Introduction

The Federal Arbitration Act (FAA) is now eighty years old. The time is right for a complete reformulation of federal arbitration law, whether that be international or interstate. The old FAA, passed in the Roaring Twenties, is completely outmoded. This eighty-year-old statute has been consistently disregarded by the Supreme Court, which has recast arbitration in an activist set of cases that largely ignore careful legislative history and even the explicit words of the FAA. Most of the authors feel that the Supreme Court has largely failed in this attempt to refine arbitration doctrine through the use of setting forth rules in individual cases. We also regret the failure of Congress to confront the problems that age, fragmentation, and omission have caused for the implementation of federal arbitration law. We prefer a legislative solution in the form of a new and improved FAA.

This book sets forth the principal themes that a new reformed FAA should follow. We here lay out our thoughts on the main parts of an ideal federal arbitration law. This is legal writing that deals with optimal legislation and policies. Our task is not to criticize or analyze past mistakes by the courts in interpreting the old FAA. We collectively have written far too many words critical of the present state of arbitration doctrine. This, instead, is a policy-based effort that focuses on the more difficult task of rebuilding a new FAA.

We have given substantial thought to what topics within the field of arbitration should be emphasized. This book is not a comprehensive arbitration treatise, but, instead, focuses on optimal arbitration policy. Rather than try to cover every conceivable topic in this broad field, we have selected what we think are the most pressing problem areas within American arbitration. These topics include consent to arbitrate, arbitration of consumer and employment disputes, the scope of federal arbitration legislation as compared to state arbitration legislation, federal preemption of state law, the

role of the courts in reviewing arbitration, and the application of federal law to international arbitration.

We need to clarify the methodology used to write this book. We are four scholars who each have already written that federal arbitration law needs to be reformed. In this book we have each selected areas and written individual chapters. Each designated author of every chapter should be considered the sole author of the chapter. Nonetheless, each of the four authors has served as an editor of each individually written chapter. As individual chapter authors, we each have benefitted from the comments and criticisms of our co-authors. These editorial comments should not be confused with co-authorship. In short, each of the first six chapters identifies a sole author and each chapter, while not jointly authored, has been edited by the other three co-authors of this work.

Chapter 7 represents an outlet for stressing our major differences. In this, our final chapter, there is no one author. Instead, we set forth our individual views in a point-counterpoint fashion.

Our collective view is that new federal arbitration legislation is needed. Our appendices constitute new proposed legislation consistent with the positions set forth in our preceding chapters. We believe a legislative solution is needed and oppose reforms achieved by the present water-torture of case-by-case reformation. Although there may be differences in our individual positions, we are unified in our belief that there is an immediate need to reform federal arbitration and to accomplish this by legislation and not by a difficult to decipher set of federal judicial decisions.

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CHAPTER ONE

The Core Values of Arbitration

Edward Brunet

Arbitration appears to rest on a firm bedrock of presumed policies: efficiency, the opportunity for a fair hearing, party autonomy, privatization, arbitrator expertise, neutrality, and finality. These familiar policies, now often mere generalizations, need to be isolated and repackaged in a reformulation of American arbitration doctrine. This chapter discusses the presumed policies purportedly advanced by arbitration and seeks to identify the preferred values that form the foundation of arbitration policy. I stress that four arbitration policies – party autonomy, privatization, arbitrator neutrality, and the opportunity for a fair hearing – occupy center stage in arbitration theory. The chapter de-emphasizes arbitration values supported mostly by mythology and asserts that policies relating to expertise, efficiency, and finality are often trumped by higher order principles that support arbitration. The chapter's conclusion also reveals a previously understated additional arbitration value, that of a public dimension underlying the seemingly private arbitration process.

Section 1.1 Party Autonomy: Allocating Disputing Power and Freedom to the Disputants

Arbitration rests on a firm foundation of party autonomy. The parties own the dispute[1] and should be able to control the details of their disputing process. They may chose to litigate, mediate, or arbitrate. If the parties select arbitration, they may broadly agree to arbitrate without specifying a particular type of arbitration procedure or, alternatively, they may tailor their

[1] *See* Carrie Menkel-Meadow, *Whose Dispute Is It Anyway? A Philosophical and Democratic Defense of Settlement (In Some Cases)*, 83 Geo. L. J. 2663 (1995).

arbitration arrangement by agreeing to use particular procedures appropriate to their needs.

A contract is central to the success of party autonomy in arbitration procedure. A contract to arbitrate can set forth the essentials of the arbitration process, ranging from restrictions on discovery to the selection of a more judicialized form of arbitration, which is characterized by adopting procedures associated with conventional litigation. Parties to an arbitration agreement may contract to take a limited number of depositions or to mandate that the arbitrator apply substantive legal principles. They may also require the arbitrator to enter findings of fact or conclusions of law.

