Consumer Arbitration in the European Union and the United States

Christopher R. Drahozal* & Raymond J. Friel**

I. Introduction

Arbitration is a form of private dispute resolution, whereby parties agree to have a neutral third party resolve their dispute.\(^1\) Arbitration is based on the parties’ contract; a party must agree to arbitrate before it has any obligation to participate in an arbitration proceeding.\(^2\) Arbitration commonly is used to resolve disputes between businesses. For example, a substantial proportion of international business contracts include arbitration clauses.\(^3\)

Increasingly, however, arbitration is being used to resolve disputes between businesses and consumers.\(^4\) In the United

---

* Professor of Law, University of Kansas School of Law, Lawrence, Kansas, USA.
** Professor, School of Law, University of Limerick, Limerick, Ireland.

The authors wish to thank Tom Ginsburg, Jean Sternlight, Steve Ware, Julian Lew, Loukas Mistelis, and participants in a faculty workshop at the University of Limerick for helpful comments and discussions.

\(^1\) Christopher R. Drahozal, Commercial Arbitration: Cases and Problems §1.03 (2002).

\(^2\) Stated differently, in this paper we do not consider what some call “non-contractual” or “mandatory” arbitration, in which certain disputes are required by law to be resolved by arbitration.

\(^3\) Klaus Peter Berger, International Economic Arbitration 8 n. 62 (1993) (citing Albert Jan van den Berg et al., Arbitragerecht 134 (1988)).

\(^4\) Definitions of “consumer” vary, although for our purposes not materially. The E.U. Directive on Unfair Terms in Consumer Contracts defines “consumer” as “any natural person who... is acting for purposes which are outside his trade, business or profession.” Council Directive 93/13/EEC, art. 2(b), 1993 O.J. (L 095) 29 [hereinafter Unfair Terms Directive]. American consumer legislation commonly defines “consumer” as “an individual who incurs an obligation primarily for personal, family, or household purposes.” U.C.C. § 9-102(23) (2002); see also Magnuson-Moss Warranty – Federal Trade Commission Improvement Act, 15 U.S.C. § 2301(1) (2000) (defining “consumer product” as “tangible personal property which is distributed in commerce and which is normally used for personal, family, or household purposes”). Our primary interest is in consumer purchases of goods and services. We do not discuss individual employment contracts, which are included as consumer contracts under some broad definitions of the
Kingdom, the Chartered Institute of Arbitrators administers a number of consumer arbitration schemes, for businesses ranging from travel agents to mortgage lenders.\(^5\) In the United States, a wide variety of companies—banks, pest control companies, and securities brokerages, to name a few—commonly include arbitration clauses in their standard form contracts with consumers.\(^6\) Although in both countries such procedures are called "consumer arbitration," they differ in one important respect: in the United Kingdom, consumers agree after a dispute arises to go to arbitration; in most cases in the United States, consumers agree to arbitrate before a dispute arises, at the time they originally contract with the business.\(^7\)

This article offers a comparative perspective on the legal treatment of pre-dispute arbitration agreements in the European Union and the United States. Part II sets out a framework for characterizing consumer arbitration systems, based on the timing of the agreement (pre-dispute versus post-dispute) and whether the award is binding or non-binding.\(^8\) This part describes a number of possible variations on the structure of consumer arbitration systems, which fall on a continuum as to the extent to which they restrict a consumer's ability to go to court.

Part III analyzes the differing legal regimes that govern pre-dispute consumer arbitration agreements in the European Union (with particular focus on the United Kingdom) and the United States.\(^9\) In E.U. countries, the Directive on Unfair Terms in Consumer Contracts includes as "unfair" a contract term that has the effect of "excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions."\(^10\) As implemented in the United Kingdom, many (if not most) pre-dispute agreements for binding

---

\(^5\) Chartered Institute of Arbitrators, Dispute Resolution Services, at http://www.arbitrators.org/DRS/consumer.htm (last visited Oct. 6, 2002).

\(^6\) See infra text accompanying notes 107–09.

\(^7\) See infra text accompanying notes 102–03.

\(^8\) See infra Part II.

\(^9\) See infra Part III.

\(^10\) Unfair Terms Directive, supra note 4, Annex I(q).
consumer arbitration are unlawful. In the United States, by contrast, the Federal Arbitration Act and most state arbitration laws generally make pre-dispute agreements for binding arbitration enforceable, even in consumer contracts.

Part IV examines how the differing regulatory schemes influence online contracting practices. Not surprisingly, the dispute resolution clauses Internet merchants include in their standard form contracts governing sales in the United Kingdom differ from those in contracts governing sales in the United States. Of course, other factors also influence the use of pre-dispute arbitration clauses in consumer contracts. Nonetheless, the evidence described in this part at least suggests that the differing legal rules alter the parties’ behavior.

In Part V, we argue that the differing legal treatment of pre-dispute consumer arbitration agreements continues largely because of two distinct differences between the European Union and the United States: the different legal traditions and ethos with respect to consumer protection legislation, and the differing nature of litigation. As a matter of legal tradition and ethos, European legal systems (and the European Union itself) generally offer a higher degree of consumer protection than the American legal system. At the same time, the nature of the litigation process in the United States (as compared to the European Union) gives American businesses much stronger incentives to include pre-dispute arbitration clauses in consumer contracts than E.U. businesses, and thus much stronger incentives to oppose legal restrictions on consumer arbitration. Of course, as American businesses expand the use of pre-dispute consumer arbitration clauses, consumer groups and trial lawyers have an increasing incentive to support legal restrictions on consumer arbitration. Thus, whether the United States approach will converge in the future towards the European Union approach is unclear. Part VI concludes.

---

11 See infra Part IV.
12 See infra Part V.
13 See infra Part VI.
II. The Structure of Consumer Arbitration Systems

In describing the structure of a consumer arbitration system, we focus on two fundamental questions. First, when is the agreement to arbitrate made—post-dispute or pre-dispute? Parties can agree to arbitration either after a dispute arises or before. Post-dispute arbitration agreements, also known as submission agreements, are relatively uncontroversial.\(^{14}\) Pre-dispute arbitration agreements, by contrast, are arbitration agreements entered into before the parties have a dispute.\(^{15}\) Typically, a pre-dispute arbitration agreement takes the form of an arbitration clause included in the parties’ written contract governing the transaction.\(^{16}\)

Second, which parties are bound by the award—one, both, or neither? Binding arbitration is the resolution of a dispute by a third-party neutral, with the result binding on the parties and precluding resort to the courts (except under the deferential standards of judicial review provided in arbitration statutes).\(^{17}\) By some definitions, arbitration necessarily is binding dispute resolution; non-binding dispute resolution is not “arbitration.”\(^{18}\) Others refer to “non-binding” arbitration as describing a form of dispute resolution that resembles arbitration but that does not result in any binding outcome.\(^{19}\) The parties remain free to go to court to litigate their dispute. A possible variation is what is sometimes called “conditionally binding” arbitration, in which the

\(^{14}\) \textit{Stephen J. Ware, Alternative Dispute Resolution} § 2.3, at 20 (2001).

\(^{15}\) \textit{Id.}

\(^{16}\) \textit{Id.} There are other variations as well. For example, some consumer arbitration agreements “carve out” certain types of disputes from arbitration. Other agreements give one party but not the other the option to go to court to litigate the dispute. The option to litigate may cover the entire dispute or may cover only certain claims or types of remedies. See Christopher R. Drahozal, \textit{Nonmutual Agreements to Arbitrate}, 27 J. Corp. L. (forthcoming 2002).

\(^{17}\) \textit{Ware, supra note 14, §§ 2.2–2.3; see also Thomas J. Stipanowich, Contract and Conflict Management, 2001 Wis. L. Rev. 831, 839–40 (2001).}

\(^{18}\) See \textit{Christian Bühring-Uhle, Arbitration and Mediation in International Business} 39 (1996) (“Some scholars include the rendering of non-binding opinion in the term ‘arbitration,’ but for the purposes of this book, the term shall be limited to procedures leading to a binding decision.”).

\(^{19}\) \textit{Steven C. Bennett, Arbitration: Essential Concepts} 198 (2002).
award is binding on one party but not the other.\textsuperscript{20}

Obviously, there are numerous other considerations that go into structuring a consumer arbitration system, and many possible variations.\textsuperscript{21} Nevertheless, using this basic framework makes it possible to describe several different structures for consumer arbitration:

(1) Post-dispute nonbinding arbitration: After a dispute arises, the parties agree to resolve the dispute in arbitration. If dissatisfied with the award, however, either party can go to court instead.

