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Sarah Rudolph Cole

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Arbitration and State Action

*Sarah Rudolph Cole**

The increasing popularity of arbitration among employers and businesses has triggered skepticism and concern among the plaintiffs' employment discrimination bar and consumer advocacy groups. Groups critical of the use of arbitration often characterize the very advantages of this mechanism—its streamlined procedures, speed, and confidentiality—as problematic. According to them, streamlined procedures and speed may disproportionately impact the party who had less bargaining power when the parties negotiated the original agreement. Confidentiality suggests surreptitious and underhanded tactics swept under the rug.¹ With little empirical support, critics, particularly of the use of predispute arbitration agreements, began an attack in the mid-1990s to unseat arbitration as a popular mechanism for dispute resolution among employers and employees, as well as businesses and consumers.²

The attack on arbitration has taken different forms over time. Originally, plaintiffs asserted a type of jurisdictional challenge, claiming that statutory claims, such as discrimination, fell outside the scope of

* Professor of Law, Moritz College of Law, The Ohio State University. My thanks to E. Gary Spitko, Douglas R. Cole, June Carbone, Ruth Colker, Ned Foley, David Goldberger, Brad Joondeph, Ron Krotoszynski, Marc Spindelman, Stephen J. Ware, and the participants in a faculty workshop at the Moritz College of Law, The Ohio State University, for their helpful comments on earlier drafts of this Article. Additional thanks to Kristen Blankely, Sabrina Riggs, and Natalie Hostacky for their research assistance.

1. Several courts have found that a confidentiality provision in an arbitration agreement is unconscionable because such provisions favor the repeat participant in the arbitration process by making it difficult to determine whether the arbitrator or the arbitration process was biased. Moreover, courts find that the lack of public disclosure of arbitration results may favor repeat players over individuals. *See* *Ting v. AT&T*, 319 F.3d 1126, 1151–52 (9th Cir. 2003), *cert. denied*, 124 S. Ct. 53 (2003); *Plaskett v. Bechtel Int'l, Inc.*, 243 F. Supp. 2d 334, 343 (D.V.I. 2003); *Acorn v. Household Fin. Corp.*, 211 F. Supp. 2d 1160, 1172 (N.D. Cal. 2002); *Luna v. Household Fin. Corp.*, 236 F. Supp. 2d 1166, 1182–83 (W.D. Wash. 2002).

2. *See, e.g.*, Thomas E. Carbonneau, *Arbitration and the U.S. Supreme Court: A Plea for Statutory Reform*, 5 OHIO ST. J. ON DISP. RESOL. 231, 275 (1990); Margaret A. Jacobs, *Woman Claims Arbiters of Bias are Biased, Too*, WALL ST. J., Sept. 19, 1994, at B1. Senator Russell Feingold also introduced legislation designed to invalidate predispute arbitration agreements between employers and employees. *See* S. Res. 2405, 103d Cong. (2d Sess. 1994); HR Res. 4981, 103d Cong. (2d Sess. 1994). The proposed legislation was never enacted.

arbitration agreements.³ Repeated failure of that claim precipitated a redirection of effort. Today, challenges to arbitration primarily focus on contractual theories, particularly unconscionability.⁴ While the ultimate verdict on this tactic is still out, arbitration's critics have sought to open another front in the war on arbitration. In particular, they have begun leveling constitutional attacks against employment and consumer arbitration, contending that all forms of arbitration, whether court-ordered or contractual, are subject to the Constitution's procedural due process requirements.⁵

A necessary prerequisite for constitutional challenges to arbitration, however, is some theory under which arbitration constitutes state action. Constitutional prohibitions, after all, apply only to state action.⁶ Of course, state action is easier to see in some forms of arbitration than in others. For example, court-ordered arbitration, when a court mandates that the parties participate in arbitration as a prerequisite to a court filing, clearly involves state action.⁷ A second form of arbitration, agency-initiated arbitration, occurs when an agency requires entities it regulates to register with a private organization that utilizes arbitration to resolve disputes involving its registrants. Although mandatory registration may create state action when the private organization mandates participation in arbitration, commentators have largely ignored this issue when

3. *See, e.g., Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 27 (1991) (rejecting such a claim).

4. Unconscionability is the primary means used to challenge employer or business-drafted arbitration agreements. Courts have been fairly receptive to these challenges, striking down arbitration agreements as unconscionable when class actions are prohibited, when an employee must pay an arbitrator's fees or a high filing fee, or when the arbitral process is skewed in favor of the employer or business. *See, e.g., Morrison v. Circuit City Stores, Inc.*, 317 F.3d 646 (6th Cir. 2003); *Hooters of Am., Inc. v. Phillips*, 173 F.3d 933 (4th Cir. 1999); *Cole v. Burns Int'l Sec. Servs.*, 105 F.3d 1465 (D.C. Cir. 1997); *Brower v. Gateway 2000, Inc.*, 676 N.Y.S.2d 569 (N.Y. 1998).

5. *See* Edward Brunet, *Arbitration and Constitutional Rights*, 71 N.C. L. REV. 81, 109 (1992); Kenneth R. Davis, *Due Process Right to Judicial Review of Arbitral Punitive Damages Awards*, 32 AM. BUS. L.J. 583 (1995); Jeffery L. Fisher, *State Action and the Enforcement of Compulsory Arbitration Agreements Against Employment Discrimination Claims*, 18 HOFSTRA LAB. & EMP. L.J. 289, 295-97 (2000); Richard C. Reuben, *Constitutional Gravity: A Unitary Theory of Alternative Dispute Resolution and Public Civil Justice*, 47 UCLA L. REV. 949 (2000); Jean R. Sternlight, *Rethinking the Constitutionality of the Supreme Court's Preference for Binding Arbitration: A Fresh Assessment of Jury Trial, Separation of Powers, and Due Process Concerns*, 72 TUL. L. REV. 1493 (1997).

6. The Constitution applies to nongovernmental actors in some situations. For example, the Thirteenth Amendment to the Constitution prohibits all people from owning or being slaves. U.S. CONST. amend. XIII, § 1.

7. *See infra* Part II.A.

contemplating reform of the securities arbitration process.⁸ Courts have examined the question, but have universally rejected a finding of state action in this context.⁹ This article will demonstrate that, at least in the securities industry, since the SEC imposes a requirement that brokers and dealers register with a private self-regulatory organization (SRO), state action is present when SROs mandate that brokers and dealers participate in arbitration.

Finally, there is contractual arbitration, that is, arbitration that arises out of an agreement between two private parties. At least as an initial matter, it is difficult to see how agreements between private parties regarding arbitration involve state action. Critics, however, have developed a theory of state action in this context to attempt to allow them to overcome this hurdle. Under this arbitration as state action theory, critics contend that contractual arbitration gives rise to state action when courts enforce contractual commitments to participate in arbitration and when courts subsequently enforce arbitration awards.¹⁰ If contractual arbitration is state action, then the arbitral forum must satisfy the constitutional requirements of the Due Process and Equal Protection clauses.

Because a finding of state action in any type of arbitration would have significant, and likely adverse, implications on the continued use of arbitration, careful consideration of whether state action is present in arbitration is necessary. This article attempts to provide that analysis and offers a critique of the arbitration as state action theory that others have advanced.

Courts have had several opportunities to address the question of whether judicial enforcement of contractual arbitration agreements rises to the level of state action. Interestingly, courts and commentators are deeply divided on the question of whether state action is present in contractual arbitration. Every federal court considering the question has

8. Stephen J. Ware is a notable exception. See Stephen J. Ware, *Employment Arbitration and Voluntary Consent*, 25 HOFSTRA L. REV. 83, 145–46 (1996) (noting that because “securities laws constitute an occupational licensing scheme that conditions a license to be a securities employee” on an agreement to arbitrate, state action is present.). See also Karl E. Neudorfer, *Defining Due Process Down: Punitive Awards and Mandatory Arbitration of Securities Disputes*, 15 OHIO ST. J. ON DISP. RES. 207, 231–40 (1999).

9. *Perpetual Sec., Inc. v. Tang*, 290 F.3d 132, 138 (2d Cir. 2002); *Desiderio v. Nat’l Ass’n of Secs. Dealers, Inc.*, 191 F.3d 198, 207 (2d Cir. 1999); *Duffield v. Robertson Stephens & Co.*, 144 F.3d 1182, 1200–02 (9th Cir. 1998).

10. See, e.g., *Sternlight*, *supra* note 5 (arguing that mandatory arbitration involves state action).

concluded that there is no state action present in contractual arbitration.¹¹ Yet virtually every commentator addressing the same issue has concluded that the opposite is true.¹² What accounts for this extraordinary dichotomy is not clear. Perhaps the muddied waters of the state action doctrine are responsible. More likely, the commentators interested in this issue, particularly Professors Reuben and Sternlight, are hopeful that encouraging the adoption of the state action doctrine in arbitration will accomplish by constitutional means what legislatures have failed to provide—a wholesale cessation of the use of predispute arbitration agreements between one-shot and repeat players, such as employers and employees.¹³ Courts, by contrast, enamored with the

11. See *Perpetual Sec.*, 290 F.3d at 137–39; *Kovaleskie v. SBC Capital Mkts, Inc.*, 167 F.3d 361, 368–69 (7th Cir. 1999); *Desiderio*, 191 F.3d at 206–07; *Lodal v. Home Ins. Co. of Ill.*, 156 F.3d 1230 (table), No. 95-2187, 1998 WL 393766, at *6 (6th Cir. 1998); *Duffield*, 144 F.3d at 1200–02; *United Food & Commercial Workers Union v. Safeway, Inc.*, 165 F.3d 918 (table), No. 98-15148, 1998 WL 904719, at *1 (9th Cir. 1998); *Davis v. Prudential Sec., Inc.*, 59 F.3d 1186, 1190–92 (11th Cir. 1995); *Fed. Deposit Ins. Corp. v. Air Fla. Sys., Inc.*, 822 F.2d 833, 842 n.9 (9th Cir. 1987); *Elmore v. Chi. & Ill. Midland Ry. Co.*, 782 F.2d 94, 96 (7th Cir. 1986); *Dluhos v. Strasberg*, No. 00-CV-3163, 2001 WL 1720272, at *5, *11, (D.N.J. 2001), *aff'd in part*, 321 F.3d 365 (3d Cir. 2003); *Brannon v. Mass. Mut. Life Ins., Co.*, No. Civ A. 99-3497, 2000 WL 122241, at *5 (E.D. La. 2000); *D'Alessio v. N.Y. Stock Exch., Inc.*, 125 F. Supp. 2d 656, 659 (S.D.N.Y. 2000); *Moorning-Brown v. Bear, Stearns & Co., Inc.* No. 96 Civ. 4130 JSR HBP, 2000 WL 16935, at *3 (S.D.N.Y. 2000); *Century Aluminum of W. Va. v. United Steelworkers of Am.*, 82 F. Supp. 2d 580, 583 n.4 (S.D. W. Va. 2000); *In re Knepp*, 229 B.R. 821, 840–41 (N.D. Ala. 1999) (following Eleventh Circuit law despite disagreement regarding arbitration as state action); *Martens v. Smith Barney, Inc.*, 190 F.R.D. 134, 137–38 (S.D.N.Y. 1999); *McDonough v. Equitable Life Assurance Soc'y of the United States*, No. 98 Civ. 3921 (BSJ), 1999 WL 731424, at *3 n.4 (S.D.N.Y. 1999); *Cremin v. Merrill Lynch Pierce Fenner & Smith, Inc.*, 957 F. Supp. 1460, 1465–70 (N.D. Ill. 1997); *Mantle v. The Upper Deck Co.*, 956 F. Supp. 719, 734–35 (N.D. Tex. 1997); *Glennon v. Dean Witter Reynolds, Inc.*, No. 3-93-0847, 1994 WL 757709, at *10–13 (M.D. Tenn. 1994); *Cort v. Am. Arbitration Ass'n*, 795 F. Supp. 970, 973 (N.D. Cal. 1992); *Austern v. Chi. Bd. Options Exch., Inc.*, 716 F. Supp. 121, 125 (S.D.N.Y. 1989).

No state courts have found state action in contractual arbitration, and only one state court suggests that a state action finding is possible. See *Williams v. O'Connor*, 310 N.W.2d 825, 826 (Mich. Ct. App. 1981). One federal district court stated in dicta that it “respectfully doubts that the rationale for the result set forth in *Davis* . . .—viz. that an arbitration award involves no state action—is well-founded.” *Commonwealth Assocs. v. Letsos*, 40 F. Supp. 2d 170, 177 n.37 (S.D.N.Y. 1999).

12. See *Brunet*, *supra* note 5, at 109; *Davis*, *supra* note 5, at 583; *Fisher*, *supra* note 5, at 295–297; *Reuben*, *supra* note 5, at 992; *Sternlight*, *supra* note 5, at 40. *But see* Stephen J. Ware, *Punitive Damages in Arbitration: Contracting Out of Government's Role in Punishment and Federal Preemption of State Law*, 63 *FORDHAM L. REV.* 529, 559–67 (1994).

13. *Lewis Maltby, Paradise Lost—How the Gilmer Court Lost the Opportunity for Alternative Dispute Resolution to Improve Civil Rights*, 12 *N.Y.L. SCH. J. HUM. RTS.* 1, 1–10 (1994); *Reuben*, *supra* note 5, at 1032 (arguing that courts do not scrutinize repeat player and one-shot player agreements carefully enough); *Katherine Van Wezel Stone, Mandatory Arbitration of*

efficiency of arbitration, would prefer not to undermine the process by finding state action. Whatever the reason, additional attention to this question, and to the question of whether agency-initiated arbitration involves state action, would provide normative benefits for courts and commentators alike.

In Part I, this Article will offer a basic outline of the Court's current state action doctrine. In Part II, the Article will use the Court's basic approach and apply it to three different types of arbitration: (1) court-ordered arbitration, (2) agency-initiated arbitration, and (3) contractual arbitration. The application of the state action doctrine in these contexts yields quite different results and suggests that constitutional violations that arise in private dispute resolution procedures are not actionable under the constitution while violations in agency-initiated arbitration, at least in the securities industry, as well as court-ordered arbitration, are. Part II will also critique current commentary and judicial decisions on the question of whether state action is present in agency-initiated or contractual arbitration. Part III offers a brief conclusion.

I. THE STATE ACTION DOCTRINE

The Supreme Court's state action doctrine explains that constitutional protections of individual rights and liberties apply only to the actions of governmental bodies.¹⁴ Unless the person or entity charged with a constitutional violation is acting on behalf of the state, no constitutional action against that person or entity can be maintained.¹⁵ The state action doctrine is important because it assures the maintenance of the public/private dichotomy that lies at the very heart of liberal democratic theory.¹⁶ In order to maintain the dichotomy, the state action

Individual Employment Rights: The Yellow Dog Contract of the 1990s, 73 DENV. U. L. REV. 1017, 1020 (1996).

14. See, e.g., *Edmonson v. Leesville Concrete Co.*, 500 U.S. 614, 619 (1991) (noting that private parties' actions lie outside the scope of the Constitution's protection generally).

15. See, e.g., *id.* at 624 (holding that a private litigant's exercise of peremptory challenges invokes the formal authority of the court and is state action).

16. See JOHN LOCKE, *SECOND TREATISE OF GOVERNMENT* 44–73 (T. Peardon ed., Prentice Hall 1952) (1690); Paul Schiff Berman, *Cyberspace and the State Action Debate: The Cultural Value of Applying Constitutional Norms to "Private" Regulation*, 71 U. COLO. L. REV. 1263, 1288–89 (2000); G. Sidney Buchanan, *A Conceptual History of the State Action Doctrine: The Search for Governmental Responsibility (Part I)*, 34 HOUS. L. REV. 333, 336 (1997); Erwin Chemerinsky, *Rethinking State Action*, 80 NW. U. L. REV. 503, 535–36 (1985); Sheila S. Kennedy, *When Is Private Public? State Action in the Era of Privatization and Public-Private Partnerships*, 11 GEO. MASON U. CIV. RTS. L.J. 203, 209 (2001).

doctrine dictates that courts must carefully consider the implications of extending to nongovernmental actors constitutional norms designed to limit governmental power. Proper consideration is essential to ensure that the boundaries between judicial and legislative authority are maintained,¹⁷ that constitutional norms are not extended so far that they become liberty-infringing rather than liberty-enhancing,¹⁸ and that federal governmental authority remains properly circumscribed.¹⁹ At the same time, a state action doctrine is necessary in order to prevent the state from doing through private actors what it could not do for itself: infringe on or violate the rights of others.

