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## **The Privatization of Civil Justice: An Exposition on New York's Prompt Payment Law and Its Imposition of Mandatory Arbitration**

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## The Privatization of Civil Justice: An Exposition on New York's Prompt Payment Law and Its Imposition of Mandatory Arbitration

Cover Page Footnote

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## THE PRIVATIZATION OF CIVIL JUSTICE: AN EXPOSITION ON NEW YORK'S PROMPT PAYMENT LAW AND ITS IMPOSITION OF MANDATORY ARBITRATION

*James M. Tsimis*\*

### I. INTRODUCTION

In a world of constant flux and fluctuation, one rule generally remained invariable: arbitration required the mutual assent of both parties. It seems, however, that all good and simple things come to an end. In 2009, the New York State legislature amended the Prompt Payment Law with the objective of establishing a default rule that prescribes the manner with which providers of construction services are compensated for the work and services they provide.<sup>1</sup> The legislature observed that, generally, those who receive construction services and the providers that render them “contract freely and, in good faith, meet their obligations in a timely and just manner.”<sup>2</sup> Nevertheless, the crux of the legislation addresses the concern of undue delay

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<sup>1</sup> Editor's Notes to N.Y. GEN. BUS. LAW § 756 (CONSOL. 2010) (describing legislative intent).

<sup>2</sup> *Id.* Most sophisticated construction contracts are, at a minimum, fundamentally derived from form contracts as provided for by the American Institute for Architects, and most—if not all—include arbitration provisions. Gerald Lebovits & Lucero Ramirez Hidalgo, *Alternative Dispute Resolution in Real Estate Matters: The New York Experience*, 11 CARDOZO J. CONFLICT RESOL. 437, 451 n.41 (2010). Where a contract exists that dictates the terms between the parties, the default rules of the Prompt Payment Law need not apply. Editor's Notes to GEN. BUS. § 756.

of payments for approved services in the construction industry.<sup>3</sup> Moreover, the law provides for the authorization of “remedies including reasonable interest payments and circumstances for stop work provisions.”<sup>4</sup> The legislature explained that:

it is the intent of this legislation to encourage parties to construction contracts to make payments at least as expeditiously as existing contracts require and further reduce existing payment processing time wherever feasible, while at the same time permitting such entities to contract freely, perform proper and reasonable management and financial oversight activities designed to ensure that construction services are provided in a safe, efficient and fiscally prudent manner.<sup>5</sup>

Thus, for private construction projects worth over \$150,000,<sup>6</sup> this law is designed to assuage the anxieties of those engaging in, and soliciting the business of, construction providers. This law is an attempt to promote a market with safeguards and regulation. This law assures that compensation is justly dispersed. Yet this law, the author argues, is unconstitutional.

While the Prompt Payment Law is not wholly egregious, its flagrancy nevertheless stems from section 756-b.<sup>7</sup> The statute provides that any violation of the prompt payment conditions may be settled by “binding arbitration at the request of the ‘aggrieved party.’ ”<sup>8</sup> The statute provides as follows: First, violations must be brought to the written attention of the party who is alleged to have violated the statute by the other “aggrieved” party who claims the violation.<sup>9</sup> After receipt of that notice, the parties should attempt to re-

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<sup>3</sup> *Id.* Timely payments create a more productive and efficient work environment and can drastically reduce both external and internal transactional costs. *Id.*

<sup>4</sup> *Id.* Stop work provisions allow the contractor or subcontractor to do as the name suggests—stop work—but more importantly, it gives the construction provider leverage against the party with whom disagreement or conflict exists because stopping work will inevitably incur additional expenses on behalf of the defaulting party.

<sup>5</sup> *Id.* (describing legislative intent).

<sup>6</sup> Editor’s Notes to N.Y. GEN. BUS. LAW § 756. The previous version of the Prompt Payment Law called for the price of the project to be \$250,000 or greater so as to trigger the statute. N.Y. GEN. BUS. LAW § 756 (2002), *amended by* N.Y. GEN. BUS. LAW § 756 (2009).

<sup>7</sup> N.Y. GEN. BUS. LAW § 756-b.

<sup>8</sup> Neal M. Eiseman & Robert J. MacPherson, *Mandatory Arbitration in Construction Payment Disputes*, 243 N.Y. L.J. 4, 4 (2010).

<sup>9</sup> N.Y. GEN. BUS. LAW § 756-b(3)(a).

solve the matter on their own volition.<sup>10</sup> In the event that no resolution can be agreed upon, the “aggrieved” party then has fifteen days from the time the other party receives the written notice to initiate “an expedited arbitration pursuant to the Rules of the American Arbitration Association.”<sup>11</sup>

Quite obviously, the procedure just described is inherently problematic. For instance, the party receiving the notice may not consent to the arbitration—that is, he may not wish to waive his right to a jury trial should one be afforded to him. Furthermore, any existing contract between the parties, whether memorialized in written form or not and absent provisions to the contrary, may implicitly and impliedly reflect that any disputes arising from or relating to the contract shall be resolved in a court of law.<sup>12</sup> Irrespective of those underlying contractual connotations, however, the arbitrator, according to the statute, will then render his or her decision to the parties with respect to the alleged violation, and “the award of the arbitrator shall be final,”<sup>13</sup> leaving the only effective means of vacating the arbitrator’s final decision by way of C.P.L.R. Section 7501.<sup>14</sup> Thus, this provision of the Prompt Payment Law provides for the aggrieved party’s redress at the expense of the other party’s constitutional rights.

Adding teeth to this provision, section 757 states that any proviso “affecting a construction contract [which states] that expedited arbitration as expressly provided for and in the manner established by section seven hundred fifty-six-b of this article is unavaila-

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<sup>10</sup> *Id.* at § 756-b(3)(a)(vii) (“Upon receipt of written notice of a complaint . . . the parties shall attempt to resolve the matter giving rise to such complaint.”).

<sup>11</sup> N.Y. GEN. BUS. LAW § 756-b(3)(c).

<sup>12</sup> *See* Eiseman & MacPherson, *supra* note 8 (describing the way in which a party compelled to arbitrate may not have contemplated it at all).

<sup>13</sup> N.Y. GEN. BUS. LAW § 756-b(3)(e).

<sup>14</sup> *See id.*; N.Y. C.P.L.R. § 7501 (CONSOL. 2010). Section 7501 states:

A written agreement to submit any controversy thereafter arising or any existing controversy to arbitration is enforceable without regard to the justiciable character of the controversy and confers jurisdiction on the courts of the state to enforce it and to enter judgment on an award. In determining any matter arising under this article, the court shall not consider whether the claim with respect to which arbitration is sought is tenable, or otherwise pass upon the merits of the dispute.

N.Y. C.P.L.R. § 7501. A looming question, therefore, is what if the parties never agreed to arbitrate?

ble to one or both parties” is void and unenforceable.<sup>15</sup> As a result, any party attempting to circumvent the statute’s imposition of arbitration is frustrated by section 757.

Forcing parties to mandatory, binding arbitration runs counter to parties’ rights to a jury trial and due process as provided for in both the Federal and New York Constitutions.<sup>16</sup> Therein lies the irony, however: the Prompt Payment Law is clearly a statute that is designed to reduce the burden of the courts by encouraging arbitration—yet its intrinsic egregiousness may well thrust the parties into the very courts it was designed to prevent them from entering. A contractor or owner will very likely contest the validity of the law’s draconian imposition of arbitration.

For these reasons, this article will expose the Prompt Payment Law’s brazen constitutional transgressions. Section II will offer a backdrop of the three alternative dispute resolution mechanisms that are most prevalent, and will discuss that which differentiates them. Section III exposes how companies utilize arbitration to their advantage, and how it is sometimes an abuse of constitutional rights. Section IV endeavors to chronicle the Supreme Court’s preference for arbitration, its influence on New York, and how arbitration is adverse to the Seventh Amendment and New York’s analog, as well as the due process implications of both Federal and New York’s Constitutions. Finally, Section V concludes this Article with a proposition for how arbitration should be interpreted and where it fits in the twenty-first century.

## II. THE TOOLS OF THE TRADE THAT COMPRISE ALTERNATIVE DISPUTE RESOLUTION

### Negotiation

Arbitration is but one tool in a vast toolbox of alternative dispute resolution devices available to resolve conflicts between contracting parties. Negotiation and mediation are two other popular dispute resolution techniques that are effective, but do not have the same consequence as does arbitration, namely because they are non-

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<sup>15</sup> N.Y. GEN. BUS. LAW § 757(3) (CONSOL. 2010).