(2) Post-dispute binding arbitration: After a dispute arises, the parties agree to resolve the dispute in arbitration. The arbitration panel issues a binding award. The arbitration agreement precludes the parties from going to court to resolve their dispute, other than to challenge the arbitration award under the standards prescribed by law.\textsuperscript{22}

(3) Pre-dispute nonbinding arbitration: The parties agree to arbitrate future disputes at the time their original contract is formed. But the award of the arbitration panel is not binding and does not preclude either of them from seeking a court remedy at any time.

(4) Pre-dispute nonbinding arbitration with exhaustion requirement: The parties agree to arbitrate future disputes at the time their original contract is formed. The award of the arbitration panel is not binding and does not preclude either of them from later seeking a court remedy. However, a party cannot go to court until the arbitration proceeding is completed—i.e., it must exhaust its arbitration remedy before going to court.

(5) Pre-dispute conditionally binding arbitration (only business is bound): The parties agree to arbitrate future disputes at the time their original contract is formed, but only one party (ordinarily the business) is bound by the award. If the consumer is dissatisfied with the award, he or she can go to court. (This


\textsuperscript{21} See, e.g., Stipanowich, \textit{supra} note 17.

\textsuperscript{22} See 9 U.S.C. § 10 (2002).
structure may or may not be coupled with an exhaustion requirement).

(6) Pre-dispute binding arbitration: The parties agree to arbitrate future disputes at the time their original contract is formed. The arbitration panel issues a binding award. The arbitration agreement precludes the parties from going to court to resolve their dispute, other than to challenge the arbitration award under the standards prescribed by law.

These possibilities form a continuum as to how much they restrict consumers' ability to pursue remedies in court. The most restrictive is pre-dispute binding arbitration, under which consumers agree to give up their court remedies before a dispute has arisen. The least restrictive is post-dispute non-binding arbitration, under which consumers do not give up their court remedies other than agreeing (after the dispute arises) to seek a non-binding award from a third party. The others fall in between.

III. Legal Framework Governing Pre-Dispute Consumer Arbitration Agreements

A. European Union

One of the difficulties with attempting trans-Atlantic comparisons is that the European Union does not have a common legal system that can in any way be said to be analogous to that of the United States. However, this is not an insurmountable problem, at least not with regard to the law on consumer arbitration clauses. First, consumer protection is now dealt with at the Union level, and considerable strides have been made in forging a harmonized approach to member state legislation in this sphere. 23 Second, the traditional approach of the English common law is consistent with the uniform approach promulgated under Union Directives. 24 This consistency permits an analysis of


24 See discussion id., and in particular, the similarity between the traditional common law approach and the Union approach, infra notes 25–81 and accompanying
English common law as a means of establishing the foundation to the Union’s approach in the area of consumer protection. Finally, as will become obvious, the societal and policy basis for a common European approach can be relatively easily discerned.

As the purpose of this article is to examine the difference in approach between Europe and the United States to pre-dispute consumer arbitration clauses, the analysis will commence with the primary European law that affects the validity of these clauses.

1. Unfair Terms in Consumer Contracts Directive

The Unfair Terms Directive (Directive) arises as a result of membership of the European Union and the need to harmonize the differing jurisdictional approaches of the member states. Simply put, the Directive provides that any term of a consumer contract, with the exception of subject matter and price, can be challenged on the grounds that it has not been individually negotiated and is unfair. For the first time, and in an expansive way, the legislature has imposed a qualitative analysis on parties’ contractual terms.

There are a number of key elements to understanding the Directive. First, as is clear from the title, the Directive applies only to consumer contracts. Further, the Directive applies only where a consumer is dealing with a non-consumer. Therefore, a contract negotiated between two consumers is not covered by the Directive.

Second, and perhaps more importantly, the Directive applies only to clauses that have not been individually negotiated by the parties. Contract terms that are drafted in advance of the conclusion of the contract by one party and without any opportunity by the consumer to influence the substance of the

---

26 Provided such clauses are in plain and intelligible language. Id. art. 5. Accordingly it appears that an obfuscated statement as to the calculation of the price of the contract may in fact be the subject of the Regulations.
27 Id. art. 3(1).
28 For a definition of consumer, see supra note 4.
30 Or indeed two non-consumers. Id.
31 1993 O.J. (L 95) 29, art. 3(1).
clause would fall within this definition.\textsuperscript{32} For the most part this would cover standard form contracts, which would probably be the normal modus operandi in consumer transactions.\textsuperscript{33}

Third, the term must be unfair.\textsuperscript{34} The concept of unfairness is so nebulous that it is further detailed in the regulations as consisting of two principal elements: (a) a "significant imbalance" in the rights of the consumer to his or her detriment; and (b) "contrary to the principles of good faith."\textsuperscript{35} The inherent uncertainty involved in these requirements may be intentional, inasmuch as it reposes considerable power in the court to determine the fairness, or otherwise, of any individual term. However, the Directive does go on to provide further guidance for each of these requirements. In making a determination as to whether an imbalance has arisen, the court should take account of factors such as the nature of the subject matter of the contract, the circumstances attending the conclusion of the contract and all the other terms of the contract, or any other contract upon which this contract is dependent.\textsuperscript{36} Where such an imbalance has been found, the court must determine if it is contrary to the principles of good faith.\textsuperscript{37} Here again the Directive provides four basic principles on which this can be assessed: the strength of the bargaining positions of the parties, any inducements made to the consumer to secure agreement to the term, whether the subject matter of the contract was a special order by the consumer, and the extent to which the seller or supplier has dealt fairly or equitably with the consumer.\textsuperscript{38} It is clear that these principles do little in the way of assisting lawyers to prospectively adjudicate upon the validity of any contractual term. Accordingly the Directive provides yet another layer of explanations, effectively creating a list of prima facie unfair terms.\textsuperscript{39} One of these prima facie unfair terms stipulated is any term that excludes or hinders the consumer's rights to take

\textsuperscript{32} Consumer Protection, (1994) SI 1994/3159, art. 3(3).

\textsuperscript{33} See RAYMOND FRIEL, THE LAW OF CONTRACT 174-75, 221-24 (2d ed. 2000).

\textsuperscript{34} 1993 O.J. (L 95) 29. art. 3(1).

\textsuperscript{35} Id.

\textsuperscript{36} Id. art. 4(1).

\textsuperscript{37} Id. art. 3(1).


\textsuperscript{39} 1993 O.J. (L 95) 29, art. 3(3), and Annex §§ 1(a) through (q).
legal action, or exercise any other legal remedy, in particular, "terms requiring the consumer to take disputes exclusively to arbitration not covered by legal provision."\textsuperscript{40}

The exact ambit of this is unclear, inasmuch as it refers to "arbitration not covered by legal provision."\textsuperscript{41} G. H. Treitel suggests that this provision applies to an arbitration clause that seeks to exclude absolutely the power of the court to review the arbitrator's determination.\textsuperscript{42} If that is the full limit of the provision, then it merely reinforces, but does not alter, the existing common law rule that would render such a term contrary to public policy.\textsuperscript{43} Another possible interpretation would confine the provision to arbitrations not regulated by statutory regulations. Such a construction would involve interpreting the phrase "legal provision"\textsuperscript{44} in both a narrower and a conjunctive sense. Such clauses would be prima facie void only where they concerned arbitration which did not fall within the jurisdiction of legislation on arbitration. In reality there would probably be very little practical difference in the result achieved, but it would have certain consequences.\textsuperscript{45}

\textsuperscript{40} Id. Annex § 1(q); see also Commission Recommendation on the Principles Applicable to the Bodies Responsible for Out-of-Court Settlement of Consumer Disputes (98/257/CE), 1998 O.J. (L 115) 31, available at http://europa.eu.int/eur-lex/pri/en/oj/dat/1998/1_115/1_11519980417en00310034.pdf [hereinafter Recommendation 98/257/CE] ("Principle of liberty" providing that "[t]he consumer's recourse to the out-of-court procedure may not be the result of a commitment prior to the materialisation of the dispute, where such commitment has the effect of depriving the consumer of his right to bring an action before the courts for the settlement of the dispute.").

\textsuperscript{41} See 1993 O.J. (L 95) 29 at Annex § 1(q).

\textsuperscript{42} See G.H. TREITEL, THE LAW OF CONTRACT 251 (9th ed. 1995).

\textsuperscript{43} For a full discussion on the validity of contracts whose effect is to oust the jurisdiction of the Courts at common law, see id. at 406–410; see also FRIEL, supra note 33, at 294–95.

\textsuperscript{44} 1993 O.J. (L 95) 29 at Annex § 1(q).

