ALASKA LEGISLATURE COMMITTEE FILES, 2003-2004 8672
10783 HOUSE JUDICIARY

fourth quarter product. Manufacturers and retailers are now realizing that they have been more responsible than consumers for imposing the mistaken belief that remote car starters can only be sold in the winter. Surveys taken by many remote starter manufacturers over the past two to three years have shown that a high percentage of consumers are as concerned with pre-cooling their car in the summer as they are concerned with pre-heating their car in the winter. Manufacturers and retailers are now trying to tap into this opportunity by beginning to market the benefits of having a remote car starter in the summer.

In addition to being increasingly sold year round, remote car starters are increasingly sold as a deluxe feature on alarm or keyless entry systems. One main reason that the remote car starter market is growing so quickly is because consumers who are looking for only a simple car alarm or a keyless entry system now often choose to spend a little extra to buy deluxe all-in-one systems. Car enthusiasts and new car buyers are the most likely to purchase all-in-one systems because they often don't want the high cost and inconvenience of purchasing and installing separate remote starter, alarm, and keyless entry systems.

One of the major challenges that the industry is trying to meet this year is marketing remote car starters to an older and more female demographic group than the traditional young male automotive parts buyers. A variety of new features have appeared recently on remote car starters in attempts to appeal to a wider range of consumers. Multi-car capability is one new feature that is designed to appeal to families and older consumers. Transmitters with multi-car capability offer consumers the convenience of carrying only one transmitter on a keychain instead of two or more.

DesignTech International is offering newly designed AutoCommand® transmitters for the '00 season that have the ability to control multiple cars with AutoCommand units.

Another hot feature that consumers are looking for this year is programmable automatic starting at a specific time, battery voltage, or vehicle temperature. Users can program DesignTech's AutoCommand systems to automatically start a vehicle at pre-selected temperatures to warm up or cool down the vehicle or to automatically start at low battery voltage to prevent a dead battery. Prestige's APS-775 system can be programmed to start and run a vehicle for 10-15 minutes every 2 hours. AutoCommand systems can be programmed to automatically start at the same time the next day.

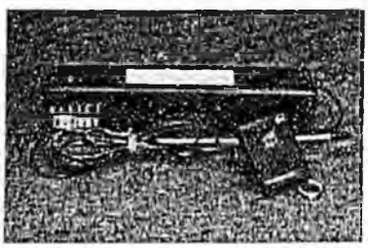
For quite some time, remote car starter manufacturers have been competing to have transmitters with the longest range. Unlike alarms and keyless entry systems, remote car starters require a minimum of 300-400 feet of range and most manufacturers advertise 500-1000 or more feet of range. However, remote start systems with ranges beyond 1,500 feet often require cumbersome extendable antennas on transmitters or special antennas for the car to achieve the additional range.

Transmitter ranges are a hotly contested issue in the remote starter industry because ranges farther than 1,500 to 2,000 feet are often only reached by overstepping the government's legal limits for radio transmissions. Many two-way transmitters have been measured to be above the FCC's limits since two-way transmissions usually require more power than standard one-way systems. Certain remote starter manufacturers are now working with the FCC to level the playing field an crack down on manufacturer's who use illegal transmitter ranges.

The biggest demands of average consumers this year are for remote car starters to be easily available, low cost, safe, dependable, and easy to install. Remote car starter manufacturers are meeting these demands by increasing distribution, offering remote car starters for extremely competitive prices, redesigning transmitters and cases, designing greater numbers of safety and easy-installation features, and increasing technical support.

In order to handle the exploding number of remote car starter sales expected this year, manufacturers are strengthening technical support and increasing the number and quality of easy-installation features to cut down the number of tech calls. DesignTech International increased their technical support staff by over 60% this past year to meet the greater number of tech calls. A few manufacturers even include installation videos in some packages to make the remote starter friendlier to do-it-yourself installers who benefit from the greater visual detail in videos. Of course, technical support on manufacturers' web sites is as critical as ever.

Despite new features that are constantly being developed for remote car starters, sales of basic remote car starters remain the highest in the fourth quarter, when many end up as holiday gifts. Remote starters have turned into a very big holiday gift item within the past two years. The best-selling remote car starter for this year will most likely continue to be DesignTech International's basic AutoCommand Remote Car Starter (model 20021) because average consumers want AutoCommand's safety and dependability but don't want to spend extra on additional features such as keyless

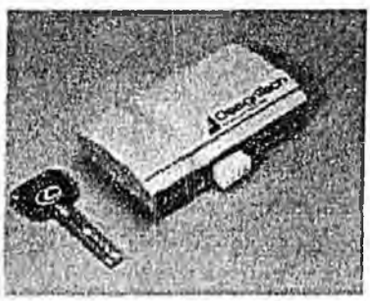


DesignTech's popular AutoCommand 20021

entry and an alarm. Although car enthusiasts usually want deluxe models of remote car starters with fancier features, average consumers tend to favor basic remote starters with low enough prices to justify impulse purchases. As always, appealing product design and packaging are also extremely important to attract impulse buyers.

Another way that manufacturers are helping make remote car starters easier to sell and install is by offering security system bypass modules. The use of bypass modules is now widespread due to the increasing number of vehicles that come with a factory-installed security system. The majority of mid-priced to luxury vehicles manufactured since 1998 have some type of factory-installed anti-theft system. A large number of new vehicles this year such as Toyota Camry, Honda Accord, Ford Taurus, Nissan Maxima, Chevy Malibu, and many others have factory-installed anti-theft systems.

A bypass module temporarily turns off a vehicle's security system to allow remote starting and to prevent an alarm's horn or siren from sounding. A bypass module then turns the vehicle's anti-theft system back on once the car's engine is running. Some manufacturers such as Directed Electronics and Crimestopper offer separate bypass modules for individual types of anti-theft systems. DesignTech International offers a Universal Alarm Bypass Module (model 20402). DesignTech's one model can be used to bypass all types of factory-installed anti-theft systems including PATS, VATS, Passlock, transponder, and Saturn systems.



DesignTech's
Universal Alarm Bypass Module

Almost every retailer of remote car starters had satisfying remote car starter sales over the past year. Pep Boys, AutoZone, Murray's, VIP, and other automotive parts and accessories retailers continue to sell tens of thousands of remote car starters each year. Remote car starters have also become a commonly carried product at mass merchandisers over the past two years, with BJ's Wholesale Club, Bradlees, Costco, Kmart, Sears, and Target all carrying remote car starters in 1999.

"An end to the expansion of remote car starter sales is not in sight," says DesignTech President Skip West, "Although most remote car starter companies gained double-digit percentage sales increases this past year, the potential market for remote car starters is still mainly untapped. Remote car starters are such great convenience products, yet they are still relatively unknown to average consumers. The average consumer still thinks of James Bond or spaceships when remote car starters are mentioned. Until remote car starters become standard features on the majority of vehicles, sales should increase by large percentages every year. I expect remote car starter sales to increase dramatically from the current level before slowing down."

Digital images on CDROM or color slides are available upon request.

For more information, please contact:
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7955 Cameron Brown Court
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Tel: 1-800-337-4468 or 703-866-2000 ext. 131
Fax: 703-866-2001
dan@designtech-intl.com
www.designtech-intl.com

Attachment B

Jim Mateja, "GM to Make Remote Starter Factory Option,"
Chicagotribune.com, November 11, 2002

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http://www.chicagotribune.com/classified/automotive/columnists/chi-0211110022nov11,0,7233171.column

GM to make remote starter factory option

Jim Mateja

November 11, 2002

The wind is howling, the snow is blowing and your car is sitting outside waiting to chauffeur you to work.

Only you have to get to the car and warm it up for your trip. And none of the kids are home to perform the chore.

Be patient. Beginning in the '04 model year, General Motors will be the first automaker to offer a remote vehicle starter so you need only push a button on your key fob and the car will start and warm up while you have that second cup of coffee.

The system will be as beneficial for Floridians in July as it will be for Midwesterners in January because the idling car will get the air conditioner or the heater/defroster ready.

Remote starters aren't new. Aftermarket companies have sold them for years. What's new is that the GM system will be factory installed and factory warranted. That should lead Ford, Chrysler, Toyota, Honda and, well, you name it, to join in to keep GM from having a competitive edge.

Aftermarket units can run $400, but no word on price as an option at GM.

One press of the key fob button activates the GM system--the headlamps will flash to let you know it's working. Push another button to start the engine.

When the system's on, the vehicle doors will automatically lock and any anti-theft system will engage. Once you feel the vehicle is sufficiently warmed or cooled, you can walk outside and unlock the doors by pressing a button on the key fob.

At any time after the remote start, you can shut the engine off by pressing a key fob button. And if you haven't entered the car within 10 minutes of the remote start and inserted the ignition key, the engine shuts off.

To guard against someone in the house unknowingly pushing the fob when Dad is in the garage working on the car, the system won't start the engine if the hood is open.

The system also checks engine oil pressure, engine temperature, engine r.p.m., throttle position, brake/transmission shift interlock and battery voltage. Any problems, and remote start won't function. So you can't override a dead battery or the fact you left the car parked in "drive."

Though the engine will be running, you must insert the key in the ignition to take the gear selector out of "park" to get moving. The reason, of course, is that the key has a theft code imbedded in it to prevent someone from slipping into the idling car and motoring away.

No word on which GM vehicles will offer a remote starter. GM spokesman Alan Gagne said it will be available as an option in a variety of 2004 cars.

Gagne said some of the vehicles offering remote start will come with automatic climate control and some with manual climate control, which means it probably will be in more than just upper-end models.

Sportage hiatus: To increase production capacity on new 2003 Sorento midsize sport-utility vehicle, Kia Motors had to halt production of its subcompact Sportage SUV that's been sold in the U.S. since the 1995 model year.

Peter Butterfield, executive vice president and chief executive of Kia Motors, says the capacity problem should be resolved and Sportage--or a replacement of the same size--will return in '04 or '05.

Sorento is important to Kia because it is expected to attract buyers with an average age of 40 and average household income of $62,000, which compares with an average age of 46 and average household income level of $82,000 for the midsize SUV segment, Butterfield said. Kia buyers now average 39 and income of $45,000.

By the way, that's local-boy-makes-good Peter Butterfield, a graduate of New Trier High School in Wilmette and Northern Illinois University in DeKalb.

Attachment C

Lori Strothard, "Stop Idling Cars and Save Both Gas and the Environment," *TheRecord.com*, December 26, 2002

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Monday February 10, 2003

- Local
- National
- World
- Births
- Obituaries
- Celebrations
- Special Reports

Exploring the challenges and opportunities of growth faced by Waterloo Region.

More stories...

Stop idling cars and save both gas and the environment

Thursday December 26, 2002
LORI STROTHARD

For the past two years, the Idling Reduction Task Force, a subcommittee of the Citizens' Advisory Committee on Air Quality (Waterloo Region) has been investigating what are the correct things to do regarding vehicle idling.

The good news is that the behaviours that best reduce air pollution are also the best ways for drivers to save money and increase engine longevity.

We decided on a public education campaign rather than a bylaw after hearing how other cities which have idling bylaws -- which allow idling up to three, five or 10 minutes -- not only have major enforcement problems, but the real recommended limit on idling, according to Natural Resources Canada, is only 10 seconds.

That's right. For all cars built in the 1970s or later with catalytic converters, it is proven to be better for your vehicle, your gas consumption and the environment, to turn your engine off when stopped or parked for longer than 10 seconds, and then you should restart your vehicle when needed.

Contrary to what many believe, this does not cause extra wear and tear on the starter or engine, nor an extra burst of gas when restarting.

In fact:

Idling for more than 10 seconds burns gas almost twice as fast as driving and produces almost double the amount of toxic emissions per second than a vehicle moving at average speed.

Leaving your car idling for more than short periods causes incomplete combustion which can damage engine components.

If for some reason you must idle, it is better to put your car in neutral. This rests the engine, fewer emissions are produced and your car will be quieter and vibrate less.

Exceptions to this rule would be extreme temperatures when you need to keep warm or cool in your vehicle, or to defrost a windshield, etc. But when possible, if waiting for someone, go inside the heated or air-conditioned building to wait, rather than sitting in your car, letting it idle.

Does this mean you should turn your car off at stoplights? The Natural Resources Canada answer to this is no. Because of the five per cent of cars which have trouble restarting, it doesn't recommend that people do this as common practice. In situations such as rush hour in Toronto, one stalled car can cause major tie-ups.

What about drive-throughs? Other than parking and going in to get your food, you can put your car in neutral while you are not moving. You could turn your engine off, but you never know when the line will start to move.

What about remote starters and pre-warming cars in winter? Vehicles in good working order do not need to be warmed up more than 30 seconds and the best way to warm up your engine is by driving it.

Remote starters can too easily cause people to warm up their cars for five to 15 minutes, which is generally unnecessary. Block heaters on timers (start one to two hours before driving) are good for very cold temperatures.

We need to be careful about how much we idle our cars because, despite all the seemingly modern advances in pollution controls, cars still produce, on average, 2.4 kilograms of air pollution for every 10 kilometre we drive -- that's like producing a 10-pound bag of potatoes equivalent weight of toxic air for every 20 kilometres.

And it all ties into things like the skyrocketing asthma cases in children (cases have increased four-fold in the last 20 years), and the extreme heat and droughts we have been experiencing.

Scientists are reporting air pollution is now inhibiting the ability of water vapour in clouds to form water droplets -- rain. We have to drive our cars for a lot of reasons, so whenever we don't need to be running our cars, we shouldn't.

So, next time you are wondering whether to keep the car running or turn if off while waiting for someone etc., turn it off. We must keep our air -- one of our essential life-support systems -- as healthy and clean as possible.

For more information, visit the local air quality Web site at www.airqualitywaterlooregion.org or Natural Resources Canada's site called The Idle-Free Zone at http://oee.nrcan.oc.ca/autosmart/idling.

Next week: Restorative landscaping.

Lori Strothard is the chairwoman of the Citizens' Advisory Committee on Air Quality (Waterloo Region) and has been a member of the Vehicle Idling Reduction Task Force since 2000. She is also chairwoman of the Waterloo Citizens Environmental Advisory Committee.

E-mail this page to a friend Make this page printer friendly

225 Fairway Road South,
Kitchener, Ontario, Canada, N2G 4E5
519-894-2231

THE RECORD

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Subject: Re: car remote starters
Date: Fri, 14 Feb 2003 20:19:18 EST
From: MikeAllanEllis@cs.com
To: Nancy_Manly@Legis.state.ak.us

Nancy, I surveyed a number of the dealers in both Fairbanks and Anchorage. Of the six dealers I spoke with in Anchorage, they claim to have sold 11,000 remote starts in last year. I spoke with three dealers in Fairbanks, who put their sales at about 4400 last year. I did get an e mail passed on to me from the mayor of Fairbanks claiming they promote the usage of remote starts as they help cut down on air pollution. Apparently a warm running car is much less prone to harmful exhaust than a cold car.

Anyway these numbers do not fully represent the total number sold but maybe between 40% and 50% state wide by my rough estimate.

Please feel free to contact me for any other information you may need.

Mike Ellis w/Forty-Niner Marketing
7803 45th Southwest
Seattle, WA 98136 206-940-3215

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: HB 77
() Publish Date:

Revision Date/Time (Note if correction):
Dept. Affected: Law
Title "An Act allowing certain motor vehicles to be operated while unattended."
BRU Criminal Division
Component Criminal Justice Litigation
Sponsor Representative Lynn
Requester House Judiciary Committee
Component No. 2202

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type–Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0
Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

This bill prohibits the adoption of a regulation forbidding operation of a motor vehicle while it is unattended. This provision would not apply to an unlocked motor vehicle, or one occupied by a disabled person or a person under 14 years old.

Passage of this legislation will have no fiscal impact on the Department of Law.

Prepared by: Joan M. Kasson
Phone (907) 465-5370
Division Attorney General's Office
Date/Time 3/11/03 11:02 AM
Approved by: Kathryn Daughhetee for Gregg D. Renkes, Attorney General
Date 3/11/2003
Agency Department of Law

(Revised 9/2002 OMB)

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: HB 77
() Publish Date:

Revision Date/Time (Note if correction):
Dept. Affected: Public Safety
Title: An Act allowing certain motor vehicles to be operated....
BRU: Alaska State Troopers
Component: AST Detachments
Sponsor: Representative Lynn
Requester: House Judiciary
Component No.: 2325

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

Estimate of any current year (FY2003) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*
No fiscal impact.

Prepared by: Lieutenant Matthew Leveque
Phone 907 269-0390
Division: Alaska State Troopers
Date/Time 3/12/03 9:30 AM
Approved by: William Tandeske, Commissioner
Date 3/12/2003
Agency: Department of Public Safety

(Revised 9/2002 OMB)

HB

82

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: CSHB 82 (L&C)
() Publish Date:

Revision Date/Time (Note if correction):
Dept. Affected: Law
Title "An Act making certain activity related to commercial electronic mail unlawful and an unfair method of . . ."
BRU Civil Division
Component Fair Business Practices
Sponsor Representative Meyer
Requester House Judiciary Committee
Component No. 2206

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type–Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0
Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

CSHB 82 (L&C) prohibits unsolicited commercial e-mail sent from a computer in Alaska or to an e-mail address that the sender knows is held by an Alaskan resident which contains sexually explicit material without the subject line beginning with the characters "ADV:ADLT".

The Department of Law does not anticipate a fiscal impact from passage of this legislation.

Prepared by: Joan M. Kasson
Phone (907) 465-5370
Division Attorney General's Office
Date/Time 2/20/03 3:36 PM
Approved by: Kathryn Daughhetee for Gregg D. Renkes, Attorney General
Date 2/20/2003
Agency Department of Law

(Revised 9/2002 OMB)

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: CSHB 82(L&C)
() Publish Date:

Revision Date/Time (Note if correction):
Dept. Affected: Public Safety
Title: An act making certain activity related commercial electronic mail unlawful and ....
BRU: AST Detachment
Component: AST Detachment
Sponsor: Representative Meyer
Requester: House Judiciary
Component No.: 2325

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

No fiscal impact.

Prepared by: Lieutenant Matthew Leveque
Phone 907 269-0390
Division: Alaska State Troopers
Date/Time 2/19/03 10:58 AM
Approved by: William Tandeske, Commissioner
Date 2/19/2003
Agency: Department of Public Safety

(Revised 9/2002 OMB)

REPRESENTATIVE KEVIN MEYER

HOUSE DISTRICT 30

MEMORANDUM

DATE: February 13, 2003

TO: Representative Lesil McGuire
Chair, House Judiciary Committee

FROM: Representative Kevin Meyer

RE: CS HB 82(L&C)

At your earliest convenience, please schedule CS HB 82(L&C) Commercial Electronic Email for hearing in the House Judiciary Committee, pending referral.

Under CS HB 82(L&C), individuals are prohibited from sending unsolicited commercial electronic mail that contains explicit sexual material, without the subject line of the communication containing "ADV:ADLT" as the first eight characters.

Thank you for your time and consideration.

Email: Representative_Kevin_Meyer@legis.state.ak.us • Toll Free: (866) 465-4945
Session: State Capitol, Juneau, Alaska 99801-1182 • Phone: (907) 465-4945 Fax: (907) 465-3476
Interim: 716 W. 4th Ave., Anchorage, Alaska 99501-2133 • Phone: (907) 269-0199 Fax: (907) 269-0197

REPRESENTATIVE KEVIN MEYER

HOUSE DISTRICT 30

Sponsor Statement

CS HB 82 (L&C)

"An Act making certain activities related to commercial electronic mail unlawful as unfair methods of competition or unfair or deceptive acts or practices under the Act enumerating unfair trade practices and consumer protection."

Under CS HB 82(L&C), individuals are prohibited from sending unsolicited commercial electronic mail that contains explicit sexual material, without the subject line of the communication containing "ADV: ADLT" as the first eight characters.

It is not uncommon to receive unsolicited e-mail messages that contain strong sexual content and hyperlinks to pornographic Web sites. With a commonly used e-mail software (e-mail client software that can display HTML documents), it takes just a single mouse click to be viewing a pornographic Web site. The frustration and annoyance of unsolicited commercial e-mail becomes apparent when the advertisements reach those who have no interest in such material, and when such material reaches children. Age is not a discriminatory factor in who receives electronic advertisements for sexually explicit material.

Publishers, distributors, and adult entertainment business owners are legally forbidden from selling, renting, or displaying explicit sexual material to children in a bookstore or video store. However, the same material is made available on-line through Web sites and unsolicited advertisements sent through e-mail. By requiring those who wish to send unsolicited e-mail with age appropriate material to include in the subject line of the advertisements "ADV:ADLT", Internet users and parents are provided sufficient information as to the content of an e-mail.

CS HB 82(L&C) is a consumer protection measure. Currently 29 states have laws pertaining to unsolicited commercial e-mail. Nine of the states have the same labeling requirement as proposed in CS HB 82(L&C). CS HB 82(L&C) is not a direct ban on unsolicited commercial electronic mail. This bill will enable Internet users and parents to know exactly what is being sent electronically to them and to their children.