<sup>16</sup> See Eiseman & MacPherson, *supra* note 8 (foreseeing a string of litigation due to the constitutional implications of the Prompt Payment Law).

binding.<sup>17</sup> Negotiation, for instance, can be rather informal because it occurs between the parties with no outside help.<sup>18</sup> Moreover, negotiations need not take place only when a problem arises; often, terms are bargained for through some form of negotiation before a contract is even executed.<sup>19</sup> The relationship between parties can consist of a constant ebb and flow of negotiations, and it does not matter whether or not a contract has already been signed. The reality is that most transactions revolve around some form of negotiation, and in the context of dispute resolution, it is a simple yet effective tool that may result in an expeditious solution.<sup>20</sup>

### Mediation

Slightly more formal is the dispute resolution tool of mediation, which, by its nature, requires not only the parties at the table, but also a neutral third person facilitating a civil and objective resolution.<sup>21</sup> Hence, mediation is frequently called “facilitated negotiation.”<sup>22</sup> Often, courts will require some form of mediation prior to filing with the court, which, in such a context, provides a valuation for what a case is worth.<sup>23</sup>

In order for mediation to be successful, the parties must truly intend to make amends.<sup>24</sup> A mediator’s role is to encourage open communication between the disputing parties so as to come to a mutual resolution.<sup>25</sup> Rather than impressing upon the parties a half-hearted resolution, the mediator’s goal is to inspire a creative solution

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<sup>17</sup> Lebovits & Hidalgo, *supra* note 2, at 439-41 (discussing the pros and cons of negotiation, mediation and arbitration). The authors further note that, with regard to negotiation, “[t]he parties in dispute attempt to reach an agreement using their negotiating skills and leverage.” *Id.* at 439.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* (“The advantage of negotiation over other ADR techniques is that parties that negotiate can eliminate the cost associated with a third-party neutral (if any) and overcome adversarial bias.”).

<sup>21</sup> Lebovits & Hidalgo, *supra* note 2, at 440-41.

<sup>22</sup> *Id.* at 440; see also Leonard L. Riskin, *Understanding Mediators’ Orientations, Strategies, and Techniques*, 1 HARV. NEGOT. L. REV. 7, 13 (1996).

<sup>23</sup> Lebovits & Hidalgo, *supra* note 2, at 440.

<sup>24</sup> *Id.* at 441 (stating that the parties must have a “genuine intention to reach an agreement [otherwise] mediation will fail. Mediation is not advisable when . . . one side is unreasonable, when one side has a decidedly superior legal position, or when the parties are so antagonistic that concessions between them are not viable.”).

<sup>25</sup> *Id.* at 440.

that is satisfactory to all the parties involved.<sup>26</sup> Any conclusion to the conflict between the parties as a result of mediation will only be the product of voluntary, consensual agreement.<sup>27</sup> Thus, mediation maintains the spirit of willingness associated with negotiation, but is more structured and formal.

### Arbitration

Finally, in the continuum of formality of dispute resolution tools, arbitration is the most formal and consequential—it is binding adjudication.<sup>28</sup> There are, indeed, compelling benefits associated with voluntary arbitration. First, the parties must agree that if a dispute were to arise between them during the life of the contract, then arbitration would be the choice of adjudication to which they would agree to resolve the conflict. Therefore, when a signed agreement between parties contains an arbitration clause, it is presumably there because it was consensually approved by them, and is thus, voluntary. The venue of the arbitration, the neutral arbitrator, and the rules which shall govern are matters which should be mutually agreed upon by the parties.<sup>29</sup>

Secondly, arbitration is private and the decision of the arbitrator is not made public.<sup>30</sup> For those who cherish their privacy, arbitration can be an invaluable alternative. Finally, arbitration is a more expeditious process than litigation, and as a result, arbitration is, by and large, faster and cheaper—a benefit that does not require further explanation.<sup>31</sup> Beware, however, because the old adage, “you get what you pay for,” rings especially true here.

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<sup>26</sup> *Id.*; see also James J. Alfani, *Mediation as a Calling: Addressing the Disconnect Between Mediation Ethics and the Practices of Lawyer Mediators*, 49 S. TEX. L. REV. 829, 831 (2008) (“[S]elf-determination . . . is the one value that distinguishes mediation from other dispute resolution processes.”).

<sup>27</sup> Lebovits & Hidalgo, *supra* note 2, at 441.

<sup>28</sup> *Id.* (“The arbitrators’ ruling or award is ultimately binding on the parties just as it were rendered by a court as a final judgment.”).

<sup>29</sup> Soia Mentschikoff, *Commercial Arbitration*, 61 COLUM. L. REV. 846, 849 (1961) (calling this type of arrangement “individuated arbitration, [wherein] the making of all arrangements, including the procedures for arbitration, rests entirely with the parties concerned”).

<sup>30</sup> *Id.* In addition to the privacy that arbitration provides, there is also the fact that experts in the relevant field act as arbitrators in the matter, as well as “the random acceptance by many businessmen of the idea that arbitration is faster and less expensive than court action.” *Id.*

<sup>31</sup> *Id.*



In any event, that which most differentiates negotiation and mediation from arbitration is that the latter's effects are binding; that is, a party may not appeal the arbitrator's decision in a court of law.<sup>32</sup> Arbitration has its own set of rules, and as such, it need not follow substantive law.<sup>33</sup> Arbitration does not have the power to hold parties in contempt or award punitive damages.<sup>34</sup> An arbitrator can essentially employ his subjective notions of justice, without any rationality, yet purport to be objective in his outcome. To much dismay, these truths are what the Supreme Court and the New York Court of Appeals favor.<sup>35</sup>

### Exposing Arbitration: The "Repeat" Theories

Aside from the intuitive problems that are inherent with arbitration, there are two other understated issues that warrant attention. First is the "repeat provider" theory, which explains that organizations that repeatedly provide arbitration services for companies that include arbitration clauses in contracts with consumers and employees do not have a financial incentive to arbitrate dispassionately, but rather to settle cases before them in a manner that is most beneficial to the companies that ultimately pay the arbitration fees.<sup>36</sup> The American Arbitration Association and the National Arbitration Forum are but two arbitration organizations that have agreements with

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<sup>32</sup> In reality, a party may in fact appeal an arbitrator's award, but under only under limited circumstances as prescribed by C.P.L.R. Article 75. See, e.g., N.Y. C.P.L.R. § 7511 (CONSOL. 2010).

<sup>33</sup> See Matthew Savare, *Clauses in Conflict: Can an Arbitration Provision Eviscerate a Choice-of-Law Clause?*, 35 SETON HALL L. REV. 597, 598 (2005); see also *Lentine v. Fundaro*, 278 N.E.2d 633, 635 (N.Y. 1972) ("Absent provision to the contrary in the arbitration agreement, arbitrators are not bound by principles of substantive law or rules of evidence.").

<sup>34</sup> Lawrence N. Gray, *Judiciary and Penal Law Contempt in New York: A Critical Analysis*, 3 J.L. & POL'Y 81, 84-86 (1994) (noting that only judges can hold a party in contempt).

<sup>35</sup> See generally, *Moses H. Cone Mem'l Hosp. v. Mercury Const. Corp.*, 460 U.S. 1, 5 (1983) (discussing the finality and binding effect of arbitration decisions); *Weinrott v. Carp*, 298 N.E.2d 42, 45 (N.Y. 1973) (" 'Once it be ascertained that the parties broadly agree to arbitrate a dispute arising out of or in connection with the agreement, it is for the arbitrators to decide what the agreement means and to enforce it according to the rules of law which they deem appropriate in the circumstances.' " (quoting *Matter of Exercycle Corp. (Maratta)*, 174 N.E.2d 463, 464 (N.Y. 1961))).

<sup>36</sup> Jean R. Sternlight, *Creeping Mandatory Arbitration: Is It Just?*, 57 STAN. L. REV. 1631, 1650 (2005) [hereinafter Sternlight, *Creeping Mandatory Arbitration*] ("Arbitration organizations . . . are now competing to provide arbitration services for particular companies that require their consumers to arbitrate future disputes. . . . Obviously, once an entity is named as the provider, financial benefits accrue to that provider.").

various large companies that name them as the provider of their arbitration services.<sup>37</sup> These organizations earn fees, either as a percentage of the amount charged by the arbitrators or, at the very least, administrative fees.<sup>38</sup> However one rationalizes it, the arbitration organizations and the companies that hire them are very likely to get a gluttonous slice of some financial pie.

