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SENATE

REPORT
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THE MOTOR VEHICLE FRANCHISE CONTRACT ARBITRATION FAIRNESS ACT

SEPTEMBER 10, 2002.—Ordered to be printed

Mr. LEAHY, from the Committee on the Judiciary, submitted the following

R E P O R T

together with

MINORITY VIEWS

[To accompany S. 1140]

[Including cost estimate of the Congressional Budget Office]

The Committee on the Judiciary, to which was referred the bill (S. 1140) to amend chapter 1 of title 9, United States Code, to provide for greater fairness in the arbitration process relating to motor vehicle franchise contracts, having considered the same, reports favorably thereon, without amendment, and recommends that the bill do pass.

CONTENTS

I. PURPOSE OF LEGISLATION

The Motor Vehicle Franchise Contract Arbitration Fairness Act, S. 1140, is a targeted amendment to the Federal Arbitration Act which requires that whenever a motor vehicle franchise contract provides for the use of arbitration to resolve a controversy arising out of or relating to the contract, arbitration may be used to settle the controversy only if both parties consent in writing after such controversy arises. This legislation would allow motor vehicle dealers the option of either going to arbitration or utilizing procedures and remedies available under State law such as those involving State-established administrative boards specifically created and uniquely equipped to resolve disputes between motor vehicle dealers and manufacturers. This legislation is intended to ensure that motor vehicle dealers are not required to forfeit important rights and remedies afforded by State law as a condition of obtaining or renewing a motor vehicle franchise contract.

II. LEGISLATIVE HISTORY

In the 106th Congress, legislation similar to S. 1140 was introduced by Senators Grassley and Feingold as S. 1020, the Motor Vehicle Franchise Contract Arbitration Fairness Act of 1999. The legislation was referred to the Committee on the Judiciary and given a hearing on March 1, 2000, in the Subcommittee on Administrative Oversight and the Courts. It was subsequently placed on the markup calendar on October 5, 2000, but no Committee action was taken. A similar measure, H.R. 534, was reported favorably by the House Committee on the Judiciary on September 13, 2000, by voice vote, and approved by the House of Representatives on October 3, 2000, by voice vote.

On June 29, 2001, Senator Orrin G. Hatch introduced S. 1140, the Motor Vehicle Franchise Contract Arbitration Fairness Act of 2001, along with Senators Feingold, Grassley, Leahy, Warner, Breaux, Burns, Reid, Craig, Torricelli, Bennett, Snowe, DeWine, Thomas, and Hutchinson as original cosponsors.[1] On March 29, 2001, a similar measure, H.R. 1296, was introduced in the House of Representatives with over 30 original cosponsors.[2]

III. VOTE OF THE COMMITTEE

The Committee on the Judiciary, with a quorum present, met on Thursday, October 18, 2001, at 10 a.m., to consider S. 1140. The Committee ordered the Motor Vehicle Franchise Contract Arbitration Fairness Act to be reported favorably to the full Senate by voice vote, with one dissenting vote by Senator Sessions, with a recommendation that the bill do pass.

IV. BACKGROUND

Dealers of new motor vehicles are virtual economic captives of automobile manufacturers. Unlike some other franchisees, who may have a broad choice of franchisers with which to contract, new

[1] Since its introduction, S. 1140 has received exceptionally strong bipartisan support and is currently cosponsored by more than 60 Members of the Senate.

[2] H.R. 1296 is currently cosponsored by more than 200 Members of the House of Representatives.

motor vehicle dealers may only obtain the right to merchandise and sell their product from an extremely limited group of manufacturers. As a result of the imbalance in bargaining power inherent in this relationship, manufacturers possess unparalleled leverage over dealers and potential franchisees. Motor vehicle manufacturers have historically, and do currently, require dealers to execute standard contracts of adhesion defining the manufacturer-dealer contract on a "take it or leave it" basis. Additionally, manufacturers have broad discretion to allocate vehicle inventory and to control the timing for delivery of dealer stock. Manufacturers also exercise considerable control over the flow of revenue to dealers, such as warranty payments.

In recognition of the disparity in bargaining power between motor vehicle dealers and manufacturers, all States have enacted laws specifically designed to level the playing field between manufacturers and dealers and prevent unfair contract terms and practices. In fact, State laws govern nearly every aspect of the franchise contract (except for the inclusion of arbitration clauses as discussed below). Motor vehicle franchise contracts and resulting disputes greatly affect the competitive distribution of vehicles which directly affects consumers as well as individual States' economies generally. In fact, the U.S. Supreme Court has held that State legislatures are constitutionally empowered to regulate the motor vehicle contractual relationship as a valid exercise of their police powers. *New Motor Vehicle Board* v. *Orrin W. Fox Co.,* 99 S. Ct. 403 (1978). As a result, dealers have clear and enforceable rights under State franchise laws. Generally, these State rights and procedures are nonwaivable, and contract terms that conflict with State law are routinely rendered unenforceable, irrespective of contract terms.