Last Updated: February 12, 2003

Email: Representative_Kevin_Meyer@legis.state.ak.us • **Toll Free:** (866) 465-4945
Session: State Capitol, Juneau, Alaska 99801-1182 • Phone: (907) 465-4945 Fax: (907) 465-3476
Interim: 716 W. 4th Ave., Anchorage, Alaska 99501-2133 • Phone: (907) 269-0199 Fax: (907) 269-0197

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number:
Bill Version: HB 82
() Publish Date:

Revision Date/Time (Note if correction):
Dept. Affected: Law
Title "An Act making certain activities related to commercial electronic mail unlawful as unfair methods of . . ."
BRU Civil Division
Component Fair Business Practices
Sponsor Representative Meyer
Requester House Labor and Commerce Committee
Component No. 2206

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type–Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0
Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

HB 82 places certain limitations on commercial electronic mail (e-mail) sent to Alaskans. Commercial e-mail would not be allowed if the sender does not have an existing personal or business relationship with the recipient, if the recipient has not granted permission or asked for the e-mail, if the e-mail contains misleading information on the origin or routing of the e-mail, or if the subject line contains misleading information. Finally, the bill prohibits unsolicited commercial e-mail which contains sexually explicit material that other laws require be made available only to persons 18 years or older without the subject line beginning with the characters "ADV:ADLT".

The Department of Law does not anticipate a fiscal impact from passage of this legislation.

Prepared by: Joan M. Kasson
Phone (907) 465-5370
Division Attorney General's Office
Date/Time 2/11/03 9:12 AM
Approved by: Kathryn Daughhetee for Gregg D. Renkes, Attorney General
Date 2/11/2003
Agency Department of Law

(Revised 9/2002 OMB)

Sec. 45.50.471. Unlawful acts and practices

(a) Unfair methods of competition and unfair or deceptive acts or practices in the conduct of trade or commerce are declared to be unlawful.

(b) The terms "unfair methods of competition" and "unfair or deceptive acts or practices" include, but are not limited to, the following acts:

(1) fraudulently conveying or transferring goods or services by representing them to be those of another;

(2) falsely representing or designating the geographic origin of goods or services;

(3) causing a likelihood of confusion or misunderstanding as to the source, sponsorship, or approval, or another person's affiliation, connection, or association with or certification of goods or services;

(4) representing that goods or services have sponsorship, approval, characteristics, ingredients, uses, benefits, or quantities that they do not have or that a person has a sponsorship, approval, status, affiliation, or connection that the person does not have;

(5) representing that goods are original or new if they are deteriorated, altered, reconditioned, reclaimed, used, secondhand, or seconds;

(6) representing that goods or services are of a particular standard, quality, or grade, or that goods are of a particular style or model, if they are of another;

(7) disparaging the goods, services, or business of another by false or misleading representation of fact;

(8) advertising goods or services with intent not to sell them as advertised;

(9) advertising goods or services with intent not to supply reasonable expectable public demand, unless the advertisement prominently discloses a limitation of quantity;

(10) making false or misleading statements of fact concerning the reasons for, existence of, or amounts of price reductions;

(11) engaging in any other conduct creating a likelihood of confusion or of misunderstanding and which misleads, deceives or damages a buyer or a competitor in connection with the sale or advertisement of goods or services;

(12) using or employing deception, fraud, false pretense, false promise, misrepresentation, or knowingly concealing, suppressing, or omitting a material fact with intent that others rely upon the concealment, suppression or omission in connection with the sale or advertisement of goods or services whether or not a person has in fact been misled, deceived or damaged;

(13) failing to deliver to the customer at the time of an installment sale of goods or services, a written order, contract, or receipt setting out the name and address of the seller and the name and address of the organization that the seller represents, and all of the terms and conditions of the sale, including a description of the goods or services, which shall be stated in readable, clear, and unambiguous language;

(14) representing that an agreement confers or involves rights, remedies or obligations which it does not confer or involve, or which are prohibited by law;

(15) knowingly making false or misleading statements concerning the need for parts, replacement, or repair service;

(16) misrepresenting the authority of a salesman, representative or agent to negotiate the final terms of a consumer transaction;

(17) basing a charge for repair in whole or in part on a guaranty or warranty rather than on the actual value of the actual repairs made or work to be performed on the item without stating separately the charges for the work and the charge for the guaranty or warranty, if any;

(18) disconnecting, turning back or resetting the odometer of a vehicle to reduce the number of miles indicated;

(19) using a chain referral sales plan by inducing or attempting to induce a consumer to enter into a contract by offering a rebate, discount, commission, or other consideration, contingent upon the happening of a future event, on the condition that the consumer either sells, or gives information or assistance for the purpose of leading to a sale by the seller of the same or related goods;

(20) selling or offering to sell a right of participation in a chain distributor scheme;

(21) selling, falsely representing or advertising meat, fish or poultry which has been frozen as fresh food;

(22) failing to comply with AS 45.02.350 ;

(23) failing to comply with AS 45.45.130 - 45.45.240;

(24) counseling, consulting or arranging for future services relating to the disposition of a body upon death whereby certain personal property, not including cemetery lots and markers, will be furnished or the professional services of a funeral director or embalmer will be furnished, unless the person receiving money or property deposits the money or property, and money or property is received, within five days of its receipt, in a trust in a financial institution whose deposits are insured by an instrumentality of the federal government designating the institution as the trustee as a separate trust in the name only of the person on whose behalf the arrangements are made with a provision that the money or property may only be applied to the purchase of designated merchandise or

services and should the money or property deposited and any accrued interest not be used for the purposes intended on the death of the person on whose behalf the arrangements are made, all money or property in the trust shall become part of that person's estate; upon demand by the person on whose behalf the arrangements are made, all money or property in the trust including accrued interest, shall be paid to that person; this paragraph does not prohibit the charging of a separate fee for consultation, counseling or arrangement services if the fee is disclosed to the person making the arrangement; any arrangement under this paragraph which would constitute a contract of insurance under AS 21 is subject to the provisions of AS 21;

(25) failing to comply with the terms of AS 45.50.800 - 45.50.850 (Alaska Gasoline Products Leasing Act);

(26) failing to comply with AS 45.30 relating to mobile home warranties and mobile home parks;

(27) failing to comply with AS 14.48.060 (b)(13);

(28) dealing in hearing aids and failing to comply with AS 08.55;

(29) violating AS 45.45.910 (a), (b), or (c);

(30) failing to comply with AS 45.50.473 ;

(31) violating the provisions of AS 45.45.400 ;

(32) knowingly selling a reproduction of a piece of art or handicraft that was made by a resident of the state unless the reproduction is clearly labeled as a reproduction; in this paragraph, "reproduction" means a copy of an original if the copy is

(A) substantially the same as the original; and

(B) not made by the person who made the original;

(33) violating AS 08.66 (motor vehicle dealers);

(34) violating AS 08.66.200 - 08.66.350 (motor vehicle buyers' agents);

(35) violating AS 45.63 (telephonic solicitations);

(36) violating AS 45.68 (charitable solicitations);

(37) violating AS 45.50.474 (on board promotions);

(38) referring a person to a dentist or a dental practice that has paid or will pay a fee for the referral unless the person making the referral discloses at the time the referral is made that the dentist or dental practice has paid or will pay a fee based on the referral;

(39) advertising that a person can receive a referral to a dentist or a dental practice without disclosing in the advertising that the dentist or dental practice to which the person is referred has paid or will pay a fee based on the referral if, in fact, the dentist or dental practice to which the person is referred has paid or will pay a fee based on the referral;

(40) violating AS 45.50.477 (a) - (c);

(41) failing to comply with AS 45.50.475 ;

(42) violating AS 45.35 (lease-purchase agreements);

(43) violating AS 45.25.400 - 45.25.590 (motor vehicle dealer practices);

(44) violating AS 45.66 (sale of business opportunities).

Sec. 11.41.455. Unlawful exploitation of a minor

(a) A person commits the crime of unlawful exploitation of a minor if, in the state and with the intent of producing a live performance, film, audio, video, electronic, or electromagnetic recording, photograph, negative, slide, book, newspaper, magazine, or other material that visually or aurally depicts the conduct listed in (1) - (7) of this subsection, the person knowingly induces or employs a child under 18 years of age to engage in, or photographs, films, records, or televises a child under 18 years of age engaged in, the following actual or simulated conduct:

(1) sexual penetration;

(2) the lewd touching of another person's genitals, anus, or breast;

(3) the lewd touching by another person of the child's genitals, anus, or breast;

(4) masturbation;

(5) bestiality;

(6) the lewd exhibition of the child's genitals; or

(7) sexual masochism or sadism.

Online Victimization:
A Report on the Nation's Youth

BY THE CRIMES AGAINST CHILDREN RESEARCH CENTER

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JUNE 2000

FUNDED BY THE U.S. CONGRESS THROUGH A GRANT TO THE
NATIONAL CENTER FOR MISSING & EXPLOITED CHILDREN

The National Center for Missing & Exploited Children is the national clearinghouse and resource center funded under Cooperative Agreement #98-MC-CX-K002 from the Office of Juvenile Justice and Delinquency Prevention, U.S. Department of Justice. Points of view or opinions in this report are those of the authors and NCMEC and do not necessarily represent the official position or policies of the U.S. Department of Justice. National Center for Missing & Exploited Children® is a registered service mark of the National Center for Missing & Exploited Children.

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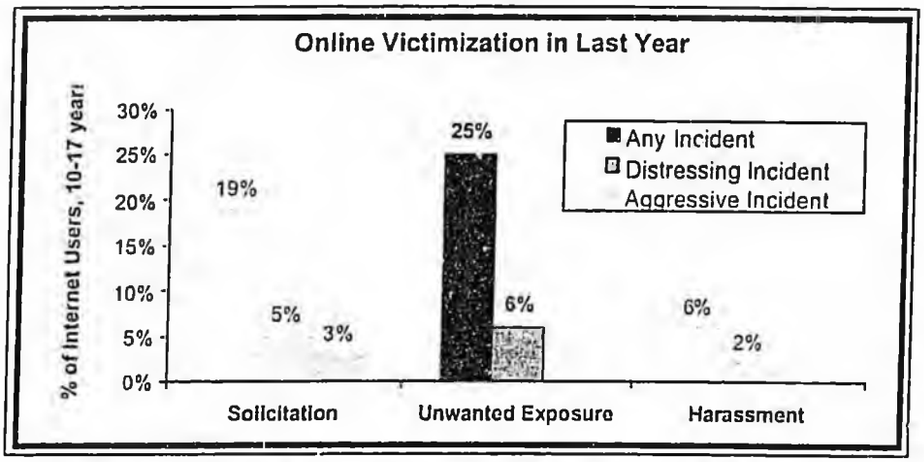
2. Unwanted Exposure to Sexual Material

While it is easy to access pornography on the Internet, what makes the Internet appear particularly risky to many parents is the impression that young people can encounter pornography there inadvertently. It is common to hear stories about children researching school reports or looking up movie stars and finding themselves subjected to offensive depictions or descriptions.

In this part of the survey, we were interested in **unwanted** exposures to sexual material, those that occurred when the youth were not looking for or expecting sexual material. We were interested in material that came up while doing searches online and surfing the world wide web, as well as material that might have appeared when a youth was opening E-mail or clicking on message links. In this section on sexual material, we focus on unwanted exposure to **pictorial images of naked people** or **people having sex.**

A quarter (25%) of the youth had at least one unwanted exposure to sexual pictures in the last year. (*See* Figure 2-1 with incidence rates for unwanted exposure to sexual material emphasized.) Seventy-one per cent of these exposures occurred while the youth was searching or surfing the Internet, and 28% happened while opening E-mail or clicking on links in E-mail or Instant Messages.

Figure 2-1



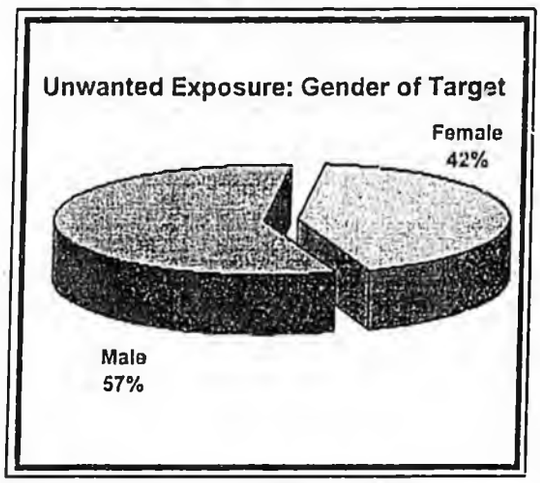
Exposure to sexual material, even when unwanted, is not necessarily upsetting to people. So we have designated a category of **distressing exposures** in which the youth said they found the exposure very or extremely upsetting. Six per cent of regular Internet users said they had a distressing exposure to unwanted sexual pictures on the Internet in the last year.

Which youth had the unwanted exposures?

- Boys outnumbered girls slightly (57% to 42%). (*See* Figure 2-2.)
- More than 60% of the unwanted exposures occurred to youth 15 years of age or older. (*See* Figure 2-3.)
- 7% of the unwanted exposures were to 11 and 12 year old youth.
- None of the 10 year olds reported unwanted exposures.

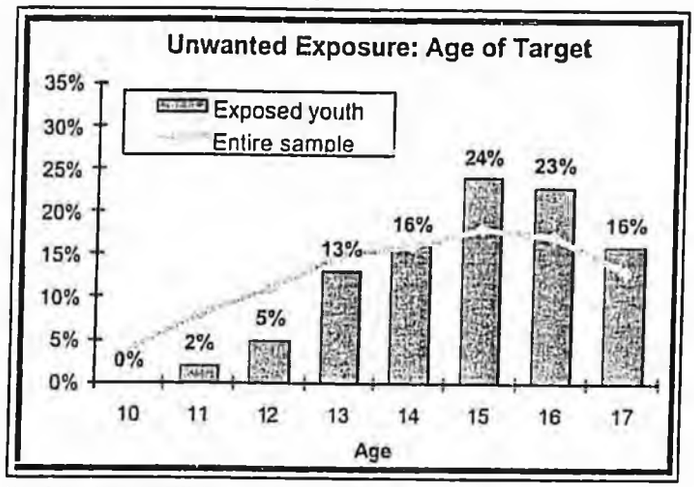
The somewhat greater exposure of boys to unwanted sexual material ma ' reflect the reality that boys tend to allow their curiosity to draw them closer to such encounters. But the rel: tively small difference should not be over-emphasized. Approximately a quarter of both boys and girls had such exposures. Boys were slightly more likely than girls to say the exposure was distressing.

Figure 2-2



Note: Adds to less than 100% due to rounding and/or missing data.

Figure 2-3



Note: Adds to less than 100% due to rounding and/or missing data.

What was the content and source of the unwanted exposure?

- 94% of the images were of naked persons
- 38% showed people having sex
- 8% involved violence, in addition to nudity and/or sex
- Most of the unwanted exposures (67%) happened at home, but 15% happened at school, and 3% happened in libraries

Unfortunately, we do not know how many of the exposures involved child pornography. Important as this question is, we had decided that our youth respondents could not be reliable informants about the ages of individuals appearing in the pictures they viewed.

For the youth who encountered the material while surfing, it came up as a result of

- Searches (47%)
- Misspelled addresses (17%)
- Links in web sites (17%)

For youth who encountered the material through E-mail

- 63% of unwanted exposures came to an address used solely by the youth
- In 93% of instances, the sender was unknown to the youth

In 17% of all incidents of unwanted exposure, the youth said they did know the site was X-rated before entering. (These were all encounters described as unwanted or unexpected.) This group of episodes was not distinguishable in any fashion from the other 83% of episodes, including the likelihood of

being distressing. Almost half of these incidents (48%) were disclosed to parents. It is not clear to what extent it was some curiosity or just navigational naivete that resulted in the opening of the sites despite prior knowledge of the illicit content.

Pornography sites are also sometimes programmed to make them difficult to exit. In fact, in some sites the exit buttons take a viewer into other sexually explicit sites. In 26% of the incidents where sexual material was encountered while surfing, youth reported they were brought to another sex site when they tried to exit the site they were in. This happened in one third of distressing incidents encountered while surfing.

Testimony From Youth

- An 11-year-old boy and a friend were searching for game sites. They typed in "fun.com," and a pornography site came up.
- A 15-year-old boy looking for information about his family's car typed "escort" into a search engine, and a site about an escort service came up.
- Another 15-year-old boy came across a bestiality site while he was writing a paper about wolves for school. He saw a picture of a woman having sex with a wolf.
- A 16-year-old girl came upon a pornography site when she mistyped "teen.com." She typed "teeen" instead.
- A 13-year-old boy who loved wrestling got an E-mail message with a subject line that said it was about wrestling. When he opened the message, it contained pornography.
- A 12-year-old girl received an E-mail message with a subject line that said "Free Beanie Babies." When she opened it, she saw a picture of naked people.

How did the youth respond to the exposure?

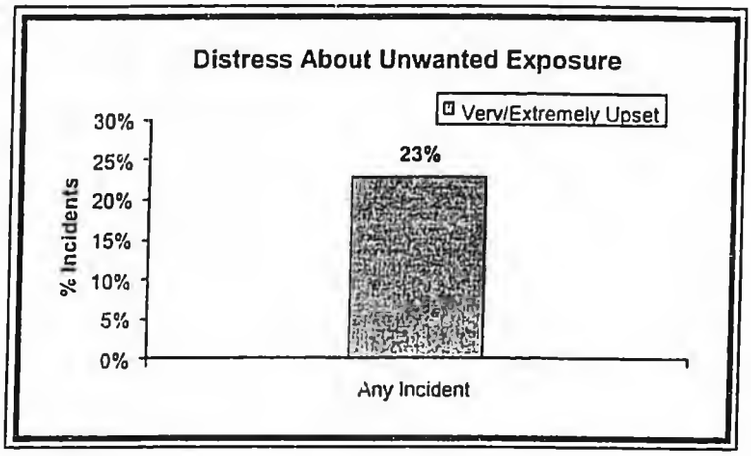
- Parents were told in 39% of the episodes.
- Youth disclosed to no one in 44% of incidents.
- In a few cases authorities were notified, most frequently a teacher or school official (3% of incidents), and Internet service providers (3%). None of these incidents were reported to a law-enforcement agency.
- Only 2% of youth who encountered sexual material while surfing said they returned later to the site of the exposure. None of the youth with distressing exposures who encountered the material while surfing returned to the site.

The fact that so many youth did not mention their exposure to anyone, even a friend, even to laugh or talk about it as an adventure, is noteworthy. It probably reflects some degree of guilt or embarrassment on the part of many youth. It might be healthier and helpful to youth if they were talking about it more.

How did the exposure affect the youth?

- 23% of youth who reported exposure incidents were very or extremely upset by the exposure. This amounts to 6% of the youth we interviewed. (*See* Figure 2-4.)
- 20% of youth were very or extremely embarrassed.
- 20% reported at least one symptom of stress.

Figure 2-4



Summary

Unwanted exposure to sexual material does appear to be widespread, occurring to a quarter of all youth who used the Internet regularly in the last year. While it is not a new thing for young people to be exposed to sexual material, the degree of sudden and unexpected exposure in an unwanted fashion may be an experience made much more common by the widespread use of the Internet. Such exposure occurs primarily to the group age 15 and older, but some youth as young as 11 had experiences to report. Even in the older group, the exposure does not merely evoke laughs or mild discomfort. About a quarter of the exposed youth, or 6% of all regular Internet users said they were very or extremely upset by an exposure. As with sexual solicitations, most exposure incidents, even the distressing ones, do not get reported to adults or authorities, although a proportion of these are disclosed to friends and siblings.

The experiences conform readily to anecdotal accounts from both youth and adult users. Unwanted exposures mostly occur when doing Internet searches, misspelling addresses, or clicking on links. More than a third of the imagery was of sexual acts, rather than simply naked people, and 8% involved some violence in addition to nudity and/or sex.

From a social-scientific view, the issues about youth exposure to unwanted sexual material are difficult to evaluate, in part, because there is almost no prior research on the matter. No one knows the effects of such exposure. The research on exposure to advertising and media violence makes it clear that media exposure can have effects. Media can affect attitudes, engender fears, and model behaviors (both pro and antisocial).

Previous research on exposure to pornography is not relevant to the many issues of concern here. That research has been done with adults and is based on an assumption of voluntary exposure. The present survey shows that in the case of unwanted exposure there are strong negative, subjective feelings for

certain youth and certain youth who manifest symptoms of stress. We do not know how long these feelings or symptoms last or what ramifications they have, but they should mobilize our concern. Questions that should be of particular interest and need attention for future investigation are

- Do any of youth so exposed have full-fledged, clinical-level traumatic reactions or other highly disturbed reactions?
- Is there any influence, traumatic or otherwise, on developing attitudes and feelings about sex?
- Do youth who have experienced unwanted exposure relate to future Internet sexual material in different ways — either more avoidant or more attracted?
- Do Internet exposures to sexual material figure negatively in family dynamics, creating conflicts or barriers in any way?

Nonetheless, for many people, the issues about youth exposure are even more basic than its effects. Whatever the effects, they would argue that people in general and young people in particular have a right to be free from unwanted intrusion of sexual material in a public forum such as the Internet. On this point, some of the constitutional debate about the Internet has concerned what kind of forum the Internet is. Is it a forum like a bookstore, where if it is signposted, people can readily stay away from the sexually explicit material if they so choose, or more like a television channel, where people are much more captive of the material that is projected at them? Clearly, the Internet has aspects of both. But the present research does suggest that, in its current form, it is not simple for those who want to avoid sexual material on the Internet to do so.