The second trend is known as the “repeat player” bias.<sup>39</sup> As the name suggests, the companies that repeatedly include arbitration clauses in their contracts are more likely to arbitrate against a multitude of customers or employees.<sup>40</sup> The companies thus garner much more experience and inevitably become more adept at handling the arbitration proceedings.<sup>41</sup> Conversely, consumers and employees are less likely to arbitrate a matter more than once in their lifetime as opposed to a large company, and the “repeat player” theory suggests that familiarity with the process can either be beneficial or detrimental to the success of the arbitration, depending on which side of the table one sits.<sup>42</sup>

Notwithstanding the benefits of arbitration when it is chosen *voluntarily* between parties, the negatives associated with *involuntary* mandatory arbitration are too severe to be forced on any party by statute. The language of the Prompt Payment Law reads that the aggrieved party has the option to arbitrate, as evidenced through the use of the non-mandatory language of “may.”<sup>43</sup> Proponents of the statute may argue that this language mitigates the mandating effect that the statute imposes on the other party because it is ultimately the ag-

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<sup>37</sup> *Id.*

<sup>38</sup> *Id.* (“[P]roviders have a financial incentive to make sure that the company is pleased with the results in arbitration.”).

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> Sternlight, *Creeping Mandatory Arbitration*, *supra* note 36, at 1651.

<sup>42</sup> *Id.* at 1651; *see also* Lisa B. Bingham, *On Repeat Players, Adhesive Contracts, and the Use of Statistics in Judicial Review of Employment Arbitration Awards*, 29 MCGEORGE L. REV. 223, 239 (1998) (“[T]he perception of fairness is as important as the reality”).

<sup>43</sup> N.Y. GEN. BUS. LAW § 756(b)(3)(c) (2010). The relevant portion of the statute is reproduced here:

If efforts to resolve such matter to the satisfaction of all parties are unsuccessful, the aggrieved party may refer the matter, not less than fifteen days of the receipt of third party verification of delivery of the complaint, to the American Arbitration Association for an expedited arbitration pursuant to the Rules of the American Arbitration Association.

*Id.*

*grieved* party's choice. This argument, of course, has no merit. It is the statute which enables the aggrieved party to force the other to arbitrate in the first place.<sup>44</sup> Without this language, the aggrieved party would not have the statutory option to single-handedly arbitrate, and might otherwise go to court as previously imagined by the parties.

If the parties do not negotiate a conflict resolution clause in their contract voluntarily, arbitration should not be intrusively imposed on any party by the legislature, and should not be the default rule under any circumstances. The Prompt Payment Law violates the right to a jury trial and the right to due process, both of which are guaranteed by the United States Constitution.<sup>45</sup>

### III. CONSTITUTIONAL PROTECTIONS OPTIONAL

Today's backdrop of civil litigation is drastically different than the backdrop existing when the Constitution was drafted. The Constitution guarantees that civil litigants have a right to due process of law<sup>46</sup> and the right of trial by jury.<sup>47</sup> More modern statutes and rules assure that the parties in litigation conduct discovery in order to inform the opposing parties of the other's evidence and to limit surprises in court as much as possible.<sup>48</sup> A neutral judge or jury then hears the facts and weighs the evidence, and judgment is rendered based on the pertinent law.<sup>49</sup> If the losing party finds that error was made, he can appeal to a higher court which can review the law as applied to the facts, and if substantial error is found, the higher court can reverse the judgment.<sup>50</sup> The process just summarized describes the judicial system, which affords an even playing field for all parties

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<sup>44</sup> *See id.* (stating that the aggrieved party is responsible for referring the matter to the American Bar Association).

<sup>45</sup> U.S. CONST. amend. VII; U.S. CONST. amend. XIV § 1.

<sup>46</sup> U.S. CONST. amend. XIV (“[N]or shall any State deprive any person of life, liberty, or property, without due process of law.”).

<sup>47</sup> U.S. CONST. amend. VII.

In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law.

*Id.*

<sup>48</sup> FED. R. CIV. P. 26(b).

<sup>49</sup> *See generally, Right to a Jury Trial*, 37 GEO. L.J. ANN. REV. CRIM. PROC. 519 (2008) (discussing the Sixth Amendment right to a fair and neutral jury).

<sup>50</sup> *See* FED. R. APP. P. 3 (explaining the process for appeal as of right).

involved, thereby assuring just outcomes.

Times change, and with time so did the application of those aforementioned constitutional rights. Many contracts today contain alternative dispute resolution provisions.<sup>51</sup> The “alternative” is a binding resolution outside of the so-called cumbersome court system, but it is not always justice. Companies, small and large alike, include such provisions in their employment contracts because it is often less expensive to arbitrate than it is to engage in the prolonged and expensive process of filing a lawsuit. Employees who sign these contracts, however, have little option but to agree to these provisions because the initial offers are presented to them in a “take it or leave it” fashion. Oftentimes, some form of arbitration is agreed to even though there may exist a huge disparity of bargaining power between the parties.<sup>52</sup>

Proponents of arbitration claim that it is preferred over litigation because it is less expensive, especially for an employee bringing suit against a large corporation who might have refused to do so if faced with the prohibitive expense of hiring an attorney and filing a lawsuit. Nonetheless, the expense is still high for less affluent employees that bring arbitration against their employer “big-company” because arbitrators may charge up to \$5,000 per day in certain instances.<sup>53</sup> Moreover, attorney’s fees are not recoverable in arbitration.<sup>54</sup> It is even more expensive when one considers the inferior value one receives through arbitration as opposed to the value one receives from litigating in court, where the arbiter is a truly neutral judge bound by the law of the land.

Ultimately, however, parties under these employment-contract circumstances agree to them and are bound by them—that is,

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<sup>51</sup> See Sternlight, *Creeping Mandatory Arbitration*, *supra* note 36, at 1639 (“It is difficult to assess how common mandatory arbitration clauses have become, but they certainly seem ubiquitous.”).

<sup>52</sup> See, e.g., *Brennan v. Bally Total Fitness*, 198 F. Supp. 2d 377, 382 (S.D.N.Y. 2002) (“While inequality in bargaining power between employers and employees is not alone sufficient to hold arbitration agreements unenforceable, such inequality, when coupled with high pressure tactics that coerce an employee’s acceptance of onerous terms, may be sufficient to show that an employee lacked a meaningful choice.” (internal citations omitted)).

<sup>53</sup> See Christopher R. Drahozal, *Arbitration Costs and Contingent Fee Contracts*, 59 VAND. L. REV. 729, 738 (2006) (illustrating arbitrators’ fees from the American Arbitration Association in Table 1).

<sup>54</sup> See Sternlight, *Creeping Mandatory Arbitration*, *supra* note 36, at 1641-43 (“Companies are increasingly using their arbitration clause not only to require arbitration but also to further limit consumers’ procedural and even substantive rights.”).

a prospective employee has the opportunity to walk away from a contract before signing it, or at least attempt to amend a clause so as to tip it more in her favor. The employee is ostensibly cognizant of the possibility of arbitration because of its mention in the contract, and when such a contract is signed in an employment setting, there is less sympathy for the employee because she presumably knew the risks beforehand. Accordingly, employment arbitration agreements are often upheld in the name of efficiency and in accord with precedent.<sup>55</sup>

Notwithstanding the Constitution's limitations, however, some state legislatures enacted legislation that not only promote arbitration, but, in fact, mandate it.<sup>56</sup> Arbitration essentially embodies the privatization of the judicial system.<sup>57</sup> Such privatization runs counter to the safeguards that the Constitution provides and is an egregious violation thereto. As one commentator put it, "[the Constitution] precludes the state from helping one party require another to give up her day in court in favor of an arbitration process that is unfair or that deprives an unwitting party of her right to a jury or a life-tenured judge."<sup>58</sup> This succinctly encapsulates what the New York State Legislature has done through the Prompt Payment Act.

#### IV. THE PROMPT PAYMENT LAW AND ARBITRATION IN A CONSTITUTIONAL CONTEXT

Interpreting the Securities Act of 1933, the Supreme Court decided *Wilko v. Swan*,<sup>59</sup> where it ruled that arbitration is less protective than litigation.<sup>60</sup> The Court further stated that arbitration requires

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<sup>55</sup> See Jean R. Sternlight, *Rethinking the Constitutionality of the Supreme Court's Preference for Binding Arbitration: A Fresh Assessment of Jury Trial, Separation of Powers, and Due Process Concerns*, 72 TUL. L. REV. 1, 18-19 (1997) [hereinafter Sternlight, *Rethinking*] ("Courts have apparently been so impressed by the value of arbitration that they have abandoned their purported practice of interpreting a statute according to its plain meaning, in order to favor arbitration over litigation.").

