions of Title VII." *Christiansburg Garment Co. v. EEOC*, 434 U.S. 412, 422 (1978).

Currently, the validity of such "Loser Pays" provisions under federal and state law is evaluated by courts, and at least one court has held that these requirements are substantively unconscionable as a matter of state contract law. *See Sosa v. Paulos*, 924 P.2d 357, 362 (Utah 1996) (arbitration clause requiring medical malpractice plaintiff to pay litigation costs of doctor if patient "wins less than half the amount of damages sought in arbitration" held unconscionable). Under Petitioners' and their *amici's* approach, parties would have to arbitrate before a service that publicly endorses "Loser Pays" rules in order to obtain a determination as to whether these rules are legal and enforceable. Only courts can ensure that corporations and their allies do not use such practices to prevent individuals from enforcing their statutory rights.

Still another issue demonstrating the need for judicial involvement at the outset involves the costs of some arbitration

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Attorney Fee Awards § 5.01 at 266 n. 1 (1993) (statutes providing attorneys' fees only to prevailing plaintiffs include TILA, the Consumer Credit Protection Act, the Fair Debt Collection Practices Act, the Consumer Product Safety Act, ERISA, the Clayton Act, and the Equal Credit Opportunity Act).

systems. This Court held that an arbitration clause should not be enforced where it is proven that the clause would impose prohibitive costs that would prevent parties from vindicating their statutory rights. *Green Tree v. Randolph*, 531 U.S. at 90. While arbitration may often be cheaper than litigation, there have been several cases where courts found based on record evidence that the costs of particular arbitration systems would prevent individual consumers or employees from effectively vindicating their statutory rights.

In *Camacho v. Holiday Homes, Inc.*, 167 F. Supp. 2d 892 (W.D. Va. 2001), for example, the parties stipulated that the arbitrators' filing fees and "case" fees for a consumer case would amount to $2,000. The parties further stipulated that, although the consumer could "apply for fee deferral or reduction due to 'extreme hardship,' . . . that waiver of fees is extremely rare in practice." Beyond those fees, the parties stipulated that the plaintiff would have been required to pay arbitrators' fees of between $600 and $4,100. *Id*. at 896-97. After examining the limited financial means of this plaintiff (who was allowed to proceed in court *in forma pauperis*), the court concluded that the arbitration clause would prohibit her from effectively vindicating her statutory rights, and therefore was unenforceable. *Id*.

Similarly, in *Popovich v. McDonald's Corp.*, 189 F. Supp. 2d 772 (N.D. Ill. 2002), a consumer bringing claims alleging deceptive business practices produced record evidence establishing the arbitration costs he faced. This unrefuted evidence obtained from a certified arbitrator showed that the rules used for the case would require the consumer to bear costs "likely to be as much as $48,000 and perhaps as high as $126,000." *Id*. at 778. The court found based on this evidence that "the costs of arbitration are likely to be staggering." *Id*. It was undisputed that these costs would be

prohibitive for the plaintiff. *Id*. Accordingly, the court held that the arbitration clause was unconscionable. Several other courts have reached the same or similar conclusions.[13]

Under Petitioners' and their *amici's* approach, an individual claimant would be forced to surmount these barriers in order to obtain an arbitrator's determination "in the first instance" as to whether the arbitrators' own fees were so high as to be prohibitive, and therefore illegal or unconscionable. It goes almost without saying that few, if any, arbitrators are likely to declare that their own income is so excessive as to be illegal. In any case, such an approach plainly violates the bedrock principle of fairness that "no

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[13] *See, e.g.*, *Ting v. AT&T*, 182 F. Supp. 2d 902 (N.D. Cal. 2002) (appeal pending) (finding that prohibitive arbitration fees would bar many consumers from effectively vindicating their rights based in part on record evidence obtained from the American Arbitration Association ("AAA") showing that: "A random sampling compiled by an AAA Vice President of 82 arbitrators on the AAA Commercial Panel in Northern California provides the following compensation information: (a) arbitrator compensation ranges from $600 to $3,850 per day; (b) the average (mean) daily rate of arbitrator compensation is $1,899; c) the median daily rate of arbitrator compensation is $1,750."); *Brower v. Gateway 2000*, 676 N.Y.S.2d 569, 571 and 574 (N.Y. App. Div. 1998) (arbitration clause required customers to pay advance fee of $4,000 (exceeding the cost of most of the defendant's products), half of which "was nonrefundable even if the consumer prevailed at the arbitration;" court held that "the excessive cost factor that is necessarily entailed in arbitrating before the ICC is unreasonable and surely serves to deter the individual consumer from invoking the process."); *Matter of Arbitration Between Teleserve Sys., Inc. and MCI Telecomm. Corp.*, 659 N.Y.S.2d 659, 660, 664 (N.Y. App. Div. 1997) (the arbitration filing fee alone for the claimant in an antitrust dispute would amount to more than $200,000, which would have "[t]he practical effect" of barring the plaintiff from pursuing its claims).

man is permitted to try cases where he has an interest in the outcome." *In re Murchison*, 349 U.S. 133, 136 (1955).