\textsuperscript{45} See also NICHOLAS LOCKETT & MANUS EGAN, UNFAIR TERMS IN CONSUMER AGREEMENTS: THE NEW RULES EXPLAINED 49 (1995) ("it remains unclear whether the Directive intends to prohibit such [arbitration] clauses in the event that the arbitration body in question is completely unregulated or only partially so"); Jean R. Sternlight, Is the U.S. Out on a Limb? Comparing the U.S. Approach to Mandatory Consumer and Employment Arbitration to That of the Rest of the World, 56 U. MIAMI L. REV. 831 ("Although the 1993 Directive takes a gray list approach that does not by its terms unequivocally bar all mandatory arbitration in the consumer area, subsequent EU
In summary, the Directive clearly confers a power upon the court to invalidate any term in a consumer contract it considers to be unfair.\textsuperscript{46} A pre-dispute arbitration clause, which has not been individually negotiated, appears prima facie to be void under the Directive, but only where the arbitration is not covered by legal provision.\textsuperscript{47} Where an arbitration is covered by legal provision, then it may still fall foul of the Directive, but the onus rests with the consumer to demonstrate that it is unfair in that it imbalances the rights of the parties to the detriment of the consumer and contrary to the principles of good faith.\textsuperscript{48}

2. United Kingdom Law

As there is no Union-wide framework for the regulation of purely domestic arbitration, it is left to each individual state to provide its own framework. By domestic arbitration we mean an arbitration that arises exclusively within a single jurisdiction and where no cross-jurisdictional issues arise.\textsuperscript{49} It would be impossible in an article of this length to examine each of the fifteen member states' laws on arbitration; instead, it will concentrate on the law of the United Kingdom. This is justifiable for a number of reasons.\textsuperscript{50} We begin with an overview of English common law of

\textsuperscript{46} Although the balance of the contract remains binding on the parties and indeed it appears as if the impugned unfair element is not binding on the consumer, but might be still binding on the other party, this would be unlikely to arise in practice. See 1993 O.J. (L 95) 29, art. 6(1).

\textsuperscript{47} Id. art. 3(3), Annex § 1(q).

\textsuperscript{48} The annex provides for an indicative list of potentially unfair clauses which is neither exclusive nor exhaustive, see id. art 3(3). Thus, where an arbitration is covered by legal provision it falls outside of those types of clauses which are likely to be regarded as unfair, but it is still open to plaintiff to establish as a matter of fact that the clause is unfair.

\textsuperscript{49} See Arbitration Act, 1996, c. 23, § 85 (Eng.).

\textsuperscript{50} First, English law is by far the most common in terms of commercial trade. Second, the legislative provisions are representative of the general thrust from other
arbitration and then examine the implementation of the Unfair Terms Directive in the Arbitration Act of 1996.\(^{51}\)

a. English Common Law

Under traditional English common law, a contractual clause that purported to oust the jurisdiction of the courts was void as being contrary to public policy.\(^{52}\) As Pollock CB stated, "the superior courts of law cannot be ousted of their jurisdiction by the mere agreement of the parties . . . ."\(^{53}\)

The rationale for this rule is clearly based on the premise that each citizen is entitled to have his or her legal position determined by the lawfully established courts of the land.\(^{54}\) Any attempt to deny such a right strikes at the very heart of the rule of law, and, perhaps even more importantly, permits the development of a rival dispute resolution system.\(^{55}\) A contract clause that purports to confer dispute resolution powers on an independent third party, or arbitrator, clearly comes within this prohibition.\(^{56}\) However, a strict enforcement of such a rule would be both clearly ineffective and inappropriate. Arbitration clauses are common to many commercial transactions, and it is unlikely that business people would willingly forego such a useful mechanism.\(^{57}\) Moreover, such clauses offer cheap and speedy resolution of commercial

---

\(^{51}\) Arbitration Act, 1996, c. 23 (Eng.).

\(^{52}\) See Treitel, supra note 42, at 406.


\(^{54}\) Or indeed any foreign court, since it appears that a clause that requires the parties to have a dispute resolved by a foreign court is valid. However, English courts have tended to ignore this element if it can be shown that the local jurisdiction (i.e., England) is the more convenient forum. See The Fehmarn, 1 W.L.R. 159, 162 (1958) (Denning MR).

\(^{55}\) As was the difficulty facing English common law courts in dealing with the emergence of arbitration. See H.W. Arthurs, 'Without the Law': Administrative Justice and Legal Pluralism in Nineteenth Century England (1985).

\(^{56}\) The scope of this article concerns legally enforceable agreements. A provision in a non-legally binding agreement to oust the jurisdiction of the courts is of no concern since the agreement itself has no legal consequence. See Treitel, supra note 42, at 409.

\(^{57}\) See, e.g., Keith Hylton, Agreements to Waive or to Arbitrate Legal Claims: An Economic Analysis, 8 SUP. CT. ECON. REV. 209, 213 (2000).
disputes and free the courts to concentrate on more significant matters.58 Accordingly, the application of the prohibition on arbitration clauses has always been the subject of a rather loose interpretation.59

First, the rule is only infringed where there is an attempt to oust the jurisdiction of the courts in matters of law.60 It has for some time been recognized that issues of fact may be determined outside of the court system.61 In Dobbs v. National Bank of Australasia Ltd.,62 the court held that an exclusive power conferred on an arbitrator to determine issues of fact was necessary to give "efficacy to the award."63 This approach has been approved in the recent case of West of England Shipowners Mutual Insurance Association v. Cristal Ltd.,64 where it was accepted that a chosen tribunal could be a final arbiter of fact.65 There is no inconsistency in this approach: the public policy interest is limited to retaining the role of the courts in determining the legal rights of the parties to a dispute. Questions of fact are properly matters for the parties themselves, which is why, in the adversarial common law system, the parties to a dispute may reach common ground with respect to the facts. Where they are unable to do so, then resort must be made to other fact triers, such as a jury. But the issue of fact resolution is not crucial to the public interest that needs to be protected. It would appear that this also extends to mixed issues of fact and law. In Overseas Union Insurance Ltd. v. AA Mutual International Insurance Co.,66 the court upheld an arbitration clause that required the arbitrator to interpret a contract as an


59 See infra notes 60–79.


61 See id.


63 Id. at 652.


65 Id. at 377.

“honourable engagement” and not under the strict rules of construction.

Second, a clause that requires that the parties undertake an intermediate step prior to pursuing the issue in a court of law is not prohibited. Thus, a clause that requires an arbitrator to have made an award prior to the accrual of any cause of action is valid. Such clauses, often referred to as “Scott v. Avery clauses,” from the name of the seminal case in which they were recognized, clearly illustrate the limited policy behind the rule. The aim of the rule is to render null and void any attempt to prevent access to the court system; however, there is no public policy to be protected in the imposition of reasonable pre-litigation steps negotiated freely by the parties and voluntarily included in their contract. However, considerable care needs to be taken in the drafting of such a clause. The Irish case of Mansfield v. Doolin is an interesting application of interpretation powers of the courts. In that case, a contract had a clause that appeared to provide that an award of an arbitrator was to be a condition precedent to any legal proceedings. The Irish court ruled that the correct interpretation of the clause did not establish the clause as being a condition precedent to proceedings, and therefore did not prevent the plaintiff from immediately pursuing a claim through the courts without having to wait for the arbitrator to make an award. The ruling in the case is probably better confined to its own facts because Irish courts have subsequently upheld Scott v. Avery clauses. However, it does leave open the possibility that the interpretive role of the court may impact the significance of such clauses at common law. The key issue would appear to be whether the clause constitutes a condition precedent to litigation. If it does not constitute a condition precedent, then it is possible to commence litigation immediately.