<sup>56</sup> Pennsylvania is the only state thus far that has legislation that compels parties to arbitrate regardless of either party's willingness to do so. See 55 A.L.R.2d 432 (Originally published in 1957).

<sup>57</sup> Sternlight, *Rethinking*, *supra* note 55, at 6.

<sup>58</sup> *Id.* at 12-13 (noting that courts should honor an arbitration agreement between two businessmen who voluntarily decide to partake in it, but should otherwise be weary of arbitration agreements wherein one party signs it unwittingly or without the full understanding that his substantive rights will be abridged).

<sup>59</sup> 346 U.S. 427 (1953), *overruled by* *Rodriguez de Quijas v. Shearson/Am. Exp., Inc.*, 490 U.S. 477, 484 (1989).

<sup>60</sup> *Id.* at 436 (indicating that a substantial curbing of constitutional protections comes with

subjective findings that must not only be determined, but also applied “without judicial instruction on the law” and that the arbitrator’s award “may be made without explanation of their reasons and without a complete record of their proceedings, [and that] the arbitrators’ conception of the legal meaning of such statutory requirements as ‘burden of proof,’ ‘reasonable care’ or ‘material fact,’ . . . cannot be examined.”<sup>61</sup> Since then, the Court has taken a stance in diametric opposition to its reasoning in *Wilko*. In the ensuing years, the Court began to flirt with the idea of enforcing arbitration clauses between two business entities of equal sophistication.<sup>62</sup> Thirty-six years later, in 1989, the Court finally cemented its slow shift from skepticism of arbitration to the favorable attitude it harbors toward it today.<sup>63</sup>

Construction matters offer a particularly salient backdrop for showcasing the Supreme Court’s current preference for arbitration. In 1983, the Court first articulated its broad consent of the use of arbitration over litigation in *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*<sup>64</sup> There, two parties, a contractor and a hospital, entered into a contract which called for arbitration as the avenue for which to resolve disputes between them.<sup>65</sup> Mercury, the contractor, attempted to initiate such an arbitration proceeding pursuant to its allegation that the hospital owed it damages for causing delays in construction.<sup>66</sup> The hospital filed a *lawsuit*, however, to thwart Mercury’s attempt from initiating arbitration as delineated in the contract.<sup>67</sup> The hospital’s main contentions were that, “Mercury’s claim was without factual or legal basis and that it was barred by the statute of limitations[,]” and that “Mercury had lost any right to arbitration under the contract due to waiver, laches, estoppel, and failure to make a timely demand for arbitration,” and sought as relief “a declaration

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arbitration).

<sup>61</sup> *Id.*

<sup>62</sup> *See, e.g.,* Scherk v. Alberto-Culver Co., 417 U.S. 506, 520-21 (1974) (ruling that, in a claim between the two American and German companies, arbitration in this international commercial context is favorable due to social policy concerns).

<sup>63</sup> *Rodriguez de Quijas*, 490 U.S. at 481 (“‘By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum.’”) (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985)).

<sup>64</sup> 460 U.S. 1 (1983).

<sup>65</sup> *Id.* at 4-5.

<sup>66</sup> *Id.* at 7.

<sup>67</sup> *Id.*

that there was no right to arbitration [and] a stay of arbitration.”<sup>68</sup> The Supreme Court ruled that because the growing trend was leaning toward favoring arbitration,<sup>69</sup> laches and estoppel should be interpreted narrowly as defenses to arbitration, and that the arbitration provision would prevail.<sup>70</sup>

In justifying its obtuse alignment with arbitration over the constitutionally-provided-for right to litigation, the Court expanded its 1967 decision in *Prima Paint Corp. v. Flood & Conklin Manufacturing Corp.*,<sup>71</sup> where it first determined that fraud in the inducement was an arbitrable issue according to the United States Arbitration Act.<sup>72</sup> In *Moses*, the Court expounded on this basis, stating that:

[Since *Prima Paint Corp.*,] courts of appeals have . . . consistently concluded that questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration. We agree. The Arbitration Act establishes that, as a matter of federal law, *any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration*, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability.<sup>73</sup>

The Supreme Court of the United States allowed the lower courts to effectively dictate its ruling. Commentators have astutely pointed out, however, that although federal policy “favoring arbitration” more accurately stands for the proposition that arbitration is a valuable alternative, the Supreme Court here made it unambiguously clear that it supports the policy of favoring arbitration *over* litigation.<sup>74</sup> Moreo-

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<sup>68</sup> *Id.*

<sup>69</sup> *Moses*, 460 U.S. at 24.

The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability.

*Id.* at 24-25.

<sup>70</sup> *Id.*

<sup>71</sup> 388 U.S. 395 (1967).

<sup>72</sup> *Id.* at 406 (“Federal courts are bound to apply rules enacted by Congress with respect to matters—here, a contract involving commerce—over which it has legislative power.”).

<sup>73</sup> *Moses*, 460 U.S. at 24-25 (emphasis added).

<sup>74</sup> Sternlight, *Rethinking*, *supra* note 55, at 18.

ver, the Court stated that any hesitation of whether arbitration is appropriate should nevertheless be tipped in its favor.<sup>75</sup> Surely this is not the voice of reason or justice, nor one that could have been anticipated by the founders of this nation. Even so, the favor of arbitration remains the prevailing sentiment—one which is supported by not one scintilla of sound reasoning, but one that is nonetheless perpetuated by courts' reference to *Moses*.

Once this ruling was handed down and it became clear that the Supreme Court favored arbitration, companies across the gamut started to implement arbitration clauses in their employment and consumer contracts.<sup>76</sup> Companies have since sought arbitration in order to escape the niceties of litigation—jury awards, punitive damages, meaningful discovery, class actions, and of course, publicity.<sup>77</sup> Moreover, companies design arbitration clauses that further curb the procedural and substantive rights of consumers and employees.<sup>78</sup> For instance, some clauses have shortened statutes of limitations, others require claims to be filed in distant forums, and still others bar particular forms of relief (e.g., injunctive relief or attorney's fees).<sup>79</sup>

State courts have followed suit, and the New York State legislature, autonomous as it may be in the scheme of federal policy, does not legislate in a vacuum. It undoubtedly takes into account the policy considerations of the federal government, as evidenced by the arbitration provision of the prompt payment statute. A legislature does not make laws it foresees will be overturned; it presumably contemplates the laws' consequences and enacts them responsibly. Here, the statutorily mandated arbitration provision is the progeny of the federal government's misguided philosophy that arbitration is favorable over litigation.

The New York legislature passed the Prompt Payment statutes

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<sup>75</sup> *Moses*, 460 U.S. at 26 & n.34. Yet, the Court acknowledges that:

[t]he Arbitration Act is something of an anomaly in the field of federal-court jurisdiction. It creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate, yet it does not create any independent federal-question jurisdiction under 28 U.S.C. § 1331 (1976 ed., Supp. IV) or otherwise.

*Id.* at 26 n.32.

<sup>76</sup> Sternlight, *Creeping Mandatory Arbitration*, *supra* note 36, at 1638 (noting that “businesses jumped on the opportunity” to force arbitration in contexts that previously might not have been enforced).

<sup>77</sup> *Id.*

<sup>78</sup> *Id.* at 1641.

<sup>79</sup> *Id.* at 1641-42.



with provisions mandating arbitration because the national trend had been leaning in that direction in recent years.<sup>80</sup> This trend is largely due to the Supreme Court perpetuating a skewed interpretation of the Federal Arbitration Act (“FAA”). When Congress enacted the FAA in 1925, the original intention was to allow two parties of equal sophistication to engage in arbitration instead of litigation.<sup>81</sup> The Court, however, has since interpreted the FAA to mean that it allows large, sophisticated companies to take advantage of less powerful parties who have no choice but to adhere to the former’s contracts in a “take it or leave it” fashion.<sup>82</sup> Admittedly, the enforcement of agreements between parties of the same sophistication that bargain for arbitration as the means by which to resolve their disputes is not problematic. To imagine, however, that a legislature would enact a statute that practicably mandates arbitration is an unfortunate legal reality disconnected from rationality.

#### A. The Seventh Amendment and New York’s Analog

State courts have enforced mandatory arbitration agreements as if the agreements were between two voluntary parties.<sup>83</sup> Similarly, the Prompt Payment Law compels parties into arbitration from agreements that merely contemplated litigation. This imposition of arbitration is unconstitutional because it deprives the party of the right to a hearing by jury under the Seventh Amendment and its New York analog.<sup>84</sup>

The Seventh Amendment challenge can only be made if the case is brought in federal court, under common law, and for damages of twenty dollars or more.<sup>85</sup> To call on a state’s Seventh Amendment

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<sup>80</sup> See, e.g., *Moses*, 460 U.S. at 24 (noting the “liberal federal policy favoring arbitration agreements”).