While the theory underlying state action is well understood, determining whether an individual is a state actor when she allegedly violates constitutional rights is not easily predictable. As numerous commentators have stated, predicting when and under what circumstances state action exists is both one of the more difficult and important questions confronting the federal courts today.²⁰

The threshold inquiry in any case involving a private individual or entity accused of violating a person's constitutional rights is whether that

17. See *Lugar v. Edmondson Oil Co., Inc.*, 457 U.S. 922, 936–37 (1982) (noting that court enforcement of state action transfers authority from the legislative to judicial branch, rendering the regulatory framework subject to judicial modification); *Costa del Moral v. Servicios Legales de Puerto Rico*, 63 F. Supp. 2d 165, 172 (D.P.R. 1999); *Parker v. Clarke*, 905 F. Supp. 638, 642 (E.D. Mo. 1995); *Total Television Entm't Corp. v. Chestnut Hill Vill. Assocs.*, 145 F.R.D. 375, 378–79 (E.D. Pa. 1992); *Smith v. Wood*, 649 F. Supp. 901, 908 (E.D. Pa. 1986); *Matter of Johnson*, 460 N.Y.S.2d 932, 946 (N.Y. App. Div. 1983) (Niehoff, J., dissenting).

18. For example, procedural due process requirements that ensure governmental action is neither arbitrary nor capricious would greatly disrupt the operation of a private business or dispute resolution system. See Chemerinsky, *supra* note 16, at 535–36 (“[T]he doctrine protects individual liberty by defining a zone of private conduct that does not have to comply with the Constitution.”).

19. See *Lugar*, 457 U.S. at 936; *Flagg Bros. v. Brooks*, 436 U.S. 149, 156 (1978); *Jackson v. Metro. Edison Co.*, 419 U.S. 345, 349–50 (1974); *The Civil Rights Cases*, 109 U.S. 3, 11–12 (1883); *Cnty. Med. Ctr. v. Emergency Med. Servs. of Northeastern Pa.*, 712 F.2d 878, 879 (3d Cir. 1983); *Elam v. Montgomery County*, 573 F. Supp. 797, 803 (S.D. Ohio 1983); see also Chemerinsky, *supra* note 16, at 536 (“[L]imiting the Constitution’s protections to state action preserves state sovereignty by giving the states almost complete authority to regulate private behavior.”).

20. See Charles L. Black, Jr., *Foreword: “State Action,” Equal Protection, and California’s Proposition 13*, 81 HARV. L. REV. 69, 95 (1967) (asserting that state action is a “conceptual disaster area”); Chemerinsky, *supra* note 16, at 503; Ronald J. Krotoszynski, Jr., *Back to the Briarpatch: An Argument in Favor of Constitutional Meta-Analysis in State Action Determinations*, 94 MICH. L. REV. 302, 304 (1995) (applying the state action test is difficult); Reuben, *supra* note 5, at 990; Martin A. Schwartz & Erwin Chemerinsky, *Dialogue on State Action*, 16 TOURO L. REV. 775, 776 (2000) (noting the Supreme Court’s silence on the issue); Ware, *supra* note 12, at 559; R. George Wright, *State Action and State Responsibility*, 23 SUFFOLK U. L. REV. 685, 685 (1989).

private entity may be regarded as a state actor.²¹ According to Supreme Court jurisprudence, private conduct becomes state action in three situations. First, state action exists when the government becomes excessively entangled with private behavior and encourages or causes the unconstitutional behavior.²² Second, state action exists when a private entity performs what is traditionally an exclusively public function.²³ Third, state action exists when the private actor and the government have a “symbiotic relationship.”²⁴

In the case of court-ordered, agency-initiated, and contractual arbitration, the only relevant categories are the first two: entanglement and public function.²⁵ Thus, only those two state action tests will be addressed here.

21. Krotoszynski, *supra* note 20, at 314.

22. See *Am. Mfrs. Mut. Ins. Co. v. Sullivan*, 526 U.S. 40, 52 (1999); *Rendell-Baker v. Kohn*, 457 U.S. 830 (1982) (holding no close nexus between private school’s personnel decisions and state even though state extensively regulates school); *Blum v. Yaretsky*, 457 U.S. 991 (1982) (holding that the state is not responsible for nursing home decision to transfer patients even though state extensively regulates nursing homes); *Flagg Bros.*, 436 U.S. at 165–66; *Jackson*, 419 U.S. at 357; *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 170 (1970); *Reitman v. Mulkey*, 387 U.S. 369, 378 (1967); *Moose Lodge No. 107 v. Irvis*, 407 U.S. 163, 173 (1972); *Mentavlos v. Anderson*, 249 F.3d 301, 311 (4th Cir. 2001); *Lansing v. City of Memphis*, 202 F.3d 821, 828 (6th Cir. 2000); *DeBauche v. Trani*, 191 F.3d 499, 507 (4th Cir. 1999).

23. *Edmonson v. Leesville Concrete Co.*, 500 U.S. 614, 621 (1991); *Rendell-Baker*, 457 U.S. at 842; *Flagg Bros.*, 436 U.S. at 157; *Jackson*, 419 U.S. at 353.

24. *Rendell-Baker*, 457 U.S. at 843 (citing *Burton v. Wilmington Parking Auth.*, 365 U.S. 715 (1961) (defining symbiotic relationship)).

25. To establish a symbiotic relationship that turns a private entity into a state actor, courts engage in a “highly contextual” inquiry that focuses on whether the private entity receives state subsidies or aid. See *Burton*, 365 U.S. at 722–23; A. Michael Froomkin, *Wrong Turn in Cyberspace: Using ICANN to Route Around the APA and the Constitution*, 50 DUKE L.J. 17, 123 (2000) (citing *J.K. v. Dillenberg*, 836 F. Supp. 694, 698 (D. Ariz. 1993)). In *Burton*, the Court emphasized that the correct inquiry involved “sifting facts and weighing circumstances” to determine if there is a symbiotic relationship. 365 U.S. at 722. The Court determined in *Burton* that the public funds provided to the facility, together with state agency ownership and operation, created a symbiotic relationship. *Id.* *Burton* was the high watermark for the symbiotic relationship test. Today, the Court will find symbiotic relationships only in cases involving direct governmental aid to the alleged state actor. See JOHN E. NOWAK ET AL., CONSTITUTIONAL LAW § 12.4, at 528 (6th ed. 2000). In arbitration, direct government subsidies to the alleged wrongdoer, the arbitral litigant, are nonexistent. Even when the government pays the neutral private third party, which happens only in court-ordered arbitration, application of the symbiotic relationship test will result in a finding that the arbitrator is a state actor, a fact that this article concedes. Because no direct subsidy is provided to the arbitral litigants in court-ordered or contractual arbitration, the symbiotic relationship test is inapposite.

A. Entanglement

To determine whether government is entangled in private conduct, a court considers whether there is such a close nexus between the state and the challenged action that the action may be “fairly treated as that of the State itself.”²⁶ Action taken by private entities with the mere approval or acquiescence of the state is not state action;²⁷ entanglement may only be found if the challenged activity results from the state’s provision of “significant encouragement, either overt or covert.”²⁸

The question of whether the nexus between the state and the private action is sufficiently close to transform the private party into a public party has always been a fact-intensive inquiry.²⁹ Nevertheless, certain principles guide Supreme Court jurisprudence. Essentially, the Supreme Court divides entanglement cases into two categories: (1) cases that involve direct or indirect racial decision making, and (2) cases that do not involve race-based classifications. To understand how the Court would analyze arbitration—specifically, enforcement of arbitration agreements and arbitration awards—one must first understand how the Court approaches each category. Once the Supreme Court’s analysis of each category is understood, this article will consider whether arbitration falls into category one or category two and then apply the appropriate state action analysis. A finding that there is state action in any type of arbitration would result in substantial revision of the arbitration process in order to bring it into conformity with constitutional due process requirements.

1. The intersection of race and state action

A review of cases involving direct and indirect racial decision making suggests that the Court is more willing to find state action when a court must determine a party’s skin color in order to ascertain the

26. *Brentwood Acad. v. Tenn. Secondary Sch. Athletic Ass’n*, 531 U.S. 288, 295 (2001) (citing *Jackson*, 419 U.S. at 351); see also *Flagg Bros.*, 436 U.S. at 166; *Adickes*, 398 U.S. at 170; *Moose Lodge*, 407 U.S. at 173.

27. *Blum*, 457 U.S. at 1004–05; *Flagg Bros.*, 436 U.S. at 164–65; *Jackson*, 419 U.S. at 357.

28. *Blum*, 457 U.S. at 1004.

29. *Brentwood*, 531 U.S. at 295–96; *Lugar v. Edmonson Oil Co., Inc.*, 457 U.S. 922, 939 (1982) (stating that the state action determination is a “necessarily fact-bound inquiry”); *Burton*, 365 U.S. at 726 (explaining that a state action finding “can be determined only in the framework of the peculiar facts or circumstances present”); see also *Jackson*, 419 U.S. at 349–50; *Moose Lodge*, 407 U.S. at 172 (quoting *Burton*, 365 U.S. at 722).

correct outcome.³⁰ So, for instance, as discussed more fully below, enforcement of a private contract that prevents sales to African Americans would entail state action (as it requires the court to ascertain a party's skin color to know whether the provision was violated), notwithstanding that the contractual provision itself was the result of choices made by seemingly private actors.³¹ By contrast, the Court will not find state action when a party seeks to enforce a facially neutral law but does so in a discriminatory manner (for example, a homeowner who only reports trespassing when the trespasser is Hispanic). The reason, perhaps, is that, because the Court is not called upon to expressly participate in the racial decision making (that is, the court need not ascertain a party's skin color to resolve the trespassing complaint), the nexus, and thus the entanglement, is more attenuated.³² Thus, an important factor in assessing the role of state action in arbitration is to determine the nature of the Court's involvement in racial decision making.

In this section, the article analyzes the cases that most clearly elaborate the Court's jurisprudence on the intersection between race and state action: *Shelley v. Kraemer*,³³ *Bell v. Maryland*,³⁴ and *Evans v. Abney*.³⁵ After reconstructing the Court's basic state action framework in this area, the article will then more closely examine those cases that commentators have argued are perhaps the most similar factually to the arbitration context; namely, those cases in which the Court has addressed whether a private litigant is a state actor when he exercises a peremptory challenge to a juror in court.

Shelley involved landowners attempting to enforce a racially restrictive covenant to prevent Shelley, an African-American, from taking possession of property subject to that covenant.³⁶ The Court concluded that when private parties seek to enforce racially restrictive covenants in court, and the court requires compliance with the discriminatory covenants, the seemingly private enforcement effort becomes state action.³⁷ Thus, according to the Court in *Shelley*, state

30. See *Shelley v. Kraemer*, 334 U.S. 1 (1948).

31. See *id.*; *infra* Part II.C.

32. See *Evans v. Abney*, 396 U.S. 435 (1970); *Bell v. Maryland*, 378 U.S. 226 (1964).

33. 334 U.S. 1 (1948).

34. 378 U.S. 226 (1964).

35. 396 U.S. 435 (1970).

36. 334 U.S. at 5–6.

37. *Id.* at 20.

action is present when a court commands a private party to comply with a private contract that requires racial discrimination. Following *Shelley*, then, a judicial finding of entanglement is more likely when private parties seek judicial assistance to enforce racially discriminatory agreements.³⁸

Many commentators worried about *Shelley*'s possible implications. According to some, *Shelley* could be interpreted to create state action in any contract dispute that resulted in court involvement.³⁹ Concerns over *Shelley*'s implications never materialized, however. The Court, perhaps concerned about the loss of the critical dichotomy between public and private law and the constitutionalization of contract law, has rejected the invitation to extend *Shelley*.⁴⁰ Since *Shelley*, no other case has found state action solely on the basis that the court enforced an otherwise private arrangement.⁴¹

38. See Louis H. Pollak, *Racial Discrimination and Judicial Integrity: A Reply to Professor Wechsler*, 108 U. PA. L. REV. 1, 13 (1959) (“[A]n employer may freely contract with a union to maintain a lily-white shop, but that the provision is one which fails whenever the employer’s self-interest so dictates: the union cannot coerce compliance through an injunction or an award of damages.”).

39. Some commentators caution against an extension of *Shelley*, fearing the consequences the constitutionalization of contract law would have on private interaction. See, e.g., Mark C. Alexander, *Attention, Shoppers: The First Amendment in the Modern Shopping Mall*, 41 ARIZ. L. REV. 1, 24 (1999); Francis A. Allen, *Remembering Shelley v. Kraemer: Of Public and Private Worlds*, 67 WASH. U. L.Q. 709 (1989); Chemerinsky, *supra* note 16, at 505; Lino A. Graglia, *State Action: Constitutional Phoenix*, 67 WASH. U. L.Q. 777 (1989); Louis Henkin, *Shelley v. Kraemer: Notes for a Revised Opinion*, 110 U. PA. L. REV. 473 (1962); Kennedy, *supra* note 16, at 215 n.78; Krotoszynski, *supra* note 20, at 316; Shelley Ross Saxer, *Shelley v. Kraemer’s Fiftieth Anniversary: “A Time for Keeping; A Time for Throwing Away,”* 47 U. KAN. L. REV. 61 (1998); Steven Siegal, *The Constitution and Private Government: Toward the Recognition of Constitutional Rights in Private Residential Communities Fifty Years After Marsh v. Alabama*, 6 WM. & MARY BILL RTS. J. 461, 501 (1998) (arguing that a literal, unbound reading of *Shelley* could extend to all private transactions enforced by the courts).

40. Judicial decisions that disadvantage racial minorities do not involve state action unless there is some nonneutral involvement of the court with the private action. Thus, a court can uphold a trespass conviction based on a private person’s decision not to allow racial minorities on his property. Because neither the state nor the court has “prompted or required” the private person’s discriminatory behavior, state action does not arise. See *Bell v. Maryland*, 378 U.S. 226 (1964); NOWAK ET AL., *supra* note 25, § 12.3, at 521. By contrast, in *Shelley*, the Court interfered in a private, nondiscriminatory transaction, mandating a racial distinction in the sale of property.

41. *Evans v. Abney*, 396 U.S. 435, 445 (1970) (“[T]he situation presented in this case is also easily distinguishable from that presented in *Shelley* . . .”); *Bell*, 378 U.S. at 328 (Black, J., dissenting) (refusing to extend *Shelley*); *Davis v. Prudential Sec., Inc.*, 59 F.3d 1186, 1191 (11th Cir. 1995) (“[T]he holding of *Shelley*, however, has not been extended beyond the context of race discrimination.”); *Jojola v. Wells Fargo Bank, No. C71-900 SAW*, 1973 WL 158166, at *4 (N.D. Cal. 1973) (*Shelley* limited to its facts); Brunet, *supra* note 12, at 111 (same).

