Opening the Door to Justice: Amending the Federal Arbitration Act to Remedy the Unjust Use of Predispute Arbitration Agreements.

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Abstract: This paper assesses the Arbitration Fairness Act’s proposed amendments to the Federal Arbitration Act, as well as the possibility of contracting for heightened judicial review of arbitration awards. In brief, I support the amendments as well as the possibility of review.

Section 2(b) of the AFA would prohibit the enforcement of predispute arbitration agreements that require arbitration of employment, consumer, or franchise disputes or disputes arising under any statute intended to protect civil rights. I demonstrate why the prevailing practice of summarily enforcing predispute arbitration agreements is unjust in these contexts, and why Congressional amendment, rather than State law or contract-based remedies, is necessary to fix the problem. Section 2(c) of the AFA would render the validity and enforceability of arbitration agreements subject to the determination of the court rather than an arbitrator. I claim the doctrine of separability and the distinction between substantive and procedural arbitrability should be abolished, and that this amendment does so. Lastly, parties should be free to contract for heightened judicial review of arbitration awards. If neither amendment is feasible, improvements in the world of arbitration could still be attained by relaxing the currently severe restraints on arbitral review.

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Introduction

The Federal Arbitration Act\textsuperscript{2} was enacted in 1925 to legislatively abolish the ouster doctrine, a hoary common law rule whereby courts refused to enforce arbitration agreements. Congress mandated the enforcement of arbitration agreements in §2 of the FAA: “A written provision in any […] contract […] to settle by arbitration a controversy thereafter arising out of such contract […] shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.” Arbitration has served well to resolve “disputes between commercial entities of generally similar sophistication and bargaining power”\textsuperscript{3} and was intended to allow voluntary arbitration agreements to be on parity with garden variety contract clauses. In adhering to Congressional policy, however, the judicial sea-change created a rip current.

Predispute arbitration agreements should be categorically invalid in the context of non-union employees, individual consumers, franchisees or where civil rights are at stake. Furthermore, the validity or enforceability of an agreement to arbitrate should be determined by a judge, rather than an arbitrator, whether the challenge is to the container agreement or simply the arbitration provision. Further, parties should be free to contract for heightened review of arbitration awards. Ultimately, the Arbitration Fairness Act is a much needed remedy to serious arbitration problems.

Amendment § 2(b)

The first amendment I address is found in the Arbitration Fairness Act, § 2(b): “No predispute arbitration agreement shall be valid or enforceable if it requires arbitration of (1) an employment, consumer, or franchise dispute; or (2) a dispute arising under any statute intended to protect civil rights.”

This amendment carves out risky cases (where the disputants almost invariably have unequal sophistication and access to resources) from mandatory binding arbitration. These classes of cases are inapt for arbitration because the virtue of arbitration as a dispute resolution process is compromised by the risk of unfairness to the weaker party. The advantages of arbitration over litigation derive from party autonomy, such as the power to decide substantive and procedural issues over which they would otherwise have no control. But when the signatories are unmatched in relative power, these advantages are wanting. In particular, predispute arbitration agreements are increasingly including “provisions that deliberately tilt the systems against individuals, including provisions that strip individuals of substantive statutory rights, ban class actions, and force people to arbitrate their claims hundreds of miles from their homes.”\textsuperscript{4} It doesn’t take a lot of imagination to see how such provisions effectively deny access to justice and allow corporations to engage in tortious or otherwise illegal conduct without meaningful deterrence, retribution, or compensation.

In these cases, a judicial imprimatur on arbitration works to corrupt justice on an individual basis, and when it becomes widespread, the threat to justice becomes systemic. In the years after the FAA was passed, the talismanic invocation of a federal policy in favor of enforcing arbitration

\textsuperscript{2} 9 USC Sec. 1 et seq. (2000) (hereinafter “FAA”).
\textsuperscript{3} Arbitration Fairness Act, §2(1) (hereinafter “AFA”).
\textsuperscript{4} AFA, §2(7).
agreements lead to widespread adoption of these provisions in boilerplate contracts in a proliferating universe of markets, which in turn lead to millions of Americans being stripped of their right to a judge and jury by fine print. The adoption of arbitration agreements spilled over from the intended class of equally situated corporate entities into contracts between employees and employers, franchisees and franchisors, consumers and manufacturers, and individuals and corporations. These practices lead naturally to the risk of pressure if not capture on the part of arbitration companies (a nationwide group of entrepreneurial, unregulated private organizations) to devise arbitration procedures which favor the repeat clients of these services. In light of the market norm of incorporating these provisions and lack of alternative choice for these individuals, the ideology of freedom of contract fails to justify a policy of nonintervention.