67 Id. at 65, 71–72.
68 See id.
70 See id.
71 4 Ir. R.-C.L 17 (Q.B. 1869).
72 Id. at 23–24.
73 Id. at 31.
74 See, e.g., Gregg & Co. v. Fraser & Sons, [1906] 2 Ir. R. 545, 555 (K.B).
Finally, a variation of *Scott v. Avery*,\(^75\) namely the *Atlantic Shipping*\(^6\) clause, appears to be valid. Under the terms of such a clause, no cause of action arises unless an arbitrator has been appointed within a specified time period.\(^77\) The difference here is that no award needs to have been made by the arbitrator before court proceedings can commence; it is sufficient that an arbitrator has been appointed.\(^78\)

Thus, by the early 1970s, Judge Windeyer of the High Court of Australia felt confident enough to state that: “the grandiloquent phrases of the eighteenth century condemning ousting of the jurisdiction of courts cannot be accepted in the second half of the twentieth century as pronouncement[s] of a universal rule.”\(^79\)

However, a note of caution needs to be sounded. The essence of Windeyer’s statement was that the rule was no longer universal, not that it had been abandoned. Thus, as stated in *Home & Overseas Insurance Co. v. Mentor Insurance Co. (UK)*,\(^80\) “a clause which purported to free arbitrators to decide without regard to the law and according, for example, to their own notions of what could be fair would not be a valid arbitration clause.”\(^81\)

In summary therefore, the common law position appears to be as follows:

1. An arbitration clause, being a clause to oust the jurisdiction of the courts, is void as being contrary to public policy, save as detailed below.
2. An arbitration clause that purports to confer an arbitrator with the exclusive right to determine issues of fact, broadly defined, appears valid as it does not conflict with public policy.
3. A clause that requires as a condition precedent to litigation either (a) the appointment of arbitrator or (b) an award from an arbitrator prior to the commencement of a legal action is valid because the clause does not oust the jurisdiction of the courts but merely sets reasonable preconditions.

\(^{75}\) *Scott v. Avery*, 25 L.J.Ex. 308 (H.L. 1856).


\(^{77}\) *Id.* at 256, 258.

\(^{78}\) *See id.*


\(^{81}\) *Id.* at 485.
However, the widespread use of arbitration in commercial transactions has attracted the attention of the legislature, and many arbitration clauses are now governed by statutory provisions, as discussed below. It is to these provisions that we now turn.

b. Arbitration Act of 1996

The Arbitration Act of 1996 governs generic arbitrations held within the United Kingdom.\(^{82}\) In particular, section 85 governs domestic arbitrations.\(^{83}\) A domestic arbitration arises when none of the parties is a national of,\(^{84}\) or habitually resident in, another state, and where the “seat of arbitration”\(^{85}\) is in the United Kingdom.\(^{86}\) Any agreement in a domestic arbitration seeking to exclude the jurisdiction of the courts in either the determination of preliminary points of law,\(^{87}\) or challenges to an award or appeal on points of law\(^{88}\) are ineffective unless such an agreement was entered into after the commencement of the arbitral proceedings.\(^{89}\)

However, the Act goes on to extend the application of the Unfair Terms in Consumer Contracts Regulations 1994,\(^{90}\) which incorporate the Union Directive into English law, to a term which constitutes an arbitration agreement.\(^{91}\) Essentially, the Act routes consumer arbitration towards the Unfair Contract Terms

---

\(^{82}\) Arbitration Act, 1996, c. 23 (Eng.). The 1996 Act (see Schedule 4) repealed the Consumer Arbitration Agreements Act 1988, c. 21 (Eng.), which had made unenforceable in a consumer contract “an agreement that future differences arising between parties to the contract are to be referred to arbitration” without consent or participation after the dispute arises. Id. § 1(1).

\(^{83}\) Arbitration Act, 1996, c. 23, § 85(1) (Eng.).

\(^{84}\) Or in the case of a corporation, when one of the parties is not incorporated in, or has its central control and management exercised in, a state other than the United Kingdom. Id. § 85(2)(b).

\(^{85}\) The “seat of arbitration” is defined in sections 3, 5(1) and 6 of the Act. Id.

\(^{86}\) Id. § 85(2).

\(^{87}\) Id. § 45.

\(^{88}\) Id. § 69.

\(^{89}\) Id. § 87.


\(^{91}\) Arbitration Act, 1996 § 89(1) (applying the term “arbitration agreement” to any agreement to submit to arbitration, present or future, any dispute or difference whether contractual or not).
Directive, discussed earlier;\textsuperscript{92} the primacy of Union consumer protection is therefore reinforced. Moreover, section 91 of the Act specifically stipulates that a term that constitutes an arbitration agreement with respect to a claim that does not exceed a specified amount (currently £5,000)\textsuperscript{93} is to be deemed unfair.\textsuperscript{94} The cumulative effect is as follows:

(1) Certain provisions in pre-dispute arbitration clauses, of a non-consumer classification, are ineffective.

(2) Pre-dispute consumer arbitration clauses are deemed to be unfair when the amount of potential claim is less than £5,000 and

(3) In all other cases, pre-dispute consumer arbitration clauses must be found to be unfair in accordance with the Unfair Contract Terms Directive.

The UK Office of Fair Trading ("OFT") in its \textit{Unfair Contract Terms Guidance} explains its interpretation of the 1996 Arbitration Act as follows:

17.2 Under section 91 of the Arbitration Act 1996, a compulsory arbitration clause is automatically unfair if it relates to claims of £5,000 or less. This is currently the only instance of a term that is always unfair under the Regulations regardless of circumstances. A compulsory arbitration clause forbidden by the 1996 Act is both legally ineffective and open to regulatory action in all cases.

17.3 If such a term is not to be deleted, the element of compulsion should be removed, for instance by making clear that consumers (or both parties) have a free choice whether to go to arbitration or not. Arbitration in the UK is fully covered by legal provisions, and so non-compulsory arbitration clauses are unlikely to encounter objections provided they are in clear language and not misleading.\textsuperscript{95}

The OFT has effected changes in consumer contract terms through implementation of the Act. The OFT consistently has

\textsuperscript{92} See supra notes 25–48 and accompanying text.


\textsuperscript{94} Arbitration Act, 1996 § 91.

\textsuperscript{95} Office of Fair Trading, Unfair Contract Terms Guidance ¶ 17.2 &17.3 (Feb. 2001).
required businesses either to delete pre-dispute binding arbitration clauses altogether,\textsuperscript{96} or to give consumers the option to arbitrate after a dispute arises.\textsuperscript{97} As one OFT report explained, a company whose contract was at issue agreed to delete an arbitration clause that was objectionable because it “failed to make clear that the consumer had a choice about whether to take a dispute to arbitration.”\textsuperscript{98} The OFT has taken action even in cases involving sellers of high-value consumer goods, such as automobiles, including one case in which “a term which stated that disputes could be resolved only by means of arbitration” was revised because it “was considered potentially unfair in light of paragraph 1(q).”\textsuperscript{99}


B. United States

In the United States, pre-dispute arbitration clauses in consumer contracts generally are enforceable, even if they provide for binding arbitration.\textsuperscript{100} The Federal Arbitration Act ("FAA") overturned the common law hostility toward arbitration by making pre-dispute arbitration agreements "valid, irrevocable, and enforceable," without distinguishing between business contracts and consumer contracts.\textsuperscript{101} Moreover, federal statutory claims brought by consumers ordinarily can be resolved in binding arbitration, to the exclusion of a court trial.\textsuperscript{102} Indeed, a number of U.S. Supreme Court cases have rejected challenges to pre-dispute arbitration clauses in consumer contracts,\textsuperscript{103} explaining in one case that "Congress, when enacting [the FAA], had the needs of

\textsuperscript{100} See infra notes 102–03.


consumers, as well as others, in mind.”\textsuperscript{104}

The FAA governs many, although not all, consumer arbitration agreements. By its terms, the FAA applies to arbitration provisions contained “in any maritime transaction or a contract evidencing a transaction involving commerce.”\textsuperscript{105} In \textit{Allied-Bruce Terminix Cos. v. Dobson}, the U.S. Supreme Court construed the scope of the FAA broadly, to the full scope of Congress’ power to regulate interstate commerce.\textsuperscript{106} When enacted in 1925, the FAA applied to few consumer contracts, because of the narrow interpretation of the Commerce power at the time.\textsuperscript{107} Since then, however, the Supreme Court has construed the Commerce power more expansively, so that today, many consumer contracts are subject to the FAA.\textsuperscript{108} \textit{Allied-Bruce} itself, which held the FAA applicable to a pest control contract entered into between a consumer and a local franchisee of a nationwide business, illustrates the breadth of the FAA’s reach.\textsuperscript{109} If the FAA applies, it makes the consumer arbitration agreement enforceable.\textsuperscript{110} If the FAA does not apply, state arbitration law governs.\textsuperscript{111} Many, but not all, state arbitration laws likewise make consumer arbitration agreements enforceable.\textsuperscript{112}

Even when the general rule of enforceability applies (under

\textsuperscript{104} \textit{Allied-Bruce Terminix Cos.}, 513 U.S. at 280.


\textsuperscript{106} 513 U.S. at 277.


\textsuperscript{108} \textit{Id}.