<sup>81</sup> See Sternlight, *Creeping Mandatory Arbitration*, *supra* note 36, at 1636 (“Until quite recently, . . . arbitration agreements were not used by U.S. businesses to require consumers, employees, franchisees, or other weaker parties to resolve disputes through private arbitration rather than in court.”).

<sup>82</sup> *Id.*

<sup>83</sup> See *id.* at 1642 (noting that courts are not persuaded by the fact that arbitration agreements with small print or in a form contract constitute grounds for nullifying them); see also *Harris v. Green Tree Fin. Corp.*, 183 F.3d 173, 177-78 (3d Cir. 1999) (recognizing the validity of the contract in question wherein the arbitration clause was in fine print and inconspicuously placed toward the back and bottom of the agreement).

<sup>84</sup> U.S. CONST. amend. VII; N.Y. CONST. art. I, § 2.

<sup>85</sup> U.S. CONST. amend. VII.

analog, the challenger must further ensure that the Federal Arbitration Act does not preempt the relevant state statute.<sup>86</sup>

The New York State Constitution provides that “[t]rial by jury in all cases in which it has heretofore been guaranteed by constitutional provision shall remain inviolate forever; *but a jury trial may be waived by the parties in all civil cases in the manner to be prescribed by law.*”<sup>87</sup> The State Constitution further provides that “[t]he legislature may enact laws, not inconsistent herewith, governing the form, content, manner and time of presentation of the instrument effectuating such waiver.”<sup>88</sup> Notwithstanding the Constitution’s permission to the legislature in delineating statutory waiver requirements, there is no statute that expressly defines the criteria for which a waiver of jury trial in civil cases must be obtained.<sup>89</sup> New York courts, however, as well as most other state and federal courts, have prescribed the manner with which the right to a jury trial in civil cases may be waived.<sup>90</sup> The waiver of a civil jury trial must be clear, unequivocal, and explicit so as to leave no room for uncertainty regarding the parties’ intentions.<sup>91</sup>

The Prompt Payment Law requires that written notice be given of the complaint the aggrieved party has against the other party, and that after such notice is given, “the parties shall attempt to resolve the matter giving rise to such complaint.”<sup>92</sup> The written notice must be delivered, with third-party verification, to the last business address known to the party giving notice of the complaint.<sup>93</sup> The question remains whether this effectuates a waiver as defined by the courts. It is doubtful that a mere letter of complaint by one party to

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<sup>86</sup> Sternlight, *supra* note 36, at 1646.

<sup>87</sup> N.Y. CONST. art. I, § 2 (emphasis added).

<sup>88</sup> *Id.*

<sup>89</sup> N.Y. C.P.L.R. § 4101 (McKINNEY 2010) lists the actions for which issues of fact shall be tried by a jury, unless a jury trial is waived. They are: (1) where a party is able to prove a judgment for a sum of money; (2) for “an action of ejectment; for dower; for waste; for abatement of and damages for a nuisance; to recover a chattel”; (3) any other action provided for by the New York Constitution. N.Y. C.P.L.R. § 4101(1)-(3). Waiver of jury trial in criminal cases is governed by N.Y. CRIM. PROC. § 320.10 (McKinney 2010).

<sup>90</sup> Jean R. Sternlight, *The Rise and Spread of Mandatory Arbitration as a Substitution for the Jury Trial*, 38 U.S.F. L. REV. 17, 25 (1991) [hereinafter Sternlight, *Rise and Spread*].

<sup>91</sup> *Edsaid Realty Corp. v. Samuels*, 92 N.Y.S.2d 897, 899 (N.Y. City Ct. 1949) (“While parties may unquestionably, by agreement, waive the constitutional right of trial by jury in civil cases, the waiver must be clear and explicit, and *must leave no room for doubt as to the intention of the parties.*”) (emphasis added).

<sup>92</sup> N.Y. GEN. BUS. LAW § 756(b)(3)(a).

<sup>93</sup> *Id.* § 756 (b)(3)(b).

another constitutes waiver of a jury trial for the other party, but the subsequent provision of the Prompt Payment Law introduces the arbitration provision: “the aggrieved party may refer the matter, not less than fifteen days of the receipt of third party verification of delivery of the complaint, to the American Arbitration Association for an expedited arbitration pursuant to the Rules of the American Arbitration Association.”<sup>94</sup> The party who was served with the letter is thus placed in an inferior position because the “aggrieved” party has at its disposal the statutory mandate to arbitrate. As one commentator put it, “there is a great difference between a legislature mandating arbitration and a private company doing the same.”<sup>95</sup>

### **B. Framework for Arbitration in New York Practice: Article 75**

Article 75 of the Civil Practice Law and Rules (“CPLR”) defines the scope of arbitration between private contracting parties and allows for judicial oversight over the process.<sup>96</sup> Prior to the enactment of Article 75 of the CPLR in 1920, there existed a judicial hostility toward arbitration among the courts.<sup>97</sup> Thus, the advent of CPLR Article 75 ushered in an era of refreshed judicial philosophy, one that welcomed the new procedural guidelines that made arbitration more attractive. As a result, the Court of Appeals, mirroring its federal counterpart,<sup>98</sup> now favors arbitration as the best alternative to the judicial forum for dispute resolution.<sup>99</sup> Part of the appeal for arbitration is that it results in expeditious resolutions that are often less

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<sup>94</sup> *Id.* § 756 (b)(3)(c).

<sup>95</sup> Sternlight, *supra* note 36, at 1647.

<sup>96</sup> See N.Y. C.P.L.R. § 7511 (explaining how a party can vacate or modify an arbitration award as determined by a judge).

<sup>97</sup> See, e.g., *Meacham v. Jamestown, F. & C.R. Co.*, 105 N.E. 653, 654-55 (N.Y. 1914).

[A] distinction [has been] made between the provisions of a contract providing that before a right of action shall accrue certain facts shall be determined, or amounts or values ascertained, and an independent covenant or agreement to provide for the adjustment and settlement of all disputes and differences by arbitration to the exclusion of the courts.

*Id.* at 654.

<sup>98</sup> See, e.g., *Moses*, 460 U.S. at 24.

<sup>99</sup> *Weinrott v. Carp*, 298 N.E.2d 42, 47 (N.Y. 1973) (“The result we suggest in this case is consistent with the policy adopted by the Federal courts, and is significant since the Federal arbitration statute is almost identical to, and is derived from, our own arbitration statute.”).

expensive and more private.<sup>100</sup>

Notwithstanding the extreme favorability for arbitration, there exists a tension between the disadvantages it places on parties—resulting from the surrendering of significant procedural rights intrinsic in arbitration—with any recognized benefits. In *Silverman v. Benmor Coats, Inc.*,<sup>101</sup> for example, the Court of Appeals is disheartened that,

[A]bsent [a] provision in the arbitration clause itself, an arbitrator is not bound by principles of substantive law or by rules of evidence. He may do justice as he sees it, applying his own sense of law and equity to the facts as he finds them to be and making an award reflecting the spirit rather than the letter of the agreement, even though the award exceeds the remedy requested by the parties. His award will not be vacated even though the court concludes that his interpretation of the agreement misconstrues or disregards its plain meaning or misapplies substantive rules of law, unless it is violative of a strong public policy, or is totally irrational, or exceeds a specifically enumerated limitation on his power. Nor will an arbitration award be vacated on “ ‘the mere possibility’ ” that it violates an express limitation on the arbitrator’s power.<sup>102</sup>

Through this excerpt of *Silverman*, it is clear that the New York Court of Appeals substantially mirrored its apprehension toward arbitration as the Supreme Court did in *Wilko* 31 years earlier. Therefore, due to the substantial curbing of procedural rights, courts still serve a chaperoning function when a party calls for judicial intervention. When a party solicits the involvement of a court, the law addresses these preliminary threshold issues: whether there actually was a valid arbitration agreement that contemplated the matters to be arbitrated;<sup>103</sup> whether the applicable statute of limitations has

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<sup>100</sup> *Sablosky v. Edward S. Gordon Co.*, 535 N.E.2d 643, 646 (N.Y. 1989) (“Although a party gives up an important right when it agrees to submit a dispute to arbitration, such proceedings are not less effective in discovering the truth than are judicial proceedings and it is not, as a matter of public policy, per se unfair to give one party the right to select them.”).

<sup>101</sup> 461 N.E.2d 1261 (N.Y. 1984).

