The Arbitration Legacy of Justice Sandra Day O'Connor

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JUSTICE Sandra Day O'Connor's impact on arbitration cannot be overstated. From her appointment in 1981 by President Ronald Reagan as the first woman to sit on the United States Supreme Court, Justice O'Connor participated in landmark decisions that established the place of arbitration to today's society. Among these are such legendary cases as *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.* (1983), [1] *Southland Corp. v. Keating* (1984),[2] *Dean Witter Reynolds Inc. v. Byrd* (1985), [3] *Allied-Bruce Terminix Companies, Inc. v. Dobson* (1995),[4] *Mastrobuono v. Shearson Lehman Hutton, Inc*. (1995), [5] *Vimar Seguros y Reaseguros, S. A. v. M/V Sky Reefer* (1995),[6] *Doctor's Associates v. Casarotto* (1996), [7] *Circuit City Stores, Inc. v. Adams* (2000),[8] *Green Tree Financial Corp. v. Randolph* (2000), [9] *Howsam v. Dean Witter Reynolds, Inc*.

[1] 460 U.S. 1, 103 S. Ct. 927, 74 L. Ed. 2d 765 (1983).
[2] 465 U.S. 1, 104 S. Ct. 852, 79 L. Ed. 2d 1 (1984).
[3] 470 U.S. 213, 105 S. Ct. 1238, 84 L. Ed. 2d 158 (1985).
[4] 513 U.S. 265, 115 S. Ct. 834, 130 L. Ed. 2d 753 (1995).
[5] 514 U.S. 52, 115 S. Ct. 1212, 131 L. Ed. 2d 76 (1995).
[6] 515 U.S. 528, 115 S. Ct. 2322, 132 L. Ed. 2d 462 (1995).
[7] 517 U.S. 681, 116 S. Ct. 1652, 134 L. Ed. 2d 902 (1996).
[8] 532 U.S. 105, 121 S. Ct. 1302, 149 L. Ed. 2d 234 (2000).
[9] 531 U.S. 79, 121 S. Ct. 513, 148 L. Ed. 2d 373 (2000).

(2002), [10] *Citizens Bank v. Alafabco* (2003),[11] and *Green Tree Financial Corp. v. Bazzle* (2003).[12] Through these decisions handed down during Justice O'Connor's 25 years on the high court, Justice O'Connor's positions cemented arbitration as a means of commercial dispute resolution in the United States. They also established the primacy of the Federal Arbitration Act in cases involving international or interstate arbitration. This article highlights Justice O'Connor's role in landmark arbitration decisions in recognition of the special relationship between The IADC Foundation and iCivics.

Spearheaded by the Honorable Sandra Day O'Connor, iCivics is a web-based education project designed to reinvigorate civics teaching and learning. iCivics features free lesson plans, interactive modules, and games. With these tools, iCivics empowers the first generation of 'digital natives' to become knowledgeable civic participants and leaders.

The IADC Foundation has supported iCivics for a decade and was one of its first supporters. The IADC Foundation is working with the assistance of IADC members to promote iCivics and bring it into classrooms across the United States. Lawyers interested in helping with iCivics should visit the iCivics website for more information and a guide for volunteering in the classroom.

I. *Shearson/American Express Inc. v. McMahon*

One of Justice O'Connor's most significant opinions on arbitration was the 1987 holding in *Shearson/American Express Inc. v. McMahon* (*Shearson*).[13] This case arose when two customers of Shearson brought suit in the United States District Court for the Southern District of New York seeking damages for alleged violations of the antifraud provisions of the Securities Exchange Act of 1934 (the Exchange Act)[14] and the Racketeer Influenced and Corrupt Organizations Act (RICO).[15] The customers' agreement with Shearson contained an arbitration provision requiring arbitration of any controversy relating to the accounts. Shearson moved to compel arbitration of the claims pursuant to section 3 of the Federal Arbitration Act (FAA).[16]

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[10] 537 U.S. 79, 123 S. Ct. 588, 154 L. Ed. 2d 491 (2002).
[11] 539 U.S. 52, 123 S. Ct. 2037, 156 L. Ed. 2d 46 (2003).
[12] 539 U.S. 444, 123 S. Ct. 2402, 156 L. Ed. 2d 414 (2003).
[13] 482 U.S. 220, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987).
[14] 15 U.S.C. § 78j(b) and SEC Rule 10b-5.
[15] 18 U.S.C. § 1962(c).
[16] 9 U.S.C. § 3.