In 1987, many automobile and truck manufacturers began to include mandatory binding arbitration clauses in their dealer contracts. Mandatory binding arbitration clauses require that all disputes between the dealer and manufacturer be resolved by binding arbitration under the Federal Arbitration Act ("FAA"). These provisions ultimately require dealers to relinquish forums otherwise available under State law, including many of the State-established boards designed to regulate the relationship between dealers and manufacturers. Since dealers are unable to modify boiler-plate franchise contracts and delete the mandatory binding arbitration provisions, they have no choice but to accept such provisions as part of the standardized franchise contract or risk losing a business or prospective business.

Today, almost every major motor vehicle manufacturer uses mandatory binding arbitration either in the dealer franchise contract or in side contracts with certain dealers.[3] Manufacturers increasingly are inserting mandatory binding arbitration clauses in non-negotiated side contracts with dealers, such as those governing dealer finance disputes and incentive disputes. Many States, frustrated by the fact that mandatory binding arbitration provisions

[3] These manufacturers utilizing mandatory binding arbitration in their dealer franchise contracts include: Bering Truck, DaimlerChrysler (which provided limited opt-out of arbitration by addendum), Freightliner Truck/DaimlerChrysler, Sterling Truck/DaimlerChrysler, Ferrari, Ford Dealer Development—principally with dealer development programs, General Motors Dealer Development—principally with dealer development programs, Saturn/GM, Hino Diesel—Toyota majority stock holder, Kenworth Truck, Nissan Diesel, Peterbilt Trucks, Suzuki, and Western Star.

nullify their State statutes and procedures, have repeatedly attempted to enact laws to prohibit the inclusion of mandatory binding arbitration clauses in certain contracts. These State laws, however, have been universally preempted by the FAA.

The Supreme Court articulated the preemptive effect of the FAA in *Southland Corporation* v. *Keating,* 104 S. Ct. 852 (1984). Chief Justice Burger, writing for the Court, stated that "[i]n creating a substantive rule applicable in state as well as federal courts, Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements." Id. at 854.

In 1985, the Supreme Court further held that the FAA provided no basis for implying a presumption against arbitration of statutory claims or for departing from the Federal policy favoring arbitration in situations where a party bound by an arbitration agreement raises claims founded on statutory rights. In the case of *Mitsubishi Motors Corporation* v. *Soler Chrysler-Plymouth,* 105 S. Ct. 3346 (1985), a motor vehicle dealer attempted to avoid the enforcement of a mandatory arbitration provision in its distribution agreement on the grounds that the enforcement of the arbitration clause would deprive the dealer of the ability to invoke its statutory right to bring an antitrust action under the Sherman Act. The Supreme Court was not persuaded by the argument that only contractual disputes, not statutory rights, should be determined through mandatory binding arbitration even when the claims presented are complex and carry as many public policy implications as a claim under the Sherman Act. Writing for the Court, Justice Blackmun stated that, "[b]y agreeing to arbitrate a statutory claim, a party does not forego the substantive rights afforded by the statute; it only submits to their resolution in an arbitral rather than a judicial forum." Id. at 3354. Thus, the Court implied that statutory rights are not infringed when adjudicated in an arbitral rather than a judicial forum.

Following this line of cases, the Federal preemption principle was specifically interpreted by the Fourth Circuit Court of Appeals to apply to contracts between motor vehicle dealers and manufacturers in "Saturn Distribution Corp. v. *Williams,* 905 F.2d 719 (4th Cir. 1990). In 1989, Saturn filed suit against the Virginia Commissioner of Motor Vehicles when the Commissioner refused to approve Saturn's franchise contract. The Saturn Contract was rejected because it contained a mandatory binding arbitration clause in violation of the Virginia Motor Vehicle Licensing Act. Va. Code Ann. § § 56.1–515 et seq. That law specifically precludes any provision that denies access to the procedures, forums and remedies provided for under State law. The Commissioner had indicated to Saturn that he would approve the contract if it gave the dealer the option to delete the exclusive arbitration clause, but that Saturn could not make the inclusion of that clause a prerequisite to becoming a dealer. Saturn declined to make these modifications. *Saturn Distribution Corp* v. *Williams,* 717 F. Supp. 1147, 1149 (E.D. Va. 1989).

At trial, the district court ruled in favor of the Commissioner. Id. at 1153. However, the fourth circuit, holding that the Virginia Motor Vehicle Licensing Act conflicts with the FAA and is preempted under the Supremacy Clause of the United States Constitution. The court relied on two Supreme Court decisions, *Southland,*

104 S. Ct. 852 (1984), and *Perry* v. *Thomas,* 107 S. Ct. 2520 (1987). The Supreme Court denied certiorari and let stand the mandatory binding arbitration provision in Saturn's dealer franchise contract.