—Why Congress and Not the States?—

Advocates of limited federal congressional involvement might ask why Congress, rather than the States, should be responsible for these contract-based concerns. The answer is that the Supreme Court has (over dissent) castrated State efforts to remedy these problems by invoking the Supremacy Clause, declaring the FAA a substantive law, and claiming that limiting the applicability of the FAA to federal courts would promote forum shopping. According to Supreme Court holdings in the wake of Southland, the FAA preempts State laws that give primary jurisdiction to any but arbitral fora; State laws which declare certain contract provisions void ab initio; and State laws which require contracts to include a notice provision that would alert the signatory of the inclusion of an arbitration clause. These rulings have stripped States of the prerogative to protect their citizens from corporate behavior properly judged with opprobrium.

While State law may be applied to invalidate an arbitration agreement without contradicting § 2 “if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally,” this is a remarkably limited universe of laws. A generally applicable law that remedies the specific concerns raised by critics of mandatory predispute arbitration may very well be inconceivable, which implies that States just cannot remedy arbitration issues.

A state law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with this requirement of § 2. See Prima Paint, supra, at 388 U. S. 404; Southland Corp. v. Keating, 465 U.S. at 465 U. S. 16-17, n. 11. A court may not, then, in assessing the rights of litigants to enforce an arbitration agreement, construe that agreement in a manner different from that in which it otherwise construes nonarbitration agreements under state law. Nor may a court rely on the uniqueness of an agreement to arbitrate as a basis for a

6 Preston v. Ferrer, 128 S.Ct. 978, 987 (2008) (“When parties agree to arbitrate all questions arising under a contract, the FAA supersedes [sic] state laws lodging primary jurisdiction in another forum, whether judicial or administrative.”).
state law holding that enforcement would be unconscionable, for this would enable the court to effect what we hold today the state legislature cannot.  

Hence, neither State legislatures nor courts are in a position to remedy the concerns raised by critics of mandatory predispute arbitration in the context of lopsided contracting parties.

Even the vindication of statutory rights, say, to be free from age discrimination, can be limited to the arbitral forum (though employers cannot require an employee to pay for the arbitrator’s fees).

If the Supreme Court will not allow States to protect the “little guys,” then Congress has a duty to act in order to remedy the egregious unfairness plaguing the arbitration system in light of these terms.

While some believe that the FAA is a procedural law and hence Congress is without constitutional authority to impose it on State courts, my concern here is less over federalism than sheer unfairness to individuals. If allowing States to carve out exceptions to predispute arbitration clauses were a surefire way of protecting the little guys, then a federalism exception may be the most politically feasible remedy here, appealing to conservatives and liberals alike: Let States do the work, to the benefit of consumers and the little guys. Nonetheless, the FAA was meant to apply to roughly equal commercial entities and there is broad consensus that mandatory arbitration is systematically biased against the non-drafting party. Without some basis for thinking State laws would remedy these concerns if they were only allowed, Congress is in the best position to make this right.

—Why an Amendment Instead of Contractual Defenses?—

It may reasonably be asked why this amendment is necessary when parties can rely on traditional contract law remedies for unfair predispute arbitration provisions. After all, § 2 of the FAA includes the caveat, “save upon such grounds as exist at law or in equity for the revocation of any contract.” Even where the parties have bilaterally agreed to arbitrate it is possible for an employee to avoid arbitration if the provision is challenged as egregiously unfair and lacking good faith. It would seem that the predispute arbitration provisions aimed at by the proposed amendment would fall tidily into the category of unconscionability, rendering the amendment