Commentators have, however, exaggerated *Shelley's* influence. If the contract the Court enforced in *Shelley* had not been racially restrictive *on its face*, the argument that applying *Shelley* in subsequent cases would constitutionalize contracts might be viable.⁴² Moreover, *Shelley* is an unusual case that will not likely be repeated. The Court's decision turned on the fact that the lower court had to look at the color of Shelley's skin in order to determine whether to enforce the contract. Without race as a factor, the enforcement of a facially neutral covenant would not have been state action.⁴³

The Court's refusal to extend *Shelley* has resulted in reluctance to find state action, even in comparable situations where race discrimination is a consequence of the private litigants' behavior. For example, in *Bell v. Maryland*, the Court considered whether a business owner could use state trespass laws to prosecute minorities who did not leave his premises after he refused to serve them at his restaurant.⁴⁴ While the Court vacated the trespass convictions on other grounds, the dissent, written by Justice Black, did not find state action because neither the state nor the court compelled the private person's discriminatory behavior.⁴⁵ Although discriminatory enforcement of laws may result from the private person's actions, the government need not question the motives of the party seeking relief, nor determine the alleged trespassers' skin color, in order to enforce the law.⁴⁶ In other words, when a private actor utilizes a neutral law in a discriminatory manner, the Court will not find state action. A majority of the Court ultimately adopted Justice Black's *Bell* dissent and found that a private group or individual's decision to exclude minorities from one's premises did not amount to state action.⁴⁷

42. In *Shelley*, enforcing the covenant resulted in judicial encouragement of racial discrimination. Because state encouragement of racial discrimination is a particularly egregious and, in modern times, a unique use of state power, it is easy to distinguish from judicial enforcement of facially neutral private contracts.

43. Unlike other cases involving state exercise of coercive power, the *Shelley* case involved a court's enforcement of a covenant that was contrary to the wishes of both parties to the case and resulted in race discrimination. *Shelley v. Kraemer*, 334 U.S. 1, 19 (1948). This element likely added to the Court's willingness to overturn the lower court decisions. As with the race aspect of *Shelley*, this aspect of the case is unusual and unlikely to be repeated.

44. 378 U.S. 226 (1964).

45. *Id.* at 318 (Black, J., dissenting).

46. *Id.* at 332 (Black, J., dissenting).

47. *Moose Lodge No. 107 v. Irvis*, 407 U.S. 163 (1972) (holding that there is no state action when the state does not encourage private club's decision to restrict membership based on race).

Similarly, in *Evans v. Abney*,⁴⁸ the Court considered whether state action exists when a court permits land to revert to descendants of a senator who gave land for a public park on the condition that it would be for whites only.⁴⁹ The Court found no state action even though racial minorities were disadvantaged through the reversion.⁵⁰ While the city and park trustees could not run a park that limited admission based on race, reversion of the park to the senator's heirs did not result in discrimination against black persons.⁵¹ Instead, it applied equally to all people who might have benefited from the use of the park. Thus, the Court held, judicial enforcement of neutral state property laws is not state action. As in *Bell*, the Court did not need to determine any party's skin color in order to enforce the law. From *Bell* and *Evans* evolves the principle that judicial enforcement of neutral laws that may result in harm to minority groups does not involve state action unless the court must expressly participate in racial decision making in order to resolve the dispute.

As these cases illustrate, the more involved a court is in encouraging or sanctioning discriminatory behavior, the more likely the court will find that the private discrimination constitutes state action. Thus, it is not surprising that the Supreme Court viewed judicial oversight of the use of peremptory challenges to achieve discrimination inside the courtroom as state action. In a case from the early 1990s, the Supreme Court extended the *Batson v. Kentucky*⁵² principle to the use of peremptory challenges in the civil litigation context. In *Edmonson v. Leesville Concrete Co.*,⁵³ the Supreme Court applied a two-part inquiry to determine whether the discriminatory actions of a civil litigant constituted state action. Careful examination of the cases discussed so far is necessary because the peremptory challenge process used to select juries is similar to the process used to select an arbitrator. Thus, a court considering whether state action is present in contractual arbitration would look to these cases in conducting its analysis.

In *Edmonson*, the Court first inquired into "whether the claimed [constitutional] deprivation has resulted from the exercise of a right or

48. 396 U.S. 435 (1970).

49. *Id.* at 446.

50. *Id.* at 445.

51. *Id.*

52. 476 U.S. 79 (1986). In *Batson*, the Supreme Court held that the Equal Protection Clause precludes a prosecutor's peremptory challenge on the basis of race.

53. 500 U.S. 614 (1991).

privilege having its source in state authority.”⁵⁴ In considering the discriminatory use of peremptory challenges, the Court concisely answered this question in the affirmative: the Court noted that the state need not grant any peremptory challenges to a civil litigant or a criminal defendant, but in doing so invites a private party to help compose a government actor—the jury.⁵⁵ “By their very nature, peremptory challenges have no significance outside of a court of law. Their sole purpose is to permit litigants to assist the government in the selection of an impartial trier of fact.”⁵⁶ The Court emphasized that without the State’s voluntary authorization of peremptory challenges, the private party would not be able to engage in the alleged discrimination.⁵⁷

Second, the Court inquired into “whether the private party charged with the deprivation could be described in all fairness as a state actor.”⁵⁸ To resolve the latter issue the Court made three additional inquiries: “[1] the extent to which the actor relies on governmental assistance and benefits; [2] whether the actor is performing a traditional government function; and [3] whether the injury caused is aggravated in a unique way by the incidents of government authority.”⁵⁹ The Court answered each of these questions in the affirmative with respect to peremptory challenges for both a civil litigant and a criminal defendant.

The Court reached this conclusion both because of the nature of jury selection and the court’s involvement in the jury selection process. State action exists because the court “has not only made itself a party to the [biased act] but has elected to place its power, property, and prestige behind the [alleged] discrimination.”⁶⁰ In so doing, the government has “create[d] the legal framework governing the [challenged] conduct and in a significant way has involved itself with invidious discrimination.”⁶¹

One proponent of a broad state action doctrine in the arbitration context, Richard Reuben, argues that considered together, *Shelley* and *Edmonson* stand for the proposition that the court’s participation in enforcing an unlawful private arrangement that would “offend the

54. *Edmonson*, 500 U.S. at 620 (quoting *Lugar v. Edmondson Oil Co.*, 457 U.S. 922, 939 (1982)); see also *Georgia v. McCollum*, 505 U.S. 42, 51 (1992).

55. *McCollum*, 505 U.S. at 51; *Edmonson*, 500 U.S. at 620–21.

56. *Edmonson*, 500 U.S. at 620.

57. *Id.* at 621.

58. *Id.* at 620.

59. *Id.* at 621–22 (citations omitted).

60. *Id.* at 624 (quoting *Burton v. Wilmington Parking Auth.*, 365 US 715, 725 (1961)).

61. *Id.* (citations omitted).

Constitution if committed directly by the government” is state action since it aggravates the constitutional injury suffered in a “unique way because of the unique place of the courts in a democratic government.”⁶² In other words, the court’s unique position as an institution integral to our democratic society imposes on the court an obligation to avoid enforcing discriminatory arrangements.

Yet this view simply restates what the Court has rejected repeatedly since deciding *Shelley*, *Bell*, and *Evans v. Abney*—that a court’s involvement in enforcing neutral private arrangements is state action. Moreover, *Edmonson* is a much different case from *Shelley*⁶³ since the court’s involvement in *Edmonson* is of a deeper nature. In *Edmonson*, the parties were involved in the creation of the jury, which is “the quintessential governmental body.”⁶⁴ The jury will interact closely with the judge and will share with her decision-making functions. Permitting discriminatory jury selection impugns the function of the court system and affirms discriminatory behavior. Thus, the entanglement between judge and jury is much more intimate than between a judge and private parties attempting to enforce a contract that results in discrimination. As such, it would seem more problematic than the discriminatory behavior that the *Shelley* Court found to be state action.

In addition, the discriminatory conduct in *Edmonson* takes place in the courtroom itself following procedures the court articulated.⁶⁵ That the government permits the discrimination to take place within a public courtroom, the Court reasoned, exacerbates the injury caused by the discrimination because it “mars the integrity of the judicial system and prevents the idea of democratic government from becoming a reality.”⁶⁶ The role of the courts in our democracy requires that the court acts with institutional integrity when conducting proceedings. To maintain institutional integrity, a court must avoid the appearance of engaging in discriminatory behavior; and it cannot maintain its integrity if it *presides over* discriminatory action without attempting to prevent it. Moreover, presiding over discriminatory behavior is quite different from using neutral legal principles to enforce a private contract without inquiring into the underlying subject matter of the contract. In such a situation, the

62. Reuben, *supra* note 5, at 1009.

63. In *Edmonson*, the Court stated that “[t]he alleged state action here is a far cry from that which the Court found, for example, in *Shelley v. Kraemer*.” *Edmonson*, 500 U.S. at 635.

64. *Id.* at 624.

65. *Id.* at 616.

66. *Id.* at 628.

court's integrity as an institution capable of applying neutral laws is not in jeopardy.

Finally, *Edmonson* is a case that involves significant state coercion. A juror is in court as a result of the issuance of a subpoena.⁶⁷ If a juror does not come to court in response to a judicial request for his presence, he can be held in contempt of court.⁶⁸ Thus, in *Edmonson*, concern arises because the state coerces jurors into appearing in court, subjects them to public examination, compels them to remain, and then permits discrimination against them. State acts of coercion, when the parties have no alternative to appearing or complying, are more likely to rise to the level of state action. Ultimately, coercion, together with race discrimination, rises to the level of state action. While both of these elements are present in *Edmonson*, and in court-ordered as well as agency-initiated arbitration, the absence of either factor in the case of contractual arbitration is fatal.

Shelley, Bell, Evans v. Abney, and *Edmonson* provide an appropriate framework to consider whether judicial involvement in private, agency-initiated, and court-ordered arbitration is state action when race is an issue. While the analysis may change depending on the type of arbitration at issue, these decisions establish the parameters a court will use to analyze whether court involvement in a private or semiprivate arbitral setting is racially motivated or racially neutral.

2. Nonrace-based entanglement cases

The Supreme Court's nonrace-based entanglement jurisprudence focuses primarily on private party use of statutory schemes to enforce rights and is relevant to the question of whether contractual arbitration involves state action because contractual arbitration involves private party use of the Federal Arbitration Act or state equivalent to ensure enforcement of arbitration agreements and awards. A review of the seminal cases in this area, *Flagg Bros. v. Brooks*⁶⁹ and *Lugar v. Edmonson Oil Co.*,⁷⁰ reveals that the Court is extremely reluctant to find state action when private parties utilize statutory schemes to enforce

67. 28 U.S.C. §§ 1866(b), 1866(g) (2003) (jurors will be summoned to appear and, if they fail to appear, will be required to come to court and show good cause why they did not appear or be subject to fine or imprisonment); LA. CODE CRIM. PROC. ANN. art. 21 (West 2002).

68. 42 PA. CONS. STAT. ANN. § 4132 (West 2003).

69. 436 U.S. 149 (1978).

70. 457 U.S. 922 (1982).

rights even when they make use of the judicial system to accomplish their goals. Unless the state becomes actively involved in the deprivation of the complaining party's right, as by seizing property (*Lugar*), the court will not find state action arising from private party use of a statutory scheme. These cases are relevant for considering whether private party use of the statutory arbitration process for enforcement of arbitration agreements and awards amounts to state action. Because this article ultimately concludes that the rules governing arbitration are facially neutral, the *Flagg-Lugar* analysis would be applied to assess whether state action is present when a private party seeks enforcement of an arbitration agreement. Applying this doctrine to arbitration, a court should conclude that there is no state action in contractual arbitration. Application of this test to agency-initiated and court-ordered arbitration, by contrast, results in a state action finding.

Flagg exemplifies the Court's reluctance to find state action when race issues are absent.⁷¹ In *Flagg*, the Court considered whether a warehouse company's use of a state statutory scheme to force a sale of goods in order to enforce a possessory lien was state action.⁷² In *Flagg*, a warehouse company stored Brooks' possessions when Brooks was evicted from her apartment. When Brooks did not pay the storage costs, Flagg Brothers proposed to sell Brooks' goods, as the New York Uniform Commercial Code section 7-210 authorizes.⁷³ Brooks sued to enjoin the sale, and the Supreme Court ultimately considered whether Flagg Brothers' sale of her goods was state action that would need to comply with constitutional due process requirements.

The Court considered both whether the resolution of private disputes is a traditional public function⁷⁴ and whether Flagg Brothers' action was properly attributable to the state. In deciding that the state was not responsible for the actions of a private party, the Court emphasized that the state's "mere acquiescence" in a private action does not create state action.⁷⁵ Thus, the creation of a state statute that does not prohibit certain private behavior cannot be said to encourage that behavior. In other words, the state is not responsible for the private decision of a party to

71. 436 U.S. 149.

72. *Id.* at 151-52.

73. *Id.* at 153.

74. Whether dispute resolution is a traditional governmental function will be discussed *infra* at Part I.B.

75. *Flagg Bros.*, 436 U.S. at 164 (citing *Jackson v. Metro. Edison Co.*, 419 U.S. 345, 357 (1974)).

utilize a statutory scheme to force a sale of goods that “permits but does not compel” such action.⁷⁶

Since *Flagg*, the Court has found state action in only one nonrace-based commercial case, *Lugar v. Edmonson Oil Co.*⁷⁷ Thus, *Lugar*, in part, establishes the parameters of the state action doctrine in the nonrace-based context. In *Lugar*, a creditor wished to obtain a writ for prejudgment attachment of a debtor’s property. The clerk of court signed the writ and the county sheriff enforced it by attaching Lugar’s property.⁷⁸ The *Lugar* Court announced a two-part test for determining whether state action exists: “First, the deprivation must be caused by the exercise of some right or privilege created by the State, or by a rule of conduct imposed by the State or by a person for whom the State is responsible”⁷⁹ Second, the plaintiff must establish that the action is fairly attributable to the state because the private actor acted together with the state, received significant aid from the state, or engaged in conduct for which the state should be responsible.⁸⁰

The Court found that the first part of the test was satisfied because the state created the statutory scheme permitting an individual to obtain a writ of attachment.⁸¹ Applying the second prong, the Court found the cooperation of the party and the sheriff sufficient to constitute state action, explaining that “a private party’s joint participation with state officials in the seizure of disputed property is sufficient to characterize that party as a ‘state actor’ for purposes of the Fourteenth Amendment.”⁸² Thus, the Court in *Lugar* held that a private party’s ex parte application for attachment, when state officials perform the actual attachment, amounts to state action.

At first glance, *Lugar* and *Flagg* appear to be remarkably similar cases with inexplicably opposing outcomes. Yet closer analysis reveals a fundamental difference between the two cases: in *Lugar*, the sheriff was directly involved in dispossessing the debtor of his property, while in *Flagg*, the warehouse company engaged in self-help to seize the property in dispute. The Court used this distinction as a basis for reconciling the cases, indicating that a state official’s participation in a private party’s

76. *Id.* at 165.

77. 457 U.S. 922 (1982).

78. *Id.* at 924–25.

79. *Id.* at 937.

80. *Id.*

81. *Id.* at 941.

82. *Id.*

action is “sufficient to characterize that party as a ‘state actor’ for purposes of the Fourteenth Amendment.”⁸³ As Erwin Chemerinsky later emphasized, “in *Flagg Brothers*, involvement of the sheriff was unnecessary precisely because the state’s law allowed the repossession action without assistance of the sheriff.”⁸⁴ Thus, private actions that do not deal with race do not rise to the level of state action absent some overt assistance from state officials.

The Supreme Court’s most recent commercial state action case, *American Manufacturers Mutual Insurance Co. v. Sullivan*,⁸⁵ serves to reinforce the notion that state action is a rare commodity in nonrace-based cases. In *Sullivan*, the Court examined Pennsylvania’s workers’ compensation scheme. Under this scheme, an employer found liable for an employee’s work-related injury, is responsible for all “reasonable and necessary” medical expenses.⁸⁶ In 1993, Pennsylvania created a utilization review organization (URO) to evaluate contested workers’ compensation claims. Under the 1993 legislation, insurers were authorized to withhold payment of workers’ compensation benefits to employees after the insurer filed a claim with the URO asserting that the payments were not reasonable and necessary.⁸⁷ The claimants in *Sullivan*, ten employees and two employee organizations who received benefits under the act, sued defendants, two Pennsylvania program administrators and private insurance companies that offered workers’ compensation coverage.⁸⁸ The claimants contended that the state’s creation of a system designed to permit withholding of payments was state action, which denied them due process because withholding occurred without proper notice or hearing.