V. The Need for Legislation

In the majority of States, an agency is charged with administering and enforcing motor vehicle franchise law.[4] These State forums, boards, and commissions serve as efficient and cost-effective alternative dispute resolution systems for motor vehicle franchise disputes because State agencies have both expertise and experience in these matters. State motor vehicle administrative forums were specifically established for the public policy purpose of providing alternative dispute resolution mechanisms, but with the added features of important legal safeguards, particularly that of a right to appeal.

Additionally, most metropolitan motor vehicle dealer associations participate in nonbinding third-party dispute resolution programs designed to mediate disagreements between consumers and new car dealers and/or manufacturers.[5] The Automotive Consumer Action Program ("AUTOCAP") is one such program, voluntarily sponsored by franchised motor vehicle dealer associations and administered in accordance with national standards established by the National Automobile Dealers Association.[6] AUTOCAP is available in many States and in the District of Columbia.[7] Often, these programs are run in conjunction with the offices of State attorneys general.

AUTOCAP dispute resolution begins with an effort at informal mediation. If informal mediation is unsuccessful, disputes are then mediated by a panel comprised of consumer representatives and motor vehicle dealers. The decision to accept or reject an AUTOCAP decision is at the sole discretion of the parties, and in all cases is nonbinding on the consumer. If dissatisfied with the outcome a consumer is free to pursue other types of legal recourse. The Council of Better Business Bureaus sponsors a similar program, Auto Line, in which manufacturers participate on a manufacturer-by-manufacturer basis.

The use of mandatory binding arbitration can be distinguished from State-established administrative boards and programs such as AUTOCAP and Auto Line in that mandatory binding arbitration does not allow for further judicial review. A dealer seeking to overturn an arbitration decision often cannot appeal the decision even when it is clear that the law has been misapplied. Arbitration also lacks the formal court-supervised discovery process often necessary to learn facts and obtain documents. Arbitrators generally have no

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[4] Arizona, Arkansas, California, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, North Carolina, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, and Wisconsin have such agencies.

[5] Mandatory binding arbitration clauses are not prevalent in most dealer-consumer new car contracts except in Alabama, and some State associations actively discourage the practice.

[6] States with AUTOCAP programs are Arizona, California (San Diego), District of Columbia (MD and VA area), Hawaii, Illinois, Kentucky, Montana, New Hampshire, New Mexico, New York, North Carolina, North Dakota, Ohio, Rhode Island, South Carolina, South Dakota, Texas, and Vermont.

[7] Manufacturers including BMW, Honda/Acura, Isuzu, Jaguar, Mitsubishi, Nissan/Infiniti, and Volvo use the AUTOCAP resolution program.

obligation to provide a factual or legal basis for the decision in a written opinion, and the impartiality of arbitration providers may be affected by the knowledge that the manufacturer may be likely to bring them repeat business but the dealer is not. In addition, the fees required to initiate an arbitration proceeding can be prohibitive to a small business owner, particularly in contrast to State forums that may be otherwise available.

The inclusion of mandatory binding arbitration clauses in contracts between dealers and manufacturers also provides automobile manufacturers with an advantage in disputes with dealers because these clauses create an easy means by which to avoid State-established forums. For example, a dealer in Virginia, who believed he met all of Virginia's franchise requirements to remain a Sterling Truck dealer, had his franchise terminated by the manufacturer because of his refusal to comply with a unilateral contract modification that mandated 8-hour shifts in the dealership's parts and service department on Sundays and required the creation of a separate facility to house a new line of trucks. When the dealer sought a hearing before the Virginia Division of Motor Vehicles, the administrative body designated to hear these disputes, the request was denied because the dealer had been forced in his franchise contract to waive his rights under State law and submit to mandatory binding arbitration.

The dealer decided that due to the legal expense involved, fighting Sterling in arbitration was not economically feasible, and Sterling subsequently terminated his franchise despite his 42-year tenure as a heavy-duty truck dealer. Had the dealer not been forced to accept mandatory binding arbitration, he could have proceeded to the Virginia Division of Motor Vehicles dispute resolution forum, where, had State law been applied, he believes he would likely have successfully retained the franchise.[8]

Mr. William Shack, a California dealer and long-time member of the National Association of Minority Automobile Dealers, testified before the Senate Administrative Oversight and the Courts Subcommittee on March 1, 2000, about his adverse experience with mandatory binding arbitration with his automobile manufacturer, Saturn. After a substantial financial investment by Mr. Shack and his partner, Saturn unilaterally terminated their dealer contract and forced them into mandatory binding arbitration. Mr. Shack believed the arbitration panel's monetary award to be grossly inadequate considering his total acquisition-related expenses, all incurred to comply with Saturn's terms and conditions. As a result of the mandatory binding arbitration clause unilaterally inserted in the franchise contract by the manufacturer, Mr. Shack believes he never received a fair hearing on the merits. Mr. Shack's franchise was terminated, and he consequently suffered tremendous economic loss.