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10 Id.
13 This useful, gender-neutral expression is from Jean Sternlight’s Panacea or Corporate Tool?: Debunking the Supreme Court’s Preference for Binding Arbitration, 74 Wash. U. L. Q. 637 (1996).
17 See Hooters of America, Inc. v. Phillips, 173 F.3d 933 (4th Cir. 1999) (describing the voided arbitration clause as a “sham.”).
superfluous. An arbitration agreement is procedurally unconscionable when there is no meaningful opportunity to turn it down (including the claim of surprise that would cover buried arbitration agreements). Substantive unconscionability can be shown by one-sidedness or overly harsh terms (including claims that provisions compromise arbitrator neutrality, impose excessive expenses, proscribe remedies, or fail to treat the parties even-handedly). However, many unconscionability challenges to arbitration provisions are unsuccessful, as they require a factually-intensive demonstration of both substantive and procedural unconscionability.

Rather than simply level the playing field, federal courts have tilted the table in favor of mandatory binding arbitration. The rhetoric of the courts suggest that arbitration clauses were the beneficiaries of the contractual equivalent to equal protection enjoyed by citizens, spared from discrimination and only subject to generally applicable laws. But truly the courts have gone above and beyond putting arbitration clauses on equal footing, and have by judicial fiat instituted the contractual equivalent of affirmative action for arbitration clauses. Despite the black-letter contract law that ambiguities are resolved against the drafter, arbitration is special: ambiguities are construed in favor of arbitration. Courts construe defenses such as fraud, coercion or duress narrowly when used to get out from underneath an arbitration provision. Further, courts rarely grant appeals of arbitral awards. Despite that the drafting party is usually a repeat player with much greater resources (which would justify placing the onus of proving accessibility on the drafter), “the party resisting arbitration bears the burden of proving that the claims at issue are unsuitable for arbitration.”

Clearly, arbitration awards are not on equal footing with other contract clauses, but have benefited from aggressive judicial protection. Any pretense that arbitration clauses are treated just like other contractual provisions under the law is frankly disingenuous.

—How Does this Amendment Remedy these Problems?—

The remedy to these foregoing concerns is not an outright ban on arbitration, but a significant qualification to the federal policy endorsing the validity and enforceability of these agreements. Limiting the enforceability of predispute arbitration agreements to roughly equal commercial entities and in the context of collective bargaining should suffice. Further, the solution to these problems is not a ban on arbitration agreements entered into after the dispute had arisen. By limiting the prohibition of enforcement only to predispute agreements, this amendment

preserves access to a range of dispute resolution procedures for weaker signatories. It is simply a matter of common sense that a person should choose the forum for dispute resolution after a dispute arises, not before. No reasonable person would choose their remedy before knowing the wrong.

In thinking about this amendment to ban predispute arbitration agreements in employee, consumer, franchisee, and civil rights claims, I considered what the effect would be of an exception. What if the party who drafted the provision could prove the provision is entirely fair? The amendment would have to include standards for making the exception, which could be that the consumer/employee/franchisee/civil right-bearer is entitled to influence the choice of arbitrator, arbitration process, and arbitration location. This would allow the judge to serve as a gatekeeper to arbitration where, as evidenced by the contract, the forum is demonstrably unfair to the plaintiff, while allowing the weaker party access to arbitration when doing so doesn’t raise any red flags. These standards, by ensuring some degree of procedural control on the part of employees/consumer/franchisees/civil right-bearer, would enhance perceptions of procedural justice in arbitration. Including these standards would come at an administrative cost, however, as the court would routinely hear litigation over whether the exception applies. We should not adopt a rule that has the effect of “breeding litigation from a statute that seeks to avoid it.”

In enforcing arbitration provisions in adhesion contracts, courts practically give corporations the power to dictate the means to and quality of justice to individuals. The question isn’t simply whether this is too much power, but also whether it’s the right kind of power to be handing over to the drafter. According to congressional findings in the Arbitration Fairness Act, predispute arbitration agreements stipulated in standard form contracts systematically favor the drafter, leading to hardship or injustice. In my view this renders the predispute arbitration agreements targeted by this amendment presumptively unfair, and, as a poor substitute for public justice, unenforceable. Outlining the proper use of superior bargaining power and influence over the choice of dispute resolution procedure would require a granular evaluation of each case, while a more certain rule that prohibits these provisions categorically would spare the expense. A bright line rule, rather than a multi-factored balancing test, would promote judicial economy and keep transaction costs low for disputants. Such is the approach of this amendment.