Applying *Lugar*, the Court stated that claimants must show both that a constitutional deprivation of a state-created right or privilege had occurred and that the “party charged with the deprivation [is] a person who may fairly be said to be a state actor.”⁸⁹ Acknowledging that the 1993 amendments may encourage insurers to withhold payments for disputed medical treatment, the Court concluded that the second

83. *Id.*

84. Erwin Chemerinsky, *State Action*, in 618 PRACTICING LAW INSTITUTE, LITIGATION ADMINISTRATIVE PRACTICE COURSE HANDBOOK SERIES—LITIGATION 183, 213 (1999).

85. 526 U.S. 40 (1999).

86. *Id.* at 44.

87. *Id.* at 45.

88. *Id.* at 47.

89. *Id.* at 50 (quoting *Lugar v. Edmondson Oil Co.*, 457 U.S. 922, 937 (1982)).

requirement was not satisfied by a demonstration that the state encouraged the behavior. According to the Court,

subtle encouragement is no more significant than that which inheres in the State's creation or modification of any legal remedy. We have never held that the mere availability of a remedy for wrongful conduct, even when the private use of that remedy serves important public interests, so significantly encourages the private activity so as to make the State responsible for it.⁹⁰

In other words, a scheme that enables or even encourages withholding payment will not create state action when the decision whether to withhold is made by the private insurer acting alone.⁹¹

The Court also considered whether a private party's use of a state-created dispute resolution system imbued the private action with state action characteristics. Although the URO's decisions, like any other state-created adjudicative entity, would be considered state action, the Court concluded that a private party's mere use of the state's dispute resolution machinery, without the "overt, significant assistance of state officials," cannot similarly constitute state action.⁹² Thus, even when the state creates both the mechanism and the procedures through which a deprivation may occur and, by so doing, encourages parties to use it, the Court will not find state action.⁹³

Sullivan clarifies the state action entanglement exception, at least for cases that do not involve discrimination against members of a racial minority. *Sullivan* states that government entanglement alone is not enough to create state action. Instead, one must establish both entanglement and state encouragement of the contested activity before a finding of state action will be entered.⁹⁴ Following *Sullivan*, a court evaluating whether private parties' use of the Federal Arbitration Act (FAA) or analogous state statutes to assist them in enforcing a private arbitration agreement amounts to state action would examine the arbitral process to determine whether there is government entanglement as well as state encouragement of the use of the statutory scheme. Applying the *Flagg-Lugar-Sullivan* line of cases to private party use of the FAA, or

90. *Id.* at 53 (citing *Tulsa Prof'l Collection Servs., Inc. v. Pope*, 485 U.S. 478, 485 (1988) ("Private use of state-sanctioned private remedies or procedures does not rise to the level of state action.)); *see also* *Flagg Bros. v. Brooks*, 436 U.S. 149, 165-66 (1978); *Lugar*, 457 U.S. at 937.

91. *Sullivan*, 526 U.S. at 53.

92. *Id.* at 54 (quoting *Tulsa*, 485 U.S. at 486).

93. *Id.* at 56 n.11.

94. Erwin Chemerinsky, *Narrowing the State Action Doctrine*, TRIAL, July 1999, at 101, 102.

state equivalent would result in a finding of no state action because states make no effort to encourage private party use of the FAA nor do any state officials assist private parties in utilizing the existing statutory arbitration schemes. While this issue will be discussed extensively in Part II, because a private party challenging the use of the arbitral process on state action grounds might also argue for application of the public function exception, a brief discussion of that issue follows.

B. Public Function

State action exists when a function that is traditionally an exclusive governmental service is delegated to a private actor. For example, running a political primary⁹⁵ and managing a town⁹⁶ are both traditionally exclusive public functions that are, on occasion, delegated to private entities. When the government delegates, the question is at what point along the public/private continuum the entity performing the delegated function becomes the state and therefore must comply with the Constitution. In evaluating whether an entity is performing a “public function,” a court considers whether the activity is one that is traditionally exclusively controlled by the state.⁹⁷ In other words, a private entity or person does not become a state actor simply by engaging in an activity that the government *could* perform—state action attaches only to those functions that the government *traditionally has* performed. Even if the private entity performs a task of extraordinary importance to society, courts cannot find state action under the public function test unless the action is also traditionally a function of the state.⁹⁸

Supreme Court jurisprudence on whether something is a public function has resulted in a rather narrow doctrine. The Court’s use of “exclusivity” as a means for determining whether a particular private action is a public function resulted in a test that is very difficult to satisfy.⁹⁹ Nevertheless, a brief review of the major cases in which the

95. *Terry v. Adams*, 345 U.S. 461 (1953).

96. *Marsh v. Alabama*, 326 U.S. 501 (1946).

97. *Jackson v. Metro. Edison Co.*, 419 U.S. 345 (1974); *see also*, *Rendell-Baker v. Kohn*, 457 U.S. 830, 842 (1982); *Blum v. Yaretsky*, 457 U.S. 991, 1011 (1982); *Flagg Bros. v. Brooks*, 436 U.S. 149, 157–58 (1978).

98. *Jackson*, 419 U.S. at 352–53 (holding that a public utility is not a state actor).

99. *Krotoszynski*, *supra* note 20, at 319 (“[T]he exclusive state function test . . . is something of an empty set.”); *Schwartz & Chemerinsky*, *supra* note 20, at 806 (commenting that no one can satisfy the exclusive government function test).

Court applied the public function exception is helpful in identifying the contours of the doctrine.

*Marsh v. Alabama*¹⁰⁰ is perhaps the classic example of the public function analysis. In *Marsh*, private corporate agents working for and in a “company town” arrested a Jehovah’s Witness for distributing religious leaflets on the company town’s private streets.¹⁰¹ The Court held that when a company opens its private property to public use, and the property is designed for public use, the statutory and constitutional rights of those who use the property will trump the company’s constitutional right to exclude people from its property.¹⁰² In other words, the Court will balance the private property rights of the owners against the constitutional rights of people to enjoy freedom of press and religion when the owners’ operation is a public function, built primarily for the public’s benefit.¹⁰³

Although *Marsh* is a case unlikely to occur again, given the demise of corporate-owned towns, it explains that to the extent that a private entity controls property or services that the public in general is invited to use, state action is present. Yet this reading is quite broad and fails, it appears, to consider whether the action engaged in is a traditional and exclusive government function. In fact, many of the early cases applying the public function exception did not address the exclusivity question. As a result, at least initially, the public function exception doctrine was fairly broad in its application.¹⁰⁴

The contraction of the public function exception analysis is exemplified by the Court’s holding in *Jackson v. Metropolitan Edison*

100. 326 U.S. 501 (1946).

101. *Id.* at 503–04.

102. *Id.* at 509.

103. *Id.*

104. See *Evans v. Newton*, 382 U.S. 296 (1966) (holding that a private park that received governmental assistance cannot exclude racial minorities); see also Richard J. Anns, Jr., *Drawing Lines in the Shifting Sand: Where Should the Establishment Wall Stand? Recent Developments in Establishment Clause Theory: Accommodation, State Action, the Public Forum, and Private Religious Speech*, 8 TEMP. POL. & CIV. RTS. L. REV. 1, 38–39 (1998); William Brooks, *The Privatization of the Civil Commitment Process and the State Action Doctrine: Have the Mentally Ill Been Systematically Stripped of their Fourteenth Amendment Rights?*, 40 DUQ. L. REV. 1, 55 (2001) (noting that the *Jackson* decision emphasized the exclusivity requirement for state action); Buchanan, *supra* note 16, at 364 (noting that Justice Harlan’s dissent in the *Civil Rights Cases* advanced the public function issue until the *Jackson* decision); Jody Freeman, *Annual Regulation of Business Focus: Privatization: Private Parties, Public Functions, and the New Administrative Law*, 52 ADMIN. L. REV. 813, 842 n.82 (citing *Jackson* as articulating the current, narrow test); David A. Sklansky, *The Private Police*, 46 UCLA L. REV. 1165, 1257–58 (1999) (“*Evans* remains for all that the high point of the public function doctrine.”).

Co.¹⁰⁵ In that case, the Court firmly established that the public function exception applies only when the function at issue is traditionally an *exclusive* state function. In *Jackson*, a customer claimed her due process rights were violated when the electric utility terminated her services without notice and a hearing.¹⁰⁶ The Court held that no state action was present even though the state licensed the utility and the company had a virtual monopoly on the provision of electrical services. According to the Court, only activities traditionally performed by or reserved to the state would constitute public functions.¹⁰⁷ Following *Jackson*, only the most fundamental and essential services governments offer, which have no private sector counterparts, seem to rise to the level of public function. While maintaining company towns and running elections would still be considered public functions, business activities, even when performed by licensed or regulated industries, are not likely to reach the same level.

Interestingly, the application of *Jackson* to private party use of a state-created dispute resolution process confirms both the limited nature of the public function exception and that private party use of dispute resolution machinery is not state action. In *Flagg*, the debtor contended that the forced sale of goods to resolve a credit dispute is state action because the resolution of private disputes is a traditional function of the state.¹⁰⁸ Emphasizing that few functions are the state's exclusive province, the Court concluded that debtor-creditor dispute settlement is not traditionally an exclusive state function.¹⁰⁹ In fact, the Court identified only two exclusive state functions: election of public officials and running a company town.¹¹⁰ Unlike the company town in *Marsh* or the election of a public official in *Terry*,¹¹¹ however, debtors and creditors have "a far wider number of choices than has one who would be an elected public official, or a member of Jehovah's Witnesses who wished to distribute literature" to resolve their disputes.¹¹² In fact, as the Court pointed out, section 7-210 is but one of several methods by which

105. 419 U.S. 345 (1974).

106. *Id.* at 347.

107. *Id.* at 352-53.

108. 436 U.S. at 157.

109. *Id.* at 161.

110. *Id.* at 162 (citing *Terry v. Adams*, 345 U.S. 461 (1953) (discussing the election of public officials); *Marsh v. Alabama*, 326 U.S. 501 (1946) (examining whether a company town can prohibit distribution of literature)).

111. *Terry*, 345 U.S. 461.

112. *Flagg Bros.*, 436 U.S. at 162.

Flagg Brothers could resolve its dispute. The Court concluded that, given the numerous methods available to resolve the dispute, the legislature's delegation of the power to resolve disputes through the forced sale of goods is not an exclusive state function.¹¹³

Under *Jackson* and *Flagg*, the Court holds that a private party engages in a public function when it performs a task that is traditionally an exclusive state function. Moreover, the *Flagg* Court explicitly held that private party use of a statutory dispute resolution scheme is not state action. While this Article will consider this question more fully in Part II, at first blush it seems unlikely that the Court would find that private party use of a statutory arbitration scheme would amount to state action.

II. APPLICATION OF STATE ACTION IN ARBITRATION

Having explicated the basic framework for defining whether state action exists, the Article turns to assessing whether or not various forms of arbitration involve state action. Arbitration can be characterized by different levels of state involvement. This Article will examine three forms of arbitration: (1) court-ordered; (2) agency-initiated; and (3) contractual. With regard to each, the Article will discuss and critique the commentators' and courts' conclusions on the state action issue and offer an independent analysis on that question. Based on this critique and analysis, the Article concludes that state action is present in court-ordered and agency-initiated arbitration but is not present in contractual arbitration.

A. Court-Ordered Arbitration

Court-ordered arbitration involves state action because the party participation in the arbitral process is compulsory and required by a government actor as opposed to a private agreement. Thus, court-ordered arbitration must satisfy constitutional due process requirements. Court-ordered arbitration provides for compulsory, nonbinding arbitration in smaller federal civil actions, typically when damages claimed are less than \$150,000.¹¹⁴ For example, in Arizona, a federal district court

113. *Id.* at 161.

114. As of 1992, twenty-two of the ninety-four federal district courts, as well as thirty-three states, offered court-ordered arbitration. See ELIZABETH PLAPINGER & MARGRET SHAW, COURT ADR: ELEMENTS FOR PROGRAM DESIGN (1992). By 1998, one-quarter of federal district courts had created either court-ordered or voluntary arbitration programs. See KATHERINE V.W. STONE, PRIVATE JUSTICE: THE LAW OF ALTERNATIVE DISPUTE RESOLUTION 4 (2000). The Alternative Dispute Resolution Act of 1998, 28 U.S.C. § 651–58 (1998), requires every federal district court to

mandates referral to arbitration for most civil cases when the relief sought does not exceed \$150,000.¹¹⁵ Similarly, in the Western District of Michigan, federal courts must order civil actions to arbitration if the amount in controversy does not exceed \$100,000.¹¹⁶ In some jurisdictions, the court appoints the arbitrator or a panel of three arbitrators from a list the court created.¹¹⁷ In other jurisdictions, the litigants select the arbitrator.¹¹⁸ The court or the litigants typically pay the arbitrator fees, ranging from \$100 per day to up to \$300 per hour.¹¹⁹

implement a dispute resolution program, which may include arbitration, and authorizes the court to create mandatory mediation programs. Court rules require arbitration in cases ranging from \$50,000 to \$150,000. *See* ARIZ. DIST. CIV. CT. R. 2.11 (2002); CAL. CODE CIV. P. § 1141.11 (2000); N.D. CAL. ADR LOC. R. 4-1 to 4-5, 4-12 (2002); M.D. FLA. R. 8.01-8.06 (2003); W.D. MICH. CIV. LOC. R. 16.6 (2003). Mandatory mediation statutes or court rules are also quite common. *See* COLE ET AL., *MEDIATION: LAW, POLICY & PRACTICE* 7:1 (2d ed. 1994) (describing extent of mandatory mediation). Fifty-one federal district courts maintain court-annexed mediation programs. *See* STONE, *supra*, at 4. Numerous state statutes mandate mediation for a variety of disputes. *See* COLE, *supra*, at 7:2 n.1. In Alaska, for example, a court may order parties to mediate child custody disputes within thirty days after a petition for child custody is filed. *See* ALASKA STAT. § 25.20.080 (2000). As with most child custody and family mediations, the court would first screen the case to make sure that mediation is an appropriate remedy for the parties. Pursuant to the Alaska statute, if one of the parties is a victim of domestic violence, mediation will not take place without the consent of that party after advice from the court that the party need not agree to mediation and that no judicial bias will be created as a result of the decision not to participate in mediation. In mandatory mediation, the court may pay for the mediation, or may require one or both of the parties to pay. *Id.* § 25.20.080(e). Failure to participate in mandatory mediation will result in sanctions. As with court-annexed arbitration, some states that authorize courts to order party participation in mediation provide parties to those procedures one or more peremptory challenges to the mediator. For example, in the Alaska statute discussed above, each party may peremptorily challenge one appointed mediator. *Id.* § 25.20.080(a); *see also, id.* § 25.24.060(b) (authorizing parties to peremptorily challenge any mediator appointed once).

115. ARIZ. DIST. CIV. CT. R. 2.11.

116. W.D. MICH. CIV. LOC. R. 16.6(b)(i).

117. *See, e.g.*, M.D. GA. CIV. R. 16.2(a), 16.2.4(a) (providing that the chief judge certifies the arbitrator in such numbers as he deems appropriate and that the court administers arbitrator selection processes).

118. ARIZ. DIST. CIV. CT. R. 2.11 (authorizing parties to select an arbitrator); W.D. MICH. CIV. LOC. R. 16.6(b)(ii) (allowing parties to select an arbitrator from a list the court maintains or court will appoint arbitrator); W.D. OKL. ADR CIV. R. 16.3 (Supp. 5.3) (parties may select arbitrators from list supplied by court).

119. In Florida, the court selects either one or a panel of three arbitrators. FLA. STAT. ch. 44.103 (2003). Parties pay the arbitrators whose fees may not exceed \$200 per day. *Id.* at 44.103(3). In Arizona, the Southern and Eastern Districts of New York, and the Western District of Michigan federal courts, courts pay the arbitrator \$250 per day or \$250 per case, whichever is greater. *See* ARIZ. DIST. CIV. CT. R. 2.11(g); W.D. MICH. CIV. LOC. R. 16.6(b)(ii)(d)(iii); E.D.N.Y. CIV. R. 83.10; W.D.N.Y. CIV. R. 83.10 (requiring \$250 per case). In New Mexico and the United States District Court for the Eastern District of Pennsylvania, the federal court pays the arbitrator \$100 per case. N.M. 2d JUD. DIST. LOC. R. 2-603 § 4(D); PA. DIST. CIV. CT. R. 53.2.