Table 2-1. Unwanted Exposure to Sexual Material (N=1,501)

Individual Characteristics	All Incidents (N=376) 25% of Youth	Distressing Incidents (N=91) 6% of Youth
Age of Youth		
• 10	—	—
• 11	2%	1%
• 12	5%	5%
• 13	13%	21%
• 14	16%	18%
• 15	24%	22%
• 16	23%	15%
• 17	16%	18%
Gender of Youth		
• Male	57%	55%
• Female	42%	45%
Episode Characteristics	**All (N=393)**	**Distressing (N=92)**
Location of Computer		
• Home	67%	61%
• School	15%	16%
• Someone Else's Home	13%	16%
• Library	3%	3%
• Some Other Place	2%	3%
Type of Material Youth Saw[1]		
• Pictures of Naked Person(~)	94%	92%
• Pictures of People Having Sex	38%	42%
• Pictures That Also Included Violence	8%	9%
How Youth Was Exposed		
• Surfing the Web	71%	72%
• Opening E-mail or Clicking on an E-mail Link	28%	30%
• Youth Could Tell Site Was X-rated Before Entering	17%	12%
Surfing Exposure	**All (N=281)**	**Distressing (N=66)**
How Web Site Came Up		
• Link Came Up as Result of Search	47%	36%
• Misspelled Web Address	17%	18%
• Clicked on Link When In Other Site	17%	24%
• Other	15%	18%
• Don't Know	3%	3%
• Youth Has Gone Back to Web Site	2%	—
• Youth Was Taken Into Another X-rated Site When Exiting the First One	26%	33%

E-mail Exposure	All (N=112)	Distressing (N=26)
• Youth Received E-mail at a Personal Address	63%	58%
• E-mail Sender Unknown	93%	96%
Episode Characteristics (Surfing & E-mail)	**All (N=393)**	**Distressing (N=92)**
Incident Known or Disclosed to[1]		
• Parent	39%	43%
• Friend and/or Sibling	30%	33%
• Another Adult	2%	2%
• Teacher or Schcol Personnel	3%	9%
• ISP/CyberTipline	3%	4%
• Police or Other Authority	—	—
• Someone Else	1%	—
• No One	44%	39
Distress: Very/Extremely		
• Upset	23%	100%[2]
Youth With No/Low Levels of Upset	76%	—
Youth Was Very/Extremely Embarrassed	20%	48%
Stress Symptoms (more than a little/all the time)[1,3]		
• **At Least One of Following**	**20%**	**43%**
• Stayed Away From Internet	17%	34%
• Thought About It and Couldn't Stop	6%	16%
• Felt Jumpy or Irritable	2%	7%
• Lost Interest in Things	1%	7%
Presence of 5 or More Depression Symptoms[4,5]	11%	15%

[1] Multiple responses possible

[2] Degree of upset was used to define this category of youth.

[3] These items were adapted from a psychiatric inventory of stress responses and represent avoidance behaviors, intrusive thoughts, and physical symptoms.

[4] In the entire sample, 8% of youth (N=117) reported 5 or more symptoms of depression.

[5] The values for this category are based on individual characteristics rather than episode characteristics.

Note: Categories that do not add to 100% are due to rounding and/or missing data.

4. Risks and Remedies

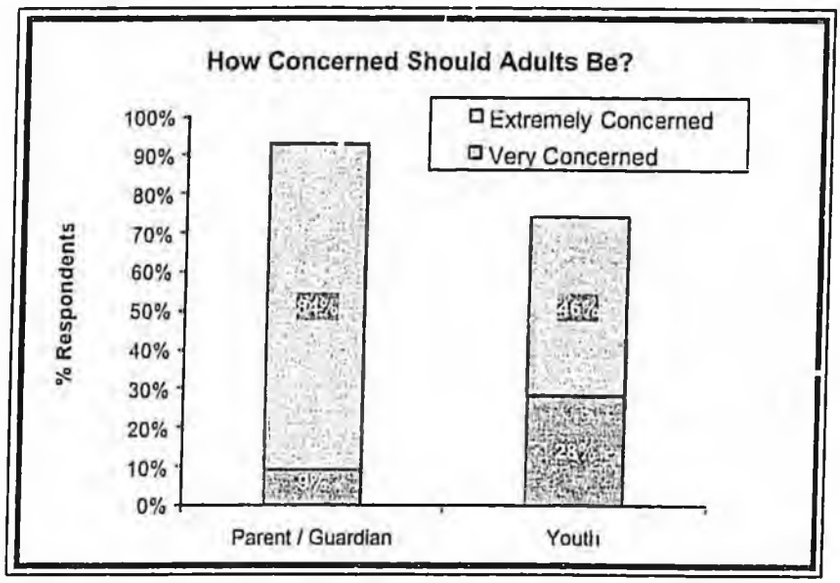
Our lack of knowledge about the dimensions and dynamics of the problems this new technology has created for young people is, of course, a barrier to devising effective solutions. But, even in the absence of knowledge, there has been no dearth of suggestions about things to do. Parents have been urged to supervise their children and talk with them about Internet perils. Youth have been urged to avoid certain risky situations. Organizations have been established to monitor and investigate suspicious episodes. Have any of these remedies been taken to heart?

The survey asked a variety of questions to find out more about the prospects for prevention. We tried to determine to what degree parents are monitoring and advising their children about Internet activities. We asked about the prevalence of Internet activities that may put youth at risk. And we asked about parent and youth knowledge about what remedies or information sources are available for them when they run into problems.

How concerned should adults be about the problem?

Parents and youth both believed that adults should be concerned about the problem of young people being exposed to sexual material on the Internet. As might be expected, parents thought adults should be more concerned than youth thought adults should be, with 84% of parents saying adults should be extremely concerned, compared to only 46% of the youth. (*See* Figure 4-1.) Some inflation of concern might be expected in a survey with this topic, but other surveys confirm that this is an issue of substantial immediacy for parents and youth.

Figure 4-1



Are parents supervising their children?

Many parents or guardians said they had supervised their child's Internet use in the past year. Most claimed to have talked to youth about such matters as giving out addresses, chatting with strangers, or going to X-rated web sites. Four out of five had rules about specific things the young person was not

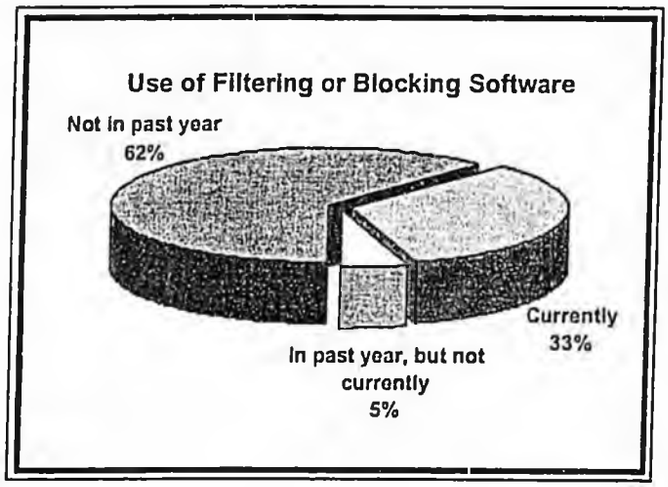
supposed to do online. Approximately four out of five also asked youth about what they did on the Internet. Since many parents might feel guilty about appearing not to have done these things, it is possible that responses to survey interviewers inflate the percentage of parents who have actually supervised their children to this extent. We also did not ask about the details or circumstances of these discussions.

Virtually all parents who had Internet access in their homes said they had looked at the computer screen on occasion to see what their child was doing. At a higher level of supervision that characterized around two-fifths of the households, parents or guardians with home Internet access reported that they checked their child's files or diskettes, required the youth to get permission before going on the Internet, or limited the amount of time the youth could spend online. In approximately three-fifths of households with home Internet access, parents or guardians checked the computer history function to find out where on the Internet the youth had been visiting.

Have families utilized blocking and filtering technology?

Thirty-three percent of households were currently using filtering or blocking software at the time of the interview. (*See* Figure 4-2.) The most common option used by far is the access control offered by America Online to its subscribers, used by 12% of the households with home Internet access, or 35% of households using filtering or blocking software. Interestingly, another 5% of the households in our sample had used some kind of filtering or blocking software during the past year, but were no longer doing so, suggesting some possible dissatisfaction with its use.

Figure 4-2



Are many youth doing *risky things* on the Internet?

We also asked questions to get a sense of how much risky behavior youth were engaging in, in spite of parental-control efforts. The percentages overall were not very large, but some of these behaviors are sensitive enough that youth may have been less than fully candid.

Only 8% admitted to going voluntarily to X-rated Internet sites. Less than 1% said they had used a credit card without permission. Only 5% had posted a picture of themselves for general viewing. Eleven percent had posted some personal information in a public Internet space, mostly their last name. Twenty-

seven percent of E-mail users had posted their E-mail address in a public place on the Internet, but this may be an underestimate since almost any posting to a bulletin board or signing on to a chat room gives a child's E-mail address this kind of exposure. Of youth who said they talked online with people they did not know in person, 12% had sent a picture to someone they met online, and 7% had willingly talked about sex online with someone they had never met in person.

Among the most common of the potentially risky behaviors was making rude or nasty comments to someone online — practiced in the past year by 14% of youth. A similar number played a joke on or annoyed someone online, mostly friends they already knew. One percent admitted to having harassed someone online.

As a measure of those who may be testing the limits most dramatically or persistently, we asked whether the youth had gotten in trouble for something they did online in the past year. Five percent had been in trouble at home, and 3% of youth who used the Internet at school had been in trouble there for online activities.

Do families and youth know about sources of help?

We noted earlier that relatively few of the Internet episodes reported by youth (solicitation, unwanted exposures to sexual material, or harassment) were reported to official sources. One possibility is that youth and their families are not familiar with places that are interested in or receptive to such reports. Almost a third of parents or guardians said they had heard of places where troublesome Internet episodes could be reported, but only approximately 10% of them could cite a specific name or authority. (*See* Figure 4-3.) Only 24% of youth stated they had heard of places to report, and only 17% could actually name a place. (*See* Figure 4-4.) Reporting the episode to an Internet service provider was the option most often thought of. For most of these households, the Internet service provider was America Online.

Figure 4-3

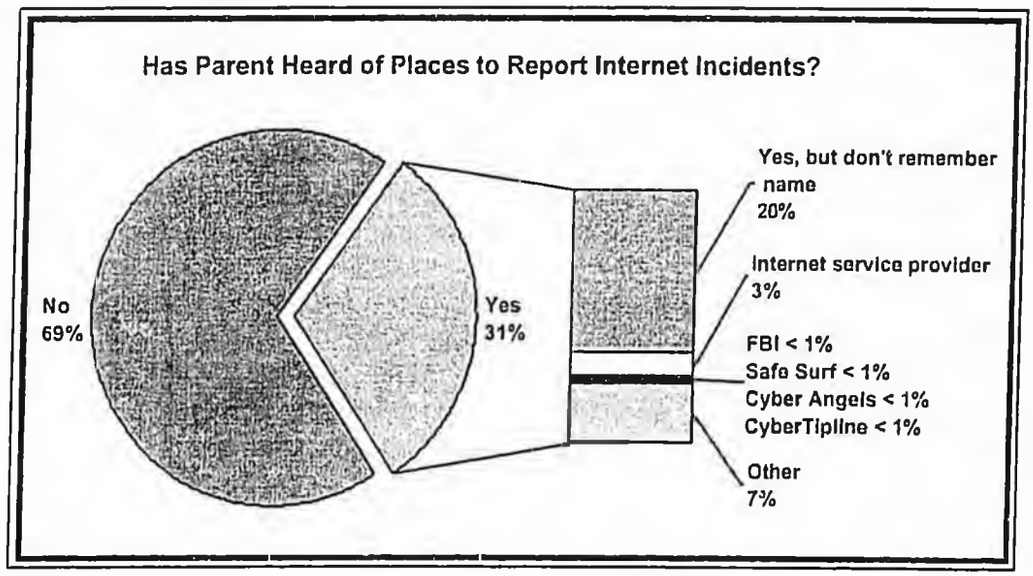
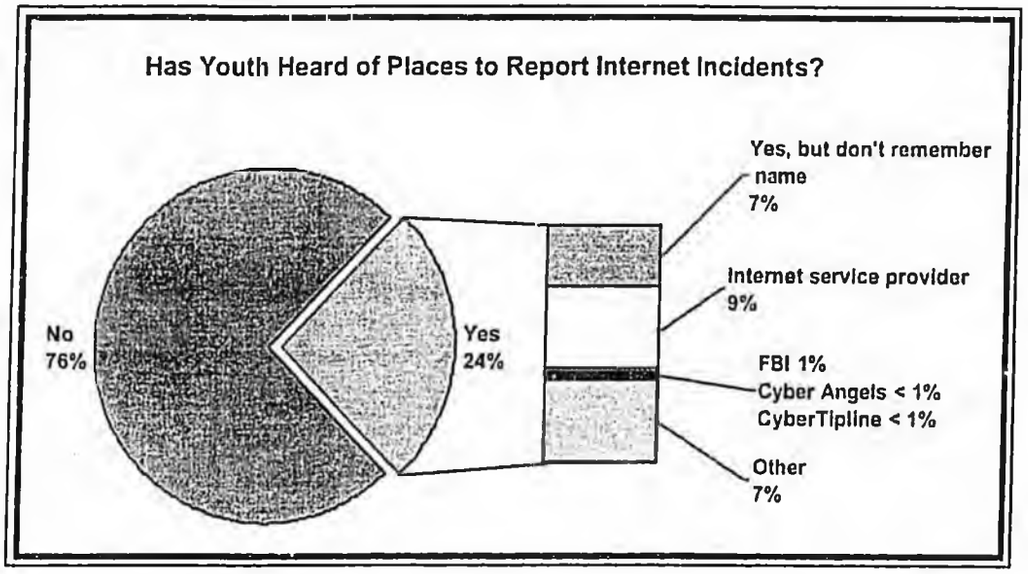


Figure 4-4



Have they heard of the CyberTipline?

Very few of the youth, parents, or guardians could think of the CyberTipline when asked a general question about possible places to report cases. When interviewers said the name "CyberTipline" and asked respondents if they knew about it, larger numbers said they had heard of it, almost 10% of the parents or guardians and 2% of the youth.

Summary

For those concerned about youth Internet safety, there is good and bad news in the survey responses about general Internet practices. While the majority of parents and guardians of Internet users say they supervise their children's online activity, there is a small segment of the population (7%) that does not. Discussions are going on in most households between adults and youth about Internet perils, but it is hard to know how detailed or effective they are. The vast majority of youth, for their part, appear to be playing it safe, and not engaging in risky online behavior. This is generally good news.

The survey, however, reveals notable problems as well. First, there does appear to be a tremendous lack of knowledge about what help sources are available to deal with offensive or disturbing Internet episodes. This may reflect the fact that parents or guardians do not feel they need to know about such sources until something bad happens. But the low level of reporting of incidents suggests that even when bad things happen, people do not make the effort to locate possible help sources. Thus, if the findings point to some area where progress needs to be made, it is in the area of alerting people about possible help sources for problematic Internet encounters.

Secondly, there is a segment of the youth population who are taking risks on the Internet such as engaging in sexual conversations, seeking out X-rated sites, posting pictures of themselves online, or harassing other Internet users. The rates are not high compared to other more conventional risky behavior like using drugs, drinking alcohol, or stealing, but they reflect a new dimension of deviance that needs to be incorporated into a larger understanding of the perils of childhood and addressed in a variety of ways.

Finally, the survey raises questions about the use of filtering and blocking software. Despite the high level of family concern about exposure to sexual material, only a minority of families had adopted the use of any software to address their concern, and some who had adopted it had discontinued its use. This may not reflect a problem. Many parents may be correct in their judgment that discussions with their children and some level of parental monitoring are adequate to manage the problem. But the lack of adoption may also reflect parental doubts about the effectiveness of the available software or a sense that its adoption would create family conflicts that they are reluctant to confront. The findings suggest we need to learn more about actual family concerns about and experiences with filtering and blocking software as a solution to their concerns about Internet safety.

Table 4-1. Parental Supervision of Internet Activities[1]

Supervision (in past year)	Parent/Guardian % Yes
Talked With Youth About (N=1,501)[2]	
• Being Careful About Chatting With Strangers on Internet	85%
• Giving Address/Telephone Number to People Meet on Internet	83%
• Going to X-rated Web Sites or Other X-rated Places	83%
• Talking Online About Very Personal Things (*e.g.*, sex)	77%
• Trying to Meet People Youth Gets to Know on Internet	73%
• Responding to Nasty/Mean Messages	72%
• None of the Above	7%
Look at Screen to See What Youth Is Doing	97%
Rules About Things Youth Is Not Supposed to Do on Internet (N=1,501)	80%
Ask Youth About What He or She Does on Internet (N=1,501)	78%
Check History Function for Sites Youth Has Visited	63%
Check Files and Diskettes	48%
Youth Must Ask Permission to Go on Internet	44%
Rule About Number of Hours Youth Can Spend on Internet	39%

[1] N=1,033 unless otherwise stated. These questions were only asked of households with home Internet access.
[2] Multiple responses possible.

Table 4-2. Risky Online Behavior (N=1,501)

Risky Online Behavior in the Past Year	All Youth % Yes
Youth Went to X-rated Sites on Purpose	8%
Talked About Sex Online With Someone Youth Never Met in Person (N=839)[1]	7%
• Youth Knew He or She Was Talking to an Adult	2%
• Adult Knew He or She Was Talking With a Minor	2%
Used Credit Card Online Without Permission	<1%
Posted Picture of Self for Anyone to See	5%
Sent Picture of Self to Someone Met Online (N=839)[1]	12%
Posted Some Personal Information for All to See	11%
• Posted Last Name	9%
• Posted Telephone Number	1%
• Posted Name of School	3%
• Posted Home Address	2%
Posted E-mail Address for Anyone to See (N=1,143)[2]	27%
Made Rude/Nasty Comments to Someone Online	14%
Played Joke or Annoyed Someone Online	14%
• Played Joke/Annoyed Someone Youth Knew	13%
• Played Joke/Annoyed Stranger	2%
Harassed/Embarrassed Someone Youth Was Mad at Online	1%
• Harassed/Embarrassed Stranger	<1%
• Harassed/Embarrassed Someone Youth Knew	1%
Youth Was In Trouble at Home for Something He or She Did Online	5%
Youth Was In Trouble at School for Something He or She Did Online (N=1,100)[3]	3%

[1] Only asked of youth who reported talking online with people they didn't know in person.
[2] Only asked of youth who reported having an E-mail address.
[3] Only asked of youth who reported using the Internet at school.

5. Major Findings and Conclusions

By providing more texture and details to our picture of the cyber-hazards facing youth, the national *Youth Internet Safety Survey* has much to contribute to current public-policy discussions about what to do to improve the safety of young people. What follows are some key conclusions based on the important findings from the survey.

1. A large fraction of youth are encountering offensive experiences on the Internet.
The percentage of youth encountering offensive experiences — 19% sexually solicited, 25% exposed to unwanted sexual material, 6% harassed— are figures for one year only. The number of youth encountering such experiences from when they start using the Internet until they are 17, a time which might include five or more years of Internet activity, would certainly be higher.

The level of offensive behavior reported in this survey might be placed in this perspective. Any workplace or commercial establishment where a fifth of all employees or clients were sexually solicited annually would be in serious trouble. What if a quarter of all young visitors to the local supermarket were exposed to unwanted pornography? Would this be tolerated? We consider these levels of offensiveness unacceptable in most contexts. But on the Internet will we simply accept it as the price for this new technology and because it is anonymous? Sadly, the Internet is not always the nice, safe, educational and recreational environment that we might have hoped for our young people.

2. The offenses and offenders are even more diverse than we previously thought.
The problem highlighted in this survey is not just adult males trolling for sex. Much of the offending behavior comes from other youth. There is also a substantial amount from females. The non-sexual offenses are numerous and quite serious too. We need to keep this diversity in mind. Sexual victimization on the Internet should not be the only thing that grabs public attention.

3. Most sexual solicitations fail, but their quantity is potentially alarming.
Based on the results of this study, it appears that several million young people ages 10 through 17 get propositioned on the Internet every year. (*See* Table 7-2.) If even some small percentage of these encounters results in offline sexual assault or illegal sexual contact— a percentage smaller than we could detect in this survey — it would amount to several thousand incidents. The good news is most young people seem to know what to do to deflect these sexual "come ons." But there are youth who may be especially vulnerable through lack of knowledge, neediness, disability, or poor judgment. The wholesale solicitation for sex on the Internet is worrisome for that reason.