\textsuperscript{109} 513 U.S. at 277. Examples of contracts that some courts have held not subject to the FAA are a building repair contract entered into with a local construction company; see Sisters of the Visitation v. Cochran Plastering Co., 775 So.2d 759 (Ala. 2000), and a real estate purchase contract between two local property owners; see Brown v. Dewitt, Inc., 808 So.2d 11 (Ala. 2001). Of course, even if the FAA does not apply, the arbitration agreement may be enforceable under state arbitration law. If the FAA does apply, it preempts any state arbitration law that otherwise might make the arbitration agreement unenforceable. Southland Corp. v. Keating, 465 U.S. 1 (1984).


either the FAA or state arbitration laws), there remain two grounds on which courts may invalidate or limit the enforceability of pre-dispute agreements to arbitrate consumer disputes. First, for federal statutory claims, even if the claim is one that generally is subject to arbitration, a court may permit a consumer to bring the claim in court if the procedures in arbitration “preclude [the] litigant . . . from effectively vindicating her federal statutory rights in the arbitral forum.”\footnote{Green Tree Fin. Corp.–Ala. v. Randolph, 531 U.S. 79, 90 (2000).} Thus, if arbitration costs are too high, or if the arbitration agreement attempts to waive a nonwaivable statutory remedy, courts may refuse to enforce the arbitration agreement in whole or in part.\footnote{Id.} Second, parties can raise general contract law defenses to defeat the enforceability of agreements to arbitrate.\footnote{9 U.S.C. § 2 (2000) (arbitration agreement “shall be valid, irrevocable and enforceable, save upon such grounds as exist in law or in equity for the revocation of any contract”); Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 265 (1995).} One such defense is unconscionability: that a certain provision of the arbitration agreement is so unfair that the provision, or the arbitration agreement as a whole, is unenforceable.\footnote{E.g., Armendariz v. Found. Health Psychcare Servs., Inc., 6 P.3d 669 (Cal. 2000) (arbitration clause unconscionable when it provided for arbitration only for employee wrongful termination claims and limited damages recoverable); Harold Allen’s Mobile Home Factory Outlet, Inc. v. Butler, 825 So.2d 779 (Ala. 2002) (arbitration clause unconscionable when it gave seller unilateral right to select arbitrator).} Under both grounds, however, there is no across-the-board rule that pre-dispute consumer arbitration agreements are unenforceable. Instead, courts police the fairness of consumer arbitration agreements on a case-by-case basis, and the fact that a consumer contract contains a pre-dispute binding arbitration clause alone is not enough to make it unenforceable.\footnote{Stephen J. Ware, Arbitration and Unconscionability after Doctor’s Associates, Inc. v. Casarotto, 31 WAKE FOREST L. REV. 1001, 1034–35 (1996).}

There also have been private efforts to promote the fairness of consumer arbitration in the United States. For example, in 1998, the National Consumer Disputes Advisory Committee, established by the American Arbitration Association (AAA), promulgated a Consumer Due Process Protocol in an attempt to define standards of fairness for consumer arbitration.\footnote{National Consumer Disputes Advisory Committee, Consumer Due Process Protocol, \textit{at} http://www.adr.org/index2.1.jsp?JSPsid=15711&JSPsrc=upload} The Protocol provides, for
example, that “[a]ll parties are entitled to a Neutral who is independent and impartial,” “the proceedings should be conducted at a location which is reasonably convenient to both parties,” and “[t]he arbitrator should be empowered to grant whatever relief would be available in court under law or in equity.”\textsuperscript{119} The AAA has stated that it “will only administer [a consumer] dispute if the arbitration clause meets certain fairness standards that are contained in the AAA’s Consumer Due Process Protocol.”\textsuperscript{120} In addition, the AAA provides low-cost consumer arbitration services under its Supplementary Procedures for Consumer-Related Disputes.\textsuperscript{121} Of course, there is no requirement that businesses provide for such arbitration in their consumer contracts, although doing so no doubt enhances the enforceability of arbitration agreements and awards.\textsuperscript{122}

IV. Online Contracting Practices and Consumer Arbitration

This section examines how the differing legal frameworks governing pre-dispute consumer arbitration agreements are reflected in online contracting practices. We examine the standard contract terms of three large online merchants: the three largest American personal computer (PC) makers that sell (or at least sold) via the Internet to consumers in the United States and worldwide. At the time we conducted this study, Dell and Compaq were the two largest PC makers both in the United States and internationally.\textsuperscript{123} Gateway was the fourth largest PC maker

\textsuperscript{119} Id.


\textsuperscript{123} Extreme Tech, \textit{PC Market Actually Grows Smaller} (July 20, 2001), at http://www.extremetech.com/article2/0,33973,159585,00.asp (on file with the North
in the United States, and had a significant international presence as well.\textsuperscript{124} Gateway is of particular interest because its arbitration clause has been extensively litigated in American courts.

In each case, we collected information on the dispute resolution clauses included in the company's standard contract terms and conditions for online sales. These standard terms and conditions were available through links on the company's websites. Our focus was on the English-language web pages, although each of the companies sold in non-English-speaking countries as well. A consumer agrees to the company's standard terms and conditions when he or she purchases a personal computer online.\textsuperscript{125}

As the following sections make clear, the dispute resolution clauses were as one would expect. For their sales in the United States, two of the three companies (Dell and Gateway) included a binding arbitration clause in their consumer contracts. For their sales in the United Kingdom, none of the companies included a binding arbitration clause in its consumer contracts. Instead, all three provided for disputes to be resolved in court, although the Gateway clause expressly provided for arbitration if both parties agreed after a dispute arose. Interestingly, Gateway's contract with business customers contained a pre-dispute arbitration clause, which suggests that Gateway may have included such a clause in its consumer contracts were it permitted to by law.

\textsuperscript{124} After we had collected the information that follows, Gateway announced that it was discontinuing its international operations in a cost-cutting move. See Gary McWilliams, Gateway Plans to Shut Offices and Trim Staff, WALL ST. J., Aug. 29, 2001, at A3.

A. Dell

In 2001, Dell was the largest personal computer maker in the world, overtaking previous number one Compaq. The Dell Terms and Conditions for home and small business customers in the United States began by broadly making consumer disputes subject to arbitration:

ANY CLAIM, DISPUTE, OR CONTROVERSY (WHETHER IN CONTRACT, TORT, OR OTHERWISE, WHETHER PREEXISTING, PRESENT OR FUTURE, AND INCLUDING STATUTORY, COMMON LAW, INTENTIONAL TORT AND EQUITABLE CLAIMS) AGAINST DELL . . . SHALL BE RESOLVED EXCLUSIVELY AND FINALLY BY BINDING ARBITRATION ADMINISTERED BY THE NATIONAL ARBITRATION FORUM (NAF) under its Code of Procedure then in effect.

The NAF is one of the arbitration institutions that provides low-cost consumer arbitration proceedings, and it adheres to an Arbitration Bill of Rights that provides at least some protections for consumers. The Dell consumer arbitration clause then stated that “[t]he arbitration will be limited solely to the dispute or controversy between Customer and Dell,” excluding by contract the possibility of any consolidated or class-wide arbitration proceedings. Finally, the arbitration clause concluded: “PROVIDED, HOWEVER, THAT THIS BINDING ARBITRATION REQUIREMENT DOES NOT APPLY TO CLAIMS AGAINST DELL ARISING UNDER THE

---

126 See supra note 123.
APPLICABLE WRITTEN WARRANTY. SUCH CLAIMS MAY BE PURSUED IN ANY COURT OF COMPETENT JURISDICTION.”

Dell’s Terms and Conditions of Sale for corporate customers in the United States provided that the parties are first to “attempt to resolve any claim, or dispute or controversy . . . through face to face negotiation with persons fully authorized to resolve the Dispute or through mediation utilizing a mutually agreeable mediator, rather than through litigation.” If unsuccessful “within a reasonable time,” they then were to proceed to arbitration under the CPR Rules for Non-Administered Arbitration. The clause modified those rules in several respects: (1) the dispute was to be resolved by three impartial and independent arbitrators, with each party naming one and the two party-appointed arbitrators then naming the presiding arbitrator; (2) the hearing was to take place in Austin, Texas (where Dell is located); (3) the arbitrators were to decide based on the agreement “and will follow the law and judicial precedents that a United States District Judge sitting in the Western District of Texas would apply to the dispute”; (4) the award was to be in writing and include findings of fact and conclusions of law; and (5) the parties had the right to seek provisional relief from any court of competent jurisdiction, although the merits of the case still had to be decided by the arbitrators.