The goal of ADR is to settle disputes “effectively, early, and informally, with relatively minor diversion of financial and human resources.” Yet these priorities must give way when “agreements […] implicate significant disparities in bargaining power.” Private groups are apparently unable to police the system of private arbitration. Hence, legislative action and judicial oversight are needed. Because of the unjust abuse of arbitration agreements, and the administrative burden of litigating exceptions, a bright line exclusion of these classes of cases seems the most efficient and just policy. Speculations about efficiency gains from arbitration that are empirically inconclusive are not a legitimate basis to privatize justice in these risky cases.

24 Allied-Bruce Terminix Cos. V. Dobson, 513 U.S. 265, 275 (1995). On this head I distinguish between allowing litigation over contractual and statutory rights, on one hand, and breeding litigation over threshold issues on the other.
26 Id.
Amendment § 2(c)

The second amendment I address is found in the Arbitration Fairness Act, §2(c): “An issue as to whether this chapter applies to an arbitration agreement shall be determined by Federal law. Except as otherwise provided in this chapter, the validity or enforceability of an agreement to arbitrate shall be determined by the court, rather than the arbitrator, irrespective of whether the party resisting arbitration challenges the arbitration agreement specifically or in conjunction with other terms of the contract containing such agreement.” This amendment abolishes the doctrine of separability as well as the distinction between procedural and substantive arbitrability.

—The Doctrine of Separability—

The law of separability applies whenever a container agreement contains an arbitration clause, and operates to separate the arbitration agreement from the remainder of the contract. According to the Supreme Court in *Prima Paint*, challenges to the contract as a whole are determined by the arbitrator, though challenges to the arbitration agreement itself can go to the courts. But, in standard form contracts, it is difficult to conceive of an instance where the arbitration award is subject to dispute while the contract as a whole is not. Hence, the law of separability may very well preclude judicial review of arbitration agreements in standard form contracts, as the defenses under contract law would most fittingly be leveled against the contract as a whole rather than the particular arbitration provision. *Prima Paint* has lead to the atrophy of contract revocation defenses: “the vast bulk of fraud, misrepresentation, illegality, and other traditional recision defenses [are now] the province of the arbitrator.” Many courts find the separability doctrine hostile to the ideology that Americans deserve their day in court, leading to “massive doctrinal complexity, confusion, and uncertainty.” This amendment would repudiate the doctrine of separability, allowing courts to rule on the validity of an arbitration provision regardless of whether the challenge is to the arbitration agreement alone or to the entire contract.

—Substantive and Procedural Arbitrability—

A higher-order concern is whether the decision to arbitrate should be decided by an arbitrator or by the court. Whether the arbitration clause covers the dispute in question is an issue of substantive arbitrability resolved by the court, and “courts should not assume that the parties agreed to arbitrate arbitrability unless there is ‘clear and unmistakable’ evidence that they did so.” On the other hand, whether conditions have been met which would trigger an arbitration provision is an issue of procedural arbitrability resolved by the arbitrator. The import of this distinction is that courts determine “whether an agreement to arbitrate exists or a controversy is subject to an

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27 *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395 (1967). To be sure, these challenges are usually an exercise in futility.
agreement to arbitrate,” while “[a]n arbitrator shall decide whether a condition precedent to arbitrability has been fulfilled and whether a contract containing a valid agreement to arbitrate is enforceable.” This distinction breeds litigation and ought to be abolished.

Because arbitration awards are not generally appealable to a court, it is paramount that a court (qua neutral decisionmaker) assesses the matter of substantive and procedural arbitrability in the first instance. It takes only a superficial understanding of human motivation to see that arbitrators are inherently biased in favor of arbitration. Those whose only tool is a hammer see all problems as nails. This bias serves to enhance their personal welfare through increased fees, so is self-reinforcing. Despite professional standards of neutrality, if the decisionmaking power over dispute resolution procedure remains lodged in the arbitrator in the first instance, it would be unusual indeed for the issue of arbitrability to be resolved in favor of anything other than arbitration. Asking a person who stands to gain from arbitration whether an arbitration agreement is valid simply begs for a biased answer uniformly in favor of the validity of the arbitration agreement.