The customers advanced two specific arguments in opposition to arbitration. The first was that Section 29(a) of the Exchange Act[17] voided any agreement to waive compliance with any provision of the Exchange Act. Section 27 of the Exchange Act[18] confers exclusive jurisdiction over violations of the Exchange Act in the federal district courts. The customers argued that an arbitration agreement is necessarily unenforceable because it voids the jurisdictional requirement of Section 27. The customers' second argument was that public policy and RICO's treble damages provision[19] makes RICO claims unsuitable for arbitration and must be decided in federal courts.

The District Court granted Shearson's motion in part, ruling that the Exchange Act claims were arbitrable but that the RICO claim was not. When the case reached the Second Circuit, the appellate court affirmed as to the RICO claim but reversed on the Exchange Act claims. It rejected the argument that any waiver of the jurisdictional provision of Section 27 prohibits arbitration of Exchange Act claims. The Supreme Court granted certiorari.

Writing for the unanimous Court, Justice O'Connor expressed the view that claims under the Exchange Act are arbitrable under the provisions of the FAA in accordance with the terms of the arbitration agreements. Section 29(a) of the Exchange Act does not prohibit a waiver of Section 27, because Section 29(a) only prohibits a waiver of the substantive obligations imposed by the Exchange Act. The Court rejected assumptions made about the earlier case of *Wilko v. Swan*.[20] *Wilko* was decided under the Securities Act of 1933, not the Securities Exchange Act. *Wilko* must be read as barring waiver of a judicial forum only where arbitration is inadequate to protect the substantive rights at issue. Moreover, intervening changes in the regulatory structure of the securities laws negate much of the impact of the *Wilko* decision.

As to RICO, the Supreme Court pointed out that nothing in RICO's language regarding treble damages or in RICO's legislative history shows congressional intent to exclude RICO claims from arbitration. Thus, the Court held all the claims in *Shearson* to be arbitrable. The judgment of the Court of Appeals for the Second Circuit was reversed, and the case remanded for further proceedings.

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[17] 15 U.S.C. § 78 cc(a).
[18] 15 U.S.C. § 78 aa.
[19] 18 U.S.C. § 1964(c).
[20] 346 U.S. 427, 74 S. Ct. 182, 98 L. Ed. 168 (1953).

II. Post-*Shearson* Jurisprudence Regarding Pre-Dispute Arbitration Agreements

In the wake of Justice O'Connor's opinion in *Shearson*, subsequent decisions by the Supreme Court further cemented the arbitrability of disputes and the reliance on the FAA to enforce pre-dispute arbitration agreements. While *Shearson* paved the way for the increased use of arbitration in securities disputes, it also led to the expansion of arbitration as an alternative means to resolve other types of disputes.

Only two years after Justice O'Connor delivered the *Shearson* opinion, on May 15, 1989, a 5-4 majority of the Supreme Court, in *Rodriguez de Quijas v. Shearson/American Express, Inc.*,[21] decided that Securities Act claims were subject to arbitration in the same way as the Exchange Act claims at issue in *Shearson*.[22] This decision, in which Justice O'Connor joined the majority opinion, finished the job that *Shearson* started and finally overruled *Wilko*. The appellate court reversed a district court order to submit all claims to arbitration except for those raised under Section 12(2) of the Securities Act.[23] Noting that the district court had relied on *Wilko*, the Court of Appeals reversed and ordered the parties to submit all claims to arbitration.[24] The Court of Appeals reasoned that the Supreme Court's post-*Wilko* rulings, particularly *Shearson*, had reduced *Wilko* to "obsolescence."[25] The Supreme Court affirmed and found that *Wilko* was "incorrectly decided and inconsistent with the prevailing uniform construction of other federal statutes governing arbitration agreements in the setting of business transactions."[26]

Shortly thereafter, in *Gilmer v. Interstate/Johnson Lane Corp*.,[27] the Supreme Court held that an Age Discrimination in Employment Act (ADEA) claim was subject to compulsory arbitration pursuant to a pre-dispute arbitration agreement. The plaintiff filed suit against his employer alleging that he had been discharged because of his age in violation of the ADEA.[28] The plaintiff's moved to compel arbitration based upon the FAA and an agreement contained in the plaintiff's registration application with the New York Stock Exchange. The employer's motion to compel arbitration was denied by the district court, but the Fourth Circuit