Along the same lines, several courts have addressed challenges to arbitration agreements that required parties to travel long distances to pursue their claims in arbitration. In one notorious case, a state court of appeals held unconscionable a sub-prime lender's adhesion contract requiring California borrowers to travel all the way to Minnesota to pursue small consumer claims. *See Patterson v. ITT Consumer Fin. Corp.*, 18 Cal. Rptr. 2d 563 (Cal. Ct. App. 1993).[14] Under Petitioners' and their *amici's* approach, these low-income borrowers would have to travel halfway across the country to obtain an arbitrator's ruling as to whether this travel requirement is itself illegal and unenforceable. This would effectively leave consumers with no remedy for such an abusive arbitration clause, *and therefore no remedy for their underlying claims*, because the costs of such travel would usually be prohibitive.[15]

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[14] *See also Philyaw v. Platinum Enters.*, 2001 Va. Cir. LEXIS 10, at *6-*7 (Va. Cir. Ct. Jan. 9, 2001) ("Common sense dictates that retail purchasers such as the Philyaws could not afford the time and expense to go to Los Angeles to arbitrate a claim arising from a used car sale in Virginia.")

[15] The arbitration service in *Patterson*, the National Arbitration Forum ("NAF"), would have been particularly unlikely to hold that its own rules were unconscionable in favoring ITT. Evidence submitted in the record in *Toppings v. Meritech Mortgage Serv's, Inc.*, 569 S.E.2d 149 (W.Va. 2002), established that the General Counsel of the NAF had left ITT Financial, where he had been a lawyer with some responsibility for defending consumer cases, shortly before *Patterson* was decided. Indeed, requiring consumers with small claims to travel across the country is pefectly consistent with NAF's promises in a periodical aimed at defense counsel to

Finally, in cases involving perhaps the most serious abuses of private arbitration, courts have addressed challenges to arbitration clauses that were designed to ensure that the arbitrators would favor the employer or corporation that drafted the clause over an individual claimant in a dispute. In *Hooters of America, Inc. v. Phillips*, 173 F.3d 933 (4th Cir. 1999), for example, the Fourth Circuit refused to compel arbitration in a case arising out of an employee's sex discrimination claims, where an employer's arbitration rules were "crafted to ensure a biased decision-maker." *Id.* at 938. Noting that the employer retained complete control over the selection of two of the three arbitrators on a panel, to the point where *even the company's own managers* could serve as arbitrators, the court found that "the selection of an impartial decisionmaker would be a surprising result." *Id.* at 939. Accordingly, the court refused to enforce the arbitration clause, holding that the employer had created "a sham system unworthy even of the name of arbitration." *Id.* at 940.[16]

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provide a system of handling consumer claims whose economics are "entirely different" from court, because the arbitral forum will ensure that it is not "cost-free" for consumers to bring claims against businesses. *Do an LRA: Implement Your Own Civil Justice Reform Program NOW*, Metropolitan Corp. Couns., Aug. 2001; *cf.* Caroline E. Mayer, *Win Some, Lose Rarely? Arbitration Forum's Rulings Called One-Sided*, Wash. Post, Mar. 1, 2000 (discovery in a case in Alabama demonstrated that in 19,618 cases between a lender and its customers that were arbitrated before NAF , the lender had prevailed in all but 87 of the cases, a success rate of 99.6%.) Only after *Patterson* held that the requirement of traveling to Minnesota was unconscionable did NAF re-write its rules to permit consumers to bring cases in an accessible location.

[16] *See also Murray v. United Food and Commercial Workers Int'l Union*, 289 F.3d 297, 303-04 (4th Cir. 2002) (holding arbitration clause

Under Petitioners' and their *amici's* approach, however, the arbitrators named under this "sham" selection system would have had the primary authority to pass on the legality of the system itself. This would have required the plaintiff to go all the way through arbitration with these hand-picked arbitrators before she could ever obtain a court's determination as to whether this system is inherently unfair in preventing her from vindicating her Title VII claims. Since courts have consistently acted "in the first instance" to ensure that arbitration clauses provide individual claimants with neutral decision-makers, the removal of courts from this equation would be an invitation for enormous abuse.

The Court should affirm the decisions below and hold that courts have exclusive authority under the FAA to determine the legality of arbitration clauses whose terms would prevent parties from effectively vindicating their statutory rights. A contrary ruling would risk transforming the FAA from a statute sanctioning contractual forum selection into a vehicle for undermining the federal and state laws that protect consumers, workers, and other parties against abuses of corporate power.

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unconscionable for giving employer complete control over list of eligible arbitrators and for arguably prohibiting arbitrators from contravening employer's right to terminate employees; finding that clause was one "under which the prospective litigant cannot effectively vindicate the statutory cause of action"); *Ditto v. Re/Max Preferred Properties, Inc.*, 861 P.2d 1000 (Okla. Ct. App. 1993) (refusing to enforce arbitration clause giving one party control over selection of arbitrator).

CONCLUSION

The judgment of the court of appeals should be affirmed.

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