

Federal Legislation Would Invalidate Arbitration Clauses in Consumer, Employment and Franchise Agreements

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Since 1925, when Congress enacted the Federal Arbitration Act (FAA), contractual provisions requiring binding arbitration of disputes have been "valid, irrevocable, and enforceable," unless legal or equitable grounds exist for revocation of the contract. Consistent with the federal policy in favor of arbitration reflected in the FAA, arbitration clauses are common in many consumer, employment, and franchise and distribution contracts.

Such arbitration provisions would become unenforceable if the Arbitration Fairness Act of 2007 becomes law. This legislation, introduced July 12, 2007, would invalidate pre-dispute agreements to arbitrate "consumer," "employment" and "franchise" disputes as defined by the statute. The Senate version of the bill, S. 1782, and its House of Representatives counterpart, H.R. 3010, have been referred to the Senate and House Judiciary Committees, respectively.

"Consumer" disputes are defined as those between a "person" and a seller or provider of property, services, money, or credit. To qualify as a "person," the consumer cannot be an organization. Only goods or services obtained for personal, family, or household purposes would qualify. Disputes about goods or services obtained for business purposes would not qualify as consumer disputes. A small business seeking to invalidate an arbitration clause may be able to do so, however, if the agreement was between "parties of unequal bargaining power."

"Employment" disputes are defined as those between employee and employer, as that

relationship is defined in the Fair Labor Standards Act. The statute would not apply, however, to arbitration provisions in collective bargaining agreements.

"Franchise" disputes subject to the Arbitration Fairness Act are defined as those arising under any contract whereby (1) a franchisee is granted the right to engage in business under a marketing plan prescribed in substantial part by the franchisor, (2) the operation of the franchisee's business is substantially associated with a commercial symbol, such as a trademark or logo, which designates the franchisor or an affiliate of the franchisor, and (3) the franchisee is required to pay a franchise fee, either directly or indirectly.

Because the statute would apply retroactively to contracts entered into before its enactment, the Arbitration Fairness Act would effectively rewrite existing contracts. Despite the significant impact this act would have on mandatory dispute resolution programs, it may be unwise to discard mandatory arbitration clauses from agreements and contracts prematurely. Carefully crafted, pre-dispute arbitration programs continue to be upheld by most courts, consistent with existing federal law favoring arbitration. How courts will view mandatory arbitration clauses if the Arbitration Fairness Act becomes law is unclear.

For more information, or to discuss how your program can best be tailored, please contact Jason S. Feinstein at 609.989.5057, or jfeinstein@sternslaw.com.