[21] 490 U.S. 477, 109 S.Ct. 1917, 104 L.Ed.2d 526 (1989).
[22] *Id.*
[23] *Id*. at 479.
[24] *Id*.
[25] *Id*.
[26] *Id.* at 484.
[27] 500 U.S. 20, 111 S.Ct. 1647, 114 L.Ed.2d 26 (1991).
[28] *Id.*

Court of Appeals reversed. The Supreme Court granted certiorari in order to resolve the conflict that then existed between the appellate courts as to the arbitrability of ADEA claims.[29]

Justice O'Connor joined with the majority opinion affirming the decision of the Court of Appeals. Relying on its prior decisions, the Court noted that pre-dispute arbitration agreements may control the resolution of statutory claims pursuant to the FAA.[30] Citing *Mitsubishi Motors Corp. v. Soler Chrysler – Plymouth, Inc.*,[31] the majority stated that a party to a pre-dispute arbitration agreement who is asserting a statutory claim is bound by such agreement "unless Congress itself has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue."[32] Finding that the plaintiff was unable to demonstrate such an intention to preclude arbitration in the context of the ADEA, the Court affirmed the judgment of the Court Appeals.

III. The European Approach

While alternative dispute resolution methods are in general perceived as good and favored throughout Europe, this is not the European perspective when it comes to arbitration between companies/businesses and consumers. European courts hold that arbitration proceedings are too expensive for an average consumer and usually require a higher procedural standard, such as an active enrollment within the procedure, which could constitute a higher burden for the consumer. Since a consumer generally is less sophisticated and experienced, there is a danger that he will not be able (i) to assess the meaning and impact of an arbitration clause and (ii) to conduct arbitration proceedings properly. In other words, arbitration clauses and proceedings bear the risk of disadvantaging the consumer in relation to the business.

Arbitration proceedings involving consumers, including the

[29] *Id.*
[30] *Id*. at 26.
[31] 473 U.S. 614, 105 S.Ct. 3346, 87 L.Ed.2d 444 (1985).
[32] *Gilmer*, 500 U.S. at 26 (citing Mitsubishi Motors Corp. v. Soler Chrysler–Plymouth, Inc., 473 U.S. 614, 628, 105 S.Ct. 3346, 87 L.Ed.2d 444 (1985)).

conclusion of arbitration agreements, are not uniformly regulated on the European Union level. The Regulation (EUR) No. 1215/2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters ("Brussels I Regulation" recast) explicitly clarifies that this Regulation should not apply to arbitration.

The member states of the European Union must ensure that courts and arbitral tribunals apply mandatory European Union law, which includes the European Union Council Directive on Unfair Terms in Consumer Contracts.[33] This Directive stipulates that a contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer,[34] that Member States shall ensure that such unfair terms used in the contracts between businesses and consumers shall not be binding and that adequate and effective means exist to prevent the continued use of unfair terms in such contracts.[35] This Directive applies to arbitration clauses.

The European Court of Justice (ECJ) has ruled in a number of cases on the validity of arbitration agreements in relation to the Directive on Unfair Terms in Consumer Contracts.[36]

In *Elisa María Mostaza Claro v. Centro Móvil Milenium SL*, the ECJ ruled in connection with annulment proceedings of an arbitral award that courts must interpret the Directive to mean that a national court charged with deciding an action for annulment of an arbitration award must first consider whether the arbitration agreement is void because that agreement contains an unfair term, even if the consumer had not pleaded that invalidity in the course of the arbitration proceedings. This decision was limited only to the action for annulment.