Contracting for Enhanced Review of Arbitral Awards

Arbitrators are under no obligation to provide a reasoned explanation for their award. This would suggest that review of arbitral awards by a court for errors in law or fact is superficial at best. Because the stakes of arbitration can be quite high, it makes sense that the parties would exercise their freedom of contract to include provisions for heightened judicial review. Before Hall Street, the federal courts were divided on the issue of whether the FAA allowed signatories to arbitration agreements to contract back into the public justice system by agreeing to certain forms of judicial review. The 9th Circuit allowed contracted-for judicial review as long as it was not based on unfamiliar standards. The 7th Circuit prohibited contracted-for judicial review, under the theory that federal jurisdiction cannot be established by contract. After Hall Street, parties cannot contract for judicial review of arbitration awards. While I have my doubts that a relatively weaker party could effectively negotiate for heightened judicial review of error in law or fact, I would not prohibit them from doing so.

—What Kind of Review Is Currently Available?—

Today, judicial review of arbitration is largely limited to enumerated forms of impropriety found in § (10)(a) of the FAA. These situations include: (1) when awards are procured by undue means (including fraud); (2) when the arbitrators are corrupt (or partial); (3) when the arbitrators are culpable of prejudicial treatment in procedural management (such as merciless deadlines and exclusion of relevant evidence); and (4) where the arbitrator acted ultra vires, or failed to render a mutual, final and definite award upon the subject matter submitted to her. Based on applying the interpretive canon of ejusdem generis, the Supreme Court decided that these conditions are the

33 Uniform Arbitration Act § (6)(b)-(c).
35 See Lapine Tech. Corp. v. Kyocera Corp., 130 F.3d 884, 891 (9th Cir. 1997).
38 FAA § (10)(a)(1)-(4).
exclusive grounds for vacating or modifying an arbitration award. As if this limitation were not sufficient to bolster the finality of arbitration, the party seeking vacatur on these statutorily enumerated grounds faces additional judicially-created hurdles.

Section 10(a)(1) vacation of awards procured through undue means require clear and convincing evidence which materially relates to an arbitrated issue and which was never brought to the arbitrator’s attention or was discoverable by due diligence before the arbitration. Section 10(a)(2) vacation of awards due to arbitrator partiality require a showing of either “active” or “passive” partiality, demonstrated by actions indicating the arbitrator is predisposed in favor or against a disputant, or circumstances which support an inference of partiality such as a prior relationship between the arbitrator and one of the disputants, respectively. Section 10(a)(3) vacation for procedural unfairness requires a showing of arbitrator misbehavior that “so prejudiced the rights of a party” that they are denied “a fundamentally fair hearing”; in other words, the wronged party’s right to be heard must be “grossly and totally blocked.” Section 10(a)(4) vacation of ultra vires arbitration awards requires a showing that the arbitrator issued an award on an issue that was never presented to her, or that the arbitrator failed to abide by the arbitration agreement itself. However, misconstruing the contract between the parties and erroneously stating law or fact are not grounds for vacatur: “that a court is convinced [the arbitrator] committed serious errors does not suffice to overturn [the] decision.” In sum, the statutory grounds for vacating an arbitration award have been significantly circumscribed by subsequent judicial interpretation.

Non-statutory grounds for vacating an arbitration award include manifest disregard of the law; violation of public policy; and arbitrary and capriciousness. Unsurprisingly, even these bases for reviewing or vacating an arbitration award are constrained. Manifest disregard of the law requires more than error or misunderstanding of the law; rather, the arbitrator must have blatantly, knowingly contradicted controlling law in issuing the award. Almost no arbitration awards are vacated on this basis. The public policy basis for vacation requires a showing that the award explicitly conflicted with indisputable precedent. Arbitrary and capricious challenges to arbitration awards require the aggrieved party to refute all possible rational bases for the award, or show that no judge could have conceivably issued such a poorly reasoned ruling. These grounds for vacatur may very well be “without a legitimate legal, doctrinal or theoretical basis,” which presumably makes most judges reticent to rely upon them.