Assertions of party autonomy represent manifestations of party control of the arbitration process. The courts often state the cliché that arbitration is the creature of contract.[2] As stated in the *Mastrobouno* decision, "[p]arties are generally free to structure their arbitration agreements as they see fit."[3] Such language legitimizes the parties' implementation of pre-dispute arbitration clauses by means of contract. Professor Ware has appropriately asserted that "the entire FAA embodies a strongly contractual approach to arbitration law."[4] Under a contractual approach the parties exercise their will by covenanting for specific arbitration procedures rather than merely opting for an undefined agreement to arbitrate, which will leave much of the choice of the arbitration procedure to the arbitrator or organization selected to administer the arbitration process.

In a democratic society, party autonomy should be the fundamental value that shapes arbitration. The personal autonomy inherent in arbitration constitutes a dominant policy in all areas of a democracy.[5] The freedom to select arbitration procedure is a choice that one anticipates should exist in a state

[2] *See, e.g.*, *Fils et Cables D'Acier de Lens v. Midland Metals Corp.*, 584 F. Supp. 240, 243 (S.D.N.Y. 1984). Professor Ware, writing in 1999, found 177 cases that used the phrase "arbitration is the creature of contract." Stephen J. Ware, *Default Rules from Mandatory Rules: Privatizing Law through Arbitration*, 83 MINN L. REV. 703, 709 (1999) (hereafter *Default Rules*). *See also Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468, 479 (1989) (stating that court's role is to "ensur[e] that private agreements to arbitrate are enforced according to their terms").

[3] *Mastrobouno v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995).

[4] Ware, *Default Rules*, *supra* Note 2 at 729.

[5] *See generally* Richard C. Reuben, *Democracy and Dispute Resolution: The Problem of Arbitration*, 67 LAW & CONTEMP. PROB. 279, 303 (2004) (hereafter cited as Reuben, *Democracy and Dispute Resolution*) (identifying connection between arbitration autonomy and personal autonomy in a democratic system of government, but concluding that present arbitration doctrine departs from democratic norms); Richard C. Reuben, *Democracy and Dispute Resolution: Systems Design and the New Workplace*, 10 HARV. NEG. L. REV. 11, 48–50 (2005) (emphasizing the individual's loss of personal autonomy in mandatory employment arbitration under the FAA).

that values personal autonomy. Arbitration liberty is achieved by making party autonomy the highest priority in the pantheon of arbitration values.

Viewed in this light, the important value of party autonomy is directly related to the freedom essential in a democratic state. A strong version of arbitration party autonomy exemplifies the significance of freedom of contract. In a state such as ours characterized by the respect for individual liberty, courts should enforce customized agreements to arbitrate and the legislature should regulate minimally.[6] In a society governed by rules of the free market, contract norms that guide exchanges are necessarily based on autonomous action of individual economic actors.[7]

Judicial approval and enforcement of the parties' selection of arbitration procedure contributes to private ordering. The delegation to a private arbitrator of hand-forged procedures to resolve a dispute creates a form of self-governance that operates outside more direct government regulation. When courts enforce party crafted procedures, they create an incentive for parties to draft their own rules of dispute resolution rather than leave the problem of future disputes to government. In this way, law is internalized by the disputants who form their own private culture.

Self-determination, long thought of as a central tenet of mediation theory, meshes well with arbitration's self-governance value. As recently explained by Professor Lisa Bingham, party control is also a central advantage of binding arbitration.[8] Sophisticated, repeat users of arbitration possess control over the type of process they wish to use in resolving disputes, and they can exert their self-determination by customizing arbitration clauses to embrace specific desired procedures. Over time, disputants within some industries have developed successful and hand-forged systems of arbitration that illustrate the self-determination of individual members.[9]

[6] Reuben, *Democracy and Dispute Resolution*, at 308 (concluding that democratic theory suggests that courts should not require mandatory arbitration but should "implement the will of the legislature by policing agreements to arbitrate"); Ware, *Default Rules*, *supra* Note 2 (explaining modern arbitration as a system of privatization and non-regulation with legislation that only sets forth rules of default applicable where the parties have not created their own set of arbitration norms).

[7] *See, e.g.*, Milton Friedman, Capitalism and Freedom 13 (1962) (lauding voluntary cooperation of individuals in economic transactions as permitting exchange without government coercion) (hereafter cited as Friedman, Capitalism and Freedom).