Parties may or may not be allowed to enter a peremptory challenge.¹²⁰ The hearing may be held either in a courtroom,¹²¹ a room in the courthouse,¹²² or outside of it, such as in a lawyer's office, for example.¹²³ Within some short period after the arbitration hearing, the arbitrator issues a written arbitration award that is filed with the court and served on the parties.¹²⁴ That award is entered as a final judgment

120. In Arizona, for example, parties to an arbitration have ten days to exercise a peremptory strike after notification of the arbitrator selected. *See* ARIZ. DIST. CIV. CT. R. 2.11(d)(2). Under the Arizona federal district court rules, if one side exercises a peremptory strike, the arbitration clerk will appoint another arbitrator. Only the side not exercising the first strike may peremptorily challenge the second arbitrator. Each side is limited to one peremptory challenge per case. *Id.*; *see also* ALA. B.R. 37(h) (providing that within ten days following notification of assignment to arbitration, either party to attorney fee dispute may enter one peremptory challenge); ALA. B.R. 40 (noting that each party may peremptorily challenge an arbitrator assigned); CAL. CODE CIV. P. § 170.6 (stating that a party may exercise peremptorily challenge arbitrator); CAL. CT. R.1605(a)(3) (providing that each side has ten days after notification of arbitrators CAL. CT. R. 1605.5 (providing that local courts may have rules allowing at least one peremptory challenge); CAL. MADERA SUPER. CT. R. 712 (stipulating that each party has right to disqualify one arbitrator peremptorily); selected by court administrator to reject one name on the list); M.D. GA. CIV. R. 16.2.4(a) (allowing each party to strike one of three names court clerk submits); KY ST. SUP. CT. R. 3.800(5)(B)(ii), 3.810(5)(B)(ii), 3.815(5)(B)(ii) (giving each side one peremptory strike for, respectively, legal negligence arbitration, legal fee arbitration, and arbitration); N.M. 2d JUD. DIST. LOC. R. 2-603(II)(C)(1)(b) (providing that after notice of court's arbitrator selection, each party has seven days to peremptorily strike one arbitrator); VT. STAT. ANN. tit. 12 § 7002c (2002) (allowing one or three peremptory challenges in voluntary arbitration—depending on the type of arbitrator).

121. M.D. GA. CIV. R. 16.2.4(b) (requiring that arbitration hearing be held in U.S. courthouse); E.D.N.Y. CIV. R. 83.10; S.D.N.Y. CIV. R. 83.10 (same).

122. ARIZ. DIST. CIV. CT. R. 2.11 (permitting only a neutral location or room at U.S. courthouse); N.D. CAL. ADR LOC. R. 4-1 to 4-5, 4-12 (permitting arbitration hearings to be held in any location, including room in federal courthouse if available); PA. DIST. CIV. CT. R. 53.2.

123. Kim Dayton, *The Myth of Alternative Dispute Resolution in the Federal Courts*, 76 IOWA L. REV. 889, 900 (1991) (noting that the Northern District of California's court-ordered arbitration program holds hearings outside the courtroom, while the Eastern District of Pennsylvania's hearings take place in the courtroom). In the Western District of Michigan, the hearing may be held anywhere within the Western District. W.D. MICH. CIV. LOC. R. 16.6(b)(ii)(e)(ii). In New Mexico, the Northern District of Ohio, and the Northern District of California, the federal court permits the arbitrator to select an appropriate time and location for the hearing. N.M. 2D JUD. DIST. LOC. R. 2-603 § 5(B)(1); N.D. OHIO LOC. R. 16.7(2)(A); N.D. CAL. ADR LOC. R. 4-1 to 4-5, 4-12. In Arizona, a neutral location is selected. If a neutral location cannot be found, the arbitrator may ask the arbitration clerk for a room at a U.S. courthouse facility. ARIZ. DIST. CIV. CT. R. 2.11.

124. *See* Paul Nejeleski & Andrew S. Zeldin, *Court-Annexed Arbitration in the Federal Courts: The Philadelphia Story*, 42 MD. L. REV. 787, 804 (1983) (“[a]fter hearing the testimony . . . the panel renders its decision by promptly filing an award with the clerk.”); *see also* ARIZ. SUPER. CT. R. CIV. P. 75 (providing that an arbitrator has ten days to make the award after receipt of objections by the parties); CAL. IMPERIAL SUPER. CT. LOC. R. 7.05 (providing that an arbitrator has ten days, or twenty if there is an extension, to make the award); CAL. SACRAMENTO SUPER. CT. LOC. R. 11.10(D) (allowing an arbitrator ten days to make a decision); D.C. SUPER. CT. R. CIV. ARB. P. 10(a) (stipulating that an arbitrator has fifteen days to issue an award); M.D. FLA. R. 8.05 (stating that an

unless the losing party requests a trial de novo shortly after the award is filed.¹²⁵

The state action requirement is satisfied when a court enforces a statute that mandates party participation in court-ordered arbitration.¹²⁶ When a court, pursuant to statutory authority, both compels parties to participate in a costly and time-consuming arbitral proceeding regardless of their wishes and regulates the arbitral process, the arbitrator's actions during the proceeding are state action. Courts and legislatures have recognized that state action exists in this context—to avoid infringement of the Seventh Amendment right to jury trial, for example, courts do not make court-ordered arbitration binding.¹²⁷

arbitrator has ten days following hearing to issue award); KY. UNIF. R. BOONE, CAMPBELL, GALLATIN, KENTON CT. GEN. CIV. R. ADD. A. (giving an arbitrator fifteen days to file award with court and mail to parties); MINN. 4 DIST. CT. SPEC. PRACT. R. 5.11 (providing that an arbitrator has ten days to file award with court and mail to parties); N.J. CT. R. 4:21A-5 (providing that an arbitrator has ten days to render an award); E.D.N.Y. CIV. R. 83.10(g)(1) (“The arbitration award shall be filed with the court promptly after the hearing is concluded.”); N.C. SUPER. CT. MED. SETTLE. CONF. R. 12(D)(1) (stipulating that arbitrator has twenty days after end of hearing or after receipt of posthearing briefs to render an award); W.D. OKL. LOC. ADR CIV. R. 16.3 §5.9(a) (stating that an arbitrator has ten days to render award); E.D. PA. CLERK P. HANDBOOK, PART 14(D) (stipulating that an arbitrator shall “immediately” make a simple award that does not include findings of fact, conclusions of law, or opinions); W.D. PA. LOC. R. § 16.2.7 (requiring that an arbitrator shall “promptly” after the hearing concludes file the award with the court; in exceptional cases, arbitrator can have ten days to render an award); PA. COLUMBIA, MONTGOMERY CITY LOC. R. CIV. P. 2.02 (allowing an arbitrator twenty days to file award); PA. LACKA. CTY. LOC. R. CIV. P. 1301(g) (stipulating that an arbitrator has seven days to submit an award; written opinion is discretionary); PA. ARMSTRONG CTY. LOC. R. CIV. P. L1302(d) (providing that an arbitrator has twenty days to render decision); PA. CAMERON ELK CITY LOC. CT. R. 301(1) (providing that an arbitrator has one day to file decision unless time is extended by the parties); PA. PHILADELPHIA CTY. CIV. P. R. 1300(B)(4) (providing that an arbitrator has twenty-four hours to render a decision); S.C. CIR. CT. ADR R. 7(b)(1) (stipulating that an arbitrator has five business days to write, sign, and serve award to parties and file with court); E.D. TENN. LOC. R. 16.5(m)(4) (providing that an arbitrator has 150 days to hold arbitration hearing and render opinion); UTAH ADR R. 102(1) (stipulating that an arbitrator has twenty days to render award); UTAH DIST. ADR PLAN § 5(k) (providing that an arbitrator has twenty days to render award).

125. For example, in the Eastern District of Pennsylvania, either party may seek a trial de novo within thirty days after the filing of the award. *See* E.D. PA. LOC. CT. R. 53.2 (same); *see also* ARIZ. DIST. CIV. CT. R. 2.11 (same); N.D. CAL. ADR LOC. R. 4-1 to 4-5, 4-12 (same); W.D. MICH. CIV. LOC. R. 16.6 (same).

126. Reuben, *supra* note 5, at 1014; *see also* Sternlight, *supra* note 5, at 40 (“Where a state or federal entity explicitly requires private parties to engage in binding arbitration it should be simple to prove state action.”); Davis, *supra* note 5, at 605 (“where the government compels private parties to engage in conduct, a finding of state action may be justified.”).

127. The New Mexico Supreme Court found that a regulation requiring title insurance claims under one million dollars to be arbitrated violated the Seventh Amendment. *See* Lisanti v. Alamo Title Ins. of Tex., 55 P.3d 962, 968 (N.M. 2002). In a Texas appellate case, the court held that a statutory scheme that permits binding arbitration if one, but not both, parties request it, is a violation

B. Agency-Initiated Arbitration

A more nuanced and complicated question is whether agency-initiated arbitration involves state action. Commentators have largely ignored the question of whether state action is present in securities arbitration, and courts have answered it incorrectly since the SEC mandated that brokers and dealers register with a self-regulatory organization (SRO). This section will carefully analyze the relationship between the SEC and SROs, as well as the relationship between other agencies and the private parties they regulate, to establish that agency registration requirements can, and often do, create state action when the private party mandates that the registrant resolve disputes using arbitration. Moreover, in the case of securities arbitration, the SEC's significant involvement in regulating and encouraging SROs to use arbitration in conjunction with the requirement that all brokers register with an SRO, means that state action is present in securities arbitration. As a result, the securities arbitration process must be reformed to satisfy constitutional due process requirements. Because this question arises frequently in the securities industry, this article's conclusion that securities arbitration involves state action is helpful to understand to what extent securities arbitration must be reformed. Moreover, by analogy, the finding that securities arbitration involves state action will be helpful in evaluating whether other types of agency-mandated arbitration involve state action.

In the securities industry, all customer and nondiscrimination employment disputes are resolved in arbitration sponsored by an SRO¹²⁸ such as the New York Stock Exchange (NYSE) or the National

of judicial delegation. *Glazer's Wholesale Distrib., Inc. v. Heineken U.S.A., Inc.*, 95 S.W.3d 286, 305–06 (Tex. Ct. App. 2001). The court did not analyze the case for a Seventh Amendment violation because neither litigant requested a jury. *Id.* at 306. *But see* *Shimko v. Lobe*, 2003 WL 1995650, at *3–*4 (2003). *See also* *Anderson v. Elliot*, 555 A.2d 1042, 1049 (Me. 1989) (holding a state bar rule requiring arbitration of fee disputes not unconstitutional under state constitution). Also, in *GTFM, LLC v. TKN Sales, Inc.*, 257 F.3d 235, 238 (2d Cir. 2001), the court held that a Minnesota statute requiring certain sales agreements to be resolved by binding arbitration did not violate the Seventh Amendment. In an older New Mexico case, the state supreme court held that a statute mandating arbitration for discharge of school employees did not violate the right to open courts, but it did violate the state constitution because of the limited review provisions. *See* *Bd. of Educ. of Carlsbad Mun. Sch. v. Harrell*, 882 P.2d 511, 527 (N.M. 1994). The Colorado Supreme Court, too, did not find a constitutional violation in the state's statute mandating claims of less than \$50,000 to binding arbitration. *See* *Firelock, Inc. v. Colorado*, 776 P.2d 1090, 1097 (Colo. 1989). However, the court relied on the fact that the statute allowed for trial de novo, making the statute something less than totally binding.

128. 15 U.S.C. § 78o-3(b) (1994).

Association of Securities Dealers (NASD).¹²⁹ Until 1998, SROs required arbitration for both broker-dealer employment disputes and broker-customer disputes. A 1998 rule change exempted the NASD broker-dealer employment discrimination disputes from compulsory arbitration.¹³⁰ Shortly after this rule change, the NYSE and numerous other exchanges adopted the NASD rule.¹³¹ Although discrimination claims have been exempted from arbitration, the existence of a variety of nondiscrimination employment disputes¹³² and the possibility that the NASD could reverse its decision to exempt discrimination claims from arbitration ensures that the question of whether state action is present in securities arbitration is still quite relevant.

Although SROs are responsible for protecting investors from wrongful acts their members commit, they are not federal agencies.¹³³ No statute mandated the creation of these SROs, and the government does not appoint SRO board members. Nor do government employees serve on any NASD or NYSE board or committee. Nevertheless, SROs maintain significant government connections. For example, the Securities

129. SROs include the major national securities exchanges and the NASD. *See* Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(26) (1994).

130. Constitution of the New York Stock Exchange art. XI § 1 (2003) (“Any controversy between parties who are members, allied members or member organizations and any controversy between a member, allied member or member organization and any other person arising out of the business of such member, allied member or member organization . . . shall at the instance of any such party, be submitted for arbitration in accordance with the provisions of this Constitution and such rules as the Board may from time to time adopt.”); NYSE R. 600(a) (2003) (any customer or nonmember dispute with a member shall be arbitrated pursuant to written agreement or customer or nonmember demand); NYSE R. 607 (2003) (all nonmembers and public customers with disputes involving over \$10,000 will have claims arbitrated by three-person panel); SEC Release No. 40109, 1998 WL 327716 (June 22, 1998) (associated persons are no longer required to arbitrate statutory employment discrimination claims but must still arbitrate other employment and business-related claims involving customers or other persons).

131. *See, e.g.*, NYSE R. 600(f) (June 2003) (“Any claim alleging employment discrimination, including any sexual harassment claims, in violation of a statute shall be eligible for submission to arbitration under these Rules only where the parties have agreed to arbitrate the claim after it has arisen.”).

132. When the NASD announced the rule change, it stated that “[a]ssociated persons still will be required to arbitrate other employment-related claims.” SEC Release No. 40109 (June 22, 1998). Nondiscrimination employment claims include, but are not limited to, the following: Family and Medical Leave Act, ERISA, whistleblower, Employee Polygraph Protection Act, invasion to privacy, disclosure of trade secrets or confidential information, Fair Credit Reporting Act, defamation, wrongful termination, negligent supervision, and intentional infliction of emotional distress.

133. Federal law requires the NASD to promulgate rules that balance the need to “protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.” 15 U.S.C. § 78o-3(b)(6).

Exchange Commission (SEC) is responsible for providing oversight of the SROs.¹³⁴ The SEC reviews existing SRO rules and may approve or disapprove proposed new rules.¹³⁵ Moreover, it can alter or abrogate existing rules¹³⁶ and may proceed against a SRO if the SRO does not enforce its own rules.

Few courts have considered whether the close relationship between the SEC and the SROs means that state action is present when an SRO acts.¹³⁷ Prior to the 1998 NASD rule change exempting statutory discrimination claims from arbitration, however, several member employees attempted to convince courts that the SEC-SRO relationship transformed the SRO into a state actor, at least when it mandated arbitration of discrimination claims. While the employees failed to convince the courts that SROs are state actors,¹³⁸ the arguments they advanced support a finding that, at least since 1993, when the SEC began mandating that brokers register with an SRO, SROs are state actors when they require employees and customers to participate in arbitration.

To establish state action in these discrimination cases, member employees relied principally on the excessive entanglement argument articulated in *Lugar*.¹³⁹ That is, the member employee claims that an SRO becomes excessively entangled with the government when the SEC moves from simply approving an SRO's decision to require members to

134. 15 U.S.C. § 78s (2003).

135. *Id.* § 78s(b)(1).

136. 15 U.S.C. § 78s(c); *see also* *Am. Express, Inc. v. McMahon*, 482 U.S. 220, 223 (1987) (quoting 15 U.S.C. § 78s(c)) (stating that the SEC has plenary authority over SRO arbitration procedures and has the power to "abrogate, add to, and delete from" SRO arbitration rules if necessary or appropriate to enforce the Securities Act).