4. The primary vulnerable population is teenagers.
For solicitations, as well as unwanted exposures to sexual material and harassment, most of the targets were teens, especially teens 14 and older. Thus, it is misleading to say that child molesters are moving from the playground to the living room, trading in their trench coats for digicams, as some have characterized it. Children and teenagers are different victim populations. Pre-teen children use the Internet less, in more

limited ways (Richardson, 1999; Roberts, 1999), and are less independent. It does not appear that much predatory behavior over the Internet involves conventional pedophiles targeting 8-year-old children with their modems, at least not yet. The target population for this Internet victimization is teens, and that makes prevention and intervention a different sort of challenge. Teens do not necessarily listen to what parents and other "authorities" tell them.

5. Sexual material is very intrusive on the Internet.

Large percentages of youth Internet users are exposed to sexual material when they are not looking for it, through largely innocent misspellings and opening E-mail, visiting web sites, and viewing other documents. The sex on the Internet is not segregated and signposted like in a bookstore, and it is not easy to avoid. Some heavy-duty imagery is incredibly easy to stumble upon. Apparently many people do not know this yet. They are inclined to think, "Well, I never see it, so it must be something you only get if you go looking." But youth do not have to be all that active in exploring the Internet to run across sexual material inadvertently.

6. Most youth brush off these offenses, but some are quite distressed.

Most youth are not bothered much by what they encounter on the Internet, but there is an important subgroup of youth who are quite distressed— by the exposure as well as the solicitations and harassment. We cannot assume these are just transient effects. When youth report stress symptoms like intrusive thoughts and physical discomfort, that is a warning sign. Some of this could be the psychological equivalent of a concussion, not a slight bump on the head. It may be hard to predict exactly who will get hurt. It may depend partly on things like age, prior experience — both with the Internet and sexual matters — family attitudes, the degree of surprise, and kind of exposure. Anticipating and trying to respond to negative impacts is something that needs more consideration.

7. Many youth do not tell anyone.

Nearly half of the solicitations were not disclosed to anyone. Some of this non-disclosure is certainly due to embarrassment and guilt. The higher disclosure rates for the non-sexual offenses point to that. Parents are not being informed about a lot of these episodes. They would want to know. And some youth are not even telling their friends. Thus they are not getting a chance to reflect about what happened, process it, and get ideas about how to deal with it and how to put it in perspective. It is somewhat ironic. The Internet is providing places to talk about difficult things, but at the same time, it may be increasing the number of difficult things to talk about.

8. Youth and parents do not report these experiences and do not know where to report them.

Most parents and youth did not know where to report or get help for Internet offenses, and the low rate of reporting for actual offenses confirms this lack of awareness. Even the most serious episodes were rarely reported. The Internet is a new "country" and people do not yet know who the cops or the authorities are. In fact, that seems to be part of the attraction of this territory for many, that there are not obvious cops or authorities. But people need to know how to get help, and people with antisocial tendencies need to know that there are consequences. The choice is not between anarchy and big brother, just as in most societies the choice is not between anarchy and dictatorship.

9. **Internet friendships between teens and adults are not uncommon and seem to be mostly benign.**

It would make prevention easier if Internet friendships between youth and adults were uniformly sinister, and we could simply say, "Don't do it." But one of the positive things about the Internet is that it allows people of diverse social statuses to congregate around common interests. We want young people to develop their skills and talents. We want them to find mentors. The existence of coaches who molest does not deter parents from signing their kids up for Little League. It will be a similarly complicated challenge to protect kids from dangerous Internet relationships without squelching the positive ones. We need to learn more about the signs and symptoms of potentially exploitative adult-youth relationships, not just on the Internet, but in face-to-face relationships too.

10. **We still know little about the incidence of *traveler* cases (where adults or youth travel to physically meet and have sex with someone they first came to know on the Internet), or any completed *Internet seduction* and *Internet sexual exploitation* cases including trafficking in *child pornography*.**

We know these very serious victimizations occur. Law-enforcement officials are tracking down an ever-increasing number. A recent unsystematic survey of the FBI, the National Center for Missing & Exploited Children, newspapers, and other law-enforcement sources identified almost 800 cases, confirmed or under investigation, involving adults traveling to or luring youth they first "met" on the Internet for criminal sexual activities (Ruben Rodriguez, National Center for Missing & Exploited Children, personal communication, April 3, 2000).

We did not find any in this survey of 1,501 youth, but that only means these victimizations probably occur below a certain threshold rate. We were unlikely to discover any types of incidents that occurred to fewer than 14,000 youth a year. That is still a large threshold. But it is fair to speculate that these kinds of events are probably not as common as incidents like date rape, conventional stranger sexual assault, or intrafamily sexual abuse — crimes that do tend to show up in surveys of 1,500 youth. So we will have to study these serious Internet cases in some other way, either through a very large survey, like the National Crime Victimization Survey, or through some survey of reported cases.

In the meantime, the findings of this survey should **not** be interpreted to mean that major law-enforcement initiatives focused on serious Internet crimes against children are misguided. In the last few years, specialized units from the FBI and local law-enforcement agencies have increased their activities on the Internet, often "decoying" themselves as youth to try to catch potential offenders. Given the volume of sexual solicitations and approaches young people are experiencing, the presence and publicity about these decoys is certainly a good thing. It should give potential offenders some pause before they begin their solicitations.

Law-enforcement officials are also active in investigating trafficking in child pornography. Because we judged that our youth interviewees would not be reliable informants about the ages of people appearing in sexual pictures, we have no findings relevant to the problem of child pornography on the Internet. This is nonetheless a problem that has been exacerbated by the Internet, and it is worthy of additional study.

11. Nothing in this survey should dampen enthusiasm about the potential of the Internet. Youth, families, and educators are currently riding a bandwagon of excitement about the potential of the Internet to bring new kinds of educational, recreational, interpersonal, and even therapeutic possibilities to young people. This survey should not be construed as a signal to slow the wagon down. This survey concerns what is only a small segment of Internet activity and has little to say about its broader potential.

But because the Internet is likely to become so important in our lives, it is crucial to begin to confront its potential problematic aspects as early as possible. When the automobile was first introduced, those who said it was going to kill too many people and pollute the air were dismissed as opposed to progress. The solutions that would have allowed us to have all the benefits of safer and less polluting autos might have come more quickly and at a lower social cost if these concerns had been accepted wholeheartedly from the beginning as worthy chaperones to our courtship of the car. In a similar vein, we can unleash the excitement about the Internet and the creativity it will spawn, while still making a concerted effort to monitor and rein in its potential negative effects. The sooner we start that process the better.

Limitations of the Survey

Every scientific survey has limitations and defects. Readers should keep some of these important things in mind when considering the findings and conclusions of this survey.

- We cannot be certain how candid our respondents were. Although we used widely accepted social-science procedures, our interviews involved telephone conversations with young people on a sensitive subject, factors that could contribute to less than complete candor.

- The young people we did not talk to may be different from the youth we talked to. There were parents who refused to participate or refused to allow us to talk to their children, and there were youth who refused to participate and those we could never reach. Our results might have been different if we had been able to talk to all these people.

- Our numbers are only estimates, and samples can be unusual. Population sampling is intended to produce groups representative of the whole population, but sometimes samples can be randomly skewed. For most of our major findings, statistical techniques suggest that estimates are within 2.5% or less of the true population percentage in 95 out of 100 samples like this one, but there is a small chance that our estimates are farther off than 2.5%.

6. Recommendations

1. **Those concerned about preventing sexual exploitation on the Internet need to talk specifically in their materials about the diversity of hazards including threats from youthful and female offenders.**

A stereotype of the adult Internet "predator" or "pedophile" has come to dominate much of the discussion of Internet victimization. While such figures exist and may be among the most dangerous of Internet threats, this survey has revealed a more diverse array of individuals who are making offensive and potentially exploitative online overtures. We should not ignore them. We have to remember that in a previous generation, campaigns to prevent child molestation characterized the threat as "playground predators" so that for years the problem of youth, acquaintance, and intra-family perpetrators went unrecognized. Today, those doing prevention work concerning the Internet need to be careful not to make, consciously or inadvertently, a characterization of the threat that fails to encompass all its forms. One of the reasons for the mistaken characterization of child molesters in an earlier era was that people extrapolated the problem entirely from what came to the attention of law-enforcement officials. A similar process could be underway in the case of Internet victimization, but it is probably early enough to reverse the trend. Thus we need to publicize the full variety of Internet offensive behavior.

2. **Prevention planners and law-enforcement officials need to address the problem of non-sexual, as well as sexual victimization on the Internet.**

An additional problem with the "Internet predator" stereotype just mentioned is that it does not give enough focus to non-sexual forms of Internet victimization. The current survey shows that non-sexual threats and harassment constitute another common peril for youth that can be as, or more, distressing than sexual overtures. Experience in crime prevention has shown that concerns about sexual threats often eclipse other equivalently serious crime. Concerted efforts should be made to ensure that non-sexual threats and harassment are included on educational, legislative, and law-enforcement agendas for Internet safety.

3. **More of the Internet-using public needs to know about the existence of help sources for Internet offenses, and the reporting of offensive Internet behavior needs to be made even easier, more immediate, and more important to youth Internet users.**

Multiple strategies are needed to increase reporting. The Internet-using public needs to be made aware of reporting options in as many ways as possible, through the Internet as well as through other media. The public also needs to be briefed on the reasons why they should make such reports including the importance of keeping the Internet a safe and enjoyable place for everyone to use. The Smokey the Bear and McGruff the Crime Dog campaigns come to mind as approaches to emulate. People often balk at being tattle-tales, but vigilance by individuals and community involvement have been traditional keys to community safety.

In reaching out to the public and Internet users on this issue of reporting, our survey suggests that Internet service providers are in a key position to help. They are the most recognized avenue for reporting. So it may make sense for them to become even more visible and pro-active on this front. What else can be done? Can chat rooms be urged to consider how to make the monitoring and reporting of offensive behavior easier and more acceptable? The Internet needs its own neighborhood crime-watch posters and more.

4. **Different prevention and intervention strategies need to be developed for youth of different ages.**

Most of the encounters reported to our survey occurred to teenagers, specifically older teens. The messages that will make sense and be taken seriously by this group and their parents are quite different from those that make sense for younger youth. This is a different problem from conventional child molestation, where we were trying to target and protect 7 to 13 year olds. Older teens have more independence, more experience, and a different relationship with adults and their families. For example, telling parents to regularly check the Internet and E-mail activity of older teens may be tantamount to saying parents should read their mail, and such privacy invasions will seem unrealistic in many families.

Too much of the discussion about Internet safety to date has been between policy makers and parents, without consultation from young people themselves. Policies crafted from such an adults-only discussion may be rejected, especially by older youth, because the policies may be seen as an effort to control rather than protect. Good protection strategies, especially for the teen group, cannot be heavy on the control dimension and need to be tied to youth aspirations, values, and culture. That requires the input of youth. If young people are becoming millionaires with their Internet ingenuity, it is likely that some of that creativity could hit the jackpot in the field of Internet safety as well. It is time to involve a cadre of young people in the development of Internet victimization prevention and intervention in order to craft messages to which youth will be receptive.

5. **Youth need to be mobilized in a campaign to help "clean up" the standards of Internet behavior and take responsibility for youth-oriented parts of the Internet.**

Like face-to-face sexual offenses, which run the gamut from harassment to rape, Internet sexual offenses cover a spectrum of behaviors. The less serious end of the spectrum should not be ignored, since it can be the fertile soil in which more serious offenses grow. The experience of those trying to prevent real-world sexual harassment has been that campaigns, particularly campaigns involving whole schools, can be successful, if they raise awareness about the problem and its effects, and help youth themselves enforce proper conduct among their peers. Such youth-oriented campaigns might have some success with at least some forms of Internet victimization as well, and they may be worth a try.

6. **We need to train mental health, school, and family counselors about these new Internet hazards and how these hazards contribute to personal distress and other psychological and interpersonal problems.**

This survey reveals that substantial numbers of young people do experience distress because of Internet encounters. And they are not getting help. Mental health and other counselors need to learn to be alert and ask questions to get young people to talk about such encounters. They need to know how young people use the Internet, so they can understand their problems. They need to be trained to treat the kinds of distress and conflicts that are connected with negative Internet experiences. We need educational packages for schools and all kinds of youth workers for their own professional development and to use with youth. Unfortunately, at the training conferences being offered today, most of the Internet education seems directed at law-enforcement officials. We need to develop workshops for educators, psychologists, and social workers as well.

HB

83

HOUSE COMMITTEE REPOPT

(7)
Date Referred to Committee: February 7, 2003 **FURTHER REFERRALS:**

Date of Committee Action: March 12, 2003

The JUDICIARY Committee considered: **HB 83**

HOUSE BILL NO. 83 **REVISED UNIFORM ARBITRATION ACT**

"An Act adopting a version of the Revised Uniform Arbitration Act; relating to the state's existing Uniform Arbitration Act; amending Rules 3, 18, 19, 20, and 21, Alaska Rules of Civil Procedure, Rule 601, Alaska Rules of Evidence, and Rule 402, Alaska Rules of Appellate Procedure; and providing for an effective date."

Recommends it be replaced with [ ] HCS *or* [X] CS *for* HB 83 (JUD)
For Senate Bills with new title: [ ] Technical Title [ ] New Title: HCR_____ **[X] Same Title [ ] New Title**

[ ] attach amendments
[ ] add new referral to _____Committee
[ ] Letter of Intent _____Committee

List of Abbrev for Depts.:
ADM
CED
COR
CRT
EED
DEC
DFG
GOV
HSS
LEG
LAW
LWF
MVA
DNR
DPS
REV
DOT
UA

***NEW* FISCAL NOTES**
*Assigned by Chief Clerk's Office

List by Dept(s):	*FN#	Fiscal	Indet.	Zero
LAW				✓
CRT				✓
CTR				✓

***PREVIOUS* FISCAL NOTES**

List by Dept(s):	FN#	Fiscal	Indet.	Zero

Signing with recommendations	Printed Last Name	DP	DNP	NR	AM
	Gara	✓			
	SAMUELS			✓	
Tom Anderson	ANDERSON	X			
Max Gruenberg	Gruenberg	–			
Gene Coghill	Coghill			✓	
Chair: Ralph Samuels	McGuire	✓			
Chair:					

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MEMORANDUM March 17, 2003

SUBJECT: CSHB 83(JUD) relating to arbitration
(Work Order No. 23-LS0047\I)

TO: Representative Lesil McGuire
Attn: Vanessa

FROM: Theresa L. Bannister
Legislative Counsel

This memo accompanies the bill described above.

Possible effect of amendment. The amendment may interfere with the ability of certain persons to choose to use this new arbitration chapter to handle their arbitration. The persons affected would be those persons whose arbitration is covered by the Federal Arbitration Act,[1] primarily those persons whose arbitration agreements involve interstate commerce. It appears from reading the commentary for the Revised Uniform Arbitration Act that if this bill is changed to include a provision contrary to the holding in the Prima Paint case[2] the federal act may preempt the selection of this chapter by those persons because the new provision would be considered to interfere with the pro-arbitration stance of the federal act.

If you would like further information on this issue, please advise.

TLB:med
03-310.med

Enclosure

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[1] 9 U.S.C. sec. 1 et seq.

[2] Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 35 (1967).

LEGAL SERVICES

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MEMORANDUM March 11, 2003

SUBJECT: Amendment to HB 83 relating to arbitration
(Work Order No. 23-LS0047\H.1)

TO: Representative Les Gara
Attn: Ryan

FROM: Theresa L. Bannister
Legislative Counsel

This memo accompanies the amendment you requested for the bill described above.

Description of amendment. The amendment basically takes the position of the dissent in Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967). In that case, the plaintiff filed a diversity suit in federal court to rescind an agreement for fraud in the inducement and to enjoin arbitration. The alleged fraud was in inducing assent to the underlying agreement and not to the arbitration clause itself. The Supreme Court, applying the Federal Arbitration Act (FAA) to the case, determined that the arbitration clause was separable from the contract in which it was made. The broad arbitration clause of 9 U.S.C. sec. 3 of the Federal Arbitration Act encompassed arbitration of a claim alleging that the underlying contract was induced by fraud. The result was that even though the contract was argued to have been fraudulently induced, the arbitration provision was given effect. This amendment H.1, basically states that if the contract was procured by fraud, the arbitration provision in the contract is unenforceable. The amendment represents the basic position taken by the dissent in the case.

Federal preemption issue. The adoption in proposed sec. 09.43.330 of a different position than that held in the Prima Paint case raises a preemption issue under the Federal Arbitration Act. The commentary by the National Conference of Commissioners on Uniform State Laws states, with regard to the provisions in the Revised Uniform Arbitration Act that correspond to the provisions in sec. 09.43.330:

> In light of a number of decisions by the United States Supreme Court concerning the Federal Arbitration Act (FAA), any revision of the UAA must take into account the doctrine of preemption. The rule of preemption, whereby FAA standards and the emphatically pro-arbitration perspective of the FAA control, applies in both the federal courts and the state courts. To date, the preemption-related opinions of the Supreme Court have centered in large part on the two key issues that arise at the

> front end of the arbitration process--enforcement of the agreement to arbitrate and issues of substantive arbitrability. Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 35 (1967); Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1 (1983); Southland Corp. v. Keating, 465 U.S. 2 (1984); Perry v. Thomas, 482 U.S. 483 (1987); Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265 (1995); Doctor's Assocs. v. Cassarotto, 517 U.S. 681 (1996). That body of case law establishes that state law of any ilk, including adaptations of the RUAA, mooting or limiting contractual agreements to arbitrate must yield to the pro-arbitration public policy voiced in sections 2, 3, and 4 of the FAA.

Therefore, at least to the extent that an arbitration agreement involves interstate commerce, there appears to be a preemption issue with adopting the dissent's position in the Prima Paint case.

If I may be of further assistance, please advise.

TLB:med
03-287.med

Enclosure

23-LS0047\H.1
Bannister
3/11/03

AMENDMENT

OFFERED IN THE HOUSE BY REPRESENTATIVE GARA

TO: HB 83

Page 2, line 17, following "09.43.330(a)":

Insert "or (b)"

Page 3, line 5, following "contract":

Insert ", and except as provided by (b) of this section"

Page 3, following line 5:

Insert a new subsection to read:

"(b) To the extent an agreement that contains an arbitration provision is invalidated on the grounds that a party was induced into entering into the agreement by fraud, the arbitration provision in the agreement is not enforceable, and the party is not required to prove that the party was induced into entering into the arbitration provision by fraud."

Reletter the following subsections accordingly.

Page 3, lines 9 - 10:

Delete "and whether a contract containing a valid agreement to arbitrate is enforceable"

HB 83 Revised Uniform Arbitration Act (23-LS0047\H)

Explanation of Legal Issue:

Drawing your attention to the bill, Page 3, Lines 2-14,
Sec. 09.43.330 Validity of agreement to arbitrate

A question was raised at our last meeting regarding (c), specifically, whether or not we wanted to depart from the RUAA and remove the clause on Line 9, "whether a contract containing a valid agreement to arbitrate is enforceable" (thereby giving this duty to the arbitrator versus the court).

The inclusion of this language into Alaska Statutes would have the effect of adopting the holding of the *Prima Paint* case, 388 U.S. 395 (1967). *Prima Paint* holds that the arbitration clause in a contract is separable from the rest of the contract and that allegations as to the validity of the contract in general, as opposed to the arbitration clause in particular, are to be decided by the arbitrator. The result is that even if a contract is argued to have been fraudulently induced, the arbitration provision can still be given effect.

The contrary view, that if a contract was procured by fraud, the arbitration provision in the contract is unenforceable, is explained in the memos written by Representative Gara and Therese Bannister, Leg. Legal. The drafted amendment, if adopted, would adopt this view.

in equity. . . ." 388 U.S. at 400; 87 S.Ct. at 1804. The Court then ventured to determine the scope of federal common law, and federal rules of equity, on this subject. It set forth the following framework, which is important to the understanding of both Prima Paint and later law.

The Court styled the "central question in this case" as follows: "whether a claim of fraud in the inducement of the entire contract is to be resolved by the federal court, or whether the matter is to be referred to the arbitrators." 388 U.S. at 402; 87 S.Ct. at 1805. The Court then crafted the following rule of construction. "If the claim is fraud in the inducement of the arbitration clause itself - an issue which goes to the making of the agreement to arbitrate - the federal court may proceed to adjudicate it." 388 U.S. at 403-404; 388 U.S. at 1806. When the Court states this is a "court" issue, it means to say the plaintiff is permitted to bring its fraud case in court, rather than to an arbitrator.

On the other hand, Prima Paint does not "permit the federal court to consider claims of fraud in the inducement of the contract generally." Id. The Court created a federal doctrine of "separability" to determine how much of a contract is to be invalidated when fraud in the inducement occurs. 388 U.S. at 402; 87 S.Ct. at 1805. As discussed above, this differs from Alaska's common law rule of severability, which provides that the whole contract is voidable unless it is "clear" the parties intended some provision to remain even if the main provision induced by fraud is invalidated. Johnson, 953 P.2d at 497, discussed supra.

The majority opinion was harshly criticized in a dissenting opinion by Justice Black, in which Justices Douglas and Stewart concurred. Justice Black was persuaded by the Restatement and Alaska common law rules of contract enforceability discussed above. He explained that the common law rendering fraudulently induced contracts void was clear, and should be adopted as federal common law on the issue of enforceability:

> "[Under the Act] an arbitration agreement is to be enforced by a federal court unless the court, not the arbitrator, finds grounds 'at law or in equity' for the revocation of any contract. Fraud, of course, is one of the most common grounds 'at law or in equity' for the revocation of any contract. If the contract was procured by fraud, then . . . there is absolutely no contract, nothing to arbitrate.