Mr. Shack further testified that:

> The administration of Saturn's mandatory binding arbitration process is fundamentally unfair. All of the decision makers in the process have economic ties to Saturn. Under the mandatory binding arbitration that I was subjected to,

[8] See letter to Senator John Warner, dated March 14, 2000, from Charles M. Robertson, President of Magic City Motor Corp.

> I had no state remedies, no right to a hearing on the record, no right to an unbiased decision maker, and no real right to an appeal on this issue.[9]

It is clear that dealers are being required to forfeit important rights and remedies afforded by State law as a condition of obtaining or renewing their motor vehicle franchise contracts. Furthermore, since State laws prohibiting mandatory binding arbitration clauses have been held to be preempted by the FAA, targeted Federal legislation amending the FAA is necessary to remedy this problem.

As discussed below, Congress has acknowledged that a motor vehicle dealer, after making a tremendous investment, depends completely upon the manufacturer to survive and prosper. For example, manufacturers can determine the dealer's stock with the allocation of hot selling models; manufacturers can accelerate or delay warranty payments with great discretion, or alter the rate paid for certain types of work that the dealer performs to honor the manufacturer's warranty; and manufacturers can limit dealers' rights to transfer ownership or control of the dealership—even to family members. According to a recent National Automobile Dealers Association ("NADA") survey,[10] half of the member dealerships are second or third generation family businesses, and many of the family-owned first generation dealerships plan to pass their small businesses on to their children.

Noting the imbalances in bargaining power inherent in the manufacturer-dealer relationship, in 1956 Congress enacted the Automobile Dealers Day in Court Act, 15 U.S.C. 1221–1225, to provide small business dealers with recourse in Federal court against manufacturer abuses irrespective of contract terms. This Federal statute serves as precedent for Federal legislation to deal with problems in this area caused by disparities in bargaining power between manufacturers and dealers. However, the Automobile Dealers Day in Court Act has proved to be insufficient to level the playing field between dealers and manufacturers. The act does not provide for equitable relief and fails to address the "one sidedness" of the motor vehicle franchise contract itself.

In addition, Congress has passed legislation to prevent the forced waiver of substantive rights in disputes between small business service station owners and multinational oil companies. The Petroleum Marketing Practices Act ("PMPA"), 15 U.S.C. 2801–2806, which regulates the franchise relationship between oil refineries and gasoline retailers, was enacted to prevent oil companies from improperly exploiting their unequal bargaining power and to deter unfair conduct by prohibiting refineries from forcing gasoline retailers to accept mandatory binding arbitration and surrendering important statutory rights. Similarly, S. 1140 would ensure that motor vehicle dealers will not be compelled to surrender their statutory rights as a condition of obtaining or renewing their dealer contracts.

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[9] See testimony of Mr. William Shack before the Senate Judiciary Committee, Subcommittee on Administrative Oversight and the Courts, March 1, 2000.

[10] NADA survey conducted May, 2000, of the total 2,148 surveys returned: 1st generation dealerships: 1,029 (48 percent); 2d generation dealerships: 670 (31 percent); 3d generation dealerships: 398 (19 percent); and 4th generation dealerships: 51 (2 percent).

In 1925, Congress passed the Federal Arbitration Act ("FAA") to address the judicial hostility to arbitration and make arbitration decisions enforceable in Federal courts. Since 1947, when the FAA was reenacted and codified in title 9 of the United States Code, there have only been minor amendments. However, in two recent alternative dispute resolution ("ADR") statutes discussed below, Congress specifically provided statutory language to ensure that arbitration is voluntary. In the same vein, S. 1140 does not void arbitration as a viable option for dispute resolution, it merely seeks to ensure that participation is voluntary by both parties.

In 1988, Congress first passed the Judicial Improvements and Access to Justice Act, 28 U.S.C. 651–658 (1988), authorizing 20 Federal judicial districts to establish experimental court-annexed arbitration programs as an alternative to formal civil trials. From the outset the law was drafted to ensure the voluntary nature of arbitration. Then, in 1998, Congress passed the Alternative Dispute Resolution Act ("ADR"), 28 U.S.C. 651–658 (1998 amendments), expanding the program to all Federal district courts to provide litigants in all civil cases with at least one alternative dispute resolution process such as mediation, mini trial or arbitration. In that measure, Congress specifically included protective provisions to ensure that arbitration is voluntary. Under the ADR statute a district court may only allow arbitration if the parties consent. The law further clearly creates safeguards to provide true consent by requiring procedures ensuring that "consent to arbitration is freely and knowingly obtained, and no party or attorney is prejudiced for refusing to participate in arbitration." Therefore, a party retains the right to pursue a judicial determination of the matter if it so chooses.