[8] Lisa B. Bingham, *Control Over Dispute-System Design and Mandatory Commercial. Arbitration*, 67 Law & Contemp. Prob. 221, 227 (2004) (asserting that business users of arbitration "have the power to define, through negotiation, the dispute-resolution system that culminates in arbitration," citing Commercial Arbitration at Its Best: Successful Strategies for Business Users, Thomas J. Stipanowich & Peter H. Kaskell, eds. (2001)).

[9] *See, e.g.*, Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation through Rules, Norms and Institutions*, 99 Mich L. Rev. 1724 (2001) (describing a

There is evidence that sophisticated, repeat users of arbitration are willing to pay higher transactions costs for a more complicated and judicialized style of arbitration. This trend is evident when one considers the role of substantive law in arbitration. Turn of the century textile arbitrations eschewed reliance on law and relied, instead, on expert intra-industry arbitrators to decide the dispute equitably, often by relying on trade-usage norms.[10] Modern commercial arbitration frequently operates outside the intra-industry context that often incorporates industry norms as the rule of decision. Today's arbitration parties face a choice: leave the selection of the rule of decision to the arbitrator's discretion or tie the arbitrator's hands by opting for a specific legal regime or procedure. Some business parties, unhappy with the possibility that the arbitrator may issue a compromise award at odds with legal formality, have inserted choice of law clauses in their arbitration agreements and implemented their choice by demanding that the arbitrator enter conclusions of law. The success of the National Arbitration Forum, an arbitration provider that advertises and mandates that its arbitrators must follow the law,[11] provides some evidence that there is considerable business demand for a judicialized type of arbitration.

The use of judicialized arbitration increases transaction costs by complicating the arbitration procedure and increasing the possibility that a court might set aside the award. Nonetheless, numerous business parties appear to be opting for such clauses and some courts appear willing to approve their use by means of a contract model rationale.[12] Reliance on the contract model contributes to party autonomy by upholding the intent of the parties in their choice of arbitration procedure. This reliance suggests that arbitration procedure, if left to the parties, is textured and full of variety.

Rigorous attention to consent is central to party autonomy. The policy of self-determination inherent in party autonomy must incorporate a broad notion of actual consent to arbitrate. Bilateral consent to arbitrate is essential

successful arbitration system created by disputants within the cotton industry that includes such innovations as a seven-member arbitration panel, a custom of unanimous opinions, and written opinions of an arbitration appeals board).

[10] *See* Edward Brunet, *Replacing Folklore Arbitration with a Contract Model of Arbitration*, 74 Tul. L. Rev. 39, 43 (1999) (hereafter cited as Brunet, *Contract Model*), (citing *Turnbill v. Martin*, 2 Daly 428, 430 (N.Y.C.P. 1869), a dispute regarding the sale of flannels that was submitted to arbitration before dry goods merchants selected by the disputants).

[11] *See* A.B.A.J. 20 (Feb., 2004) (advertising in $^{1}/_{2}$ page that "All Arbitration is Not the Same" because the NAF has a "procedural code requiring arbitrators to follow the law in making decisions and awards").

[12] *See, e.g., Gateway Technologies v. MCI Telecommunications Corp.*, 64 F.3d 993 (5th Cir. 1995) (overturning district court refusal to follow the parties' contract that provided for judicial review of legal error in the arbitration hearing).

to autonomy and to freedom.[13] If only one party wants arbitration, the other party loses party control. Surrogate substitutes for bilateral consent undervalue the essential policy of self-determination.

The policy of party autonomy casts grave doubt on mandatory consumer arbitration in which product manufacturers impose the arbitration option without the explicit agreement of unknowing consumers who purchase their products. Formalistic decisions, such as *Hill v. Gateway 2000, Inc.*,[14] which substitute failure to return a product for knowing consent to arbitrate, lack appropriate allegiance to the party autonomy value that is essential to arbitration. A consumer who is forced to arbitrate a dispute without having knowledgeably consented to arbitration loses both the freedom to use the court system and the freedom to contract in a knowing fashion. Mandatory arbitration of employment disputes outside the collective bargaining context is similarly plagued by lack of attention to the employee's consent to arbitrate.[15] The arbitration value of party autonomy, central to personal liberty, requires courts to take consent to arbitrate seriously.

I support party autonomy as the fundamental value of arbitration. Questions remain, however, as to how far courts should extend party intent in the arbitration arena. Subsequent subsections of this chapter and book will discuss the collision of party intent and arbitration finality and address the impact of an enhanced consent requirement upon mandatory arbitration.[16] Resolution of these value conflicts illustrate the limits of arbitration theory and the dangers of adopting rigid positions in this rapidly changing area.