388 U.S. at 412; 87 S.Ct. at 1810 (emphasis added). He criticized the majority opinion as "fantastic", and as allowing important legal questions such as fraud and "whether any legal contract exists," as opposed to simple contract disputes, to be sent to "nonlawyer[]" arbitrators. 8388 U.S. at 407; 87 S.Ct. at 1808.

State courts are split on whether their arbitration acts, and their common law governing the effect of fraud on contract enforceability, should follow the Prima Paint rule or the Restatement rule. Those that do not follow Prima Paint adhere to Justice Black's dissenting view: that if an Arbitration Act incorporates the common law on contract enforceability, it incorporates the common law rule that fraud renders a contract voidable. E.g. City of Blaine v. John Coleman Hayes & Associates, 818 S.W.2d 33, 38 (Tenn. App. 1991)(discussing Justice Black dissent); accord Monette v. Tinsley, 975 P.2d 361, 366 (N.M. App. 1999)(fraud in the inducement of contract not subject to arbitration); Shaffer v. Jeffery, 915 P.2d a910, 918 (Okla. 1996)(contract voidable upon proof of "fraudulently induced" arbitration agreement, or "contract containing that agreement"); In re Oakwood Mobile Homes, 987 S.W.2d 571, 573 (Tex. 1999)(court question if "fraud in the formation" claimed); Public Service Credit Union v. Ernest, 988 F.2d 627, 629 (6th Cir. 1993)(under Michigan law, fraudulent inducement into contract renders arbitration clause voidable).

Commentators have also criticized "the fiction that an arbitration clause within a fraudulently induced contract is not infected by fraud." E.g., K. Davis, The Arbitration Claws: Unconscionability in the Securities Industry, 78 Boston U. L. Rev. 255, 267 (1998). In this case, the arbitration clause was not only "infected by fraud," but it was inserted by McKinley to help it either get away with or limit its liability for its fraud.

Today there is debate about whether Prima Paint has been overruled. M. Donovan, A. Searles, 10 Loyola Consumer L. Rev. at 270-71.[6]

The criticism of Prima Paint is justified. That criticism sounds even louder given Alaska law on contract enforceability, and its express incorporation into the Alaska Arbitration Act. The general common law rule is that fraud renders a contract voidable. While it may be that federal common law on this point was not clear at the time of Prima Paint, and new law had to be written, Alaska common law is clear. Alaska also has its own common law on separability. That rule requires that the arbitration clause in this case be invalidated with the rest of the contract.

V. McKINLEY FRAUDULENTLY INDUCED SERRATO INTO BOTH THE 1997 CONTRACT, AND ITS ARBITRATION PROVISION

There is significant evidence that McKinley fraudulently induced Serrato into the 1997 employment agreement in this case. Those facts are discussed above. While Serrato is confident he need only prove fraudulent inducement into the contract in this case, a jury question is also presented under the stricter Prima Paint rule.

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[6]. In First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 115 S.Ct. 1920 (1995), the Court cast its federal common law under Prima Paint into doubt. It held:

> When deciding whether the parties agreed to arbitrate a certain matter courts generally should apply ordinary state-law principles that govern the formation of contracts. . . . Courts should not assume that the parties agreed to arbitrate arbitrability unless there is 'clear and unmistakable evidence' that they did so.

514 U.S. at 943-44, 115 S.Ct. at 1924 (emphasis added). It has been noted by courts and commentators that "[t]he Court's holding 'suggests that the related and antecedent issue of whether an agreement to arbitrate is a contract of adhesion, fraudulently induced, or otherwise revocable, is an issue for the court as well. . . ." Berger v. Fitzgerald, 942 F. Supp. 963, 965 (S.D. N.Y.) (citation omitted); see also M. Donovan, A. Searles, 10 Loyola Consumer L. Rev. at 270-71. Two other federal courts in New York, which sees substantial litigation over arbitration clauses in stock exchange securities cases, have voiced the same conclusion. Aviall, Inc. v. Ryder System, Inc., 913 F. Supp. 826, 831 (S.D. N.Y. 1996), aff'd 110 F.3d 892 (2nd Cir. 1997); Maye v. Smith Barney, Inc., 897 F. Supp. 100, 106 (S.D. N.Y. 1995).

LEXSEE 388 us 395

PRIMA PAINT CORP. v. FLOOD & CONKLIN MFG. CO.

No. 343

SUPREME COURT OF THE UNITED STATES

388 U.S. 395; 87 S. Ct. 1801; 18 L. Ed. 2d 1270; 1967 U.S. LEXIS 2750

March 16, 1967, Argued

June 12, 1967, Decided

PRIOR HISTORY:

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

DISPOSITION:
360 F.2d 315, affirmed.

CASE SUMMARY

PROCEDURAL POSTURE: On a writ of certiorari to the United States Court of Appeals for the Second Circuit, petitioner corporation sought review of a judgment that an arbitrator was to resolve a claim of fraud in the inducement in regard to a consulting agreement between petitioner and respondent company, that contained a broad arbitration clause governed by the United States Arbitration Act of 1925, *9 U.S.C.S. § § 1*-14.

OVERVIEW: The parties had entered into the agreement after the corporation purchased the assets of the company's paint business. After the corporation failed to make the first payment due under the agreement the company served notice to arbitrate. The corporation filed suit seeking rescission of the entire agreement on the basis of fraud allegedly consisting of the company's misrepresentation that it was solvent and able to perform the agreement while it was completely insolvent. The company moved to stay the court action pending arbitration. The company contended that whether there was fraud in the inducement of the consulting agreement was a question for the arbitrators. The district court granted the company's motion with the court of appeals affirming. The Supreme Court affirmed, holding that (1) because the agreement was tied to the interstate transfer of the assets it affected interstate commerce and was within the coverage of the Act; (2) the arbitration clause in the agreement was separable from the rest of the agreement; and (3) allegations as to the validity of the agreement in general, as opposed to the arbitration clause in particular, were to be decided by the arbitrator.

OUTCOME: The Court affirmed the court of appeals' decision that an arbitrator was to resolve the corporation's claim of fraud in the inducement in regard to the agreement the corporation had entered into with the company.

CORE TERMS: arbitration, commerce, inducement, arbitration agreement, arbitrator, consulting agreement, arbitration clause, substantive law, Arbitration Act, interstate commerce, arbitrate, diversity, enforceable, admiralty, legislative history, state law, paint, subcommittee, compete, ground of fraud, federal law, separable, customer, maritime, entire contract, agreement to arbitrate, fraudulent, interstate, revocation, evidencing

LexisNexis(TM) HEADNOTES - Core Concepts

Civil Procedure > Alternative Dispute Resolution
[HN1] Section 2 of the United States Arbitration Act of 1925, *9 U.S.C.S. § § 1*-14, provides that a written provision for arbitration in any maritime transaction or a contract evidencing a transaction involving commerce shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Constitutional Law > Congressional Duties & Powers > Commerce Clause
[HN2] The stay provisions of § 3 of the United States Arbitration Act of 1925 (Act), *9 U.S.C.S. § § 1*-14, apply only to the two kinds of contracts specified in § § 1 and 2 of the Act, namely those in admiralty or evidencing transactions in "commerce."

Constitutional Law > Congressional Duties & Powers > Commerce Clause
[HN3] A consulting agreement inextricably tied to the interstate transfer and to the continuing operations of an interstate manufacturing and wholesaling business evidences a transaction in interstate commerce.

Civil Procedure > Alternative Dispute Resolution
[HN4] Under § 4 of the United States Arbitration Act of 1925 (Act), *9 U.S.C.S. § § 1*-14, with respect to a matter within the jurisdiction of the federal courts save for the existence of an arbitration clause, the federal court is instructed to order arbitration to proceed once it is satisfied that the making of the agreement for arbitration or the failure to comply with an arbitration agreement is not in issue. Accordingly, if the claim is fraud in the inducement of the arbitration clause itself -- an issue which goes to the "making" of the agreement to arbitrate -- the federal court may proceed to adjudicate it. But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally. In passing upon an application of § 3 of the Act, for a stay while the parties arbitrate, a federal court may consider only issues relating to the making and performance of the agreement to arbitrate.

Civil Procedure > Alternative Dispute Resolution
[HN5] See § 4 of the United States Arbitration Act of 1925, *9 U.S.C.S. § § 1*-14.

Constitutional Law > Congressional Duties & Powers > Commerce Clause
[HN6] Congress may prescribe how federal courts are to conduct themselves with respect to subject matter over which Congress plainly has power to legislate. And it is clear beyond dispute that the United States Arbitration Act of 1925, *9 U.S.C.S. § § 1*-14, is based upon and confined to the incontestable federal foundations of control over interstate commerce and over admiralty.

SYLLABUS:

Respondent (F & C), a New Jersey corporation which manufactured and sold paint and paint products to wholesale customers in a number of States, entered into a contract with petitioner (Prima), a Maryland corporation, whereby F & C agreed to perform consulting and other services relating to the transfer of operations from F & C to Prima and agreed not to compete with Prima, for which Prima agreed to pay, over the six-year life of the contract, certain percentages of receipts from sales. The contract, which stated that it "embodies the entire understanding of the parties," contained a broad arbitration clause that "any controversy . . . arising out of this agreement, or the breach thereof, shall be settled by arbitration in the City of New York in accordance with the rules . . . of the American Arbitration Association." Almost a year later, after the first payment had become due, Prima notified F & C that F & C had broken the consulting agreement and an earlier agreement involving Prima's purchase of F & C's paint business. Prima's chief contention was that F & C had fraudulently represented that it was solvent and able to perform its obligations whereas it was insolvent and planned to file a bankruptcy petition shortly after executing the consulting agreement. F & C responded by serving a notice of intention to arbitrate, whereupon Prima filed this diversity action in federal court for rescission of the consulting agreement on the basis of the alleged fraudulent inducement and contemporaneously sought to enjoin F & C from proceeding with arbitration. The United States Arbitration Act of 1925 provides, in § 2, that a written arbitration provision "in any . . . contract evidencing a transaction involving commerce . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract"; in § 3, that a federal court in which suit is brought upon an issue referable to arbitration by an arbitration agreement must stay the court action pending arbitration once it has decided that the issue is arbitrable under the agreement; and, in § 4, that a federal court whose assistance is invoked by a party seeking to compel another to arbitrate, if satisfied that an arbitration

agreement has not been honored and that "the making of the agreement for arbitration or the failure to comply [with the arbitration agreement] is not in issue," shall order arbitration. The District Court granted a motion filed by F & C to stay the action pending arbitration, and the Court of Appeals dismissed Prima's appeal. *Held*:

1. The contract clearly evidenced a transaction involving interstate commerce and came within the coverage of the Arbitration Act. P. 401.

2. In passing upon an application for a stay of arbitration under § 3 of the Act, a federal court may not consider a claim of fraud in the inducement of the contract generally but "may consider only the issues relating to the making and performance of the agreement to arbitrate." Pp. 402-404.

3. The Act prescribes the manner in which federal courts are to treat questions relating to arbitration clauses in contracts which involve interstate commerce or admiralty, "subject matter over which Congress plainly has power to legislate." Hence, state rules allocating functions between court and arbitrator do not control. Pp. 404-405.

4. Since the claim of fraud here relates to inducement of the consulting agreement generally rather than in the arbitration clause and there is no evidence that the parties intended to withhold this issue from arbitration, there is no basis for granting a stay under § 3. Pp. 406-407.

COUNSEL:

Robert P. Herzog argued the cause and filed briefs for petitioner.

Martin A. Coleman argued the cause for respondent. With him on the brief was David N. Brainin.

Gerald Aksen argued the cause for the American Arbitration Association, as amicus curiae. With him on the brief were Whitney North Seymour, Sol N. Corbin, Osmond K. Fraenkel, William J. Isaacson and H. H. Nordlinger.

JUDGES:

Warren, Black, Douglas, Clark, Harlan, Brennan, Stewart, White, Fortas

OPINIONBY:

FORTAS

OPINION:

[*396] **[***1273]** **[**1802]** MR. JUSTICE FORTAS delivered the opinion of the Court.

This case presents the question whether the federal court or an arbitrator is to resolve a claim of "fraud in **[*397]** the inducement," under a contract governed by the United States Arbitration Act of 1925, n1 where there is no evidence that the contracting parties intended to withhold that issue from arbitration.

----------Footnotes----------

n1 *9 U. S. C. §§ 1-14.*

----------End Footnotes----------

The question arises from the following set of facts. On October 7, 1964, respondent, Flood & Conklin Manufacturing Company, a New Jersey corporation, entered into what was styled a "Consulting Agreement," with petitioner, Prima Paint Corporation, a Maryland corporation. This agreement followed by less than three weeks the execution of a contract pursuant to which Prima Paint purchased F & C's paint business. The consulting agreement provided that for a six-year period F & C was to furnish advice and consultation "in connection with the formulae, manufacturing operations, sales and servicing of Prima Trade Sales accounts." These services were to be performed personally by F & C's chairman, Jerome K. Jelin, "except in the event of his **[***1274]** death or disability." F & C bound itself for the duration of the contractual period to make no "Trade Sales" of paint or paint products in its existing sales territory or to current customers. To the **[**1803]** consulting agreement were appended lists of F & C customers, whose patronage was to be taken over by Prima Paint. In return for these lists, the covenant not to compete, and the

services of Mr. Jelin, Prima Paint agreed to pay F & C certain percentages of its receipts from the listed customers and from all others, such payments not to exceed $ 225,000 over the life of the agreement. The agreement took into account the possibility that Prima Paint might encounter financial difficulties, including bankruptcy, but no corresponding reference was made to possible financial problems which might be encountered by F & C. The agreement stated that it "embodies the entire understanding of the parties **[*398]** on the subject matter." Finally, the parties agreed to a broad arbitration clause, which read in part:

"Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration in the City of New York, in accordance with the rules then obtaining of the American Arbitration Association . . . ."

The first payment by Prima Paint to F & C under the consulting agreement was due on September 1, 1965. None was made on that date. Seventeen days later, Prima Paint did pay the appropriate amount, but into escrow. It notified attorneys for F & C that in various enumerated respects their client had broken both the consulting agreement and the earlier purchase agreement. Prima Paint's principal contention, so far as presently relevant, was that F & C had fraudulently represented that it was solvent and able to perform its contractual obligations, whereas it was in fact insolvent and intended to file a petition under Chapter XI of the Bankruptcy Act, 52 Stat. 905, *11 U. S. C. § 701 et seq.*, shortly after execution of the consulting agreement. Prima Paint noted that such a petition was filed by F & C on October 14, 1964, one week after the contract had been signed. F & C's response, on October 25, was to serve a "notice of intention to arbitrate." On November 12, three days before expiration of its time to answer this "notice," Prima Paint filed suit in the United States District Court for the Southern District of New York, seeking rescission of the consulting agreement on the basis of the alleged fraudulent inducement. n2 The complaint asserted that the federal court had diversity jurisdiction.

----------Footnotes----------

n2 Although the letter to F & C's attorneys had alleged breaches of both consulting and purchasing agreements, and the fraudulent inducement of both, the complaint did not refer to the earlier purchase agreement, alleging only that Prima Paint had been "fraudulently induced to accelerate the execution and closing date of the [consulting] agreement herein, from October 21, 1964 to October 7, 1964. . . ."

----------End Footnotes----------

[*399] Contemporaneously with the filing of its complaint, Prima Paint petitioned the District Court for an order enjoining F & C from proceeding with the arbitration. F & C cross-moved to stay the court action pending arbitration. F & C contended that the issue presented -- whether there was fraud in the inducement of the consulting agreement -- was a question for the arbitrators and not for the District Court. Cross-affidavits were filed on the merits. On behalf of Prima Paint, the charges in the complaint were reiterated. Affiants for F & C attacked the sufficiency **[***1275]** of Prima Paint's allegations of fraud, denied that misrepresentations had been made during negotiations, and asserted that Prima Paint had relied exclusively upon delivery of the lists, the promise not to compete, and the availability of Mr. Jelin. They contended that Prima Paint had availed itself of these considerations for nearly a year without claiming "fraud," noting that Prima Paint was in no position to claim ignorance of the bankruptcy proceeding since it had participated therein in February of 1965. They added that F & C was revested with its assets in March of 1965.

[*HR1A]** The District Court granted F & C's motion to stay the action **[**1804]** pending arbitration, holding that a charge of fraud in the inducement of a contract containing an arbitration clause as broad as this one was a question for the arbitrators and not for the court. For this proposition it relied on *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc., 271 F.2d 402 (C. A. 2d Cir. 1959)*, cert. granted, *362 U.S. 909*, dismissed under *Rule 60, 364 U.S. 801 (1960)*. The Court of Appeals for the Second Circuit dismissed Prima Paint's appeal. It held that the contract in question evidenced a transaction involving interstate commerce; that under the controlling *Robert* **[*400]** *Lawrence Co.* decision a claim of fraud in the inducement of the contract generally -- as opposed to the arbitration clause itself -- is for the arbitrators and not for the courts; and that this rule -- one of "national substantive law" -- governs even in the face of a contrary state rule. n3 We agree, albeit for somewhat different reasons, and we affirm the decision below.

----------Footnotes----------

n3 Whether a party seeking *rescission* of a contract on the ground of fraudulent inducement may in New York obtain judicial resolution of his claim is not entirely clear. Compare *Exercycle Corp.* v. *Maratta, 9 N. Y. 2d 329, 334, 174 N. E. 2d 463, 465 (1961),* and *Amerotron Corp.* v. *Maxwell Shapiro Woolen Co., 3 App. Div. 2d 899, 162 N. Y. S. 2d 214 (1957),* aff'd, *4 N. Y. 2d 722, 148 N. E. 2d 319 (1958),* with *Fabrex Corp.* v. *Winard Sales Co., 23 Misc. 2d 26, 200 N. Y. S. 2d 278 (1960).* In light of our disposition of this case, we need not decide the status of the issue under New York law.

----------End Footnotes----------

The key statutory provisions are § § 2, 3, and 4 of the United States Arbitration Act of 1925. [HN1] Section 2 provides that a written provision for arbitration "in any maritime transaction or a contract evidencing a transaction involving commerce . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." n4 Section 3 requires a federal court in which suit has been brought "upon any issue referable to arbitration under an agreement in writing for such arbitration" to stay the court action pending arbitration once it is satisfied that the issue is arbitrable under the agreement. Section 4 provides a federal remedy for a party "aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration," and directs the federal court to order arbitration once it is satisfied that an agreement for arbitration has been made and has not been honored. n5

----------Footnotes----------

n4 The meaning of "maritime transaction" and "commerce" is set forth in § 1 of the Act.

n5 See, *infra*, at 403-404.

----------End Footnotes----------

[*401]

[*HR2]** **[***HR3A]** In *Bernhardt v. Polygraphic Co., 350 U.S. 198 (1956),* this Court held that [HN2] the stay provisions of § 3, invoked here by respondent F & C, apply only to the two kinds of contracts specified in § § 1 and 2 of the Act, **[***1276]** namely those in admiralty or evidencing transactions in "commerce." Our first question, then, is whether the consulting agreement between F & C and Prima Paint is such a contract. We agree with the Court of Appeals that it is. Prima Paint acquired a New Jersey paint business serving at least 175 wholesale clients in a number of States, and secured F & C's assistance in arranging the transfer of manufacturing and selling operations from New Jersey to Maryland. n6 [HN3] The consulting agreement **[**1805]** was inextricably tied to this interstate transfer and to the continuing operations of an interstate manufacturing and wholesaling business. There could not be a clearer case of a contract evidencing a transaction in interstate commerce. n7

----------Footnotes----------

n6 This conclusion is amply supported by an affidavit submitted to the District Court by Prima Paint's own president, which read in part:

"The agreement entered into between the parties on October 7, 1964, contemplated and intended an orderly transfer of the assets of the defendant to the plaintiff, and further contemplated and intended that the defendant would consult, advise, assist and help the plaintiff so as to insure a smooth transition of manufacturing operations to Maryland from New Jersey, together with the sales and servicing of customer accounts and the retention of the said customers."

The affidavit's references to a "transfer of the assets" cannot fairly be read to mean only "expertise and know-how . . . and a covenant not to compete," as argued by counsel for petitioner.

[*HR3B]**

n7 It is suggested in dissent that, despite the absence of any language in the statute so indicating, we should construe it to apply only to "contracts between merchants for the interstate shipment of goods." Not only have we neither the desire nor the warrant so to amend the statute, but we find persuasive and authoritative evidence of a contrary legislative intent. See, *e. g.*, the House Report on this legislation which proclaims that "the control over interstate commerce [one of the bases for the legislation] reaches not only the actual physical interstate shipment of goods but also contracts relating to interstate commerce." H. R. Rep. No. 96, 68th Cong., 1st Sess., 1 (1924). We note, too, that were the dissent's curious narrowing of the statute correct, there would have been no necessity for Congress to have amended the statute to exclude certain kinds of employment contracts. See § 1. In any event, the anomaly urged upon us in dissent is manifested by the present case. It would be remarkable to say that a contract for the purchase of a single can of paint may evidence a transaction in interstate commerce, but that an agreement relating to the facilitation of the purchase of an entire interstate paint business and its re-establishment and operation in another State is not.