Similarly, the focus of S. 1140, to make binding arbitration voluntary rather than mandatory, is fully consistent with the prominent theme that arbitration must be voluntary in court-annexed proceedings. In addition, S. 1140 will not discourage alternative dispute resolution. In fact, the proposed legislation attempts to protect the State ADR forums established to resolve dealer-manufacturer disputes. Similar to court-annexed arbitration, these forums reduce costs and delays and preserve judicial time and resources.

Additional legislation enacted in 1990 and 1996, the Administrative Dispute Resolution Act, 5 U.S.C. 581–593 (1990 and 1996 amendments), authorizes Federal agencies to use arbitration to resolve administrative disputes if the parties consent. The act goes to great length to emphasize that the decision to arbitrate must be voluntary for both parties. For example, section 585 states that "an agency may not require any person to consent to arbitration as a condition of entering into a contract or obtaining any benefit." 5 U.S.C. 585 (1990). As stated in the Senate Governmental Affairs Committee Report accompanying the bill:

> A new Section 585 authorizes the use of arbitration whenever all parties consent in writing. It prohibits a federal agency from requiring any person to consent to arbitration as a condition of receiving a contractor benefit. This prohibition is intended to help ensure that the use of arbitration is truly voluntary on all sides.[11]

[11] S. Rept. 101–543, p. 12.

This provision in the 1990 statute was maintained in the 1996 legislation.

The Motor Vehicle Franchise Contract Arbitration Fairness Act, S. 1140, would simply guarantee that binding arbitration to resolve disputes involving a motor vehicle franchise contract is entered into only after voluntary agreement by both parties. Voluntary agreements would prohibit motor vehicle manufacturers from mandatorily depriving dealers of rights they are entitled to under Federal and State laws. Thus, S. 1140 conforms with recent congressional efforts to streamline the Federal judicial system, which have recognized the importance of maintaining voluntary consent to binding arbitration.

VI. SECTION-BY-SECTION ANALYSIS

Section 1.—Short title

Section 1 provides that the short title of the bill shall be the Motor Vehicle Franchise Contract Arbitration Fairness Act.

Section 2.—Election of arbitration

Section 2 amends the Federal Arbitration Act to require that whenever a motor vehicle franchise contract provides for the use of arbitration to resolve a controversy arising out of or relating to the contract, arbitration may be used to settle the controversy only if both parties consent in writing after such controversy arises. This section also requires the arbitrator to provide the parties with a written explanation of the factual and legal basis for the decision.

Section 3.—Effective date

Section 3 provides that the amendments to the FAA made by this legislation shall apply only to contracts entered into, modified, renewed or extended after the date of enactment.

VII. COST ESTIMATE

In compliance with paragraph 11(a) of rule XXVI, of the Standing Rules of the Senate, the Committee sets forth, with respect to the bill, S. 1140, the following estimate and comparison prepared by the Director of the Congressional Budget Office under section 403 of the Congressional Budget Act of 1974:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, November 2, 2001.

Hon. PATRICK J. LEAHY,
Chairman, Committee on the Judiciary,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has contemplated a cost estimate for S. 1140, the Motor Vehicle Franchise Contract Arbitration Fairness Act of 2001. The CBO staff contacts for this estimate are Lanette J. Walker (for federal costs), and Paige Piper/Bach (for the private sector costs).

Sincerely,

DAN L. CRIPPEN,
Director.

Enclosure.

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

CBO estimates that implementing S. 1140 would cost less than $500,000 annually, assuming the availability of appropriated funds. Enacting the bill would not affect direct spending or receipts, so pay-as-you-go procedures would not apply. S. 1140 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not affect state, local, or tribal governments. It would impose private-sector mandates as defined by UMRA, but CBO estimates the direct costs if those mandates would fall well below the threshold established by UMRA ($113 million in 2001, adjusted annually for inflation).

S. 1140 would provide that contract disputes between motor vehicle manufacturers and motor vehicle dealers can be resolved by arbitration only after both parties agree to arbitration as a means of settling the dispute. Under current law, manufacturers can include clauses in contracts with dealers that provide for mandatory arbitration if a contract dispute would arise.

CBO estimates that implementing the bill could increase costs to federal courts to the extent that such contract disputes are tried in federal court. Based on information from the Administrative Office of the United States Courts, CBO estimates that any increase in federal costs would be less than $500,000 a year because of the relatively small number of cases expected. Any additional costs would be subject to the availability of appropriated funds.

S. 1140 would impose private-sector mandates on certain motor vehicle manufacturers and arbitrators involved in disputes arising out of or relating to a motor vehicle franchise contract by allowing arbitration only after both parties in a dispute agree in writing to arbitration, and by requiring an arbitrator elected to resolve such a dispute to provide the parties with a written explanation of the basis for the award. Based on information provided by the National Automobile Dealers Association, the Association of International Automobile Manufacturers, and the American Arbitration Association, CBO estimates that the direct cost of those mandates would fall well below the threshold established by UMRA.