By contrast, the Dell Terms and Conditions for the United Kingdom and Ireland were much simpler and did not provide for arbitration. For U.K. customers (both consumers and businesses), the Terms and Conditions for the United Kingdom provided that “English law and the exclusive court jurisdiction of the English courts will apply to this Agreement.” For Irish customers (both

---

130 Id.


132 Id.


134 Dell Terms and Conditions UK ¶ 20, at http://www.euro.dell.com/countries/uk/
consumers and businesses), the Terms and Conditions Ireland provided that "Irish law and the exclusive jurisdiction of the Irish courts will apply to this Agreement."135

B. Compaq

At the time of the study, Compaq was the number two PC seller worldwide, although it has returned to number one with the completion of its merger with Hewlett Packard.136 Compaq sold PCs both online and through retail outlets. Unlike Dell and Gateway (to follow), Compaq did not include a dispute resolution clause in its Terms and Conditions for United States customers.137 As a result, its disputes with American consumers would be resolved in court, unless the parties agreed to arbitrate after a dispute arose.138 For its customers in the United Kingdom and Ireland, its dispute resolution clause provided that "[t]hese terms and conditions and all Contracts shall be subject to English Law and the exclusive jurisdiction of the English Courts."139

C. Gateway

Gateway, the final company studied, sold personal computers via the Internet as well as by phone and through retail outlets. In the United States, the Gateway dispute resolution clause has been widely litigated. Much of the litigation focused on the method of contract formation used by Gateway in its telephone sales, an issue not applicable to its online sales.140 But at least one court has held


136 See supra note 123.


138 Id.


140 With computers sold by phone, Gateway included its Standard Terms and Conditions – containing an arbitration clause and providing that the consumer assented to the terms if he or she did not return the computer within thirty days – in the box in
that a previous version of the Gateway clause, which provided for arbitration under the Arbitration Rules of the International Chamber of Commerce (ICC), was unconscionable and thus unenforceable, because of the high costs of ICC arbitration relative to the small amount at stake in the proceeding.\textsuperscript{141} The current Gateway clause no longer provides for ICC arbitration.\textsuperscript{142}

Initially, the introductory paragraph of the current Gateway (US) Consumer Terms and Conditions informed the consumer that “\textit{THIS AGREEMENT CONTAINS A DISPUTE RESOLUTION CLAUSE. PLEASE SEE SECTION 8 BELOW.}”\textsuperscript{143} Section 8 then provided for “any Dispute” to be resolved “exclusively and finally by arbitration administered by the National Arbitration Forum (NAF) and conducted under its rules, except as otherwise provided below.”\textsuperscript{144} The clause provided further that there was to be a single arbitrator, the arbitration was limited to the consumer and Gateway (i.e., no consolidation or class-wide relief), and the proceeding “shall be held at any reasonable location near [the consumer’s] residence.”\textsuperscript{145} Further, the clause stated in bold print:

\begin{quote}
You understand that, in the absence of this provision, You would have had a right to litigate disputes through a court, including the right to litigate claims on a class-wide or class-action basis, and that You have expressly and knowingly waived those rights and agreed to resolve any Disputes through binding arbitration in accordance with the
\end{quote}


\textsuperscript{142} \textit{See infra} text accompanying note 144.

\textsuperscript{143} \textit{Gateway} Standard Terms of Sale and Limited Warranty Agreement § 8 (U.S.), \textit{at} \url{http://www.gateway.com/about/legal/warranties/englishversion.pdf} (last visited Jan. 30, 2002).

\textsuperscript{144} \textit{Id.}

\textsuperscript{145} \textit{Id.}
provisions of this paragraph. 146

By comparison, the dispute resolution clause in the Gateway U.K./Ireland Consumer Terms and Conditions was much simpler: "Any dispute or controversy arising out of or relating to this Agreement or its interpretation will be settled in an appropriate court, or, if both parties agree, by arbitration, in London, England." 147 In other words, the Terms and Conditions did not contain a pre-dispute arbitration clause, but instead contemplated the possibility of the parties agreeing to arbitrate post-dispute if they decided then not to go to court. Interestingly, the Gateway U.K./Ireland Terms and Conditions for business customers provided for arbitration rather than litigation to resolve disputes. 148 Arbitration was to be conducted under the ICC Rules in either the UK or Ireland (depending on where the computer was delivered). 149 The clause made clear that the arbitration award was to be "final and binding on each of the parties." 150 Gateway's inclusion of an arbitration clause in its business contracts at least suggests the possibility that Gateway would have included a similar clause in its consumer contracts had it been permitted to do so by law.

146 Id.


150 Id.
V. Tradition, Politics, and Consumer Arbitration

Why do the United States and the European Union take such differing approaches to the regulation of consumer arbitration? In the United States, pre-dispute binding arbitration clauses are enforceable in consumer contracts, unless some other provision in the arbitration clause renders the entire clause unenforceable.\footnote{See supra notes 100–22 and accompanying text.} By contrast, in the European Union, pre-dispute binding arbitration clauses are unenforceable in many, if not most, consumer contracts, and even pre-dispute nonbinding arbitration is highly controversial if consumers are required to arbitrate before they can go to court.\footnote{European Commission, Comments on Alternative Dispute Resolution for Consumer Transactions in the Borderless Online Marketplace, Department of Commerce/Federal Trade Commission Public Workshop 6, at http://www.ftc.gov/bcp/altidisresolution/comments/postworkshopcomments/europeanco mmission.pdf (May 30, 2000) (“Access to [legal redress] should not be made conditional on the use or even exhaustion of the possibilities offered by [ADR]. The use of any exhaustion principles for ADR (i.e. requiring a consumer to exhaust all ADR remedies before being allowed to start a court action) would... seriously undermine consumer confidence.”).}

The most likely explanation, in our view, is due to a two-fold combination of circumstances: differing legal traditions toward consumer protection in the European Union and the United States, and significant differences between the legal systems of the United States and the European Union that give American companies much stronger incentives than their European counterparts to oppose legislation restricting pre-dispute consumer arbitration agreements.

A. Differing Legal Traditions and Ethos

The European approach to pre-dispute consumer arbitration clauses lies deep within the ethos and history that informs the two major legal systems within Europe: the common law and the civil law. Both these traditions, for different yet equally compelling reasons, tend to lean against the enforcement of these clauses. This has, in recent times, been reflected in the approach of the European Union.
1. Civil Law

In a civil law context, the general approach is far more regulatory as opposed to laissez-faire. Although both common and civil law adhere to the concept of autonomy of the will in contractual relations, there are subtle differences in the intellectual approach as to the meaning of this autonomy. For the common law, autonomy of the will is essentially analyzed through an objective examination of the facts, whereas in civil law, more emphasis is placed on a subjective analysis. Moreover, the use of good faith is inherent to the civil law approach. Essentially, interference with the right of freedom to contract is undertaken more readily in civil law, particularly where some degree of unfairness may be perceived. It is illustrative to look at the Commission's approach to out of court settlement procedures. The basic argument is that under Article 6 of the European Convention on Human Rights:

... access to the courts is a fundamental right that knows no exceptions... whereas out of court procedures cannot be designed to replace court procedures; whereas therefore, use of the out of court alternative may not deprive consumers of their right to bring the matter before the courts unless they expressly agree to do so, in full awareness of the facts and only after the dispute has materialised.

It is clear that there is no objection to the use of out of court settlement procedures per se, and in that sense, the reference to Article 6 must be regarded as somewhat misleading. The difficulty is with pre-dispute arbitration clauses, not post-dispute agreements. It is submitted that a post-dispute arbitration

---


154 See CONTRACT LAW TODAY – ANGLO-FRENCH COMPARISONS 385 (Donald Harris & Denis Tallon eds., 1989); Ebke and Steinhauer, The Doctrine of Good Faith in German Contract Law, in GOOD FAITH AND FAULT IN CONTRACT LAW 171–90 (Jack Beaton & Daniel Friedmann eds., 1995); Com 20.3.1972, JCP 1973.II.17543 (Cour de Cassation) (Fr.) (liability for the defendant where he broke off negotiations before a contract had concluded since the negotiations were at an advanced state and the defendant had therefore “broken the rules of good faith in commercial relations”), cited in NICHOLAS, supra note 153.


156 Recommendation 98/257/CE, supra note 40, recital 21 (emphasis added).
agreement is one that the consumer is able to decide with full knowledge of the offending event. Essentially, it is an agreement as to how to resolve a real dispute. A pre-dispute clause deals with a hypothetical which may or may not occur and which could be significant or minor. The approach of the civil lawyers is focused not on the freedom of the parties to make their own agreement, but instead on the subjective ability of the consumer to make an agreement in the abstract. The civil law view is that such a clause is one sided and contrary to a general concept of good faith. Not only is the consumer being asked to surrender his or her rights, but he or she will be doing so at a time when he or she will be unlikely to be alive to any possible breach of the contract, whereas the seller will. Essentially the consumer is not aware of what he or she is agreeing to, whereas the seller, with the benefit of more commercial experience, will have a far better idea.