<sup>102</sup> *Id.* at 1266 (internal citations omitted) (quoting *Matter of Tilbury Fabrics v. Stillwater, Inc.*, 435 N.E.2d 1093, 1094 (N.Y. 1982)).

<sup>103</sup> N.Y. C.P.L.R. § 7503(a) (McKINNEY 2010) (“Where there is no substantial question

lapsed;<sup>104</sup> whether the award was procured through “corrupt, fraud or misconduct”;<sup>105</sup> and the impartiality of the arbitrator<sup>106</sup> or the arbitrator exceeding his authority.<sup>107</sup> This list is illustrative rather than exhaustive, as the courts also take into consideration whether the issue is arbitrable as per prevailing public policy.

Perhaps the principal concern courts must first grapple with before compelling parties to arbitrate is to determine if, in fact, there existed such an agreement to arbitrate. A higher degree of scrutiny is required for arbitration agreements as compared to ordinary contracts.<sup>108</sup> The Court of Appeals has stated that:

[t]he reason for this requirement, quite simply, is that by agreeing to arbitrate a party waives in large part many of his normal rights under the procedural and substantive law of the State, and it would be unfair to infer such a significant waiver on the basis of anything less than a clear indication of intent.<sup>109</sup>

Thus, the Court of Appeals would agree that certain sacrosanct rights are taken away from parties who arbitrate disputes, and that opaqueness of terms in an agreement to arbitrate makes it inherently ineffective. For these reasons, an agreement to arbitrate must be “express, direct, and unequivocal as to the issues or disputes to be submitted to arbitration. But, once there is agreement or submission to arbitration, the scope of the arbitrators is unlimited and, with very limited exceptions, unreviewable.”<sup>110</sup> Consequently, the power

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whether a valid agreement was made or complied with . . .”).

<sup>104</sup> N.Y. C.P.L.R. § 7502(b) (McKinney 2010) (“If, at the time that a demand for arbitration was made or a notice of intention to arbitrate was served, the claim sought to be arbitrated would have been barred by limitation of time had it been asserted in a court of the state, a party may assert the limitation as a bar to the arbitration . . .”).

<sup>105</sup> N.Y. C.P.L.R. § 7511(b)(1)(i) (McKinney 2010).

<sup>106</sup> *Id.* § 7511(b)(1)(ii).

<sup>107</sup> *Id.* § 7511(b)(1)(iii).

<sup>108</sup> *See, e.g.,* *Marlene Indus. Corp. v. Carnac Textiles, Inc.*, 380 N.E.2d 239, 242 (N.Y. 1978) (“It has long been the rule in this State that the parties to a commercial transaction ‘will not be held to have chosen arbitration as the forum for the resolution of their disputes in the absence of an express, unequivocal agreement to that effect; absent such an explicit commitment neither party may be compelled to arbitrate.’” (quoting *Matter of Acting Supt. of Schools of Liverpool Cent. Sch. Dist. (United Liverpool Faculty Assn.)*, 369 N.E.2d 746, 748 (N.Y. 1977))).

<sup>109</sup> *Id.*

<sup>110</sup> *Gangel v. N. DeGroot, PVBA*, 362 N.E.2d 249, 250 (N.Y. 1977) (citing *Weinrott v. Carp*, 298 N.E.2d 42, 46 (N.Y. 1973)).

vested with the arbitration process is so potent that it is not something that should be wielded menacingly by powerful parties, nor used as leverage to manipulate opponents, as a means of procuring a resolution through a process which is intrinsically less stringent. Perhaps more importantly, a legislature should not mandatorily impose arbitration on any party, as the New York legislature does with the Prompt Payment Law.

In construing arbitration clauses, courts have balanced the legality of the arbitration clause in the context of the entire contract—that is to say, whether the clause is valid. The issue of validity arises most often with contracts that contain very broad arbitration clauses. The leading New York case on the issue is *Weinrott v. Carp*,<sup>111</sup> where the Court of Appeals held that arbitration clauses are separable from the contract in its entirety if portions of the contract were found to be invalid.<sup>112</sup> The contention in *Weinrott* was that because the overall contract was induced by fraud, so too should the arbitration clause be struck down as fraudulent.<sup>113</sup> The Court, however, provided that:

The CPLR arbitration provisions (CPLR 7501 et seq.) evidence a legislative intent to encourage arbitration. Certainly the avoidance of court litigation to save the time and resources of both the courts and the parties involved make this a worthwhile goal. One way to encourage the use of the arbitration forum would be to prevent parties to such agreements from using the courts as a vehicle to protract litigation. This conduct has the effect of frustrating both the initial intent of the parties as well as legislative policy. In the case at bar, there were 21 hearings and 2,750 pages of testimony.

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<sup>111</sup> 298 N.E.2d 42 (N.Y. 1973).

<sup>112</sup> *Id.* at 47 (“[W]e now hold that an arbitration provision of a contract is separable, the agreement to arbitrate would be ‘valid’ even if the substantive portions of the contract were induced by fraud.”).

<sup>113</sup> *Id.* Notice the Court’s tone when addressing appellant’s legal contention:

As often happens in this type of case, appellants moved to stay the arbitration on the ground that there was fraud in the inducement of the contract. Although appellants’ contention was ‘not supported by the record and is refuted by documentary evidence’, the arbitration continued to be stayed while that preliminary issue laboriously worked its way through the New York court system. Finally, after the issue fell exhausted at the Court of Appeals, the arbitration hearings commenced.

*Id.* (internal citation omitted).

If not for the arbitration, that entire burden would have been placed on our court system. Indeed, had the case been tried in the formality of the courtroom, it would have taken longer to dispose of than it did before the arbitrators. A broad arbitration clause should be given the full effect of its wording in order to implement the intention of the parties. Of course, where a form contract is involved or an arbitration provision seems to be less than broad, a court should give the provision and the circumstances surrounding its inclusion in the contract great scrutiny. As a general rule, however, under a broad arbitration provision the claim of fraud in the inducement should be determined by arbitrators.<sup>114</sup>

With that ruling, the Court of Appeals thus aligned New York's arbitration policy with that of the Federal government's.<sup>115</sup> This ruling effectively means that the validity of the agreement referred to in CPLR 7503(a) and (b) relates only to the arbitration provision itself, and not with the contract as a whole, on account of the arbitration provision's severability. Ultimately, this means that an arbitration provision in an invalid contract will be given effect irrespective of the alleged invalidity or illegality of substantive portions of a contract.<sup>116</sup> The Court defends its holding by stating that any contrary ruling would defeat the twin aims of arbitration: "speed and finality."<sup>117</sup>

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<sup>114</sup> *Id.* at 47-48.

<sup>115</sup> *Weinrott*, 298 N.E.2d at 47 (holding that "[t]he result we suggest in this case is consistent with the policy adopted by the Federal courts.").

<sup>116</sup> *Id.* at 46.

When the parties to a contract have reposed in arbitrators all questions concerning the 'validity, interpretation or enforcement' of their agreement, they have selected their tribunal and no doubt they intend it to determine the contract's 'validity' should the necessity arise. Judicial intervention, based upon a nonseparability contract theory in arbitration matters prolongs litigation, and defeats, as this case conclusively demonstrates, two of arbitration's primary virtues, speed and finality.

*Id.* at 47.

<sup>117</sup> *Id.*

### C. Article 75 and the Federal Arbitration Act: In Cahoots?

The preference of the United States Supreme Court, Congress, the New York Court of Appeals, and the New York legislature for arbitration over litigation is inherently unconstitutional. Never did our framers envision the privatization of our justice system, and yet mandatory arbitration is the most favored mechanism by which to dispense it, at both the federal and state level.

The concept that the Federal Arbitration Act (“FAA”) is supreme and thus preempts certain state laws is not a novel one.<sup>118</sup> Yet the boundaries of FAA preemption are not obvious, and while the Supreme Court has held that the FAA does not cover the entire field of arbitration, it does, in fact, preempt state laws that frustrate the FAA’s objectives.<sup>119</sup> It would therefore seem imprudent for a state legislature to enact laws contrary to the FAA. Moreover, so long as the FAA covers the particular arbitration field in question, it does not matter whether the case is brought in federal or state court.<sup>120</sup> The Court has differentiated between cases where state laws have invalidated arbitration clauses on the basis of unconscionability or fraud,<sup>121</sup> and state laws that substantively and procedurally invalidate arbitration contracts.<sup>122</sup>

The New York Court of Appeals acknowledges this relationship and has held that “[a] further basic principle . . . is the corollary tenet that, in situations where the FAA is applicable, it preempts State law on the subject of the enforceability of arbitration clauses.”<sup>123</sup> The FAA is unique in that it does not grant exclusive jurisdictional authority to the federal courts, thus enabling non-diverse claimants to

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<sup>118</sup> Sternlight, *Rise and Spread*, *supra* note 90, at 35. The author points out that while those who oppose mandatory arbitration argue that it infringes on state constitutional jury trial rights, supporters of arbitration argue that the FAA nevertheless preempts certain state constitutional rights. *Id.* The author argues, however, that, “it would be inappropriate to hold that the FAA preempts general jury trial waiver provisions.” *Id.*

<sup>119</sup> *Id.* at 35-36 (citing *Volt Info. Scis., Inc. v. Bd. of Trs.*, 489 U.S. 468, 477-78 (1989)).