Section 1.2 Privatization: On Secrecy, Privacy, and Self-Governance

Arbitration represents a volitional opt out of the conventional court system into a realm of private dispute resolution. When parties select arbitration, they privatize their dispute and take a form of market ownership of their

[13] *See* Friedman, Capitalism and Freedom, *supra* Note 7 at 13 (asserting that "[T]he possibility of co-ordination through voluntary co-operation rests on the elementary – yet frequently denied – proposition that both parties to an economic transaction benefit from it, *provided the transaction is bi-laterally voluntary and informed*") (emphasis in original).

[14] 105 F.3d 1147 (7th Cir.), *cert. denied*, 522 U.S. 808 (1997). The court held that the buyer of a computer assented to a form arbitration clause included in the box with the computer by using the computer.

[15] *See* Section 7.2(1), *infra* (arguing that arbitration doctrine should ban arbitration clauses that are mandatory conditions to employment outside the collective bargaining context).

[16] *See* Section 3.5, *infra* (arguing that the arbitration parties should have the power to contract for enhanced judicial review).

disputing procedure. Rather than litigate in the conventional public court system, the parties to an arbitration agreement opt for adjudication in a private forum. In this context, an arbitration clause operates as a sort of forum selection clause and can be conceived as a rejection of the public courts. As explained by Professor Drahozal, businesses select arbitration as a means to avoid jury trials and obtain a perceived "better" decision than that rendered by a jury.[17]

Private arbitration forums function in a free, competitive market. Private firms compete for the role of administering arbitrations. Private arbitrators, largely unregulated by the state, compete for the task of arbitrating disputes. Entry into the market is easy; new rival suppliers abound. Arbitrators often apply private law and eschew publically created legal rules.

Privacy and secrecy pervade the arbitration process. Hearings take place in private facilities and locations, such as hotel conference facilities, law firms, or space provided by an arbitration administrator. These hearings are effectively and intentionally shielded from the public eye. They are private because they are secret.

The desire for secrecy can be a prime determinant in selecting arbitration. Often one or more party to an arbitration agreement has an interest in avoiding a public trial with unwanted adverse publicity. It should come as no surprise that repeat users of arbitration include banks, credit card issuers, computer manufacturers, physicians, securities brokers, car dealers, and chain restaurant franchisers – each businesses with a strong desire to avoid potentially negative publicity that may accompany a public court hearing. Many of the arbitration claims involving such parties, who generally draft boilerplate arbitration arrangements, center on discrimination claims. The last thing a restaurant chain or a bank needs is a public airing of dirty linen involving allegations of discrimination. In this context, secrecy in disputing may be the primary reason that a business seeks arbitration. Professor Mentschikoff wrote years ago that the "desire for privacy" was one of the "chief motivating factors underlying commercial arbitration."[18] Assuming that there is true bilateral consent, a pre-dispute agreement to hold a private hearing should be respected.[19]

[17] *See* Christopher R. Drahozal, *A Behavioral Analysis of Private Judging*, 67 LAW & CONTEMP. PROB. 105, 131 (2004) (noting that "[A] commonly cited reason that businesses include arbitration in their contracts with consumers is to avoid jury trials" and observing that businesses think arbitration is "a way to avoid aberrant jury verdicts, implicitly if not explicitly assuming that arbitrators make 'better' decisions than juries").

[18] Soia Mentschikoff, *Commercial Arbitration*, 61 COLUM. L. REV. 846, 849 (1961).

[19] *See* Judith Resnik, *Due Process: A Public Dimension*, 39 U. FLA. L. REV. 405, 429 (1987) (questioning a public role in pre-lawsuit arbitration because "parties are not required to file lawsuits") (hereafter as Resnik, *A Public Dimension*).

Some arbitrations are private in a different sense, that of constituting secret disputes between members of a particular culture who seek to confine or cabin their dispute by placing it within the boundaries of a particular culture or industry. Professor Lisa Bernstein has described Manhattan arbitrations between disputing diamond merchants.[20] In this culture it was common for two diamond merchants to contract for arbitration to resolve their disputes and to select a respected fellow diamond merchant to be the arbitrator. The dispute might be even more inwardly focused by having the arbitrator choose to apply customs and usages of the diamond trade as a way to adjudicate the dispute. Under this form of privatized arbitration, the expert and known commodity arbitrator eschews law in deciding the dispute and, instead, looks to general principles that govern his or her business as a determinant or rule of decision.[21] The process of selecting a fellow merchant as an arbitrator facilitated the choice of a knowledgeable, expert arbitrator. Particular arbitration cultures have arisen over time. There has been a diverse use of intra-industry arbitration ranging from arbitration between cotton or textile merchants as evidenced by the inclusion of arbitration in the charter of the New York Cotton Exchange[22] and the governance of arbitration by the General Arbitration Council of the Textile Industry[23] to arbitration for movie and television screen credits between writers disputing the validity of another writer's contributions.[24]