----------End Footnotes----------

[*402] Having determined that the contract in question is within the coverage of the Arbitration Act, we turn to the central issue in this case: whether a claim of fraud in the inducement of the entire contract is to be resolved by the federal court, or whether the matter is to be referred to the arbitrators. The courts of appeals have differed in their approach to this question. The view of the Court of Appeals for the Second Circuit, as expressed in this case and in others, n8 is that -- *except where the parties otherwise intend* -- arbitration clauses as a matter of federal law are "separable" from the contracts in which they are embedded, and that where no claim is made that fraud was directed to the arbitration clause itself, a broad arbitration clause will be held to encompass **[***1277]** arbitration of the claim that the contract itself was induced by fraud. n9 The Court of Appeals for the First **[*403]** Circuit, on the other hand, has taken the view that the question of "severability" is one of state law, and that where a State regards such a clause as inseparable a claim of fraud in the inducement must be decided by the court. *Lummus Co.* v. *Commonwealth Oil Ref. Co., 280 F.2d 915, 923-924* (C. A. 1st Cir.), cert. denied, *364 U.S. 911 (1960).* n10

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n8 In addition to *Robert Lawrence Co., supra,* see *In re Kinoshita & Co., 287 F.2d 951 (C. A. 2d Cir. 1961).* With respect to claims other than fraud in the inducement, the court has followed a similar process of analysis. See, *e. g., Metro Industrial Painting Corp.* v. *Terminal Constr. Co., 287 F.2d 382 (C. A. 2d Cir. 1961)* (dispute over performance); *El Hoss Engineer. & Transport Co.* v. *American Ind. Oil Co., 289 F.2d 346 (C. A. 2d Cir. 1961)* (where, however, the court found an intent not to submit the issue in question to arbitration).

n9 The Court of Appeals has been careful to honor evidence that the parties intended to withhold such issues from the arbitrators and to reserve them for judicial resolution. See *El Hoss Engineer. & Transport Co.* v. *American Ind. Oil Co., supra.* We note that categories of contracts otherwise within the Arbitration Act but in which one of the parties characteristically has little bargaining power are expressly excluded from the reach of the Act. See § 1.

n10 These cases and others are discussed in a recent Note, Commercial Arbitration in Federal Courts, *20 Vand. L. Rev. 607, 622-625 (1967).*

----------End Footnotes----------

[*HR4]** **[***HR5A]** With **[**1806]** respect to cases brought in federal court involving maritime contracts or those evidencing transactions in "commerce," we think that Congress has provided an explicit answer. That answer is to be found in § 4 of the Act, which provides a remedy to a party seeking to compel compliance with an arbitration agreement. [HN4] Under § 4, with respect to a matter within the jurisdiction of the federal courts save for the existence of an arbitration clause, the federal court is instructed to order arbitration to proceed once it is satisfied that "the making of the agreement for arbitration or the failure to comply [with the arbitration agreement] is not in issue." n11 Accordingly, if the claim is fraud in the inducement of the arbitration clause itself -- an issue which **[*404]** goes to the "making" of the agreement to arbitrate -- the federal court may proceed to adjudicate it. n12 But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally. Section 4 does not expressly relate to situations like the present in which a stay is sought of a federal action in order that arbitration may proceed. But it is inconceivable that Congress intended the rule to differ depending upon which party to the arbitration agreement first invokes the assistance of a federal court. We hold, therefore, that in passing upon a § 3

application for a stay while the parties arbitrate, a federal court may consider only issues relating to the making and performance of the agreement to arbitrate. In so concluding, we not only honor the plain meaning of the statute but also the unmistakably clear congressional purpose that the arbitration procedure, when selected by the parties to a contract, be speedy and not subject to delay and obstruction in the courts.

----------Footnotes----------

n11 [HN5] Section 4 reads in part: "The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. . . . If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof."

[*HR5B]**

n12 This position is consistent both with the decision in *Moseley v. Electronic Facilities, 374 U.S. 167, 171, 172 (1963),* and with the statutory scheme. As the "saving clause" in § 2 indicates, the purpose of Congress in 1925 was to make arbitration agreements as enforceable as other contracts, but not more so. To immunize an arbitration agreement from judicial challenge on the ground of fraud in the inducement would be to elevate it over other forms of contract -- a situation inconsistent with the "saving clause."

----------End Footnotes----------

[*HR6]** **[***HR7]** There **[***1278]** remains the question whether such a rule is constitutionally permissible. The point is made that, whatever the nature of the contract involved here, this case is in federal court solely by reason of diversity of citizenship, and that since the decision in *Erie R. Co.* v. *Tompkins, 304 U.S. 64 (1938),* federal courts are bound in diversity cases to follow state rules of decision in matters which are "substantive" rather than "procedural," **[*405]** or where the matter is "outcome determinative." *Guaranty Trust Co.* v. *York, 326 U.S. 99 (1945).* The question in this case, however, is not whether Congress may fashion federal substantive rules to govern questions arising in simple diversity cases. See *Bernhardt v. Polygraphic Co., supra, at 202,* and concurring opinion, at 208. Rather, the question is whether [HN6] Congress may prescribe how federal courts are to conduct themselves with respect to subject matter over which Congress plainly has power to legislate. The answer to that can only be in the affirmative. And it is clear beyond dispute that the federal arbitration statute **[**1807]** is based upon and confined to the incontestable federal foundations of "control over interstate commerce and over admiralty." H. R. Rep. No. 96, 68th Cong., 1st Sess., 1 (1924); S. Rep. No. 536, 68th Cong., 1st Sess., 3 (1924). n13

----------Footnotes----------

n13 It is true that the Arbitration Act was passed 13 years before this Court's decision in *Erie R. Co.* v. *Tompkins, supra,* brought to an end the regime of *Swift v. Tyson, 16 Pet. 1 (1842),* and that at the time of enactment Congress had reason to believe that it still had power to create federal rules to govern questions of "general law" arising in simple diversity cases -- at least, absent any state statute to the contrary. If Congress relied at all on this "oft-challenged" power, see *Erie R. Co., 304 U.S., at 69,* it was only supplementary to the admiralty and commerce powers, which formed the principal bases of the legislation. Indeed, Congressman Graham, the bill's sponsor in the House, told his colleagues that it "only affects contracts relating to interstate subjects and contracts in admiralty." 65 Cong. Rec. 1931 (1924). The Senate Report on this legislation similarly indicated that the bill "[relates] to maritime transactions and to contracts in interstate and foreign commerce." S. Rep. No. 536, 68th Cong., 1st Sess., 3 (1924).

Non-congressional sponsors of the legislation agreed. As Mr. Charles L. Bernheimer, chairman of the Arbitration Committee of the New York Chamber of Commerce, told the Senate subcommittee, the proposed legislation "follows the lines of the New York arbitration law, applying it to the fields wherein there is Federal jurisdiction. These fields are in admiralty and in foreign and interstate commerce." Hearing on S. 4213 and S. 4214, before the Subcommittee of the Senate Committee on the Judiciary, 67th Cong., 4th Sess., 2 (1923). In the joint House and Senate hearings, Mr. Bernheimer answered "Yes; entirely," to the statement of the chairman, Senator Sterling, that "What you have in mind is that this proposed legislation relates to contracts arising in interstate commerce." Joint Hearings on S. 1005 and H. R. 646 before the Subcommittees of the Committees on the Judiciary, 68th Cong., 1st Sess., 7 (1924). Mr. Julius Henry

Cohen, draftsman for the American Bar Association of the proposed bill, said the sponsor's goals were: "First . . . to get a State statute, *and then to get a Federal law to cover interstate and foreign commerce and admiralty*, and, third, to get a treaty with foreign countries." Joint Hearings, *supra*, at 16 (emphasis added). See also Joint Hearings, *supra*, at 27-28 (statement of Mr. Alexander Rose). Mr. Cohen did submit a brief to the Subcommittee urging a jurisdictional base broader than the commerce and admiralty powers, Joint Hearings, *supra*, at 37-38, but there is no indication in the statute or in the legislative history that this invitation to go beyond those powers was accepted, and his own testimony took a much narrower tack.

----------End Footnotes----------

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[*HR1B]** In the present case no claim has been advanced by Prima Paint that F & C fraudulently induced it **[***1279]** to enter into the agreement to arbitrate "any controversy or claim arising out of or relating to this Agreement, or the breach thereof." This contractual language is easily broad enough to encompass Prima Paint's claim that both execution and acceleration of the consulting agreement itself were procured by fraud. Indeed, no claim is made that Prima Paint ever intended that "legal" issues relating to the contract be excluded from arbitration, or that it was not entirely free so to contract. 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. The question which Prima Paint requested the District Court to adjudicate preliminarily to allowing arbitration to proceed is one **[*407]** not intended by Congress to delay the granting of a § 3 stay. Accordingly, the decision below dismissing Prima Paint's appeal is

Affirmed.

MR. JUSTICE HARLAN: In joining the Court's opinion I desire to note that I would also affirm the judgment below on the basis of *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc., 271 F.2d 402 (C. A. 2d Cir. 1959)*, cert. granted, *362 U.S. 909*, **[**1808]** dismissed under *Rule 60, 364 U.S. 801 (1960).*

DISSENTBY:
BLACK

DISSENT:

MR. JUSTICE BLACK, with whom MR. JUSTICE DOUGLAS and MR. JUSTICE STEWART join, dissenting.

The Court here holds that the United States Arbitration Act, *9 U. S. C. § § 1*-14, as a matter of federal substantive law, compels a party to a contract containing a written arbitration provision to carry out his "arbitration agreement" even though a court might, after a fair trial, hold the entire contract -- including the arbitration agreement -- void because of fraud in the inducement. The Court holds, what is to me fantastic, that the legal issue of a contract's voidness because of fraud is to be decided by persons designated to arbitrate factual controversies arising out of a valid contract between the parties. And the arbitrators who the Court holds are to adjudicate the legal validity of the contract need not even be lawyers, and in all probability will be nonlawyers, wholly unqualified to decide legal issues, and even if qualified to apply the law, not bound to do so. I am by no means sure that thus forcing a person to forgo his opportunity to try his legal issues in the courts where, unlike the situation in arbitration, he may have a jury trial and right to appeal, is not a denial of due process of law. I am satisfied, however, that Congress did not impose any such procedures in the Arbitration Act. And I am fully satisfied that a **[*408]** reasonable and fair reading of that Act's language and history shows that both Congress and the framers of the Act were at great pains to emphasize that nonlawyers designated to adjust and arbitrate factual controversies arising out of valid contracts would not trespass upon the courts' prerogative to decide the legal question of whether any legal contract exists upon which to base an arbitration.

I.

The agreement involved here is a consulting agreement in which **[***1280]** Flood & Conklin agreed to perform certain services for and not to compete with Prima Paint. The agreement contained an arbitration clause providing that "any controversy or claim arising out of or relating to this Agreement . . . shall be settled by arbitration in the City of New York." F & C, contending that Prima had failed to make a payment under the contract, sent Prima a "Notice of Intention to Arbitrate" pursuant to the New York Arbitration Act. n1 Invoking diversity jurisdiction, Prima brought this

action in federal district court to rescind the entire consulting agreement on the ground of fraud. The fraud allegedly consisted of F & C's misrepresentation at the time the contract was made, that it was solvent and able to perform the agreement, while in fact it was completely insolvent. Prima alleged that it would not have made any contract at all with F & C but for this misrepresentation. Prima simply contended that there was never a meeting of minds between the parties. F & C moved to stay Prima's lawsuit for rescission pending arbitration of the fraud issue raised by Prima. The lower courts, relying on the **[*409]** Second Circuit's decision in *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc., 271 F.2d 402,* cert. granted, *362 U.S. 909,* dismissed, *364 U.S. 801,* held that, as a matter of "national substantive law," the arbitration clause in the contract is "separable" from the rest of the contract and that allegations that go to the validity of the contract in general, as opposed to the arbitration clause in particular, are to be decided by the arbitrator, not the court.

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n1 N. Y. Civ. Prac. § 7503 (1963) provides that once a party is served with a notice of intention to arbitrate, "unless the party served applies to stay the arbitration within ten days after such service he shall thereafter be precluded from objecting that a valid agreement was not made . . . ."

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The Court today affirms this holding for three reasons, none of which is supported **[**1809]** by the language or history of the Arbitration Act. First, the Court holds that because the consulting agreement was intended to supplement a separate contract for the interstate transfer of assets, it is itself a "contract evidencing a transaction involving commerce," the language used by Congress to describe contracts the Act was designed to cover. But in light of the legislative history which indicates that the Act was to have a limited application to contracts between merchants for the interstate shipment of goods, n2 and in light of the express failure of Congress to use language **[*410]** making the Act applicable to all contracts which "affect commerce," the statutory language Congress **[***1281]** normally uses when it wishes to exercise its full powers over commerce, n3 I am not at all certain that the Act was intended to apply to this consulting agreement. Second, the Court holds that the language of § 4 of the Act provides an "explicit answer" to the question of whether the arbitration clause is "separable" from the rest of the contract in which it is contained. Section 4 merely provides that the court must order arbitration if it is "satisfied that the making of the agreement for arbitration . . . is not in issue." That language, considered alone, far from providing an "explicit answer," merely poses the further question of what kind of allegations put the making of the arbitration agreement in issue. Since both the lower courts assumed that but for the federal Act, New York law might apply and that under New York law a general allegation of fraud in the inducement puts into issue the making of the agreement to arbitrate (considered inseparable **[*411]** under New York law from the rest of the contract), n4 the **[**1810]** Court necessarily holds that federal law determines whether certain allegations put the making of the arbitration agreement in issue. And the Court approves the Second Circuit's fashioning of a federal separability rule which overrides state law to the contrary. The Court thus holds that the Arbitration Act, designed to provide merely a procedural remedy which would not interfere with state substantive law, authorizes federal courts to fashion a federal rule to make arbitration clauses "separable" and valid. And the Court approves a rule which is not only contrary to state law, but contrary to the intention of the parties and to accepted principles of contract law -- a rule which indeed elevates arbitration provisions above all other contractual provisions. As the Court recognizes, that result was clearly not intended by Congress. Finally, the Court summarily disposes of the problem raised by *Erie R. Co.* v. *Tompkins, 304 U.S. 64,* recognized as a serious constitutional problem in *Bernhardt v. Polygraphic* **[***1282]** *Co., 350 U.S. 198,* by insufficiently supported assertions that it is "clear beyond dispute" that Congress based the Arbitration Act on its power to regulate commerce and that "if Congress relied at all on" its power to create federal law for diversity cases, such reliance "was only supplementary."

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n2 The principal support for the Act came from trade associations dealing in groceries and other perishables and from commercial and mercantile groups in the major trading centers. *50 A. B. A. Rep. 357 (1925).* Practically all who testified in support of the bill before the Senate subcommittee in 1923 explained that the bill was designed to cover contracts between people in different States who produced, shipped, bought, or sold commodities. Hearing on S. 4213 and S. 4214 before the Subcommittee of the Senate Committee on the Judiciary, 67th Cong., 4th Sess., 3, 7, 9, 10 (1923). The same views were expressed in the 1924 hearings. When Senator Sterling suggested, "What you have in

mind is that this proposed legislation relates to contracts arising in interstate commerce," Mr. Bernheimer, a chief exponent of the bill, replied: "Yes; entirely. The farmer who will sell his carload of potatoes, from Wyoming, to a dealer in the State of New Jersey, for instance." Joint Hearings on S. 1005 and H. R. 646 before the Subcommittees of the Committees on the Judiciary, 68th Cong., 1st Sess., 7. See also *id.*, at 27.

n3 In some Acts Congress uses broad language and defines commerce to include even that which "affects" commerce. Federal Employers' Liability Act, 35 Stat. 65, § 1, as amended, *45 U. S. C. § 51;* National Labor Relations Act, 49 Stat. 450, § 2, as amended, *29 U. S. C. § 152* (7). In other instances Congress has chosen more restrictive language. Fair Labor Standards Act of 1938, 52 Stat. 1062, § 6, as amended, *29 U. S. C. § 206.* Prior to this case, this Court has always made careful inquiry to assure itself that it is applying a statute with the coverage that Congress intended, so that the meaning *in that statute* of "commerce" will be neither expanded nor contracted. The Arbitration Act is an example of carefully limited language. It covers only those contracts "involving commerce," and nowhere is there a suggestion that it is meant to extend to contracts "affecting commerce." The Act not only uses narrow language, but also is completely without any declaration of some national interest to be served or some nationwide comprehensive scheme of regulation to be created, and this absence suggests that Congress did not intend to exert its full power over commerce.

n4 Although F & C requested arbitration pursuant to New York law, n. 1, *supra*, it is not entirely clear that New York law would apply in absence of the federal Act. And, as the Court points out, it is not entirely clear whether New York courts would consider Prima's promise to arbitrate inseparable from the rest of the contract. But, since *Robert Lawrence* held and the lower courts here assumed that application of New York law would produce a different result, and since the Court deems the status of state law immaterial to this case, I have assumed throughout this opinion that, in the absence of the Arbitration Act, Prima would have been able to obtain *judicial* resolution of its fraud allegations under New York law.

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[*412] II.

Let us look briefly at the language of the Arbitration Act itself as Congress passed it. Section 2, the key provision of the Act, provides that "[a] written provision in . . . a contract . . . involving commerce 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.*" (Emphasis added.) Section 3 provides that "if any suit . . . be brought . . . *upon any issue referable to arbitration* under an agreement in writing for such arbitration, the court . . . *upon being satisfied that the issue involved in such suit . . . is referable to arbitration under such an agreement*, shall . . . stay the trial of the action until such arbitration has been had . . . ." n5 (Emphasis added.) The language of these sections could not, I think, raise doubts about their meaning except to someone anxious to find doubts. They simply mean this: an arbitration agreement is to be enforced by a federal court unless the court, not the arbitrator, finds grounds "at law or in equity for the revocation of any contract." Fraud, of course, is one of the most common grounds for revoking a contract. If the contract was procured by fraud, then, unless the defrauded party elects to affirm it, there is absolutely no contract, nothing to be arbitrated. Sections 2 and 3 of the Act assume the existence of a valid contract. They merely provide for enforcement where such a valid contract **[*413]** exists. These provisions were plainly designed to protect a person against whom arbitration is sought to be enforced from having to submit his legal issues as to validity of the contract to the arbitrator. The legislative history of the Act makes this clear. Senator Walsh of Montana, in hearings on the bill in 1923, observed, "The court has got to hear and determine **[**1811]** whether there is an agreement of arbitration, undoubtedly, and it is open to all defenses, equitable and legal, that would have existed at law . . . ." n6 Mr. Piatt, who represented the American Bar Association which drafted and supported the Act, was even more explicit: "I think this will operate something like an injunction process, except where he would attack it on the ground of fraud." n7 And then Senator Walsh replied: "If he should attack it on the ground of fraud, *to rescind the whole thing.* . . . I presume that it merely [is] a question of whether he did make the arbitration agreement or not, . . . and then he would possibly set up that he was misled about the contract and entered **[***1283]** into it by mistake . . . ." n8 It is evident that Senator Walsh was referring to situations in which the validity of the entire contract is called into question. And Mr. Bernheimer, who represented one of the chambers of commerce in favor of the bill, assured the Senate subcommittee that "the constitutional right to jury trial is adequately safeguarded" by the Act. n9 Mr. Cohen, the American Bar Association's draftsman of the bill, assured the members of Congress that the Act would not impair the right to a jury trial, because it deprives a person of that right only when he has voluntarily and validly waived it by agreeing to submit certain **[*414]** disputes to arbitration. n10 The court and a jury are to determine both the legal

existence and scope of such an agreement. The members of Congress revealed an acute awareness of this problem. On several occasions they expressed opposition to a law which would enforce even a valid arbitration provision contained in a contract between parties of unequal bargaining power. Senator Walsh cited insurance, employment, construction, and shipping contracts as routinely containing arbitration clauses and being offered on a take-it-or-leave-it basis to captive customers or employees. n11 He noted that such contracts "are really not voluntarily [*sic*] things at all" because "there is nothing for the man to do except to sign it; and then he surrenders his right to have his case tried by the court . . . ." n12 He was emphatically assured by the supporters of the bill that it was not their intention to cover such cases. The significant thing is that Senator Walsh was not thinking in terms of the arbitration provisions being "separable" parts of such contracts, parts which should be enforced without regard to why the entire contracts in which they were contained were agreed to. The issue for him was not whether an arbitration provision in a contract was made, but why, in the context of the entire contract and the circumstances **[*415]** of the parties, the entire contract was made. That is precisely the issue that a general allegation of fraud in the inducement raises: Prima contended that it would not have executed any contract, including the arbitration clause, if it were not for the fraudulent representations of F & C. Prima's agreement to an arbitration clause in a contract obtained by fraud was no more "voluntary" than an **[**1812]** insured's or employee's agreement to an arbitration clause in a contract obtained by superior bargaining power.