This is a substantial difference in perspective between the United States and Europe. Whereas American law seems focused on the freedom of the parties to commercial transactions to arrange their affairs in accordance with their own needs, the European approach seeks to protect those whom it considers to be the weaker party to a commercial transaction. At its simplest, and perhaps therefore most misleading, the American approach gives primacy to a more absolute concept of autonomy of the will, whereas the European approach holds that public policy may limit that autonomy.

2. English Common Law

English common law does not conform to the civil law ethos and yet its approach is closer to that of Europe than the United States. In English common law, the two principal reasons tending against arbitration are unity and competition. In English history, the common law has provided the unifying concept for dispute resolution:

Plural jurisdictions and plural legal subsystems are a hallmark of the common law. Competition between, inter alia, ecclesiastical and secular jurisdictions; between royal and feudal jurisdictions; and later between the courts exercising common
law jurisdictions and the courts of equity spawned rivalry which in turn provoked and promoted emergence of legal procedures and remedies in response to the particular and differing needs and demands of litigants.\textsuperscript{157}

Essentially, this need to provide a unified legal system, with the common law at its apex, coupled with a shortage of personnel, led the common law to make certain accommodations,\textsuperscript{158} none more striking than in the area of arbitration.\textsuperscript{159} The common law approach to arbitration was to permit it to operate (the common law not having sufficient resources of its own to absorb this jurisdiction),\textsuperscript{160} but to impose an overall supervisory role.\textsuperscript{161} There can be little doubt that ideally the common law wanted to remove the role of arbitration fully; however, with limited resources it was unable to do so. In addition, it is clear that the common law viewed arbitration as effectively a tool for the economically powerful\textsuperscript{162} and thus was more likely to intervene in the arbitral process when the economic balance was not sufficiently equal. As the industrialization of society led to a significant consumer class who lacked the economic power associated with arbitration, the


\textsuperscript{158} The Common law was not alone in this. The Courts of Chancery, the Star Chamber, and the Council had all sub-contracted “disputes to arbitrators as a means of expanding slender resources.” CORDISH & CLARK, LAW AND SOCIETY IN ENGLAND 1750–1950 36 (1989).

\textsuperscript{159} Arbitration, referring a dispute to an outsider or independent party, has a long history in English society, ranging from the personal disputes right across to commercial disputes either between merchants or between merchants and their customers. See HOLDSWORTH, XIV A HISTORY OF ENGLISH LAW 187–98 (1964); Paul L. Syre, Development of Commercial Arbitration Law, 37 YALE L.J. 595, 597 (1928).

\textsuperscript{160} See ARTHURS, supra note 55, at 62–77.

\textsuperscript{161} Vynior’s Case, 8 Co. Rep. 81b, 77 Eng. Rep. 597 (1610). This was later reinforced by providing a legislative framework of interaction between arbitration and the court structures. See Arbitration Act 1698 (9 Will. III, c.15) (enforcement of arbitral award through the courts); Common Law Procedure Act 1854 (17 &18 Vict. C. 125, §§ 3–17 (Eng.)) (arbitrator’s power to request clarification on a point of law). Note also that the approach in several U.S. jurisdictions during the 19th century was significantly more hostile to arbitration. See MORTON J. HORSWITZ, THE TRANSFORMATION OF AMERICAN LAW 1780-1860, 140–59 (1977).

\textsuperscript{162} For example, the use of arbitrators in cartels and other anti-competitive practices was commonplace in the 19th century. See CORDISH & CLARK, supra note 158, at 269–70.
tendency was for the common law to intervene on the grounds of public policy in consumer arbitrations, particularly pre-dispute clauses where the economic disparity was even greater.\footnote{An agreement to proceed to arbitration after a dispute has arisen is unlikely to be economically disadvantageous to the consumer as he or she has a potential claim that can be bartered. In the view of the common law courts, however, the same is not true of pre-dispute clauses, where the consumer's only choice is to forego the contract.}

3. European Union

Not only does the principal E.U. legislation, the Unfair Contract Terms Directive, reflect the legal ethos of the member states, the legislation itself has been generated from a specific desire to regulate and protect consumers in various transactions.\footnote{Council Directive 93/13/EEC, supra note 4.} The legislative process itself involved consultation with the various stakeholders and pressure groups, in particular consumer groups.\footnote{Michelle Egan & Dieter Wolf, Regulation and Comitology: The EC Committee System in Regulatory Perspective, 4 COLUM. J. EUR. L. 499, 520 (1998).} It is therefore unsurprising that consumers might query any clause that on the surface appears to remove consumer rights.

More interesting, perhaps, is why the commercial world appears not to have significantly pressed for validating pre-dispute arbitration clauses in the European context. This is particularly striking when there is clear evidence that the commercial world is still in favor of such clauses, as we have seen above. The following section considers that question.

By comparison, the history of the Federal Arbitration Act ("FAA") in the United States is such that the issue of pre-dispute consumer arbitration was not much considered at the time the FAA was enacted. When enacted in 1925, the FAA applied to a much narrower class of cases than it does today.\footnote{See generally Katherine Van Wezel Stone, Rustic Justice: Community and Coercion Under the Federal Arbitration Act, 77 N.C. L. REV. 931 (1999) (discussing the history and application of the Act).} The language defining the scope of the Act remains the same: it applies to "any maritime transaction or a contract evidencing a transaction involving commerce."\footnote{9 U.S.C. § 2 (2000).} But the reach of that language has increased significantly since 1925, both because the Supreme Court has interpreted Congress' power to regulate interstate...
commerce more expansively since 1925, and because many more consumer transactions involve interstate commerce today than in 1925. As a result, the Federal Arbitration Act has evolved through judicial interpretation into a statute that makes many pre-dispute consumer arbitration agreements enforceable.

B. The Politics of Consumer Arbitration

While legal tradition is important in explaining the differing legal treatment of pre-dispute consumer arbitration in the European Union and the United States, that tradition is reinforced by politics. Because the legal system in the United States differs in several significant respects from legal systems in the European Union, American companies have a stronger incentive to oppose attempts to amend the FAA to regulate consumer arbitration. Unlike European legal systems, the United States legal system provides for the right to jury trial in civil cases, broadly available class action procedures that permit claimants to aggregate small claims, and a wider availability of punitive damages. American businesses use arbitration to reduce their legal risks from each of these sources.

First, in the United States, many parties in civil cases have a constitutional right to a jury trial. Given that many businesses perceive juries as sympathetic to consumer interests, it should not be surprising that businesses would prefer a means of dispute resolution that did not include juries, such as arbitration. By contrast, European countries, both common law and civil law, severely restrict the right to jury trial in civil cases. Thus, in the

---

168 See supra text accompanying notes 107–09.
169 See infra text accompanying notes 170–80.
170 See, e.g., U.S. CONST. amend. VII (jury trial right in federal court). To date, courts generally have rejected contentions that arbitration agreements violate jury trial guarantees. See Jean R. Sternlight, Mandatory Binding Arbitration and the Demise of the Seventh Amendment Right to a Jury Trial, 16 Ohio St. J. ON DISP. Resol. 669, 672 (2001).
171 See generally Harvey McGregor, McGregor on Damages ¶ 2090 (16th ed. 1997); Ward v. James, 1 Q.B. 273, 303 (1966) (a judge “ought not, in a personal injury case, to order trial by jury save in exceptional circumstances;” the position in England and Ireland is that jury trials in civil cases (with limited exceptions) are discretionary and that discretion is seldom, if ever, exercised.) Civil legal systems have seldom utilized the jury trial in non criminal cases. See Nigel G. Foster, German Law and Legal System 85–87 (1993).
United States, businesses have a greater incentive to use arbitration as a way to avoid potentially hostile juries.\footnote{Cf. J. Mark Ramseyer, *International Dispute Resolution: Law and Economics*, in *DREAMS AND DILEMMAS: ECONOMIC FRICTION AND DISPUTE RESOLUTION IN THE ASIA-PACIFIC* 464, 470 (Koichi Hamada et al. eds., 2000) ("The lower demand for arbitration in Japan [as compared to the United States] thus probably reflects the fact that neither party could demand a jury trial *ex post* anyway").}