<sup>120</sup> See, e.g., *Perry v. Thomas*, 482 U.S. 483, 489-90 (1987) (“‘We see nothing in the [Federal Arbitration] Act indicating that the broad principle of enforceability is subject to any additional limitations under state law.’” (quoting *Southland Corp. v. Keating*, 465 U.S. 1, 11 (1984))).

<sup>121</sup> See, e.g., *Doctor’s Assocs. v. Casarotto*, 517 U.S. 681, 687 (1996).

<sup>122</sup> Sternlight, *Rise and Spread*, *supra* note 90, at 36.

<sup>123</sup> *Fletcher v. Kidder, Peabody & Co.*, 619 N.E.2d 998, 1001 (N.Y. 1993).



rely on the FAA in state court.<sup>124</sup>

Nevertheless, the broad scope with which the FAA is applied should be viewed with skepticism and caution. This federal act should not be construed in a manner so broad that it would preempt even state constitutional protections, namely the right to a jury trial. The inherent right to a jury trial and arbitration must be viewed in harmony and not with the mindset that they have competing interests. Ultimately, the excessive favor for arbitration should be balanced, and perhaps curtailed, with the deference that is due to New York's constitutional guarantee to a jury trial.

A prime example comes from Montana in *Kloss v. Edward D. Jones & Co.*,<sup>125</sup> where the Montana Supreme Court prevented the preemption of Montana law by the FAA on the basis that a contractual waiver of basic constitutional guarantees was one which applied in various contexts, not merely in the construction of arbitration provisions.<sup>126</sup> Thus, the Montana law was construed broadly, as a general provision, and was not preempted by the FAA.<sup>127</sup> So too should New York law be interpreted.

By interpreting the FAA the way the Supreme Court currently does, it perpetuates a philosophy that is counter to the underlying constitutional principles that founded this nation: the right to jury trial, due process in courts of law, and neutral, unbiased judges.<sup>128</sup>

#### **D. Sheer Nature of Statute Creates a State Action**

In order to establish "state action" for implicating arbitration on due process grounds, there must be evidence proffered that a federal or state government directly aided in a constitutional violation.<sup>129</sup> Thus, it is obvious that when a state statute is questioned, like the Prompt Payment Law is here, there is no need for a scrupulous examination of the circumstances that give rise to the violation because

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<sup>124</sup> See *Moses*, 460 U.S. at 25.

<sup>125</sup> 54 P.3d 1 (Mont. 2002).

<sup>126</sup> *Id.* at 15-16.

<sup>127</sup> *Id.* at 16 ("The Supreme Court has . . . held . . . that if a state law governs . . . the validity, revocability and enforceability of contracts in general then generally applicable contract defenses, such as fraud, duress or unconscionability, may be applied to invalidate arbitration agreements without contravening Section 2 of the FAA.").

<sup>128</sup> Sternlight, *supra* note 55, at 10.

<sup>129</sup> *Id.* at 40.

the source is readily apparent.<sup>130</sup> In the instant controversy, the Prompt Payment Law expressly permits private parties with contracts valued at \$150,000 or higher to engage in binding arbitration.<sup>131</sup> Statutory compulsion to arbitrate is state action and is a violation of constitutional canons as delineated in the due process clauses of the State Constitution<sup>132</sup> and the Fourteenth Amendment of the Federal Constitution.<sup>133</sup>

There exists among the Supreme Court jurisprudence a plethora of cases that hold when the conduct of private entities are so entwined with the actions of public institutions that the private conduct may be deemed state action.<sup>134</sup> State legislatures that pass laws impressing arbitration on parties does indeed constitute state action, and the Prompt Payment Law is a manifestation of a deliberate and meticulous attempt by the state to deter parties from exercising their constitutional rights. Congress enacts laws, which is a direct form of state action, but in the same vein, the Supreme Court espouses its preference for arbitration over litigation through its jurisprudence, also a manifestation of state action.<sup>135</sup> Therefore, a colorable argument exists for state action on behalf of the legislature and the judiciary regarding the overt favorability of arbitration on both the federal and state levels.

*Sharrock v. Dell Buick-Cadillac, Inc.*<sup>136</sup> is a telling case where the New York Court of Appeals held that certain provisions of the Lien Law failed to comport with “traditional notions of procedural due process embodied in the State Constitution, as they deprive[d]

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<sup>130</sup> *Id.*

<sup>131</sup> N.Y. GEN. BUS. LAW § 756(b)(3)(c) (“If efforts to resolve such matter to the satisfaction of all parties are unsuccessful, the aggrieved party may refer the matter . . . to the American Arbitration Association for an expedited arbitration . . .”).

<sup>132</sup> N.Y. CONST. art. I, § 6.

<sup>133</sup> U.S. CONST. amend. XIV.

<sup>134</sup> *See, e.g.,* *Lugar v. Edmondson Oil Co.*, 457 U.S. 922, 933 (1982) (holding that where a state statute authorized a private party to commandeer private property with the assistance of a public official, the private party had a colorable claim against him under the Due Process Clause of the Fourteenth Amendment); *Burton v. Wilmington Parking Auth.*, 365 U.S. 715, 726 (1961) (holding that a private restaurant was so intimately linked to a public parking facility that the restaurant's denial of service to African-American patrons was forbidden under the Constitution). *But see* *Flagg Bros., Inc. v. Brooks*, 436 U.S. 149, 166 (1978) (holding that no state action existed where a private warehouse used self-help to recoup monies owed it).

<sup>135</sup> *See, e.g., Moses*, 460 U.S. 1, 29 (“[T]he Court acted within its authority in deciding the legal issues presented in order to facilitate the prompt arbitration that Congress envisaged.”).

<sup>136</sup> 379 N.E.2d 1169 (N.Y. 1978).

the owner of the vehicle of a significant property interest without providing any opportunity to be heard.”<sup>137</sup> Sharrock’s husband had taken her Cadillac to the defendant, Dell Buick-Cadillac, Inc., to replace the engine for a total of \$225.<sup>138</sup> There was no mention of the storage charges that Sharrock would incur should the car not be picked up immediately.<sup>139</sup> Meanwhile, the original engine that was installed was defective and had to be replaced, but by that time Sharrock’s husband had been hospitalized and he was unable to continue communicating with the shop with regard to the repair of the car.<sup>140</sup> Soon thereafter, plaintiff received a “Notice of Lien and Sale” pursuant to the Lien Law.<sup>141</sup> After storage fees brought the price of the repair up to \$502, plaintiff was urged to pay the price or sell the vehicle, which prompted the suit.<sup>142</sup>

The Court of Appeals held that in order to determine whether the Due Process Clause of the Fourteenth Amendment was violated, the pivotal issue was whether the State involved itself in what would have otherwise been private action.<sup>143</sup> Private conduct alone does not qualify as state action, no matter how reprehensible the conduct.<sup>144</sup> There must be a sufficient relation and nexus between the conduct and a public entity so as to call upon the state action doctrine.<sup>145</sup> The Court cautioned, however, that “the mere fact that an activity might not constitute State action for purposes of the Federal Constitution does not perforce necessitate that the same conclusion be reached when that conduct is claimed to be violative of the State Constitution.”<sup>146</sup> Indeed, it found that the garageman’s conduct did not violate the Due Process Clause of the Fourteenth Amendment, but it

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<sup>137</sup> *Id.* at 1171.

<sup>138</sup> *Id.*

<sup>139</sup> *Id.*

<sup>140</sup> *Id.*

<sup>141</sup> *Sharrock*, 379 N.E.2d at 1171.

<sup>142</sup> *Id.* at 1171-72.

<sup>143</sup> *Id.* at 1172 (“The threshold question in any judicial inquiry into conduct claimed to be violative of the due process clause of the Fourteenth Amendment is whether the State has in some fashion involved itself in what, in another setting, would otherwise be deemed private activity.”).