The American arbitration process also lends to its private nature. Typically, arbitration in the United States ends silently with a cryptic written award that does not contain a discursive opinion. Rather than publicize the arbitration result and its reasoning, American arbitrators typically sign a one-page award that merely denotes the final result of a dispute without explanation and thereby facilitates a silent resolution of the case. Privacy is enhanced by this common technique of eschewing written, discursive

[20] *See* Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. Legal Stud. 115 (1992).

[21] *See, e.g.*, William L. Ranson, *The Organization of Courts for Better Administration of Justice*, 2 Cornell L. Q. 261, 273 (1917) (asserting that businesses require a "determination of their rights under the facts as found and the applicable rules of law, as commonly observed in the community for the conduct of similar business dealings"). This choice of industry norms operates as a type of choice of law clause. Such "privatization occurs with every enforceable contract." Ware, *Default Rules*, *supra* Note 2 at 744.

[22] William Catron Jones, *Three Centuries of Commercial Arbitration in New York: A Brief Survey*, 1956 Wash. U. L. Q. 193, 217.

[23] *See* General Arbitration Council of the Textile and Apparel Industry, A Guide to Arbitration/Mediation for the Textile and Apparel Industries 4 (1996).

[24] *See* Writers Guild of America, Screen Credits Manual (1999) (detailing arbitration procedures to resolve disputes between movie and television script writers by submitting scripts and written statements to "arbitration committee" of anonymous screen writers).

arbitrator opinions. To be sure, it is common to see American arbitrators write opinions in labor grievance arbitrations and maritime arbitrations. Yet, such published arbitration opinions are exceptions to the customary norm of silent, one page awards that merely catalog the remedial result of the arbitration. This custom, along with the private nature of the typical arbitration hearing itself, has led some to describe arbitration as lacking transparency.[25]

The process of privatization occurs as well in arbitration's lawmaking and law-application context. Professor Ware noted that when parties agree to arbitrate, they often are opting out of a system of government-created rights and obligations into an arbitration system in which privately created rights and duties are substituted.[26] Professor Ware describes this process as filling contractual gaps with the arbitrator's discretion;[27] Professor Bernstein explains this as "a horizontal system of competing default regimes."[28] Arbitrators often fill gaps by interposing their own sense of equity, but this gap filling is more party-intended and industry focused; it is, thus, consistent with the contract model of arbitration and the notion of privatization. The frequent practice of arbitrators failing to apply the law furthers the creation of new private norms that replace public substantive legal principles.[29] The absence of significant judicial review of arbitration awards reinforces the creation of private law in a privatized arbitration system.

The value of arbitration privatization is related to self-governance. It comes as no surprise that intra-industry trade groups were and are attracted to arbitration. Rather than permit intrusion upon their functioning by third parties, including government, trade groups sought to privatize their disputes. Commentators have praised the virtues of using arbitration

[25] *See, e.g.*, Reuben, *Democracy and Dispute Resolution*, *supra* Note 5 at 301(asserting that "transparency is generally not an animating value of arbitration").

[26] *See generally* Ware, *Default Rules*, *supra* Note 2.

[27] *Id.* at 744.

[28] Lisa Bernstein, *Social Norms and Default Rules Analysis*, 3 S. Cal. Interdisc. L.J. 59, 84 (1994).

[29] *Id.* at 720–4. *See generally* Soia Mentschikoff, *Commercial Arbitration*, 61 Colum. L. Rev. 846, 861 (1961) (survey of commercial arbitrators suggests that 90% feel free to ignore substantive law if it will lead to a more just result). *Accord*: Dean Thomson, *Arbitration Theory and Practice: A Survey of AAA Construction Arbitrators*, 23 Hofstra L. Rev. 137, 154–5 (1994) (survey finds that 28% of construction arbitrators do not always follow the law in crafting awards); Ian R. Macneil, Richard E. Speidel, Thomas J. Stipanowich, Federal Arbitration Law: Agreements, Awards, and Remedies under the Federal Arbitration Act §2.1.2 (1994, supp) (noting "highly discretionary" application of norms by arbitrators who are not bound "by the law of any particular jurisdiction") Hereafter cited as Macneil et al., Federal Arbitration Law).