137. *Perpetual Sec., Inc. v. Tang*, 290 F.3d 132 (2d Cir. 2002); *Desiderio v. Nat'l Ass'n of Sec. Dealers, Inc.*, 191 F.3d 198 (2d Cir. 1999); *Duffield v. Robertson Stephens & Co.*, 144 F.3d 1182 (9th Cir. 1998). Every court has rejected the contention that the SRO requirement that securities disputes be resolved in arbitration transforms the SRO into a state actor. However, no court has analyzed the state action question since the SEC enacted its 1993 amendments that require brokers to register with an SRO.

138. In both *Duffield* and *Cremin*, the courts found that the SRO was not a state actor because, at the time the claimants began their employment with the particular SRO, the SEC's mandatory registration requirement did not exist. *Duffield*, 144 F.3d at 1185; *Cremin v. Merrill Lynch Pierce Fenner & Smith, Inc.*, 957 F. Supp. 1460, 1466 (N.D. Ill. 1997).

139. *See Cremin*, 957 F. Supp. at 1469. The Ninth Circuit in *Duffield* appeared to consider the public function argument as well. Comparing the SEC's role in regulating the SROs to the role of the Public Utilities Commission in *Jackson v. Metropolitan Edison, Co.*, 419 U.S. 345 (1974), the court concluded that the SEC "has been no more aggressive than . . . the Public Utilities Commission in *Jackson*." *Duffield*, 144 F.3d at 1202. Thus, as in *Jackson*, no state action should be found.

arbitrate to encouraging or endorsing that action.¹⁴⁰ According to claimants, the encouragement comes from the SEC's ability to approve, reject, or abrogate existing SRO rules. Courts rejected this argument, routinely holding that the SEC is not excessively entangled with SROs because nothing in the Securities Acts nor in the Commission rules or regulations *requires* arbitration as a means to resolve disputes within SROs, and the SEC does not compel SROs to utilize arbitration as a means to resolve disputes.¹⁴¹

In attempting to convince the court that state action is present, at least two litigants have argued that because the SEC compelled them to register with an SRO as a condition of their employment, the SEC was sufficiently entangled with the SRO to create state action.¹⁴² Both the Ninth Circuit in *Duffield* and the Northern District of Illinois in *Cremin* rejected this argument because, prior to 1993, no federal statute or regulation *required* a member to register with the securities exchanges or arbitrate disputes with the member's employer.¹⁴³ In 1993, however, the SEC adopted a regulation that required all broker-dealers to register with at least one SRO.¹⁴⁴ Although the *Duffield* court characterized the new rule as federal law, a "government-mandated 'condition to any participation in a . . . securities career,'"¹⁴⁵ it nevertheless rejected Duffield's argument that because the SEC compelled her to remain registered after the 1993 rule change, state action was present. According to the court, that she was compelled to remain registered was "immaterial." The court went on to say:

No federal law required Duffield to waive her right to litigate employment-related disputes by signing the Form U-4 [arbitration agreement] in 1988, and no state action is present in simply enforcing that agreement. Insofar as Duffield argues that the 'challenged action' is the requirement that she actually arbitrate her lawsuit, that requirement is found in her private contract, not in federal law.¹⁴⁶

140. *Duffield*, 144 F.3d at 1202.

141. *Perpetual*, 290 F.3d at 132; *Desiderio*, 191 F.3d at 198; *Duffield*, 144 F.3d at 1182.

142. *Duffield*, 144 F.3d at 1201; *Cremin*, 957 F. Supp. at 1466.

143. *Duffield*, 144 F.3d at 1201; *Cremin*, 957 F. Supp. at 1466.

144. See 17 C.F.R. § 240.15b7-1 (adopted May 11, 1993).

145. *Duffield*, 144 F.3d at 1201 (quoting *Blount v. SEC*, 61 F.3d 938 (D.C. Cir. 1995), *cert. denied*, 517 U.S. 1119 (1996)).

146. *Id.*

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Arbitration and State Action

The Northern District of Illinois rejected Cremin's claim on virtually identical grounds.¹⁴⁷

While it is true that the arbitration requirement is in the SRO's U-4 agreement, one might argue that if the SEC, with knowledge of the arbitration obligation, requires a broker-dealer to register with an SRO or compels the broker-dealer to remain registered with the SRO, it is directing the broker-dealer to arbitrate his or her dispute. But winning this argument is more difficult than it initially appears. In *Blum v. Yaretsky*, a leading state action case, the Court held that a state is responsible for a private decision when "it has exercised coercive power or has provided . . . significant encouragement."¹⁴⁸ While the pre-1993 SRO rule requiring arbitration may not have satisfied the state action requirement, the post-1993 requirement that broker-dealers register with one of the SROs indicates that the arbitration requirement is state action.¹⁴⁹

Such a conclusion is not automatic, however. As the *Duffield* court made clear, the requirement that broker-dealers register with an SRO is quintessential government regulation. The next question, then, is whether this government-mandated condition of registration with an SRO, when that SRO mandates that the registrant resolve all disputes using arbitration, is sufficiently overt or covert encouragement of arbitration to support a finding that the SROs are state actors when they require arbitration.

147. See *Cremin*, 957 F. Supp. at 1466 (examining law at the time Cremin registered, 1982, not the post-1993 law).

148. 457 U.S. 991, 1004-05 (1982).

149. The *Duffield* court suggested this conclusion:

In 1993, however, the Securities and Exchange Commission (SEC) adopted a regulation that required all broker-dealers to be registered with at least one of the securities organizations of which *Duffield's* firm was a member—i.e., the NASD and the NYSE—before effecting any securities transaction. See 17 C.F.R. § 240.15b7-1 (adopted May 11, 1993). That registration regulation, like the SEC's registration regulation at issue in *Blount v. SEC*, 61 F.3d 938 (D.C. Cir.1995), *cert. denied*, 517 U.S. 1119, 116 S.Ct. 1351, 134 L.Ed.2d 520 (1996), "operates not as a private compact among brokers and dealers but as federal law." *Id.* at 941. Hence, to borrow *Blount's* reasoning, as a government-mandated "condition to any participation in a . . . securities career," the current requirement that new employees register with a national securities exchange "constitutes government action of the purest sort."

144 F.3d at 1201. While the *Duffield* court did not conclude that the SRO-imposed arbitration agreement constituted state action, the holding that the registration requirement is state action suggests that consequences that flow directly from the requirement would also constitute state action.

The D.C. Circuit examined this question when it considered whether the MSRB is a state actor when it enforces rules governing municipal securities brokers' conduct.¹⁵⁰ In *Blount*, the D.C. Circuit held that a rule regulating the conduct of brokers that was promulgated by the Municipal Securities Rulemaking Board (MSRB) and approved by the SEC was state action.¹⁵¹ The court found that the MSRB was a state actor when it enforced its conduct rule because the Exchange Act requires brokers and dealers to register with the MSRB before they may trade municipal securities, and violations of MSRB rules may result in sanctions including suspension or loss of the broker-dealer's trading license.¹⁵² The court concluded that Rule G-37 was government action because it was a "government-enforced condition to any participation in a municipal securities career."¹⁵³ Under *Blount's* reasoning, then, a registration requirement, together with regulatory enforcement of the private entity's rules, satisfies the requirement for state action.

The primary difference between the MSRB and other SROs like the NASD is that the government created the MSRB but not the other SROs. Yet the D.C. Circuit put this distinction aside when it assessed whether the implementation of Rule G-37 was state action in *Blount*.¹⁵⁴ If this distinction is irrelevant,¹⁵⁵ it is difficult to see a difference between the SEC's relationship with SROs and their arbitration requirement and the MSRB's decision to promulgate a regulation that effects the purpose of the Exchange Act. After all, the SEC regulates SROs closely, and federal

150. *Blount v. SEC*, 61 F.3d 938, 941 (D.C. Cir. 1995). Rule G-37, at issue in *Blount* restricted municipal securities professionals from engaging in "pay to play." *Id.* at 939-40. In other words, the rule prohibited brokers from making contributions to or soliciting contributions on behalf of state officials from whom they obtain business.

151. *Id.* at 941.

152. *Id.*

153. *Id.*

154. 61 F.3d 938 (D.C. Cir. 1995). The court said, "[w]e put to one side the Board's questionable assertion that it is a purely private organization even though it was created by an act of Congress and directed by Congress to 'propose and adopt rules to effect the purposes of the [Exchange Act]' within specified constraints." *Id.* (quoting 15 U.S.C. § 78o-4(b)(2)).

155. The distinction may be irrelevant both because the *Blount* court did not consider it in analyzing the state action question and because it makes little difference as a practical matter. Although Congress mandated the creation of the MSRB, it is an SRO that is organized as a nonprofit corporation governed by Virginia law. A private entity does not become public simply because federal legislation creates it. ROBERT A. FIPPINGER, *THE SECURITIES LAW OF PUBLIC FINANCE* § 9:7.4, at 9:103 (PLI 2001). Fippinger concluded that "the congressional mandate of the creation of the MSRB, as opposed to its creation as a voluntary association of brokers, dealers, and municipal securities dealers, has little relevance to whether the MSRB is private or public and governmental." *Id.*

regulations mandate that broker-dealers from each SRO register with the SEC. In fact, the considerable interaction and close relationship that exists between the SEC and the nonmunicipal SROs suggests an even stronger argument in favor of state action than in the *Blount* case. Further examination of the connectedness between the SEC and the SROs offers additional support for the argument that the SEC's registration requirement together with the SEC's significant encouragement of SRO implementation of SRO arbitration amounts to state action.

Notably, the SEC has not been a passive bystander regarding the implementation of SRO arbitration. To the contrary, it has taken an active role in developing SRO policy and practice. For example, in 1975, the SEC created the U-4 registration form, which includes the standard clause mandating arbitration of all disputes arising out of a broker-dealer's employment.¹⁵⁶ In the late 1970s, the SEC began pushing for a systematic method for resolving small securities claims. In response to the SEC's initiatives, SRO representatives, the public, and the Securities Industry Association formed the Securities Industry Conference on Arbitration (SICA). SICA created a Uniform Code of Arbitration that the SROs adopted in 1979–80.¹⁵⁷ Although SROs are not obligated to follow SICA's recommendations, until very recently, they have done so.¹⁵⁸

Another example of SEC involvement in SRO practice is when, in 1986, the Supreme Court, in *Shearson/American Express v. McMahon*, ruled that federal securities claims could be arbitrated.¹⁵⁹ In response, the SEC sent a letter to SICA recommending substantial reforms of the existing informal arbitration process. Among other things, the SEC recommended that arbitrators should be trained in securities and relevant state law, that a record of the proceedings be maintained to facilitate judicial review of arbitration awards, and that the awards themselves become more detailed.¹⁶⁰ While SROs did not adopt all of the SEC's recommendations, they nevertheless instituted significant reforms to the existing arbitration process.¹⁶¹ While the SEC approved these

156. *Intercontinental Indus., Inc. v. Am. Stock Exch.*, 452 F.2d 935, 941 & n.9 (5th Cir. 1971).

157. Barbara Black & Jill I. Gross, *Making It Up As They Go Along: The Role of Law in Securities Arbitration*, 23 CARDOZO L. REV. 991, 998 (2002).

158. *Id.* at 998–99.

159. 482 U.S. 220, 238 (1987).

160. Letter from Richard G. Ketchum, Director of Division of Market Regulation, SEC, to SICA members, *reprinted in* MARK D. FITTERMAN ET AL., SEC INITIATIVES FOR CHANGES IN SRO ARBITRATION RULES, SECURITIES ARBITRATION 1988, at 257, 279 app. A (PLI Corp. Law & Practice Course, Handbook Series No. 601, 1988).

161. *Id.*

reforms,¹⁶² it did not abandon its previous efforts and indicated that it would continue to push for arbitration reform, particularly if arbitration became an exclusive forum for resolution of securities disputes.¹⁶³ The SEC has continued to monitor the use of arbitration and has recommended changes to the arbitration process throughout the 1980s and 1990s.¹⁶⁴ According to Professors Black and Gross, “the SEC and SROs have spent considerable time and effort since *McMahon* to amend procedural rules governing securities arbitrations.”¹⁶⁵

The SEC’s active involvement in regulating arbitration together with the reasoning in the *Blount* case suggests that SROs are state actors when they require broker-dealers to arbitrate disputes following the SEC’s 1993 adoption of a mandatory registration requirement.¹⁶⁶ Like the brokers in *Blount*, arbitration of nondiscrimination employment disputes is a government-enforced condition to participation in a securities career. Thus, the arbitration requirement “constitutes government action of the purest sort.”¹⁶⁷

162. See Self-Regulatory Organizations; Order Approving Proposed Rule Changes by the New York Stock Exchange, Inc., National Association of Securities Dealers, Inc., and the American Stock Exchange Inc. Relating to the Arbitration Process and the Use of Predispute Arbitration Clauses, Exchange Act Release 34,26805, 54 Fed. Reg. 21,144 (May 16, 1989).

163. See *id.* at 21,145.

164. See, e.g., SEC Release No. 34,11424, 1975 SEC LEXIS 1592 (May 16, 1975) (form U-4); SEC Release No. 34,26805, 1989 SEC LEXIS 843 (May 10, 1989) at 4 (during the past two decades, “[t]he majority of the proposals to amend the [exchanges’ arbitration] rules were . . . in response to the . . . Commission letters”); *id.* at 3–5, 7, 16, 22, 31, 32, 44 n.51, 51 n.59 (describing the SEC’s ongoing series of letters to SICA, letters that presented the SEC’s recommendations regarding the exchanges’ arbitration procedures, that “request[ed] [that the exchanges] amend their rules” to conform to the SEC’s views, and that resulted in a series of proposed rule changes that were “develop[ed] in response to the Commission’s letters”).

165. Black & Gross, *supra* note 157, at 1005.

166. Few courts have considered whether SROs are private or public entities when they enforce their rules. In *Crimmins v. American Stock Exchange, Inc.*, 346 F. Supp. 1256 (S.D.N.Y. 1972), a federal district court concluded that the American Stock Exchange acted as an arm of the federal government when it conducted a disciplinary hearing. While the court found that the SRO was a state actor, it nevertheless concluded that the hearing provided the broker-dealer satisfied the requirements of the Fifth Amendment. *Id.* at 1261. By contrast, the Seventh Circuit, in *Bernstein v. Lind-Waldock & Co.*, 738 F.2d 179, 186 (7th Cir. 1984), held that the Chicago Mercantile Exchange was not a federal actor when it auctioned off a seat. The court emphasized that the private nature of the suit as “only remotely related to the exchange’s enforcement functions” in reaching its conclusion that the exchange was not acting as an arm of the federal government. *Id.* See William I. Friedman, *The Fourteenth Amendment’s Public/Private Distinction Among Securities in the U.S. Marketplace—Revisited*, 23 ANN. REV. BANKING & FIN. L. 727, 770 (2004) (arguing that entwinement of government with SROs satisfies state action requirement).

167. See *Blount v. SEC*, 61 F.3d 938, 941 (D.C. Cir. 1995).

Further support for the conclusion that SROs are state actors following the 1993 amendments can be found in *R.J. O'Brien & Ass'n v. Pipkin*.¹⁶⁸ In that case, Pipkin claimed that the National Futures Association (NFA) denied him his constitutional right to due process when it required him to arbitrate claims made against him. The Commodity Exchange Act, like the Securities Exchange Act since 1993, requires persons who actively participate in the industry to register under the Act.¹⁶⁹ The Commodity Futures Trading Commission (CFTC) oversees the regulation of commodities trading and is also empowered to register persons under the Act.¹⁷⁰ The CFTC, as permitted by statute, delegated the registration function to the NFA, a private corporation.