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n5 This section, unlike § 4, is expressly applicable to situations like the present one where a defendant in a case already pending in federal court moves for a stay of the lawsuit. In finding an "explicit answer" in a provision "not expressly" applicable, the Court almost completely ignores the language of § 3 and the proviso to § 2, a section which *Bernhardt* held to "define the field in which Congress was legislating." *350 U.S., at 201.*

n6 Senate Hearing, *supra*, at 5.

n7 *Ibid.*

n8 *Ibid.*

n9 Senate Hearing, *supra*, at 2.

n10 "The one constitutional provision we have got is that you have a right of trial by jury. But you can waive that. And you can do that in advance. Ah, but the question whether you waive it or not depends on whether that is your signature to the paper, or whether you authorized that signature, or whether the paper is a valid paper or not, whether it was delivered properly. So there is a question there which you have not waived the right of trial by jury on." Joint Hearings, *supra*, at 17.

It seems quite clear to me that Mr. Cohen was referring to a jury trial of allegations challenging the validity of the *entire* contract.

n11 Senate Hearing, *supra*, at 9-11. See also Joint Hearings, *supra*, at 15.

n12 Senate Hearing, *supra*, at 9.

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Finally, it is clear to me from the bill's sponsors' understanding of the function of arbitration that they never intended that the issue of fraud in the inducement be resolved by arbitration. They recognized two special values of arbitration: (1) the expertise of an **[***1284]** arbitrator to decide factual questions in regard to the day-to-day performance of contractual obligations, n13 and (2) the speed with which arbitration, as contrasted to litigation, could resolve disputes over performance of contracts and thus mitigate the damages and allow the parties to continue performance under the contracts. n14 Arbitration serves neither of these functions where a contract is sought to be rescinded on the ground of fraud. On the one hand, courts have far more expertise in resolving legal issues which go to the validity of a contract than **[*416]** do arbitrators. n15 On the other hand, where a party seeks to rescind a contract and his allegation of fraud in the inducement is true, an arbitrator's speedy remedy of this wrong should never result in resumption of performance under the contract. And if the contract were not procured by fraud, the court, under the summary trial procedures provided by the Act, may determine with little delay that arbitration must proceed. The only advantage of submitting the issue of fraud to arbitration is for the arbitrators. Their compensation corresponds to the

volume of arbitration they perform. If they determine that a contract is void because of fraud, there is nothing further for them to arbitrate. I think it raises serious questions of due process to submit to an arbitrator an issue which will determine his compensation. *Tumey v. Ohio, 273 U.S. 510.*

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n13 "Not all questions arising out of contracts ought to be arbitrated. It is a remedy peculiarly suited to the disposition of the ordinary disputes between merchants as to questions of fact -- quantity, quality, time of delivery, compliance with terms of payment, excuses for non-performance, and the like. It has a place also in the determination of the simpler questions of law -- the questions of law which arise out of these daily relations between merchants as to the passage of title, the existence of warranties, or the questions of law which are complementary to the questions of fact which we have just mentioned." Cohen & Dayton, The New Federal Arbitration Law, *12 Va. L. Rev. 265, 281 (1926).*

n14 See, *e. g.*, Senate Hearing, *supra*, at 3.

n15 "It [arbitration] is not a proper remedy for . . . questions with which the arbitrators have no particular experience and which are better left to the determination of skilled judges with a background of legal experience and established systems of law." Cohen & Dayton, *supra*, at 281.

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III.

With such statutory language and legislative history, one can well wonder what is the basis for the Court's surprising departure from the Act's clear statement which expressly excepts from arbitration "such grounds as exist at law or in equity for the revocation of any contract." Credit for the creation of a rationalization to justify this statutory mutilation apparently must go to the Second Circuit's opinion in *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc., supra.* In that decision Judge Medina undertook to resolve the serious constitutional problem which this Court had avoided in *Bernhardt* by holding the Act inapplicable to a diversity case involving an intrastate contract. That problem was whether the Arbitration **[*417]** Act, passed 13 years prior to *Erie R. Co.* v. *Tompkins, 304 U.S. 64,* could be constitutionally applied in a diversity case even though its application would require the federal court to enforce an agreement to arbitrate which the state court across the street would not enforce. *Bernhardt*'s holding that arbitration **[***1285]** is "outcome determinative," *350 U.S., at 203,* **[**1813]** and its recognition that there would be unconstitutional discrimination if an arbitration agreement were enforceable in federal court but not in the state court, *id., at 204,* posed a choice of two alternatives for Judge Medina. If he held that the Arbitration Act rested solely on Congress' power, widely recognized in 1925 but negated in *Erie*, to prescribe general federal law applicable in diversity cases, he would be compelled to hold the Act unconstitutional as applied to diversity cases under *Erie* and *Bernhardt.* n16 If he held that the Act rested on Congress' power to enact substantive law governing interstate commerce, then the *Erie-Bernhardt* problem would be avoided and the application of the Act to diversity cases involving commerce could be saved.

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n16 Mr. Justice Frankfurter chose this alternative in his concurring opinion in *Bernhardt, 350 U.S., at 208,* and even the Court there suggested that its pre-*Erie* decision in *Shanferoke Coal & Supply Corp.* v. *Westchester Service Corp., 293 U.S. 449,* which applied the Act to an interstate contract in a diversity case, might be decided differently under the *Bernhardt* holding that arbitration is outcome-determinative, *350 U.S., at 202.*

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The difficulty in choosing between these two alternatives was that neither, quite contrary to the Court's position, was "clear beyond dispute" upon reference to the Act's legislative history. n17 As to the first, it is clear that Congress intended the Act to be applicable in diversity cases involving interstate commerce and maritime **[*418]** contracts, n18 and to hold the Act inapplicable in diversity cases would be severely to limit its impact. As to the second alternative, it is clear that Congress in passing the Act relied primarily on its power to create general federal rules to govern federal

courts. Over and over again the drafters of the Act assured Congress: "The statute establishes a procedure in the Federal courts . . . . It rests upon the constitutional provision by which Congress is authorized to establish and control inferior Federal courts. So far as congressional acts relate to the procedure in the Federal courts, they are clearly within the congressional power." n19 And again: "The primary purpose of the statute **[***1286]** is to make enforcible in the Federal courts such agreements for arbitration, and for this purpose Congress rests solely upon its power to prescribe **[*419]** the jurisdiction and **[**1814]** duties of the Federal courts." n20 One cannot read the legislative history without concluding that this power, and not Congress' power to legislate in the area of commerce, was the "principal basis" of the Act. n21 Also opposed to the view that Congress intended to create substantive law to govern commerce and maritime transactions are the frequent statements in the legislative history that the Act was not intended to be "the source of . . . substantive law." n22 As Congressman Graham explained the Act to the House:

"It does not involve any new principle of law except to provide a simple method . . . in order to give enforcement . . . . *It creates no new legislation, grants no new rights, except a remedy* to enforce an agreement in commercial contracts and in **[*420]** admiralty contracts." 65 Cong. Rec. 1931 (1924). (Emphasis added.)

Finally, there are clear indications in the legislative history that the Act was not intended to make arbitration agreements enforceable in state courts n23 or to provide an independent federal-question basis for jurisdiction in federal courts apart from diversity jurisdiction. n24 The absence of both of these effects -- which normally follow from legislation of federal substantive law -- seems to militate against the view that Congress was creating a body of federal substantive law.

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n17 For an analysis of these alternatives, see generally, Symposium, Arbitration and the Courts, *58 Nw. U. L. Rev. 466 (1963);* Note, *69 Yale L. J. 847 (1960).*

n18 The House Report accompanying the Act expressly stated: "The purpose of this bill is to make valid and enforcible agreements for arbitration contained in contracts involving interstate commerce . . . *or which may be the subject of litigation in the Federal courts.*" H. R. Rep. No. 96, 68th Cong., 1st sess., 1 (1924) (emphasis added). Mr. Cohen and a colleague, commenting on the Act after its passage, explained: "The Federal courts are given jurisdiction to enforce such agreements whenever under the Judicial Code they would have had jurisdiction . . . . Where the basis of jurisdiction is diversity of citizenship, the dispute must involve $ 3000 as in suits at law." Cohen & Dayton, *supra*, at 267. See, *e. g.*, Committee on Commerce, Trade & Commercial Law, The United States Arbitration Law and Its Application, *11 A. B. A. J. 153, 156;* Note, *20 Ill. L. Rev. 111 (1925).* The bill, as originally drafted by the American Bar Association, *49 A. B. A. Rep. 51-52 (1924),* and introduced in the House, H. R. No. 646, 68th Cong., 1st Sess. (1924), 65 Cong. Rec. 11081-11082 (1924), expressly provided in § 8 "that if the basis of jurisdiction be diversity of citizenship . . . the district court . . . shall have jurisdiction . . . hereunder notwithstanding the amount in controversy is unascertained . . . ." Though that provision was deleted by the Senate, the omission was not intended substantially to alter the law. 66 Cong. Rec. 3004 (1925).

n19 Committee on Commerce, Trade & Commercial Law, *supra*, *11 A. B. A. J., at 154.*

n20 Joint Hearings, *supra*, at 38.

n21 Although Mr. Cohen, in a brief filed with Congress, suggested that Congress might rely on its power over commerce, he added that there were "questions which apparently can be raised in this connection," *id.*, at 38, and expressly denied that "the proposed law depends for its validity upon the exercise of the interstate-commerce and admiralty powers of Congress," *id.*, at 37. And when he testified, he made the point clearer:

"So what we have done . . . [in New York] is that we have . . . made it a part of our judicial machinery. That is what we have done. But it can not be done under our constitutional form of government and cover the great fields of commerce until you gentlemen do it, in the exercise of your power to confer jurisdiction on the Federal courts. The theory on which you do this is that you have the right to tell the Federal courts how to proceed." *Id.*, at 17.

The legislative history which the Court recites to support its assertion that Congress relied principally on its power over commerce consists mainly of statements that the Act was designed to cover only contracts in commerce, and that is certainly true. But merely because the Act was designed to enforce arbitration agreements only in contracts in

commerce, does not mean that Congress was primarily relying on its power over commerce in supplying that remedy of enforceability.

n22 Cohen & Dayton, *supra*, at 276.

n23 See, *e. g.*, Cohen & Dayton, *supra*, at 277; Committee on Commerce, Trade & Commercial Law, *supra*, at 155, 156. Mr. Rose, representing the Arbitration Society of America, suggested that the Act might have the beneficial effect of encouraging States to enact similar laws, Joint Hearings, *supra*, at 28, but Mr. Cohen assured Congress:

"Nor can it be said that the Congress of the United States, directing its own courts . . . , would infringe upon the provinces or prerogatives of the States. . . . The question of the enforcement relates to the law of remedies and not to substantive law. The rule must be changed for the jurisdiction in which the agreement is sought to be enforced . . . . There is no disposition therefore by means of the Federal bludgeon to force an individual State into an unwilling submission to arbitration enforcement." *Id.*, at 39-40.

n24 This seems implicit in § 3's provision for a stay by a "court in which such suit is pending" and § 4's provision that enforcement may be ordered by "any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties."

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Suffice **[***1287]** it to say that Judge Medina chose the alternative of construing the Act to create federal substantive law in order to avoid its emasculation under *Erie* and *Bernhardt*. But Judge Medina was not content to stop there with a **[**1815]** holding that the Act makes arbitration agreements in a contract involving commerce enforceable in federal court even though the basis of jurisdiction is diversity and state law does not enforce such **[*421]** agreements. The problem in *Robert Lawrence*, as here, was not whether an arbitration agreement is enforceable, for the New York Arbitration Act, upon which the federal Act was based, enforces an arbitration clause in the same terms as the federal Act. The problem in *Robert Lawrence*, and here, was rather whether the arbitration clause in a contract induced by fraud is "separable." Under New York law, it was not: general allegations of fraud in the inducement would, as a matter of state law, put in issue the making of the arbitration clause. So to avoid this application of state law, Judge Medina went further than holding that the federal Act makes agreements to arbitrate enforceable: he held that the Act creates a "body of law" that "encompasses questions of interpretation and construction as well as questions of validity, revocability and enforceability of arbitration agreements affecting interstate commerce or maritime affairs." *271 F.2d, at 409.*

Thus, 35 years after the passage of the Arbitration Act, the Second Circuit completely rewrote it. Under its new formulation, § 2 now makes arbitration agreements enforceable "save upon such grounds as exist at *federal* law for the revocation of any contract." And under § 4, before enforcing an arbitration agreement, the district court must be satisfied that "the making of the agreement for arbitration, *as a matter of federal law*, is not in issue." And then when Judge Medina turned to the task of "the formulation of the principles of federal substantive law necessary for this purpose," *271 F.2d, at 409*, he formulated the separability rule which the Court today adopts -- not because § 4 provided this rule as an "explicit answer," not because he looked to the intention of the parties, but because of his notion that the separability rule would further a "liberal policy of promoting arbitration." *271 F.2d, at 410.* n25

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n25 It should be noted that the New York courts apparently do not find any inconsistency between application of a nonseparability rule and that State's policy of enforcing arbitration agreements, a policy embodied in a statute from which the federal Act was copied.

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[*422] Today, without expressly saying so, the Court does precisely what Judge Medina did in *Robert Lawrence*. It is not content to hold that the Act does all it was intended to do: make arbitration agreements enforceable in federal courts if they are valid and legally existent under state law. The Court holds that the Act gives federal courts the right to fashion federal law, inconsistent with state law, to determine whether an arbitration agreement was made and what it

means. Even if Congress intended to create substantive rights by passage of the Act, I am wholly convinced that it did not intend to create such a sweeping body of federal substantive law completely to take away from the States their power to interpret contracts made by their own citizens in their own territory.

First. The legislative history is **[***1288]** clear that Congress intended no such thing. Congress assumed that arbitration agreements were recognized as valid by state and federal law. n26 Courts would give damages for their breach, but would simply refuse to specifically enforce them. Congress thus had one limited purpose in mind: to provide a party to such an agreement "a remedy formerly denied him." n27 "Arbitration under the Federal . . . [statute] is simply a new procedural remedy." n28 The Act "creates no new legislation, grants no new rights, except a remedy to enforce . . . ." n29 **[**1816]** The drafters of the Act were very explicit:

"A Federal statute providing for the enforcement of arbitration agreements does relate solely to procedure **[*423]** of the Federal courts. *It is no infringement upon the right of each State to decide for itself what contracts shall or shall not exist under its laws.* To be sure *whether or not a contract exists is a question of the substantive law of the jurisdiction wherein the contract was made.*" Committee on Commerce, Trade & Commercial Law, The United States Arbitration Law and Its Application, *11 A. B. A. J. 153, 154.* (Emphasis added.)

"Neither is it true that such a statute, declaring arbitration agreements to be valid, is the source of their existence as a matter of substantive law. . . .

"So far as the present law declares simply the policy of recognizing and enforcing arbitration agreements in the Federal courts it does not encroach upon the province of the individual States." Cohen & Dayton, The New Federal Arbitration Law, *12 Va. L. Rev. 265, 276-277.*

All this indicates that the § 4 inquiry of whether the making of the arbitration agreement is in issue is to be determined by reference to state law, not federal law formulated by judges for the purpose of promoting arbitration.

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n26 S. Rep. No. 536, 68th Cong., 1st Sess., 2 (1924); Joint Hearings, *supra*, at 38.

n27 Cohen & Dayton, *supra*, at 271.

n28 *Id., at 279.*

n29 65 Cong. Rec. 1931 (1924).

----------End Footnotes----------

[*HR8]** Second. The avowed purpose of the Act was to place arbitration agreements "upon the same footing as other contracts." n30 The separability rule which the Court applies to an arbitration clause does not result in equality between it and other clauses in the contract. I had always thought that a person who attacks a contract on the ground of fraud and seeks to rescind it has to seek rescission of the whole, not tidbits, and is not given the option of denying the existence of some clauses and affirming the existence of others. Here F & C agreed both to perform consulting services for Prima and not to **[*424]** compete with Prima. Would any court hold that those two agreements were separable, even though Prima in agreeing to pay F & C not to compete did not directly rely on F & C's representations of being solvent? The simple fact is that Prima would not have agreed to the covenant not to compete or to the arbitration clause but for F & C's fraudulent promise that it would be financially able to perform consulting services. As this Court held in *United States v. Bethlehem Steel Corp., 315 U.S. 289, 298:*

"Whether a number of promises constitute one contract [and are non-separable] or more than one is to be determined by inquiring 'whether the parties assented to all the promises as a single whole, so **[***1289]** that there would have been no bargain whatever, if any promise or set of promises were struck out.'"

Under this test, all of Prima's promises were part of one, inseparable contract.

----------Footnotes----------

n30 H. R. Rep. No. 96, 68th Cong., 1st Sess. (1924).

----------End Footnotes----------

Third. It is clear that had this identical contract dispute been litigated in New York courts under its arbitration act, Prima would not be required to present its claims of fraud to the arbitrator if the state rule of non-separability applies. The Court here does not hold today, as did Judge Medina, n31 that the body of federal substantive law created by federal judges under the Arbitration Act is required to be applied by state courts. A holding to that effect -- which the Court seems to leave up in the air -- would flout the intention of the framers of the Act. n32 Yet under this Court's opinion today -- that the Act supplies not only the remedy of enforcement but a body of federal doctrines to determine the validity **[**1817]** of an arbitration agreement -- failure to make the Act **[*425]** applicable in state courts would give rise to "forum shopping" and an unconstitutional discrimination that both *Erie* and *Bernhardt* were designed to eliminate. These problems are greatly reduced if the Act is limited, as it should be, to its proper scope: the mere enforcement in federal courts of valid arbitration agreements.

----------Footnotes----------

n31 "This is a declaration of national law equally applicable in state or federal courts." *271 F.2d, at 407.*

n32 See n. 23, *supra.*

----------End Footnotes----------

IV.

The Court's summary treatment of these issues has made it necessary for me to express my views at length. The plain purpose of the Act as written by Congress was this and no more: Congress wanted federal courts to enforce contracts to arbitrate and plainly said so in the Act. But Congress also plainly said that whether a contract containing an arbitration clause can be rescinded on the ground of fraud is to be decided by the courts and not by the arbitrators. Prima here challenged in the courts the validity of its alleged contract with F & C as a whole, not in fragments. If there has never been any valid contract, then there is not now and never has been anything to arbitrate. If Prima's allegations are true, the sum total of what the Court does here is to force Prima to arbitrate a contract which is void and unenforceable before arbitrators who are given the power to make final legal determinations of their own jurisdiction, not even subject to effective review by the highest court in the land. That is not what Congress said Prima must do. It seems to be what the Court thinks would promote the policy of arbitration. I am completely unable to agree to this new version of the Arbitration Act, a version which its own creator in *Robert Lawrence* practically admitted was judicial legislation. Congress might possibly have enacted such a version into law had it been able to foresee subsequent legal events, but I do not think this Court should do so.

I would reverse this case.

LEXSEE 517 us 681

DOCTOR'S ASSOCIATES, INC. AND NICK LOMBARDI, PETITIONERS v. PAUL CASAROTTO ET UX.

No. 95-559.

SUPREME COURT OF THE UNITED STATES

517 U.S. 681; 116 S. Ct. 1652; 134 L. Ed. 2d 902; 1996 U.S. LEXIS 3244; 64 U.S.L.W. 4370; 96 Cal. Daily Op. Service 3502; 96 Daily Journal DAR 5705; 9 Fla. L. Weekly Fed. S 599

April 16, 1996, Argued

May 20, 1996, Decided

PRIOR HISTORY:
ON WRIT OF CERTIORARI TO THE SUPREME COURT OF MONTANA.

DISPOSITION:
274 Mont. 3, 901 P.2d 596, reversed and remanded.

CASE SUMMARY

PROCEDURAL POSTURE: Petitioner, a corporation that was a national franchiser of restaurants, sought review of the judgment of the Supreme court of Montana, which reversed a decision in favor of petitioner in a suit filed by petitioner to force arbitration of a contract dispute with respondent franchisee, based on its finding that Mont. Code Ann. § 27-5-114(4) had rendered the parties' contractual arbitration provision unenforceable.

OVERVIEW: Petitioner, a corporation, was a national franchiser of a chain of restaurants. It entered into a franchise agreement with respondent. The agreement permitted respondent to open a restaurant in Montana. The franchise agreement stated that all contract controversies would be settled by arbitration. Respondent subsequently filed suit against petitioner and its agent in Montana state court alleging state law contract and tort claims relating to the franchise agreement. Petitioner successfully demanded arbitration of those claims pursuant to the contract agreement and the Federal Arbitration Act (Act), *9 U.S.C.S. § 2.* That judgment was reversed by the court below upon its finding that Mont. Code Ann. § 27-5-114(4) rendered the agreement's arbitration clause unenforceable because the arbitration clause did not appear underlined on the first page of the agreement as required by the statute. That judgment was reversed and remanded upon the court's holding that Montana's first-page notice requirement, which governed not any contract, but specifically and solely contracts subject to arbitration, was in conflict with § 2 of the Act and therefore displaced by the federal measure.

OUTCOME: The judgment was reversed because the Montana statute at issue was held to be in direct conflict with the Federal Arbitration Act. Therefore, the Montana statute was preempted by the federal law.