This estimate was approved by Peter H. Fontaine, Deputy Assistant Director for Budget Analysis.

VIII. Regulatory Impact Statement

In compliance with paragraph (11)(b)(1), rule XXVI of the Standing Rules of the Senate, the Committee, after due consideration, concludes that S. 1140 will not have a significant regulatory impact.

IX. MINORITY VIEWS OF SENATOR SESSIONS

Senate bill 1140, the Motor Vehicle Franchise Contract Arbitration Fairness Act, takes a piecemeal exemption approach to arbitration reform. The bill takes one type of contract—motor vehicle dealership franchise contracts—and exempts the parties to such contracts from the Federal Arbitration Act (FAA). The bill does not address issues with other types of arbitration and does not attempt to reform the FAA itself. Instead, the bill reverses a long-standing congressional policy favoring arbitration in a manner that undermines the sanctity of contract and has serious implications for other types of transactions to which the FAA currently applies.

Arbitration is an informal process of resolving disputes in which a neutral third party arbitrator renders a decision after hearing both parties. As the Supreme Court has explained, "[b]y agreeing to arbitrate a * * * claim, a party does not forgo * * * substantive rights * * *; it only submits to their resolution in an arbitral, rather than a judicial, forum." [1] Arbitration in intended to avoid the formalities, expense, and delay of formal dispute resolution before courts.

In 1925, Congress passed the Federal Arbitration Act ("FAA") to preempt judicial aversion to arbitration by making arbitration decisions enforceable in Federal courts. Under the FAA, now codified in title 9, United States Code, when two parties agree to a binding contract that affects interstate commerce, an arbitration clause waiving the right to trial in court and calling for the informal settlement of any dispute arising from the contract will be enforceable.[2] If one party to the contract containing an arbitration clause attempts to avoid arbitration and file suit in court, the other party can move to stay or dismiss the action on the grounds that the FAA requires the arbitration clause of the contract to be enforced.[3]

Since 1925, Congress has amended the FAA in only minor respects. Instead of repealing the FAA, Congress has expanded arbitration, in a nonbinding form, to contexts in which the parties have not agreed to binding arbitration prior to a dispute. For example, Congress has encouraged nonbinding arbitration in the Judicial Improvements and Access to Justice Act, 28 U.S.C. 651–658 (1988), the Administrative Dispute Resolution Act, 5 U.S.C. 581–593 (1990 and 1996 amendments), and the Alternative Dispute Resolution Act (ADR), 28 U.S.C. 651–658 (1998 amendments).

As the expense of court litigation has risen, the use of arbitration has expanded. Clauses requiring parties to submit disputes to arbitration are now found in a variety of contracts, including union contracts, employment contracts, consumer credit contracts, and securities contracts. In cases dealing with arbitration contracts, the

[1] *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.,* 473 U.S. 614, 628 (1985).
[2] 9 U.S.C. 2 (1988).
[3] Id. at pars. 3 and 4.

Supreme Court has emphasized that the FAA establishes a Federal policy favoring arbitration.[4] In an unbroken line of decisions starting in 1985, the Supreme Court has consistently upheld the application of the FAA to claims arising under the Sherman Act,[5] securities law claims,[6] civil Racketeer Influenced and Corrupt Organizations Act ("RICO") claims,[7] and employment claims.[8] Thus, when parties to various types of contracts agree to arbitrate disputes, the FAA applies and the courts will enforce the arbitration clause.

In passing the FAA, Congress stated that "[a]rbitration agreements are purely matters of contract, and the effect of the [Federal Arbitration Act] is simply to make the contracting party live up to his agreement. He can no longer refuse to perform his contract when it becomes disadvantageous to him. An arbitration agreement is placed on the same footing as other contracts, where it belongs."[9] The Supreme Court has ruled that arbitration clauses must not be put on a lesser footing than any other clause of a contract.[10] Arbitration clauses are subject, however, to the same defenses available under State law to the contract itself, such as fraud duress, adhesion, or unconscionability.[11]

Senate bill 1140 would reverse the intent of Congress as interpreted by the Supreme Court by singling out arbitration clauses in motor vehicle dealer franchise contracts for non-enforcement. S. 1140 would do this even when the U.S. Chamber of Commerce reports that only a small fraction of motor vehicle franchise contracts contain arbitration clauses:

NUMBER OF FRANCHISE AGREEMENTS WITH MANDATORY BINDING ARBITRATION CLAUSE (MBAC)[1]

[Source: U.S. Chamber of Commerce (Feb. 27, 2000)]

Manufacturer[2]	Approx. No. of Dealers	Dealers with MBAC	Note
DaimlerChrysler	4,435	Appr. 1,336	Dealer option at time of agreement, except in Alabama.
Ford	4,958	5	
General Motors	7,753	0	
Saturn	236	236	
Honda and Acura	1,254	4	
Suzuki	285	285	
BMW	337	0	
Ferrari	29	29	
Hyundai	483	0	
Isuzu	567	0	
Kia	441	0	
Land Rover	118	0	
Mazda	763	0	
Mercedes-Benz	316	0	

[4] See, e.g., *Moses H. Cone Mem'l Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, at 24 (1983).