In *Asturcom Telecomunicaciones SL v. Christina Rodrígues Nogueira*, the ECJ ruled that courts must interpret the Directive to mean that a national court or tribunal hearing an action for enforcement of a final arbitration award made in the absence of the consumer must, where it has available to it the legal and factual

[33] Council Directive 93/13/EEC, 1993 OJ (L 95).
[34] *Id.* at Art. 3.
[35] *Id.* at Arts. 6-7.
[36] *See* ECJ C-168/05 Elisa María Mostaza Claro v. Centro Móvil Milenium SL, ECJ C-40/08 Asturcom Telecomunicaciones SL v. Christina Rodríguez Nogueira, ECJ C-76/10 Pohotovosť s.r.o. v. Iveta Korčkovská, ECJ C-342/13 Katalin Sebestyén v. Zsolt Csaba Kővári and Others, ECJ C-567/13 Nóra Baczó and János István Vizsnyiczai v. Raiffeisen Bank Zrt.

elements necessary for that task, assess of its own motion whether an arbitration clause is unfair, as long as, under national rules of procedure, the court is permitted to make such an assessment in similar actions of a domestic nature. If that is the case, the court or tribunal shall establish all circumstances thereby arising under national law in order to ensure that the consumer is not bound by an unenforceable clause.

An analysis of the ECJ case law shows that national courts of the member states not only have the right to examine *ex officio* the abusiveness of arbitration clauses, they also have the duty to do so in all stages of the relevant proceedings, even in the annulment and enforcement stage. Where courts find a clause to be abusive, the national procedural law must thereby be applied in a manner that renders the relevant clause invalid. In the words of the ECJ in *Katalin Sebestyén v. Zsolt Csaba Kővári and Others*: "if the clause is held to be unfair, it is for that court to draw the appropriate conclusions under national law in order to ensure that the consumer is not bound by that clause."

Faced with the question whether a clause contained in a mortgage loan contract concluded between a bank and a consumer that vested exclusive jurisdiction in a permanent arbitration tribunal, against whose decisions there is no judicial remedy under national law, to hear all disputes arising out of that contract must be regarded as unfair, the ECJ specified that all of the circumstances surrounding the conclusion of such a contract must be taken into account. These included, in particular, (i) whether the clause at issue has the object or effect of excluding or hindering the consumer's right to take legal action or exercise any other legal remedy and (ii) take account of the fact that the communication to the consumer, before the conclusion of the contract at issue, of general information on the differences between the arbitration procedure and ordinary legal proceedings cannot alone make it possible to rule out the unfairness of that clause.

Considering the circumstances in which such an imbalance arises "contrary to the requirement of good faith," the ECJ stated that, on the basis of the 16th recital in the preamble to the Directive, the national court must assess whether the seller or supplier, dealing fairly and equitably with the consumer, could reasonably assume that the consumer would have agreed to such a term in individual contract negotiations. Pursuant to Article 4(1) of the Directive, the national court must assess the fairness of a contractual term taking into account the nature of the goods or services for which the

contract was concluded and refer, at the time of conclusion of the contract, to all of the circumstances attending its conclusion. National courts, as a result, must take into account the consequences of the term under the law applicable to the contract. This requires that consideration be given to national law.

The ECJ emphasized in *Constructora Principado* that pre-contractual information relating to the contractual terms and the consequences of concluding the contract is of fundamental importance to the consumer, since it is on the basis of that information that the consumer decides whether he wishes to be bound by the conditions drafted in advance by the seller or supplier.

Austrian courts have a reputation for being arbitration friendly and respecting and enforcing arbitration agreements, particularly in arbitration proceedings between business entities. Although consumers can be party to arbitration agreements, Austrian law imposes significant restrictions on the validity of such agreements. The Austrian Consumer Protection Act (KSchG) requires businesses to individually negotiate arbitration agreements concluded with consumers in order to be binding upon them, with the business bearing the burden of proof.[37]

With the Austrian Arbitration Act 2006 (*Schiedsrechts-Änderungsgesetz 2006*), the Austrian legislature introduced Section 617 of the Austrian Code of Civil Procedure (ACCP), which provides that an arbitration agreement concluded with a consumer will be valid if a number of preconditions are met. Section 617 ACCP applies to arbitration proceedings with the seat of arbitration in Austria.

Most notably, Section 617 limits the enforceability of arbitration agreements with consumers by stipulating that an arbitration agreement between a business and a consumer can be effectively concluded only *after* a dispute has arisen.