Second, American rules of civil procedure permit plaintiffs to aggregate their claims in class actions, with representative plaintiffs suing on behalf of a large number of class members who do not actively participate in the litigation.\footnote{See Bruce Hay and David Rosenberg, "Sweethart" and "Blackmail" Settlements in Class Actions: Reality and Remedy, 75 Notre Dame L. Rev. 1377, 1378–79 (2000) (taking skeptical view of criticisms).} Class actions have been criticized for resulting in both over-compensation and under-compensation of class members.\footnote{See Jean R. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 WM. & MARY L. REV. 1, 59 (2000) (noting that a handful of states provide for class relief in arbitration).} By including pre-dispute arbitration clauses in their consumer form contracts, businesses can reduce their susceptibility to class actions.\footnote{See generally Walter Van Gerven, *Cases, Materials and Text on National, Supranational and International Tort Law* 268–70 (2000) (with respect to the inability of the German legal system to accept mass torts or class actions); Eoin Quill, *Torts in Ireland* 512 (1999) (class actions are not recognized in Irish law). But note that the position in England may be in transition toward allowing class actions, albeit based on the flexible use of procedural devices. See Hunter v. Canary Wharf Ltd., 3 A.C. 655 (1997). See generally Jillaine Seymour, *Representative Procedures and the Future of Multi-Party Actions*, 62 MOD. L. REV. 564 (1999) (discussing procedural tests used in class actions).} Because class-wide relief is not commonly available in the European Union,\footnote{See 1 Dan B. Dobbs, *Law of Remedies* § 3.11(1), at 456–57 (2d ed. 1993).} businesses in the United States have a greater incentive to provide for arbitration for this reason as well.

Third, in the United States punitive damages are available as a remedy for many tort claims.\footnote{See, e.g., Theodore Eisenberg et al., *The Predictability of Punitive Damages*, 26 J. LEGAL STUD. 623 (1997).} Although there is conflicting evidence on the frequency of large punitive damages awards,\footnote{See 1 Dan B. Dobbs, *Law of Remedies* § 3.11(1), at 456–57 (2d ed. 1993).} certainly businesses would prefer to reduce the risk of such awards. Arbitrators may be less likely (or at least perceived as
less likely) to award punitive damages, or, if they award punitive damages, to award a lesser amount. In addition, arbitrators may be more likely than judges to enforce waivers of punitive damages, which are sometimes contained in consumer contracts. By contrast, punitive damages are not routinely awarded in European legal systems. Again, the result is that arbitration is more attractive to businesses in the United States.

For all these reasons, businesses in the United States have a greater incentive to include pre-dispute arbitration clauses in consumer contracts, as the anecdotal evidence in the previous section suggests. For the same reasons, businesses in the United States have a greater incentive to oppose attempts to regulate or prohibit such clauses. So far, businesses have been largely (but not completely) successful in opposing legislation that would amend the Federal Arbitration Act to exclude certain claims or parties from the Act. Again, because businesses in the European Union have less incentive to oppose restrictions on pre-dispute consumer arbitration, it is not surprising to find a greater degree of


180 See Rooke v. Barnard, A.C. 1129, 1226 (1964) (seminal, although heavily criticized, English case restricting the award of punitive damages to three situations: oppressive state action; conduct by defendant calculated to make a profit exceeding compensation payable; and statutory authorization); see also McGREGOR ON DAMAGES, supra note 171, ¶ 430 (pointing out that the basis of the reluctance to award punitive damages may be based on the fact that it essentially aims to punish the defendant without the usual procedural safeguards available in a criminal trial). For a German perspective, see generally STOLL, HAFTUNGSFOLGEN IM BÜRGERLICHEN RECHT 147–235 (1993) (general outline of the function of compensation in German law). The notion of punitive damages is said to be foreign to German law. See LANGE, SCHADENERSATZ 12 (2d ed. 1990).

181 See supra Part IV; see also Sternlight, supra note 45 ("it does seem clear that the United States is perceived as more hospitable to plaintiffs than many jurisdictions, and it is obvious that this would give companies an added incentive to evade liability in the United States").

182 See infra notes 99–110 and accompanying text; see also Sternlight, supra note 45 ("The disparity between the United States and other jurisdictions [as to the enforceability of pre-dispute consumer arbitration agreements] may also be due to the fact that companies have more political clout in the United States than in many other places").
protection for consumer interests in the Unfair Terms Directive and the Arbitration Act of 1996.\footnote{See supra notes 23–99 and accompanying text.}

It may be, however, that the United States will increase its regulation of pre-dispute consumer arbitration agreements in the future, and thus move closer to the E.U. approach. Public Law 107-273, signed into law November 2, 2002, requires post-dispute consent to arbitrate by parties to motor vehicle franchise agreements.\footnote{See 21st Century Department of Justice Appropriations Authorization Act, § 11028(a)(2), Pub. L. No. 107-273 (Nov. 2, 2002):

Notwithstanding any other provision of law, whenever a motor vehicle franchise contract provides for the use of arbitration to resolve a controversy arising out of or relating to such contract, arbitration may be used to settle such controversy only if after such controversy arises all parties to such controversy consent in writing to use arbitration to settle such controversy.

The statute also requires that when parties agree to arbitrate disputes arising out of motor vehicle franchise agreements, “the arbitrator shall provide the parties to such contract with a written explanation of the factual and legal basis of the award.” Id. § 11028(a)(3).} In other words, it makes unenforceable pre-dispute arbitration clauses in franchise agreements between car dealers and car manufacturers. A number of other bills have been introduced into the U.S. Congress to restrict consumer (and employment) arbitration, either by excluding certain claims from arbitration or by permitting only post-dispute arbitration agreements in certain contracts.\footnote{See Drahozal, supra note 122, at 698 (citing bills).}

One might expect businesses successfully to defeat increased regulation of consumer arbitration because they are likely to have lower costs of organizing politically and more at stake than consumers.\footnote{E.g., Mancur Olson, The Logic of Collective Action 29, 48 (1965); see Fred S. McChesney, Rent Extraction and Interest-Group Organization in a Coasean Model of Regulation, 20 J. LEGAL STUD. 73, 85 (1991). Thus, it is not surprising that the only federal law restricting the enforceability of arbitration clauses, enacted to date, protects car dealers, who have lower organizational costs and higher individual stakes than consumers generally. See note 184 and accompanying text.} But business interests are likely to be opposed in the legislative process not only by consumer groups but also by trial lawyers - lawyers who represent plaintiffs and who have perhaps the most to lose from increased use of pre-dispute arbitration agreements.\footnote{Stephen J. Ware, Arbitration Under Assault: Trial Lawyers Lead the Charge,} Trial lawyers have much lower
organization costs than consumers and greater amounts at stake. Indeed, under one economic theory of regulation, the demand for increased regulation of pre-dispute arbitration agreements by both consumer groups (who make policy arguments in favor of regulation) and by trial lawyers (who have significant economic interests at stake) increases the likelihood that regulatory laws will be enacted. In short, as the demand for regulation grows in the United States, the legal treatment of pre-dispute arbitration agreements in the European Union and the United States may converge, although it is too early to know for sure.

VI. Conclusion

This article has examined the differing legal treatment of pre-dispute consumer arbitration agreements in the European Union and the United States. Under the E.U. Directive on Unfair Terms in Consumer Contracts (particularly as implemented in the United Kingdom), most such agreements are invalid. In the United States by contrast, most pre-dispute arbitration agreements are valid, even in consumer contracts, unless some other provision in the arbitration agreement renders it unenforceable. In our view, the differing legal treatment likely stems from differing legal traditions between the European Union and the United States with respect to consumer protection legislation, and key differences between the legal systems in the European Union and in the

---

Bruce Yandle describes this theory as the “Baptist and Bootlegger” theory of regulation, a name derived from efforts of American states to regulate the sale of alcoholic beverages on Sunday:

Durable social regulation evolves when it is demanded by both of two distinctly different groups. “Baptists” point to the moral high ground and give vital and vocal endorsement of laudable public benefits promised by a desired regulation. Baptists flourish when their moral message forms a visible foundation for political action. “Bootleggers” are much less visible but no less vital. Bootleggers, who expect to profit from the very regulatory restrictions desired by Baptists, grease the political machinery with some of their expected proceeds. They are simply in it for the money.

United States. More specifically, in European legal traditions, consumer interests generally are more highly protected than in the United States (particularly given that the coverage of consumer arbitration by the Federal Arbitration Act evolved through court decision rather than legislative action). Meanwhile, the greater availability of jury trials, class actions, and punitive damages in the United States gives American businesses more incentive to oppose regulation of pre-dispute consumer arbitration agreements. However, increased demand for regulation in the United States, from consumer groups and trial lawyers, may result in a greater convergence of European and American regulation in the future.