[5] *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.,* 473 U.S. 614, 638–40 (1985).

[6] See *Shearson/American Express Inc.* v. *McMahon,* 482 U.S. 220 (1987) (applying FAA to claims arising under the Securities Exchange Act of 1934); *Rodriguez de Quijas* v. *Shearson/American Express, Inc.,* 490 U.S. 477 (1989) (applying FAA to claims arising under the Securities Act of 1933).

[7] *McMahon,* supra note 3, at 239–42 (applying FAA to claims arising under RICO).

[8] See *Gilmer* v. *Interstate/Johnson Lane Corp.,* 500 U.S. 20 (1991) (applying FAA to claims arising under Age Discrimination in Employment Act); *Circuit City Stores, Inc.* v. *Adams* 532 U.S. 105 (2001) (applying FAA to State law employment discrimination claim).

[9] House Report No. 96, To Validate Certain Agreements For Arbitration, 68th Cong., 1st sess. (Jan. 24, 1924).

[10] *Doctor's Associates, Inc.* v. *Casarotto,* 517 U.S. 681, 687 (1996) ("Courts may not, however, invalidate arbitration agreements under state laws applicable only to arbitration provisions.").

[11] See id. at 686–87.

NUMBER OF FRANCHISE AGREEMENTS WITH MANDATORY BINDING ARBITRATION CLAUSE (MBAC) [1]—Continued

[Source: U.S. Chamber of Commerce (Feb. 27, 2000)]

Manufacturer [2]	Approx. No. of Dealers	Dealers with MBAC	Note
Mitsubishi	495	0	
Nissan/Infiniti	1,230	0	
Porsche	194	0	
Rolls-Royce	36	0	
Subaru	603	0	
Toyota	1,195	0	
Lexus	174	0	
Volkswagen	567	0	
Audi	258	0	
Volvo	332	0	
Saab	215	0	

[1] Excludes agreements with public companies.
[2] Manufacturers listed include members of the Alliance of Automobile Manufacturers and the Association of International Automobile Manufacturers, Inc.

By singling out arbitration clauses for non-enforcement, S. 1140 tends to undermine the sanctity of the contract and the stability of contract law.[12] This in turn undermines the certainty of transactions upon which our commerce is depends.

Further, the piecemeal, exemption approach of S. 1140 could have broader implications in areas other than motor vehicle franchise contracts. In a letter to the Judiciary Committee, the Chamber of Commerce of the United States of America stated:

> While [S. 1140] purports simply to undo the arbitration clauses in contracts between motor vehicle manufacturers and dealers, its long-term effects would cause serious damage to the use and availability of alternative dispute resolution. * * * S. 1140 would weaken clear congressional intent to encourage alternative dispute resolution. Most importantly, the legislation could also call into question the U.S. Supreme Court's continual reaffirmation of arbitration clauses including its decision earlier this year in *Circuit City Stores, Inc.* v. *Saint Clair Adams* [532 U.S. 105 (2001)].[13]

Because predispute binding arbitration is often less expensive than litigation in court,[14] arbitration provides the critical benefit of allowing access to dispute resolution to many with small claims who cannot afford the higher price of court litigation. Lewis Maltby, Director, National Task Force on Civil Liberties in the Workplace of the American Civil Liberties Union and a Director of the American Arbitration Association, has stated:

> Even if the client has clearly been wronged and is virtually certain to prevail in court, the attorney will be

[12] E. Allan Farnsworth, "The Past of Promise: An Historical Introduction to Contract", 69 Columbia Law Review 576 (1969); Charles Fried, "Contract as Promise: A Theory of Contractual Obligation", 57 (1981).
[13] Letter from R. Bruce Joston, Vice President of Governmental Affairs, U.S. Chamber of Commerce (Sept. 13, 2001).
[14] Stephen J. Ware, "Arbitration Under Assault", Cato Policy Analysis No. 433, p. 3 (Apr. 18, 2002) ("[A]rbitration typically reduces costs. Arbitration gains speed and efficiency by streamlining discovery, pleadings, and motion practice. This streamlined process generally results in much lower legal fees and related process costs.").