Further restrictions apply to arbitration agreements between businesses and consumers. Arbitration agreements to which a consumer is a party must be contained in a document which is personally signed by the consumer and not contain any agreements other than those relating to the arbitral proceedings.[38] Prior to concluding the arbitration agreement between a business and a consumer, the consumer must receive written legal instruction on relevant differences between

[37] KSchG, Section 6, para. 2, lit. 7.
[38] ACCP, Section 617, para. 2.

arbitration proceedings on the one side, and court proceedings on the other.[39] The arbitration agreement must explicitly determine the seat of the arbitration tribunal. The arbitral tribunal may only convene at a different place for an oral hearing or taking of evidence if the consumer has approved thereof, or if considerable difficulties hinder the taking of evidence at the seat of the arbitral tribunal.[40] If either at the time of concluding the arbitration agreement or at the time when the action has become pending the consumer did not have his domicile, habitual residence or place of work in the country where the arbitral tribunal has its seat, the arbitration agreement shall only be binding if the consumer invokes it.[41] Finally, Section 617 ACCP provides for additional grounds for setting aside awards in consumer-related disputes and exempts them from the exclusive jurisdiction of the Austrian Supreme Court as first and last instance in arbitration-related proceedings.

By means of another international comparison, there are also specific provisions for consumer-related disputes in Germany, although these are less strict than the Austrian ones. Arbitration agreements to which a consumer is a party must be contained in a document which is personally signed by the consumer and – unless it is in form of a notarial deed – not contain any agreements other than the arbitration agreement.[42] Several other European countries have adopted the same approach (although in the Czech Republic, arbitration clauses are prohibited in contracts between businesses and consumers).

In France, arbitration agreements could only be concluded between businesses until 2016 when Article 2061 of the Code Civil was amended. Now, an arbitration clause cannot be invoked against a party who did not conclude it as part of its professional activity. Thus, the consumer can enter into an arbitration clause, which, however, cannot be enforced against him (he can still decide to litigate in court). In Spain, arbitration agreements with consumers are not prohibited, but Spanish courts are very consumer-protective and may nevertheless hold them invalid depending on the circumstances. Switzerland has no special rules regarding conclusion of arbitration agreements with consumers and upholds a more liberal approach.

Determining whether an arbitration agreement involving a consumer is validly concluded presupposes that a consumer is

[39] *Id.* at para. 3.
[40] *Id*. at para. 4.
[41] *Id*. at para 5.
[42] GERMAN CODE OF CIVIL PROCEDURE, Section 1031, para. 5.

involved, which in turn raises the question of *who* qualifies as a consumer. Under ECJ case law and German law, a consumer is a natural person who concludes a legal transaction that predominantly cannot be attributed either to its commercial business activity or to a self-employed occupation. Contrary to the Austrian perspective, legal transactions of natural persons concluded with the aim of initiating business (preparatory acts) fall under business activities.

Under Austrian law, both natural persons and certain legal entities (trusts) can qualify as consumers, provided that the relevant legal transaction is not part of their commercial business. This legal definition of the consumer in not only broader than the approach of the ECJ, it raises a number of questions and discussions and it provoked *inter alia* extensive case law related to specific shareholder disputes addressing the questions under which circumstances shareholders qualify as consumers or not.

IV. Conclusion

"The courts of this country should not be places where resolutions of disputes begin. They should be the places where the disputes end after alternative methods of resolving disputes have been considered and tried."[43] - Justice Sandra Day O'Connor

Over the course of her distinguished 25-year tenure on the United States Supreme Court, Justice Sandra Day O'Connor's opinions left an indelible impact on the law. As the first woman on the Supreme Court, Justice O'Connor trailblazed a path for her subsequent female colleagues on the bench. From gender discrimination, to Fourth Amendment issues, to women's rights, to First Amendment Establishment Clause issues, Justice O'Connor's legacy is one that casts a wide net across the legal landscape. One area in which this legacy was most deeply felt is in the field of alternative dispute resolution. Justice O'Connor consistently supported the expansion of the authority of parties to select arbitration and enforce arbitration decisions.

European courts have taken a different path. The ECJ has addressed in a number of cases the validity of arbitration clauses and consistently concluded in favor of consumers in light of the Directive on Unfair Terms in Consumer Contracts, imposing obligations on national courts to draw appropriate conclusions under national law to

[43] Address by Justice Sandra Day O'Connor, at "Consumer Dispute Resolution, Exploring the Alternatives" (Jan. 21, 1983).

ensure that the consumer is not bound by a clause held to be unfair. The laws of various European countries show a wide range from a total prohibition to introducing specific requirements which *de facto* severely limit the option of introducing arbitration clauses into consumer contracts, and to a general validity however subject to the control by national courts and the ECJ. It will be interesting to see whether the two paths will come closer or merge someday.