<sup>144</sup> *Id.* (“Purely private conduct, however egregious or unreasonable, does not rise to the level of constitutional significance absent a significant nexus between the State and the actors or the conduct.”).

<sup>145</sup> *Id.* (“[I]t is settled that where the impetus for the allegedly unconstitutional conduct is private, the State must have ‘significantly involved itself’ in order for that action to fall within the ambit of the Fourteenth Amendment.”) (internal citations omitted).

<sup>146</sup> *Sharrock*, 379 N.E.2d at 1173.

did in fact offend the due process clause of the New York Constitution.<sup>147</sup>

After clarifying the difference between the State Constitution's due process clause with that of the Fourteenth Amendment in the Federal Constitution, the Court wrote:

State Constitutions in general, and the New York Constitution in particular, have long safeguarded any threat to individual liberties, irrespective of from what quarter that peril arose. Thus, as early as 1843, Justice Bronson, in speaking of the due process clause of our State Constitution, noted: "The meaning of the section then seems to be, that no member of the state shall be disfranchised, or deprived of any of his rights and privileges, unless the matter be adjudged against him upon trial and according to the course of the common law. It must be ascertained judicially that he has forfeited his privileges, or that some one [sic] else has a superior title to the property he possesses, before either of them can be taken from him."<sup>148</sup>

The Court determined that the Constitutional protections afforded by the New York Constitution were triggered when there was no judicial oversight of the conduct of the garageman for which the Lien Law permitted him disposal of Sharrock's property without adequate notice to Sharrock.<sup>149</sup> The State, the Court held, had so entwined itself with the private actor, here the garageman, that the Court was compelled to deem the provisions of the Lien Law as unconstitutional.<sup>150</sup>

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<sup>147</sup> *Id.* The Court reasoned that:

[T]he mere fact that an activity might not constitute State action for purposes of the Federal Constitution does not perforce necessitate that the same conclusion be reached when that conduct is claimed to be violative of the State Constitution. Indeed, on innumerable occasions this court has given our State Constitution an independent construction, affording the rights and liberties of the citizens of this State even more protection than may be secured under the United States Constitution.

*Id.*

<sup>148</sup> *Id.* at 1174 (quoting *Taylor v. Porter & Ford*, 4 Hill 140, 146 (1843)).

<sup>149</sup> *Id.*

<sup>150</sup> *Sharrock*, 379 N.E.2d at 1174 (reasoning that state action, as manifested by the Lien Law, "compels the conclusion that New York has so entwined itself into the debtor-creditor relationship as to constitute sufficient and meaningful State participation which triggers the protections afforded by our Constitution").

Thus, so too should the Court of Appeals render section 756-b of the Prompt Payment Law unconstitutional. Forcing arbitration is a direct violation of both the Federal and State constitutions because it deprives the parties of their day in court by obliging one party to force the other to arbitrate. In addition to the Prompt Payment Law being a violation of the Due Process Clause of both the Federal and State Constitutions, the next section will expound upon how the arbitration provision of the statute is unconstitutionally vague with regard to waiver of the right to jury trial.

### What Constitutes Waiver of Jury Trial?

The right to a jury trial is fundamental, both under federal and state law.<sup>151</sup> The Supreme Court established a four-prong test to determine when there is a valid constitutional right in civil matters.<sup>152</sup> These factors are derived from *Fuentes v. Shevin*,<sup>153</sup> where the Court scrutinized the clarity of the waiver of the right to jury trial,<sup>154</sup> the sophistication of the parties,<sup>155</sup> whether the waiver was voluntary,<sup>156</sup> and the substantive fairness of the waiver.<sup>157</sup> Although New York has similar considerations regarding the waiver of jury trial in civil and criminal contexts,<sup>158</sup> these factors should be at the forefront of the discussion with respect to the Prompt Payment Law notice-provision.

The waiver of constitutional rights by the courts is dealt with in an apathetic manner. The New York Constitution states that a civil jury trial may be waived by “the manner to be prescribed by law.”<sup>159</sup> Yet the legislature has not created a statute expressly discussing the manner with which one can waive the right to jury trial in civil cases. The prerequisite for arbitration according to General Business Law

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<sup>151</sup> See U.S. CONST. amend. VII; N.Y. CONST. art. I, § 2.

<sup>152</sup> Sternlight, *Rethinking*, *supra* note 55, at 57-58.

<sup>153</sup> 407 U.S. 67 (1972).

<sup>154</sup> *Id.* at 95-96 (dismissing waiver that was in fine print where party failed to explain why there could not be a hearing).

<sup>155</sup> *Id.* at 95 (declining waiver where parties had unequal bargaining power).

<sup>156</sup> *Id.* at 95-96 (rejecting waiver for which sale was allegedly conditioned upon).

<sup>157</sup> *Id.* at 95 (highlighting the importance of whether the party received anything in return for the waiver).

<sup>158</sup> *People v. Page*, 665 N.E.2d 1041, 1044 (N.Y. 1996) (“The history of the constitutional waiver provision thus establishes that the requirement that the defendant execute a signed, written waiver was considered critical to securing a knowing, intelligent and voluntary waiver of the right to trial by jury.”).

<sup>159</sup> N.Y. CONST. art. I, § 2.

section 756-b is for the aggrieved party to notify the other party by a written notice.<sup>160</sup>

It is unclear what the receiving party must do with the notice if it does not wish to arbitrate, or if the party is silent altogether. The intent of the legislature regarding the written notice required under section 756-b is unknown. If the written notice is intended to act as a waiver of jury trial rights, this is simply inadequate because the provision of the statute merely requires that the written notice contain the details of the complaint.<sup>161</sup> There is no mention of a waiver of jury trial for the receiving party. Yet the statute continues on to provide for arbitration at the behest of the aggrieved party, which has the effect of backing the other party into a corner. Since arbitrators are given great deference, and absent any blatant misconduct during the proceeding, there is little a protesting party can do once the arbitration proceeding has commenced.

The arbitration provision of the statute is an exemplification of misconduct by the New York State government, thereby qualifying the statute as state action in violation of the Due Process Clause and the right to a jury trial guaranteed by the Constitution. Furthermore, in evaluating arbitration provisions, courts should presume against waiver when constitutional rights are involved, unless it is explicit and clear that the party is waiving his right.<sup>162</sup> New York courts follow the same presumption.<sup>163</sup> It is therefore irrational to assume that a simple written notification of a complaint by the aggrieved party to the other is a waiver of the other party's constitutional right to a jury trial. If the contract between the parties is silent as to conflict resolution, and the aggrieved party sends notice of arbitration in accordance with the statute, what is the extent to which the party needs to acquiesce? What if the party who is served with the notice does not consent to arbitrate? There is nothing in the statute that states the arbitration must be consensual—may the matter then proceed to litigation if it is not? These are but a few uncertainties, the answers for which the Prompt Payment Law does not provide.

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<sup>160</sup> N.Y. GEN. BUS. LAW § 756-b(3)(b).

<sup>161</sup> See N.Y. GEN. BUS. LAW § 756-b(3)(a)-(c).

<sup>162</sup> *Fuentes*, 407 U.S. at 94-95, 95 n.31.

<sup>163</sup> *Edsall Realty Corp.*, 92 N.Y.S.2d at 899.

## V. CONCLUSION

Binding arbitration is not without purpose in the twenty-first century. When parties *agree* to be bound by alternative dispute resolution mechanisms to resolve disputes, it is indeed a swift means for reaching a conclusion. Nevertheless, it is of utmost importance that, in the context the Prompt Payment Law, we do not allow legislatures to statutorily impose mandatory binding arbitration.

Courts, unlike legislatures, have a natural inclination to “prefer” and “favor” arbitration over litigation because of the caseload it deflects from their dockets. While that is not a wholly illegitimate reason, it flirts dangerously close with overlooking many unconstitutional arbitration clauses and statutes simply by virtue of courts favoring them. It is imperative that society put this issue on the forefront of legal discourse so that statutorily mandated arbitration does not pervade other aspects of the law that intimately affect our lives—lest we forget that arbitration is not consensual when parties are mandated by the government to partake in it.

In summation, the Due Process Clause of both the Federal and New York Constitutions are violated by the Prompt Payment Law, as well as the parties’ right to a jury trial, also guaranteed by both constitutions. The Prompt Payment Law represents multiple constitutional violations under the guise and guile of lessening the influx of cases in the court system, but does so at the expense of parties’ constitutional rights. The implications of this legislation, and all like it, are profound: this republican society in which we live, and the capitalistic tenet by which it is propelled is lessened by such governmental regulation to the extent that it will not endure long after government dictates the intimate matters of private parties in contract.