To support his motion to vacate the arbitration award entered against him, Pipkin contended that the NFA is a state actor when it registers persons.¹⁷¹ The Seventh Circuit agreed, holding that the NFA “certainly is [a state actor] when it requires an applicant to agree to submit to the arbitration rules in order to register under the Act.”¹⁷² Thus, under *Pipkin*, a federal agency’s delegation of the required registration function to a private corporation transforms the private corporation into a state actor. That the private corporation creates its own arbitration procedures and rules does not alter this conclusion. Instead, the court ruled that those procedures and regulations are imposed on the registrant as a precondition to registration under the Act.¹⁷³ Because the registration function is required, agreement to the procedures is also required, and the registering entity becomes a state actor.

Applying *Pipkin* to the present situation, the conclusion seems fairly obvious that an SRO, such as the NASD, is a state actor because the SEC now requires registration with an SRO as a precondition to working in the securities industry.¹⁷⁴ Although each SRO creates the arbitration

168. 64 F.3d 257 (7th Cir. 1995).

169. See 7 U.S.C. §§ 6f(a), 6k(1) (2005).

170. See *Pipkin*, 64 F.3d at 259.

171. *Id.* at 262.

172. *Id.*

173. *Id.*

174. The *Cremin* court was not persuaded by the plaintiff’s analogy to *Pipkin*. See *Cremin v. Merrill Lynch Pierce Fenner & Smith, Inc.*, 957 F. Supp. 1460, 1466–67 (N.D. Ill. 1997). According to the court, the analogy was inapt because *Cremin* signed the arbitration agreement prior to 1993. *Id.* While the court left open the possibility that *Cremin*’s argument would be successful if she had registered after 1993, when she would have been required to do so, it rejected her claim because, prior to 1993, the SEC, unlike the CFTC, did not require individuals to register with an SRO. *Id.* This decision is wrong for the same reason *Duffield* is incorrect—even if *Cremin* registered prior to

procedures and rules, a registrant must agree to them implicitly when she, as required by federal law, registers with a SRO. Additionally, as discussed above, the SEC has a significant role in drafting, monitoring, and enforcing the procedures and roles that the broker must agree to in order to participate in the securities industry.

If the enforcement of arbitration agreements by SROs does constitute state action, constitutional requirements of due process apply.¹⁷⁵ While subsequent decisions would have to flesh out the nature of the due process requirements, at minimum, it seems likely that the arbitration hearing would need to include a neutral decision maker, confrontation of witnesses, compilation of a record, use of that record as the exclusive basis for a decision, and a decision accompanied by a statement of reasons.¹⁷⁶ While current securities arbitration rules require a neutral decision maker, a verbatim record, and a brief written decision, these rules say nothing about the ability of parties to confront witnesses or about other hearing issues.¹⁷⁷ Nor do the rules mandate a reasoned opinion. Instead, they simply require a description of the issues, the type of dispute, and the damages awarded, if any.¹⁷⁸ If state action is present in securities arbitration, the arbitral process would need to be altered to comply with at least these minimal due process requirements. Moreover, as I have noted elsewhere, if state action were present in an arbitration

1993, post-1993, she had no choice but to remain registered. Thus, her obligation to arbitrate post-1993 is the product of state action. *See supra* notes 138–49 and accompanying text.

175. Even if state action is present in securities arbitration, a claimant would need to establish a liberty interest or property right in her claim against her employer before the due process requirements of the Fifth or Fourteenth Amendment could be invoked. While not a simple inquiry, Supreme Court precedent indicates that an individual's legal claims, when those claims are created by state or federal statute, would constitute a property right. *See Logan v. Zimmerman Brush, Co.*, 455 U.S. 422 (1982) (holding that a terminated employee's employment discrimination cause of action is a property right that cannot be destroyed unless adequate procedural safeguards are followed).

176. *Goldberg v. Kelly*, 397 U.S. 254 (1970). In *Goldberg*, the Supreme Court stated that, among other requirements, the Fourteenth Amendment mandates that a decision maker's conclusions regarding a welfare recipient's eligibility to receive public assistance payments must rest solely on legal rules and evidence adduced at a pretermination hearing. *Id.* at 264. Additionally, to demonstrate compliance with that requirement, the decision maker should state reasons for his determination and indicate what evidence he relied on, though his statement need not amount to a full opinion or even formal findings of fact and conclusions of law. *Id.* at 269–70. While a dispute over the purchase or sale of securities or employment within the securities industry does not rise to the level of deprivation of welfare benefits, some hearing followed by a reasoned written opinion would seem to be required by *Goldberg* and its progeny.

177. *See, e.g.*, NASD Rule 10214, 10326 (2003); NYSE Rule 623, 627(a), (e)(2003).

178. The NASD award must contain a summary of issues and description of the type of dispute and damages. NASD Rule 10214 (2003).

hearing, then a party's discriminatory use of a peremptory challenge in arbitrator selection would also become subject to constitutional attack.¹⁷⁹ Interestingly, both the NYSE and NASD provide parties with one peremptory challenge of an arbitrator.¹⁸⁰ If a party can come forward with evidence of racial or gender discrimination in arbitrator selection, then the party should be able to present a challenge, based on *Batson*, to a court following the arbitration.

C. Contractual Arbitration

Contractual arbitration refers to any arrangement whereby parties agree that a disinterested private party will fashion a binding determination of a dispute that has arisen between them.¹⁸¹ The parties select the arbitrator who will resolve their case, typically making the selection after the dispute has arisen.¹⁸² The parties' active role in the selection process enables them to choose an arbitrator who is an expert in the subject matter of the dispute.¹⁸³ Traditional arbitration also involves

179. See Sarah Rudolph Cole & E. Gary Spitko, *Arbitration and the Batson Principle*, 38 GA L. REV. 1145 (2004).

180. NYSE Rule 609 (stating that a party has one peremptory challenge that must be used within ten days of notification of arbitrator names); NASD Rule 10311 (explaining that a party has one peremptory challenge that must be exercised within ten days after notification). Both forums allow an additional peremptory challenge "in the interests of justice." See NASD Code § 22; NYSE Rule 609.

181. See MARTIN DOMKE, 2 DOMKE ON COMMERCIAL ARBITRATION § 1.01, at 1 (Gabriel M. Wilner ed., rev. ed. 1993 & Supp. 1994) [hereinafter WILNER]. A typical statutory definition of arbitration appears in the Texas statute. According to the statute:

(a) Nonbinding arbitration is a forum in which each party and counsel for the party present the position of the party before an impartial third party, who renders a specific award; (b) if the parties stipulate in advance, the award is binding and is enforceable in the same manner as any contract obligation.

TEX CIV. PRAC. & REM. CODE ANN. § 154.027 (Vernon 1987).

182. See WILNER, *supra* note 181, § 20.02, at 301–09. Sometimes the arbitrator who will decide the dispute is named in the contract establishing arbitration as the dispute resolution mechanism. *Id.* § 20.02, at 308. Other times, parties simply state that an arbitrator provider organization, such as the American Arbitration Association, will provide a panel of arbitrators from which an arbitrator will be chosen at the time the dispute arises. *Id.* § 20.01, at 302–03. Of course, even the latter selection method is, at some level of generality, one in which the parties select the arbitrator. They have simply elected to assign their selection powers to an agent.

183. See *Alexander v. Gardner-Denver*, 415 U.S. 36, 57 (1974) (stating that parties select a particular arbitrator "because they trust his knowledge and judgment concerning the demands" and customs of the field from which the dispute originates); IAN MACNEIL ET AL., FEDERAL ARBITRATION LAW § 2.6.2 (1994) (stating that an arbitrator is expected to be an expert in the norms governing the resolution of the dispute). It may be that in at least some cases, one of the parties will not want an expert to resolve the dispute. A party who has departed from industry norms in his performance, for instance, might prefer an arbitrator who is not an expert in the industry in which the

flexible procedures. The parties may choose the extent to which they wish to be bound by formal procedural rules and may ultimately define their own procedure.¹⁸⁴ Arbitration proceedings, for instance, need not follow the rules of evidence and often limit,¹⁸⁵ or even eliminate, discovery.¹⁸⁶

These flexible procedures typically allow arbitration to proceed more rapidly than traditional courtroom litigation. The time between hearing and result is also shorter than in litigation because arbitrators are not required to publish their decisions, and usually do not.¹⁸⁷ It is also

party deals. In litigation, parties theoretically have little or no direct control over the particular judge who will decide their dispute (although plaintiffs do, of course, to a large extent control the forum, and thus can direct cases to fora that are perceived as more beneficial to plaintiffs). In arbitration, by contrast, a party might act opportunistically by selecting an arbitrator the party considers predisposed to the particular argument the party will advance. In fact, I have argued elsewhere that the possibility of opportunistic behavior in arbitrator selection provides repeat players, with their better access to historical information and stronger incentives to influence the arbitrator, a decided advantage in the arbitral forum. See Sarah Rudolph Cole, *Incentives and Arbitration: A Case Against the Enforcement of Executory Arbitration Agreements Between Employers and Employees*, 64 UMKC L. REV. 449, 453 (1996).

184. See Thomas J. Stipanowich, *Rethinking American Arbitration*, 63 IND. L.J. 425, 433–34 (1988).

185. See 9 U.S.C. § 7 (1955). The proposed revision of the UAA gives the authority to order discovery to the arbitrators, unless the parties' agreement indicates otherwise. See REVISED UNIFORM ARBITRATION ACT § 13(a) (Draft Oct. 1997).

186. See JOHN S. MURRAY ET AL., *ARBITRATION* 217 (1996) ("Another illustration of the relative informality of arbitration is the sharply limited availability of discovery, both pre-trial and at the hearing itself."). The Uniform Arbitration Act does not provide for any form of pretrial discovery. In fact, only the arbitrator has the power to order "discovery"—he may order it if he believes it is necessary to resolve the dispute. Parties do not have a right to compel discovery. *Id.* at 218 (citing UNIF. ARBITRATION ACT § 7). It is interesting to note that parties, when given the choice, tend to agree to eliminate or reduce the amount of discovery, especially in light of the far-ranging discovery that takes place in most formal judicial proceedings. The question emerges why discovery is so different in the two systems. That is, why does our formal judicial system allow for such wide-ranging discovery if it appears that litigants, when left to choose their own rules, opt for less discovery? There are at least two possible explanations for this deviation between the nature of discovery in the public and private dispute resolution systems. First, little or no discovery is the better rule in cases where parties have an existing relationship (i.e., the typical arbitration case), but broad-ranging discovery is more appropriate in nonrelationship based cases. Second, the discovery rules enshrined in the federal rules of civil procedure (and therefore also the civil rules of the vast majority of states) resulted from a process of interest group capture, i.e., by attorneys interested in increasing fees.

187. "Arbitrators have no obligation to the court to give their reasons for an award." *United Steelworkers of Am. v. Enter. Wheel & Car Corp.*, 363 U.S. 593, 598 (1960); see also *Halligan v. Piper Jaffray, Inc.*, 148 F.3d 197, 204 (2d Cir. 1998) (holding that arbitrators have no obligation to explain their award in writing). The American Arbitration Association's Commercial Arbitration Provisions contain a provision requiring that arbitrators provide a written award to the parties, but do not require the arbitrator to explain in writing or otherwise the reasons underlying that award. See

uncommon to have a transcript of the proceedings.¹⁸⁸ Because arbitrators rarely publish their opinions and are not obligated to follow precedent, one can expect an arbitral decision within days or weeks following the arbitration hearing.

Once the decision is issued, a party may appeal the arbitrator's decision. Judicial review of arbitral awards, however, is quite restricted either by contract or statute. The Federal Arbitration Act (FAA), which governs arbitration procedure, limits the grounds for refusing to enforce an arbitral award to procedural irregularities in the arbitral decision-making process, as, for example, in instances when the arbitrator has acted in excess of her authority.¹⁸⁹ Misunderstanding or misapplication of the law are not bases upon which an arbitral award may be reversed.¹⁹⁰

Contractual arbitration, therefore, is traditionally a private party arrangement. Court involvement occurs, if at all, prior to the start of arbitration and after the completion of arbitration. First, the FAA allows a party to obtain a stay of litigation pending an arbitration pursuant to a valid arbitration agreement.¹⁹¹ Second, the FAA enables enforcement of an arbitration agreement by authorizing a party to an arbitration agreement to file in federal district court a motion to compel the other party to arbitrate.¹⁹² The FAA also contains provisions for limited judicial review of arbitral awards, together with provisions articulating the process for vacation or modification of arbitral awards.¹⁹³

1. Applying entanglement jurisprudence to contractual arbitration

To determine whether state action exists when parties seek judicial enforcement of agreements to arbitrate or judicial review of arbitration

MACNEIL ET AL., *supra* note 183, § 2.6.2, at 2:37 (stating that arbitrators are not required to provide a written opinion with reasons supporting their decision); WILNER, *supra* note 181, § 29.01, at 427 (stating that the parties to the arbitration typically set the time within which the arbitrator must render his award); EDWARD BRUNET & CHARLES B. CRAVER, *ALTERNATIVE DISPUTE RESOLUTION: THE ADVOCATE'S PERSPECTIVE* 324 (1997) (explaining that only in specialized arbitrations, like labor, international commercial, and maritime arbitrations, do arbitrators write opinions).

188. See JOHN S. MURRAY ET AL., *PROCESS OF DISPUTE RESOLUTION* 640 (2d ed. 1996).

189. See 9 U.S.C. § 10(a)(1)–(4) (1992).

190. Federal courts have created additional bases for judicial review of arbitral awards. See *Wilko v. Swan*, 346 U.S. 427 (1953) (reversing lower decision due to arbitrator's manifest disregard of the law); *Halligan v. Piper Jaffray, Inc.*, 148 F.3d 197 (2d. Cir. 1998).

191. See 9 U.S.C. § 3 (1992).

192. See *id.* § 4 (1992).

193. See *id.* §§ 10–12 (1992).

awards, a court would first need to categorize arbitration as either race-based or nonrace-based. To obtain the benefit of the more lenient race-based entanglement test, a litigant would have to argue for a revival of *Shelley* or contend that enforcement of an arbitration agreement or award has a racially discriminatory impact. Courts would be unlikely to receive either of these arguments favorably. If the Court had extended *Shelley* to other contractual arrangements, an argument for its extension into arbitration might have merit. The Court's initial reluctance to extend *Shelley*, however, followed by a hasty retreat from it, suggests that reliance on *Shelley* to support an argument of state action in arbitration is misplaced. That *Shelley* required explicit racial decision making lends further credence to the theory that it is inapplicable in the arbitration context when arbitration agreements and awards are facially neutral.¹⁹⁴

Proponents of finding state action in arbitration might contend that judicial enforcement of arbitration agreements and awards should be characterized as race-based entanglement because enforcement has a discriminatory impact on those protected by various antidiscrimination statutes. Proponents might also argue that because arbitration is used frequently in discrimination cases, it has an adverse impact on minorities and, when the court enforces an agreement or award, amounts to unlawful discrimination. While some may argue that arbitration and other forms of dispute resolution systematically disfavor minorities, the mere enforcement of an agreement to arbitrate is not discriminatory; it does no immediate or direct harm to anyone. Moreover, a contention that enforcement of arbitration agreements and awards is discriminatory is purely conjecture. No evidence supports the argument.¹⁹⁵

194. Professor Barbara Snyder made a similar argument with respect to race discrimination cases. In her article, she emphasized that state action exists when the court enforces a racially discriminatory agreement or when the purported state actor admits that he took action for discriminatory reasons, but not when the court enforces facially neutral laws, as in *Evans v. Abney*, 396 U.S. 435 (1970). See Barbara Snyder, *Private Motivation: State Action and the Allocation of Responsibilities for Fourteenth Amendment Violations*, 75 CORNELL L. REV. 1053, 1062 (1990). In *Evans*, the Court used neutral trusts and estates law to permit land to revert to descendants of a senator who gave land for a public park on the condition that no racial minorities would be permitted to use the park.