41 Gaines Construction Co. v. Carol City Utilities, Inc., 164 So.2d 270 (Fla. App. 1963).
42 Apex Fountain Sales, Inc. v. Kleinfeld, 818 F.2d 1089, 1094 (3rd Cir. 1987).
45 Carte Blanche (Singapore) PTE Ltd. v. Carte Blanche Int’l, 888 F.2d 260, 265 (2d. Cir. 1989).
47 See Hoeft III v. MVL Group, 343 F.3d 57 (2d Cir. 2003) (finding the arbitrator neither manifestly disregarded the law nor acted ultra vires).
48 See Seymour v. Blue Cross/Blue Shield, 988 F.2d 1020, 1023 (10th Cir. 1993).
49 See Safeway Stores v. American Bakery and Confectionary Workers, Local 111, 390 F.2d 79, 82 (5th Cir. 1968).
“Courts are not authorized to review the arbitrator’s decision on the merits despite allegations that the decision rests on factual errors or misinterprets the parties’ agreement.”\textsuperscript{51} It appears that this admonition is in clear tension with the ultra vires grounds for vacatur. That is, if the arbitrator is bound by the parties’ agreement, yet the courts will not second-guess the arbitrator’s interpretation of that agreement, then the arbitrator ultimately has total, unconstrained control over the arbitration procedure and substance, as long as it is \textit{arguably} based on the contract (regardless of the intention of the contracting parties). Further, the manifest disregard standard would counter-intuitively allow a court to defer to an arbitrator’s award that was based exclusively on an egregious misunderstanding of the applicable law, as long as the arbitrator didn’t know any better. Notwithstanding the trouble of proving what an arbitrator knew, this creates an incentive for arbitrators to remain ignorant of the law in order to avoid being overturned. Apparently, the extant bases for judicial review and vacatur of arbitration awards are almost completely meaningless, or worse, they create perverse incentives for arbitrators to remain ignorant of the law that would otherwise control disputes.

In light of these significant constraints on review, contracted-for judicial review may be the best solution. Critics of \textit{ex post} judicial review believe allowing this “opens the door to the full-bore legal and evidentiary appeals that can render informal arbitration merely a prelude to a more cumbersome and time-consuming judicial review process.”\textsuperscript{52} However, it is not clear that this docket-flooding concern is empirically justified. The cost arguments in favor of arbitration are inconclusive.\textsuperscript{53} Theoretically, it is odd to deny parties the right to have arbitration awards reviewed by a court when they both had a right to access the courts in the first instance to hear their dispute if only the arbitration provision were absent.

If it is not politically feasible to prohibit predispute arbitration agreements as discussed above, perhaps we could reach a bipartisan agreement to allow for judicial review of arbitration awards, or at least to require arbitrators to make a record of legal and factual premises underlying their awards. The amendments proposed above are \textit{ex ante} solutions to problems in arbitration that keep certain types of cases from going to arbitration in the first place. The amendment proposed in this section is an \textit{ex post} solution to arbitration problems based on judicial review. This purports to keep unfair arbitration in check, but doesn’t have the judiciary step in until due process has been denied. Hence, if \textit{ex ante} solutions are politically infeasible, I would endorse this proposal to ensconce some modicum of arbitration oversight.

\section*{Conclusion}

I support the amendments proposed in the Arbitration Fairness Act in full, without qualification. While the amendments may not be perfect, they go some considerable length in remedying the national problem of the judiciary turning a cold shoulder to disputants with less commercial sophistication and limited resources than the parties who insert predispute arbitration agreements.

\textsuperscript{52} \textit{Hall Street Associates, LLC v. Mattel, Inc.}, 128 S.Ct. 1396 (2008).
agreements in standard form contracts. By prohibiting only *predispute* arbitration agreements for *risky* cases, the amendment would put the FAA back in its place (binding arbitration between corporate entities of roughly equal sophistication) and allow the little guys their day in court, while at the same time, preserving arbitration as a viable process for dispute resolution if agreed to after the dispute has arisen.