> forced to turn down the case unless there are substantial damages. A survey of plaintiff employment lawyers found that a prospective plaintiff needed to have a minimum of $60,000 in provable damages—not including pain and suffering or other intangible damages—before an attorney would take the case.
>
> Even this, however, does not exhaust the financial obstacles an employee must overcome to secure representation. In light of their risk of losing such cases, many plaintiffs' attorneys require a prospective client to pay a retainer, typically about $3,000. Others require clients to pay out-of-pocket expenses of the case as they are incurred. Expenses in employment discrimination cases can be substantial. Donohue and Siegelman found that expenses in Title VII cases are at least $10,000 and can reach as high as $25,000. Finally, some plaintiffs' attorneys now require a consultation fee, generally $200–$300, just to discuss their situation with a potential client.
>
> The result of these formidable hurdles is that most people with claims against their employer are unable to obtain counsel, and thus never receive justice. Paul Tobias, founder of the National Employment Lawyer's Association, has testified that ninety-five percent of those who seek help from the private bar with an employment matter do not obtain counsel. Howard's survey of plaintiffs' lawyers produced the same result. A Detroit firm reported that only one of eighty-seven employees who came to them seeking representation was accepted as a client.[15]

Indeed, Prof. Stephen J. Ware of the Cumberland School of Law has concluded that "[a]rbitration tends to reduce consumer prices, raise employee wages, and increase access to justice for meritorious claims. Those benefits would not be fully realized if binding arbitration agreements could be entered into only after a dispute arose.[16] Thus, this piecemeal, exemption approach of S. 1140, if applied to other types of transactions, could have negative implications for consumers and employees.

At least the automobile manufacturers and dealers that S. 1140 would exempt from the FAA, unlike many consumers and employees, could generally afford to litigate franchise disputes in court. The ability of a relatively wealthy group of businesses to afford to litigate, however, does not compel Congress to completely exempt that group from the FAA. Further, the ability to afford in-court litigation does not justify an exemption from the FAA when such procedural protections, much like those available in court, could be incorporated into the FAA itself.

Even with the savings in expense and delay, arbitration can result in unfairness in certain cases depending on the procedural protections for the parties embodied in the contract containing the arbitration clause or those protections that are incorporated by reference, such as the rules of the American Arbitration Association.

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[15] Lewis L. Maltby, "Private Justice: Employment Arbitration and Civil Rights", 30 Col. Hum. R.L. Rev. 29, 57–58 (1998).

[16] Ware, supra note 14, at p. 2.

Accordingly, instead of a piecemeal reform of the FAA via exemptions, a comprehensive review of procedural protections that can be used in arbitration for all parties is more appropriate at this time. For example, a comprehensive reform could include the right to notice and hearing, the right to be represented by an attorney, the right to discovery and the presentation of evidence, the right to a written decision by the arbitrator, the right to a timely resolution of the matter, and the right to a neutral arbitration selected by both parties.[17]

Given the broad Federal policy in favor of arbitration, in multiple contexts, the cost and time savings available in arbitration, the limited applicability in practice of arbitration clauses to motor vehicle franchise contracts, and the availability of procedural protections that could be incorporated into the FAA, I cannot support S. 1140 in its current form.

JEFF SESSIONS.

[17] See, e.g., Consumer and Employee Arbitration Bill of Rights, S. 3210, 106th Cong. (2000).

X. CHANGES IN EXISTING LAW

In compliance with paragraph 12 of rule XXVI of the Standing Rules of the Senate, changes in existing law made by S. 1140, as reported, are shown as follows (existing law proposed to be omitted is enclosed in bold brackets, new matter is printed in italic, and existing law in which no change is proposed is shown in roman):

UNITED STATES CODE

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TITLE 9—ARBITRATION

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CHAPTER 1—GENERAL PROVISIONS

* * * * * * *

§ 1. "Maritime transactions" and "commerce" defined; exceptions to operation of title

"Maritime transactions", as herein * * *

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§ 16. Appeals

(a) An appeal may be taken from—

(1) an order—

(A) refusing a stay of any action under section 3 of this title,

* * * * * * *

(b) Except as otherwise provided in section 1292(b) of title 28, an appeal may not be taken from an interlocutory order—

(1) granting a stay of any action under section 3 of this title;

(2) directing arbitration to proceed under section 4 of this title;

(3) compelling arbitration under section 206 of this title; or

(4) refusing to enjoin an arbitration that is subject to this title.

§ 17. Motor vehicle franchise contracts

(a) For purposes of this section, the term—

(1) "motor vehicle" has the meaning given such term under section 30102(6) of title 49; and

(2) "motor vehicle franchise contract" means a contract under which a motor vehicle manufacturer, importer, or distributor sells motor vehicles to any other person for resale to an ultimate purchaser and authorizes such other person to repair and service the manufacturer's motor vehicles.

(b) Whenever a motor vehicle franchise contract provides for the use of arbitration to resolve a controversy arising out of or relating to the contract, arbitration may be used to settle such controversy only if after such controversy arises both parties consent in writing to use arbitration to settle such controversy.

(c) Whenever arbitration is elected to settle a dispute under a motor vehicle franchise contract, the arbitrator shall provide the parties to the contract with a written explanation of the factual and legal basis for the award.

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