195. In fact, the most recent empirical study suggests the opposite conclusion. See Michael Delikat & Morris Kleiner, *Comparing Litigation and Arbitration of Employment Disputes: Do Plaintiffs Better Vindicate Their Rights in Litigation?*, A.B.A. CONFLICT MGMT., Winter 2003, at 1, available at <http://www.arb-forum.com/articles/list-articles.asp>. The researchers reviewed 125 employment discrimination cases filed in the Southern District of New York and 186 employment arbitrations in the securities industries from 1997 and 2001. They concluded there was no statistical support of bias against individual claimants in arbitrations pursuant to predispute arbitration agreements when compared to federal court. Moreover, the study demonstrated that claimants in

The case law also supports the conclusion that enforcement of arbitration agreements and awards is not state action even if enforcement disadvantages protected classes. The Supreme Court has repeatedly held that judicial decisions that disadvantage racial minorities do not involve state action unless there is some nonneutral involvement of the court with the private action. Thus, in *Bell v. Maryland*,¹⁹⁶ the Court upheld a trespass conviction based on a private person's decision not to allow racial minorities on his property. Because neither the state nor the court "prompted or required" the private person's discriminatory behavior, state action did not arise. Similarly, in *Evans v. Abney*,¹⁹⁷ the Court did not find state action when a court permitted land to revert to descendants of a senator who gave land for a public park on the condition that no members of a racial minority would be allowed in the park. The Court found no state action even though racial minorities were disadvantaged because the court's only involvement was to enforce neutral state property laws.¹⁹⁸ Parties seeking to avoid an arbitration agreement or award ask the courts to apply the FAA to determine whether they must abide by the agreement or award. Like state property laws, the FAA is a neutral enforcement scheme. Because a court's only involvement in an arbitration case is to enforce the agreement or award, the possibility, as yet unproven, that the enforcement might have a disproportionate impact on minorities is irrelevant under *Bell* and *Evans*.

Examination of the Court's most recent jurisprudence on the race-based entanglement analysis in *Edmonson* sheds additional light on the issue.¹⁹⁹ In *Edmonson*, the Court found that state action exists when a court enforces the peremptory challenge of a juror. According to the Court, the approval of the challenge is state action because the court "made itself a party to the [biased act and] . . . elected to place its power, property and prestige behind the [alleged] discrimination."²⁰⁰ The government both "create[d] the legal framework governing the [challenged] conduct" and has, in a significant way, involved itself with

arbitration were more likely to prevail than plaintiffs in federal court and that the median monetary awards were similar.

196. 378 U.S. 226 (1964).

197. 396 U.S. 435 (1970).

198. *Id.* at 445.

199. 500 U.S. 614 (1991).

200. *Id.* at 624 (quoting *Burton v. Wilmington Parking Auth.*, 365 U.S. 715, 725 (1961)) (internal quotations omitted).

invidious discrimination.²⁰¹ Although peremptory challenge of a juror in court is similar to a peremptory challenge in arbitration, the major difference—that the court’s approval of the peremptory challenge occurred in court, utilizing the court’s power and involving the court in the discrimination—would likely be dispositive. In the case of arbitration, a court would merely approve a facially neutral arbitration agreement or award. It would be difficult to describe the court’s behavior in these enforcement actions as significant involvement with invidious discrimination.²⁰² Applying the race-based entanglement analysis to enforcement of arbitration agreements and awards will inevitably result in a no state action finding.

Thus, it would seem that the most appropriate state action analysis of arbitration would rely on the nonrace-based entanglement cases discussed above: *Flagg*, *Lugar*, and *Sullivan*. Whether one applies *Flagg*, the case in which no state action was found,²⁰³ or *Lugar*, in which state action was found,²⁰⁴ the result is the same—there is no state action when parties contract to resolve their disputes, even when they utilize the courts to enforce their agreement or award. In *Lugar*, the state statute that authorizes attachment becomes operative only when a state official signs the writ of attachment.²⁰⁵ In other words, without action by the state, the writ has no operative effect. By contrast, an agreement to arbitrate is operative at the time the agreement is signed. No state action is necessary to enable the existence of the parties’ agreement. That the source of authority for sending parties to arbitration is private rather than public is what distinguishes these cases from *Lugar* and, for that matter, *Flagg*. The nonrace-based cases—*Flagg* and *Lugar*—are one step closer to the state than the arbitration situation; until the statute is utilized, a creditor has no authority to do anything. In the case of arbitration, it is the private contract that enables the party or parties to act. The difference between

201. *Id.* at 624 (citations omitted) (internal quotations omitted) (alterations in original).

202. Opponents might argue that the court’s action in turning the award into a court order, violation of which could be punished by contempt, creates state action if the underlying arbitral process was tainted in some way. Yet enforcement of the arbitral award does not involve condoning racial discrimination. If a peremptory challenge was entered for racially discriminatory reasons, for example, the effect of the improper challenge would not be evident in the award. There is no reason to suspect, without evidence, that the ultimate decision maker was biased in any way. Thus, enforcement of the award does not create state action.

203. *See supra* notes 71–76 and accompanying text.

204. *See supra* notes 77–82 and accompanying text.

205. *Lugar*, 457 U.S. at 924–25.

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voluntary agreement and state direction is a fundamental difference that serves to distinguish the cases.

Of course, one need not accept this argument in order to predict how the Supreme Court would apply *Lugar* in a case involving arbitration. In a typical arbitration case, a party seeks judicial intervention only if the other party refuses to abide by the arbitration agreement or arbitration award or if the moving party seeks to avoid arbitration or overturn an arbitral award. If the court finds the agreement valid or the award enforceable, it would require the reluctant party to participate in arbitration or abide by the award. Only if a party to the arbitration could convince the court that judicial enforcement of a contract or award is similar to sending a sheriff to assist a party in seizing property, can the arbitral party succeed in establishing its state action argument. Given *Flagg* and the other nonrace-based entanglement cases, that outcome seems unlikely.²⁰⁶

Another way to understand why an agreement to arbitrate disputes is not similar to invocation of an attachment procedure that requires state officials' involvement is to consider how the Court might have handled *Lugar* if it involved only the issuance of a writ of attachment rather than both issuance of a writ and action by a state official to seize the property. The Court's emphasis on official involvement in property deprivation as essential to a state action finding suggests that *Lugar* would have come out differently if only writ issuance had been involved. If only writ issuance occurred, the Court would likely view the state's action as "mere acquiescence" as opposed to the kind of official involvement necessary to satisfy the state action requirement.

The Supreme Court's decision in *Sullivan*²⁰⁷ serves to reinforce the notion that contractual arbitration does not involve state action. In *Sullivan*, the Court narrowed the state action entanglement test, making clear that private utilization of a statutory procedure does not constitute state action even though invocation of the statutory procedure adversely affects a certain group of people.²⁰⁸ In other words, the *Sullivan* Court closes the door on the argument that private party utilization of state-created dispute resolution machinery is state action. Thus, *Sullivan* offers significant support for the theory that no state action exists in arbitration

206. See *Lugar*, 457 U.S. at 927 (stating that *Flagg* is different because of the absence of "overt, official involvement in the property deprivation").

207. 526 U.S. 40 (1996).

208. *Id.* at 54.

because arbitration involves private parties using *privately created* dispute resolution mechanisms.

If private party use of arbitration is not state action, the remaining question is whether private party use of the court system to enforce arbitration agreements and awards is state action. *Lugar* and *Flagg* command that no state action is present when a private party uses the court system to obtain a remedy (which may result in the deprivation of another person's property) unless a state official is directly involved in the deprivation.²⁰⁹ Thus, judicial enforcement of a party's motion to compel arbitration, without "overt, significant assistance of state officials,"²¹⁰ does not amount to state action.

Proponents of a state action finding might further argue that the FAA encourages private parties to use the court system to enforce arbitration agreements and awards just as in *Sullivan* when the legislation creating the UROs may have encouraged insurers to withhold payments for disputed medical treatments. Yet, in *Sullivan* the Court held that "subtle encouragement" of parties to use dispute resolution machinery does not amount to state action, at least when the decision to withhold payment is made by the private insurer acting alone. Similarly, then, a private party's decision to use the court system to enforce an arbitration agreement or award is not state action even though a statutory scheme exists that allows the party to obtain judicial action.

2. *Public function*

The strongest argument for finding state action in arbitration under the public function doctrine is that arbitration is traditionally a unique, if not exclusive, function of the state. In his article, Reuben contends that binding dispute resolution, particularly arbitration, is "traditionally an exclusive public function."²¹¹ Reuben argues that because an arbitral ruling is enforceable only after a judge enters the award as a judgment according to the FAA or state arbitration laws, it does not operate independently from the state.²¹²

209. See *supra* notes 83–84 and accompanying text.

210. *Sullivan*, 526 U.S. at 54.

211. Reuben, *supra* note 5, at 997–98 (citing *Boddie v. Connecticut*, 401 U.S. 371, 375 (1971), in which the Court stated that the state has a "monopoly over techniques for binding conflict resolution").

212. *Id.* at 998.

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Actual arbitration practice rebuts this argument. Arbitration began as an extrajudicial mechanism for resolving disputes.²¹³ In fact, until passage of the FAA in 1925, arbitration agreements and awards were not judicially enforced. Instead, parties abided by agreements to arbitrate and arbitration awards out of fear that they would be ostracized from the commercial community and to preserve ongoing relationships.²¹⁴ Even after the FAA was passed, groups continued to utilize arbitration and enforce arbitration awards without resort to the court.²¹⁵ Thus, the contention that dispute resolution is a unique function of the state seems inaccurate.

Moreover, that parties may resort to the courts to enforce arbitration agreements or awards does not transform binding dispute resolution into a public function. Dispute resolution is different from the provision of utility services or education because the parties, not the government, delegate the power to the arbitrator to resolve the dispute.²¹⁶ That the court may ultimately become involved in the dispute does not affect the analysis. Absent government delegation of the public function to a private entity, state action under the public function test cannot be found.²¹⁷

The *Flagg* decision also supports a no public function finding. As *Flagg* made clear, dispute settlement is neither a traditional nor an exclusive state function.²¹⁸ Moreover, according to *Flagg*, debtors and creditors have numerous options in resolving their disputes.²¹⁹ Like debtors and creditors, employees and consumers have myriad options, from mediation to arbitration and beyond, to resolve their disputes. That negotiating alternatives to arbitration at the beginning of a contractual relationship would be difficult would be irrelevant to a court, as it was

213. See Sarah Rudolph, *Blackstone's Vision of Alternative Dispute Resolution*, 22 MEMPHIS ST. U. L. REV. 279 (1992).

214. *Id.*

215. See Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms and Institutions*, 99 MICH. L. REV. 1724 (2001); Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relationships in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992).

216. See Buchanan, *supra* note 16, at 345 (explaining that the public function issue considers how governmental the activity delegated to the private entity is).

217. See Davis, *supra* note 5, at 610. Judicial enforcement of the arbitration agreement or award is not state action because no discriminatory impact on minorities occurs. See discussion of *Shelley v. Kraemer*, *supra* notes 36–43 and accompanying text.

218. See *Flagg*, 436 U.S. at 157–58, 161.

219. See *id.* at 161.

immaterial to the Court in *Flagg*.²²⁰ Thus, even under a public function analysis that examines the breadth of options available to claimants, a court should find that disputants subject to an arbitration agreement may select from a variety of alternative dispute resolution mechanisms to resolve their dispute and therefore find that arbitration is not a public function.

III. CONCLUSION

Judicial willingness to enforce agreements to arbitrate statutory claims has left opponents with little recourse to challenge arbitration agreements between one-shot and repeat players. While unconscionability remains a legitimate basis for challenging one-sided arbitration agreements, opponents of arbitration of statutory claims have turned toward the state action doctrine as a means for infusing arbitration with greater due process. Perhaps they believe that by increasing process in arbitration, the results of arbitration will level the playing field for the one-shot player. Or, they may believe that by making the arbitration process more elaborate, fewer employers and businesses will select arbitration as a primary means for resolving their disputes.

Unfortunately for the commentators who hope the state action doctrine will save one-shot players from the perceived evils of arbitration, the courts have resolved the issue correctly—there is no state action in contractual arbitration. Applying current Supreme Court jurisprudence, private party use of a private dispute resolution system does not create state action. Nor is state action present when one arbitral party seeks to enforce an arbitration agreement or award. The FAA, which provides the mechanism by which such enforcement actions proceed, is a neutral regulatory scheme. No race-based decision making takes place when a court decides whether to enforce an arbitration

220. One might argue that arbitral parties' options are limited to arbitration as a method of dispute resolution because they signed an arbitration agreement at the beginning of their contractual relationship. Yet, the parties could have negotiated to resolve future disputes using any number of ADR mechanisms other than arbitration. In that way, parties to arbitration are similar to the debtors and creditors discussed in *Flagg*. The *Flagg* Court contemplated that the parties could have engaged in predispute negotiations to avoid seizure of Brooks' property under the state statutory scheme. According to the Court, "Brooks has never alleged that state law barred her from seeking a waiver of Flagg Brothers' right to sell her goods at the time she authorized their storage." *Id.* at 160. That Brooks had little bargaining power at the start of her contractual relationship with Flagg Brothers had apparently no bearing on the Court's finding. Thus, the Court would be unlikely to characterize contractual arbitration as a public function even though, like Brooks, consumers and employees have little bargaining power at the time they enter into contractual relationships.

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agreement or award. Moreover, even if such enforcement has a disproportionate impact on protected groups, courts still cannot find state action because the Supreme Court has repeatedly held that judicial enforcement of neutral laws is not state action even when the result disadvantages protected groups.

Although disappointing to antiarbitration proponents, the state action doctrine, if it is to have any integrity, should not be interpreted instrumentally. Constitutionalizing arbitration agreements and awards might (although the evidence is ambiguous on this point) benefit employees and consumers by increasing due process in arbitral proceedings or discouraging employers and businesses from utilizing arbitration as a primary dispute resolution mechanism. But constitutionalizing arbitration agreements and awards would have a deleterious effect on the law of contracts because it would be difficult to distinguish agreements to arbitrate from other forms of contract enforceable by private parties through the use of statutory schemes. Thus, a state action finding in arbitration would constitutionalize many existing contractual arrangements, interfering greatly with parties' abilities to transact business. While constitutionalizing arbitration agreements would have an instrumental value for antiarbitration opponents, the slippery slope effect on the universe of contracts is sufficiently problematic that, for both practical and doctrinal reasons, state action should not and cannot be found in contractual arbitration.

Additionally, the mere fact that the court enforces arbitration agreements and awards does not turn the arbitrator or the parties to the arbitration into state actors. Simply put, the creation of a statutory scheme that "permits but does not compel" private party action does not create state action. Unless a state official affirmatively assists a private party in depriving another party of his constitutional rights, that private party is not a state actor when it utilizes the court system to achieve a particular end.

Nor is arbitration a public function. Dispute resolution has never been and likely will never be an exclusive function of the state. Private arbitration and mediation have existed as long as the traditional justice system. Moreover, like the parties in *Flagg*, arbitral participants have access to numerous mechanisms to assist them in resolving their disputes. The availability of alternative means to resolve disputes establishes that dispute resolution is not an exclusive function of the state.

Court-ordered arbitration and agency-initiated arbitration, in contrast to contractual arbitration, do involve state action. While it is not a surprise to learn that court-ordered arbitration involves state action because the court mandates participation in the process, that agency-initiated arbitration could rise to the level of state action is a novel concept. Although agencies might differ in their approach to arbitration, at least in the securities industry, the 1993 SEC regulation that requires every broker-dealer to register with an SRO, when all SROs mandate arbitration of nondiscrimination disputes arising out of a broker-dealer's employment, amounts to state action. In the securities industry, the government is exercising coercive power to ensure that broker-dealers, who have no meaningful employment alternatives within the securities industry, resolve disputes using arbitration. A finding that state action is present in securities arbitration should result in changes to the securities arbitration process. The current approach to securities arbitration does not provide due process sufficient to satisfy constitutional requirements. As a result, the securities industry should begin the process of amending their arbitration rules to provide greater procedural benefits to parties required to utilize arbitration. Parties outside the securities industry should follow the lead of the securities industry's reformation of the arbitral process and continue the movement toward leveling the playing field for parties in all dispute resolution processes.

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