CORE TERMS: arbitration, arbitration clause, franchise agreement, notice requirement, enforceability, revocation, subject to arbitration, invalidate, enforceable, state-law, notice, save, irrevocable, underlined, preempted, declares, typed, Federal Arbitration Act, arbitration agreement, pending arbitration, oral argument, standard form, state rule, unenforceable, revocability, franchisor, first-page, footing, last term, agreements to arbitrate

LexisNexis(TM) HEADNOTES - Core Concepts

Labor & Employment Law > Collective Bargaining & Labor Relations > Arbitration > Enforcement
[HN1] The Federal Arbitration Act, *9 U.S.C.S. § 2*, declares written provisions for arbitration valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Labor & Employment Law > Collective Bargaining & Labor Relations > Arbitration > Limits
[HN2] State law, whether of legislative or judicial origin, is applicable if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally. A state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with the text of *9 U.S.C.S. § 2* of the Federal Arbitration Act.

Labor & Employment Law > Collective Bargaining & Labor Relations > Arbitration > Enforcement
Labor & Employment Law > Collective Bargaining & Labor Relations > Arbitration > Limits
[HN3] States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause upon such grounds as exist at law or in equity for the revocation of any contract. *9 U.S.C.S. § 2*. What States may not do is decide that a contract is fair enough to enforce all its basic terms, but not fair enough to enforce its arbitration clause. The Federal Arbitration Act (Act) makes any such state policy unlawful, for that kind of policy would place arbitration clauses on an unequal footing, directly contrary to the Act's language and Congress's intent.

Contracts Law > Defenses > Duress & Undue Influence
Labor & Employment Law > Collective Bargaining & Labor Relations > Arbitration > Enforcement
Contracts Law > Defenses > Unconscionability
[HN4] Generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening *9 U.S.C.S. § 2*.

Labor & Employment Law > Collective Bargaining & Labor Relations > Arbitration > Limits
[HN5] Courts may not invalidate arbitration agreements under state laws applicable only to arbitration provisions.

Labor & Employment Law > Collective Bargaining & Labor Relations > Arbitration > Limits
[HN6] By enacting *9 U.S.C.S. § 2*, Congress precluded states from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed upon the same footing as other contracts.

SYLLABUS:

When a dispute arose between parties to a standard form franchise agreement for the operation of a Subway sandwich shop in Montana, respondent franchisee sued petitioners, franchisor Doctor's Associates, Inc. (DAI), and its agent, Lombardi, in a Montana state court. The court stayed the lawsuit pending arbitration pursuant to the arbitration clause set out in ordinary type on page nine of the franchise agreement. The Montana Supreme Court reversed, holding that the arbitration clause was unenforceable because it did not meet the state-law requirement that "notice that a contract is subject to arbitration" be "typed in underlined capital letters on the first page of the contract. " Mont. Code Ann. § 27-5-114(4). DAI and Lombardi unsuccessfully argued that § 27-5-114(4) was preempted by § 2 of the Federal Arbitration Act (FAA), which declares written provisions for arbitration "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." In arguing for preemption, DAI and Lombardi dominantly relied on *Southland Corp. v. Keating, 465 U.S. 1, 79 L. Ed. 2d 1, 104 S. Ct. 852*, and *Perry v. Thomas, 482 U.S. 483, 96 L. Ed. 2d 426, 107 S. Ct. 2520*, in which this Court established that "state law . . . is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally," but not if the state-law principle "takes its meaning precisely from the fact that a contract to arbitrate is at issue." *Id., at 493, n. 9* (emphasis added). The Montana Supreme Court, however, thought *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ., 489 U.S. 468, 103 L. Ed. 2d 488, 109 S. Ct. 1248*, limited § 2's preemptive force and correspondingly qualified *Southland* and *Perry;* the proper inquiry, the Montana Supreme Court said, should focus not on the bare words of § 2 but on the question: Would the application of § 27-5-114(4)'s notice requirement undermine the FAA's goals and policies. In the Montana court's judgment, the notice requirement did not undermine these goals and policies, for it did not preclude arbitration agreements altogether. On remand from

this Court for reconsideration in light of *Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 130 L. Ed. 2d 753, 115 S. Ct. 834,* the Montana court adhered to its original ruling.

Held: Montana's first-page notice requirement, which governs not "any contract," but specifically and solely contracts "subject to arbitration," conflicts with the FAA and is therefore displaced by the federal measure. Generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2, see, *e. g., Allied-Bruce, 513 U.S. at 281,* but courts may not invalidate arbitration agreements under state laws applicable *only* to arbitration provisions, see, *e. g., ibid.* By enacting § 2, Congress precluded States from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed upon the same footing as other contracts. *Scherk v. Alberto-Culver Co., 417 U.S. 506, 511, 41 L. Ed. 2d 270, 94 S. Ct. 2449.* Montana's § 27-5-114(4) directly conflicts with § 2 because the State's law conditions the enforceability of arbitration agreements on compliance with a special notice requirement not applicable to contracts generally. The Montana Supreme Court misread *Volt* in reaching a contrary conclusion. The state rule examined in *Volt* determined only the efficient order of proceedings; it did not affect the enforceability of the arbitration agreement itself. Applying § 27-5-114(4) here, in contrast, would invalidate the arbitration clause. Pp. 686-688.

COUNSEL:
Mark R. Kravitz argued the cause for petitioners. With him on the briefs were Jeffrey R. Babbin and H. Bartow Farr III.

Lucinda A. Sikes argued the cause for respondents. With her on the brief were David C. Vladeck, Paul Alan Levy, and William C. Watt. *

----------Footnotes----------

* Briefs of amici curiae urging reversal were filed for the American Council of Life Insurance by Patricia A. Dunn, Stephen J. Goodman, and Phillip E. Stano; for the International Franchise Association et al. by William J. Fitzpatrick and John F. Verhey; and for Kaiser Foundation Health Plan, Inc., by Kennedy P. Richardson.

Deborah M. Zuckerman, Steven S. Zaleznick, and Patricia Sturdevant filed a brief for the American Association of Retired Persons et al. as amici curiae urging affirmance.

----------End Footnotes----------

JUDGES:
GINSBURG, J., delivered the opinion of the Court, in which REHNQUIST, C. J., and STEVENS, O'CONNOR, SCALIA, KENNEDY, SOUTER, and BREYER, JJ., joined. THOMAS, J., filed a dissenting opinion, post, p. 689.

OPINIONBY:
GINSBURG

OPINION:

[*906]**

[*682] [1654]** JUSTICE GINSBURG delivered the opinion of the Court.

[*HR1A]** This case concerns a standard form franchise agreement for the operation of a Subway sandwich shop in Montana. **[*683]** When a dispute arose between parties to the agreement, franchisee Paul Casarotto sued franchisor Doctor's Associates, Inc. (DAI), and DAI's Montana development agent, Nick Lombardi, in a Montana state court. DAI and Lombardi sought to stop the litigation pending arbitration pursuant to the arbitration clause set out on page nine of the franchise agreement.

[HN1] The Federal Arbitration Act (FAA or Act) declares written provisions for arbitration "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." *9 U.S.C. § 2.* Montana law, however, declares an arbitration clause unenforceable unless "notice that [the] contract is subject to arbitration" is "typed in underlined capital letters on the first page of the contract." Mont. Code Ann. § 27-5-114(4) (1995). The question here presented is whether Montana's law is compatible with the federal Act. We hold that

Montana's first-page notice requirement, which governs not "any contract," but specifically and solely contracts "subject to arbitration," conflicts with the FAA and is therefore displaced by the federal measure.

I

Petitioner DAI is the national franchisor of Subway sandwich shops. In April 1988, DAI entered a franchise agreement with respondent Paul Casarotto, which permitted Casarotto to open a Subway shop in Great Falls, Montana. The franchise agreement stated, on page nine and in ordinary type: "Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration . . . ." App. 75. **[***907]**

In October 1992, Casarotto sued DAI and its agent, Nick Lombardi, in Montana state court, alleging state-law contract and tort claims relating to the franchise agreement. DAI demanded arbitration of those claims, and successfully moved in the Montana trial court to stay the lawsuit pending arbitration. *Id.*, at 10-11.

[*684] The Montana Supreme Court reversed. *Casarotto v. Lombardi, 268 Mont. 369, 886 P.2d 931 (1994).* That court left undisturbed the trial court's findings that the franchise agreement fell within the scope of the FAA and covered the claims Casarotto stated against DAI and Lombardi. The Montana Supreme Court held, however, that Mont. Code Ann. § 27-5-114(4) rendered the agreement's arbitration clause unenforceable. The Montana statute provides:

"Notice that a contract is subject to arbitration . . . shall be typed in underlined capital letters on the first page of the contract; and unless such notice is displayed thereon, the contract may not be subject to arbitration."

Notice of the arbitration clause in the franchise agreement did not appear on the first page of the contract. Nor was anything relating to the clause typed in underlined capital letters. Because the State's statutory **[**1655]** notice requirement had not been met, the Montana Supreme Court declared the parties' dispute "not subject to arbitration." *268 Mont. at 382, 886 P.2d at 939.*

DAI and Lombardi unsuccessfully argued before the Montana Supreme Court that § 27-5-114(4) was preempted by § 2 of the FAA. n1 DAI and Lombardi dominantly relied on our decisions in *Southland Corp. v. Keating, 465 U.S. 1, 79 L. Ed. 2d 1, 104 S. Ct. 852 (1984),* and *Perry v. Thomas, 482 U.S. 483, 96 L. Ed. 2d 426, 107 S. Ct. 2520 (1987).* In *Southland,* we held that § 2 of the FAA applies in state as well as federal courts, see *465 U.S. at 12,* and "withdr[aws] the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration," *id., at 10.* We noted in the pathmarking *Southland* **[*685]** decision that the FAA established a "broad principle of enforceability," *id., at 11,* and that § 2 of the federal Act provided for revocation of arbitration agreements only upon "grounds as exist at law or in equity for the revocation of any contract." In *Perry,* we reiterated: "[HN2] State law, whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally. A state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with [the text of § 2]." *482 U.S. at 493, n. 9.*

----------Footnotes----------

n1 Section 2 provides, in relevant part:

"A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." *9 U.S.C. § 2.*

----------End Footnotes----------

The Montana Supreme Court, however, read our decision in *Volt Information Sciences, Inc. v. Board of* **[***908]** *Trustees of Leland Stanford Junior Univ., 489 U.S. 468, 103 L. Ed. 2d 488, 109 S. Ct. 1248 (1989),* as limiting the preemptive force of § 2 and correspondingly qualifying *Southland* and *Perry. 268 Mont. at 378-381, 886 P.2d at 937-939.* As the Montana Supreme Court comprehended *Volt,* the proper inquiry here should focus not on the bare words of § 2, but on this question: Would the application of Montana's notice requirement, contained in § 27-5-114(4), "undermine the goals and policies of the FAA." *268 Mont. at 381, 886 P.2d at 938* (internal quotation marks omitted). Section 27-5-114(4), in the Montana court's judgment, did not undermine the goals and policies of the FAA, for the

notice requirement did not preclude arbitration agreements altogether; it simply prescribed "that before arbitration agreements are enforceable, they be entered knowingly." *Id., at 381, 886 P 2d at 939.*

DAI and Lombardi petitioned for certiorari. Last Term, we granted their petition, vacated the judgment of the Montana Supreme Court, and remanded for further consideration in light of *Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 130 L. Ed. 2d 753, 115 S. Ct. 834 (1995).* See *515 U.S. 1129 (1995).* In *Allied-Bruce*, we restated what our decisions in *Southland* and *Perry* had established:

[*686] "[HN3] States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause 'upon such grounds as exist at law or in equity for the revocation of *any* contract.' *9 U.S.C. § 2* (emphasis added). What States may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause. The Act makes any such state policy unlawful, for that kind of policy would place arbitration clauses on an unequal 'footing,' directly contrary to the Act's language and Congress's intent." *513 U.S. at 281.*

On remand, without inviting or permitting further briefing or oral argument, n2 the Montana **[**1656]** Supreme Court adhered to its original ruling. The court stated: "After careful review, we can find nothing in the *[Allied-Bruce]* decision which relates to the issues presented to this Court in this case." *Casarotto v. Lombardi, 274 Mont. 3, 7, 901 P.2d 596, 598 (1995).* Elaborating, the Montana court said it found "no suggestion in *[Allied-Bruce]* that the principles from *Volt* on which we relied [to uphold § 27-5-114(4)] have been modified in any way." *Id., at 8, 901 P.2d at 598-599.* We again granted certiorari, *516 U.S. 1036 (1996),* and now reverse.

----------Footnotes----------

n2 Dissenting Justice Gray thought it "cavalier" of her colleagues to ignore the defendants' request for an "opportunity to brief the issues raised by the . . . remand and to present oral argument." *Casarotto v. Lombardi, 274 Mont. 3, 9-10, 901 P.2d 596, 599-600 (1995).*

----------End Footnotes----------

II

[*HR2A]** Section 2 of the FAA provides that written arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of *any* contract." *9 U.S.C. § 2* (emphasis added). Repeating our observation in *Perry*, the text of § 2 declares that state law may be **[***909]** applied "*if* that law arose to govern issues **[*687]** concerning the validity, revocability, and enforceability of contracts generally." *482 U.S. at 493, n. 9.* Thus, [HN4] generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2. See *Allied-Bruce, 513 U.S. at 281; Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 483-484, 104 L. Ed. 2d 526, 109 S. Ct. 1917 (1989); Shearson/American Express Inc. v. McMahon, 482 U.S. 220, 226, 96 L. Ed. 2d 185, 107 S. Ct. 2332 (1987).*

[*HR1B]** **[***HR2B]** **[***HR3A]** [HN5] Courts may not, however, invalidate arbitration agreements under state laws applicable *only* to arbitration provisions. See *Allied-Bruce, 513 U.S. at 281; Perry, 482 U.S. at 493, n. 9.* [HN6] By enacting § 2, we have several times said, Congress precluded States from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed "upon the same footing as other contracts." *Scherk v. Alberto-Culver Co., 417 U.S. 506, 511, 41 L. Ed. 2d 270, 94 S. Ct. 2449 (1974)* (internal quotation marks omitted). Montana's § 27-5-114(4) directly conflicts with § 2 of the FAA because the State's law conditions the enforceability of arbitration agreements on compliance with a special notice requirement not applicable to contracts generally. The FAA thus displaces the Montana statute with respect to arbitration agreements covered by the Act. See 2 I. Macneil, R. Speidel, T. Stipanowich, & G. Shell, Federal Arbitration Law § 19.1.1, pp. 19:4-19:5 (1995) (under *Southland* and *Perry*, "state legislation requiring greater information or choice in the making of agreements to arbitrate than in other contracts is preempted"). n3

[*HR2C]** **[***HR3B]**

----------Footnotes---------- n3 At oral argument, counsel for Casarotto urged a broader view, under which § 27-5-114(4) might be regarded as harmless surplus. See Tr. of Oral Arg. 29-32. Montana could have invalidated the arbitration clause in the franchise agreement under general, informed consent principles, counsel suggested. She asked us to regard § 27-5-114(4) as but one illustration of a cross-the-board rule: Unexpected provisions in adhesion contracts must be conspicuous. See also Brief for Respondents 21-24. But the Montana Supreme Court announced no such sweeping rule. The court did not assert as a basis for its decision a generally applicable principle of "reasonable expectations" governing any standard form contract term. Cf. *Transamerica Ins. Co. v. Royle, 202 Mont. 173, 180, 656 P.2d 820, 824 (1983)* (invalidating provision in auto insurance policy that did not "honor the reasonable expectations" of the insured). Montana's decision trains on and upholds a particular statute, one setting out a precise, arbitration-specific limitation. We review that disposition, and no other. It bears reiteration, however, that a court may not "rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what . . . the state legislature cannot." *Perry v. Thomas, 482 U.S. 483, 493, n. 9, 96 L. Ed. 2d 426, 107 S. Ct. 2520 (1987).*

----------End Footnotes----------

[*688] The Montana Supreme Court misread our *Volt* decision and therefore reached a conclusion in this case at odds with our rulings. *Volt* involved an arbitration agreement that incorporated state procedural rules, one of which, on the facts of that case, called for arbitration to be stayed pending the resolution of a related judicial proceeding. The state rule examined in *Volt* determined only the efficient order of proceedings; it did not **[**1657]** affect the enforceability of the arbitration agreement itself. We held that applying the state rule **[***910]** would not "undermine the goals and policies of the FAA," *489 U.S. at 478,* because the very purpose of the Act was to "ensur[e] that private agreements to arbitrate are enforced according to their terms," *id., at 479.*

[*HR1C]** **[***HR2D]** Applying § 27-5-114(4) here, in contrast, would not enforce the arbitration clause in the contract between DAI and Casarotto; instead, Montana's first-page notice requirement would invalidate the clause. The "goals and policies" of the FAA, this Court's precedent indicates, are antithetical to threshold limitations placed specifically and solely on arbitration provisions. Section 2 "mandate[s] the enforcement of arbitration agreements," *Southland, 465 U.S. at 10,* "save upon such grounds as exist at law or in equity for the revocation of any contract," *9 U.S.C. § 2.* Section 27-5-114(4) of Montana's law places arbitration agreements in a class apart from "any contract," and singularly limits their validity. The State's prescription is thus inconsonant with, and is therefore preempted by, the federal law.

[*689] * * *

For the reasons stated, the judgment of the Supreme Court of Montana is reversed, and the case is remanded for further proceedings not inconsistent with this opinion.

It is so ordered.

DISSENTBY:
THOMAS

DISSENT:

JUSTICE THOMAS, dissenting.

For the reasons given in my dissent last term in *Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 130 L. Ed. 2d 753, 115 S. Ct. 834 (1995),* I remain of the view that § 2 of the Federal Arbitration Act, *9 U.S.C. § 2,* does not apply to proceedings in state courts. Accordingly, I respectfully dissent.

STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

Frank H. Murkowski, Governor

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MAR 10 2003

March 10, 2003

Representative Ethan Berkowitz
House of Representatives
State Capitol
Mail Stop 3100
Juneau, AK 99801-1182

Re: HB 83, relating to the Revised Uniform Arbitration Act

Dear Representative Berkowitz:

I have reviewed HB 83, relating to adoption of the Revised Uniform Arbitration Act, and I see no legal issues that would impact implementation of the bill. The bill follows the recommendations of the authors of "Is the Revised Uniform Arbitration Act a Good Fit for Alaska," 19 Alaska Law Review 339.

Please don't hesitate to contact me if you have any questions about specific provisions of the bill.

Sincerely,

GREGG D. RENKES
ATTORNEY GENERAL

By: Keith B. Levy
Assistant Attorney General

KBL:sro

cc: David Marquez

TABLE 1: COMPARISON OF RUAA AND UAA SECTIONS

Revised Uniform Arbitration Act	Uniform Arbitration Act
§ 1 Definitions*	UAA § 17 for definition of "court"
§ 2 Notice*	No corresponding UAA provision
§ 3 When Act applies*	UAA § 3, § 20, and § 25
§ 4 Effect of Agreement to Arbitrate; Non-Waivable Provisions*	No corresponding UAA provision
§ 5 [Application] for Judicial Relief	UAA § 16
§ 6 Validity of Agreement**	UAA § 1
§ 7 [Motion] to Compel or Stay Arbitration	UAA § 2
§ 8 Provisional Remedies*	No corresponding UAA provision
§ 9 Initiation of Arbitration*	No corresponding UAA provision
§10 Consolidation of Separate Arbitration Proceedings*	No corresponding UAA provision
§ 11 Appointment of Arbitrator; Service as a Neutral Arbitrator	UAA § 3
§ 12 Disclosure By Arbitrator*	No corresponding UAA provision
§ 13 Action by Majority	UAA § 4
§ 14 Immunity of Arbitrator; Competency to Testify; Attorney's Fees and Costs*	No corresponding UAA provision
§ 15 Arbitration Process**	UAA § 5
§ 16 Representation By Lawyer	UAA § 6
§ 17 Witnesses; Subpoenas; Depositions; Discovery**	UAA § 7
§ 18 Judicial Enforcement of Preaward Rulingby Arbitrator*	No corresponding UAA provision
§ 19 Award	UAA § 8
§ 20 Change Award By Arbitrator	UAA § 9
§ 21 Remedies; Fees and Expenses ofArbitration Proceeding**	UAA 10
§ 22 Confirmation of Award	UAA § 11
§ 23 Vacating Award One additional basis for vacatur	UAA § 12
§ 24 Modification or Correction of Award	UAA § 13
§ 25 Judgement on Award; Attorney's Fees and Litigation Expenses*	No corresponding UAA provision for attorney fees, but see UAA §§ 14 and 15 regarding judgment on award
§ 26 Jurisdiction	UAA § 17
§ 27 Venue	UAA § 18
§ 28 Appeals	UAA § 19
§ 29 Uniformity of Application and Construction	UAA § 21
§ 30 Relationship to Electronic Signatures in Global and National Commerce Act*	No corresponding UAA provision
§ 31 Effective Date	UAA § 3, § 20, and § 25
§ 32 Repeal	UAA § 3, § 20, and § 25
§ 33 Savings Clause	UAA § 3, § 20, and § 25
* – New Section ** – Partially New Section	