

## Is Arbitration Lawless?

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### Introduction

Is arbitration “lawless”? The question is not a new one. In a 1944 article in the *Yale Law Journal*, Heinrich Kronstein wrote that “[n]o theory in support of organized arbitration can conceal the essential ‘lawlessness’ of this form of ‘private government.’”<sup>1</sup> Kronstein explained further in subsequent writing:

Arbitration is power, and courts are forbidden to look behind it. The protection of awards against judicial interference, and, under that umbrella, of the development of organized arbitration as a rule-maker have established “judicial powers” other than those provided by federal and state constitutions. It is not possible to maintain any legally established policy or order in domestic and international trade, whether it is an order of free competition protected by antitrust legislation or any other type of economic order provided by law, if courts abdicate their power in favor of private tribunals serving private interests. American courts are presently confronted with a conflict with such private courts. In the face of the current trends in our society, the central concept of a social regime whose

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<sup>1</sup> Heinrich Kronstein, *Business Arbitration—Instrument of Private Government*, 54 YALE L.J. 36, 66 (1944).

exclusive ordering is the totality of legislative and judicial mandates, has been weakened by the cession of the law to organized arbitration.<sup>2</sup>

Although Kronstein focused on arbitration's effect on the enforcement of the antitrust laws, he made clear that his concern extended as well to "any other type of economic order provided by law."<sup>3</sup>

Contemporary commentators in a variety of contexts likewise have described arbitration as lawless. According to Phillip J. McConaughay, "[i]nternational commercial arbitrations today are virtually lawless, or at least they can be, at the election of the parties or the private arbitrators who serve them."<sup>4</sup> Edward Brunet states that "securities arbitration remains lawless.... While securities arbitration surely operates in the 'shadow of the law,' it is clear that the arbitrators need not apply law."<sup>5</sup> Kenneth S.

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<sup>2</sup> Heinrich Kronstein, *Arbitration is Power*, 38 N.Y.U. L. REV. 661, 699-700 (1963).

<sup>3</sup> *Id.*

<sup>4</sup> Philip J. McConaughay, *The Risks and Virtues of Lawlessness: A "Second Look" at International Commercial Arbitration*, 93 NW. U. L. REV. 453, 453 (1999); *see also* Linda Silberman, *International Arbitration: Comments from a Critic*, 13 AM. REV. INT'L ARB. 9, 11 (2002) ("An even more basic flaw of international arbitration is its almost "lawless" character as regards national law.... [T]here is no real context for and no real check on arbitrators' rulings").

<sup>5</sup> Edward Brunet, *A Decade After McMahon: Toward Changing Models of Securities Arbitration*, 62 BROOKLYN L. REV. 1459, 1484 (1996); *see also* Barbara Black & Jill I. Gross, *Making It Up as They Go Along: The Role of Law in Securities Arbitration*, 23 CARDOZO L. REV. 991, 1040 (2002) ("While it seems that an investor may have difficulty prevailing in court under the established law, arbitration panels, on more than an occasional basis, are reaching decisions

Abraham & J.W. Montgomery III, writing about the arbitration of insurance disputes, argue that “arbitration often involves a form of contractual ‘lawlessness’ that is especially undesirable in claims that involve new legal issues. This lawlessness not only adversely affects the parties to each dispute, but the legal system as a whole.”<sup>6</sup> Although not using the word “lawless,” Charles L. Knapp expresses concerns similar to those of Kronstein:

[D]enial of access to a court of law in most cases means exactly that – denial of access not merely to a court, or even to a jury, but to the law itself.... [A]rbitrators in most cases are not bound to follow the law, nor are their decisions appealable to a court of law for any but the most egregious of defects. Mere failure to follow the law is not such a defect. The result is that whatever the rules of law may be, arbitrators are not bound to follow them, and their handiwork is subject to only the most perfunctory of judicial oversight. Arbitrators of course may choose to

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favorable to investors even where the ‘law is clear’ that there is no basis for imposing liability on the broker.”); Jennifer J. Johnson, *Wall Street Meets the Wild West: Bringing Law and Order to Securities Arbitration*, 84 N.C. L. REV. 123, 140 (2005) (“there is no meaningful oversight to ensure that arbitrators are applying the law, and limited evidence on the ground suggests that SRO panels may not in fact apply the law”).

<sup>6</sup> Kenneth S. Abraham & J.W. Montgomery, III, *The Lawlessness of Arbitration*, 9 CONN. INS. L.J. 355, 357 (2003); *see also* Richard M. Alderman, *Consumer Arbitration: The Destruction of Common Law*, 2 J. AM. ARB. 1, 11 (2003) (“Even assuming an arbitrator is committed to following the law, however, he or she cannot make it. Therein lies the problem.... Arbitration eliminates litigation in a public forum, precedent-establishing decisions, and stare decisis.”).

follow the law – nothing requires them not to – but if they do, it’s not because they have any obligation to do so, and it’s not something that a litigant or her attorney can count on going in. Knowledgeable attorneys may have some sense of the approach that an arbitration panel is likely to take to a given type of case. Still, the arbitrators bring their own “law” with them, and they take it with them when they leave.<sup>7</sup>

Knapp concludes that “the pressure for mandatory arbitration represents another step, and a giant one, in the privatization of American contract law,”<sup>8</sup> warning that “[t]he piece-by-piece dismantling of American contract law is happening under our noses, right now.”<sup>9</sup>

But while concern about the “lawlessness” of arbitration is widespread,<sup>10</sup> what the commentators mean by “lawless” varies.<sup>11</sup> The most common meaning is simply that

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<sup>7</sup> Charles L. Knapp, *Taking Contracts Private: The Quiet Revolution in Contract Law*, 71 *FORDHAM L. REV.* 761, 782-83 (2002).

<sup>8</sup> *Id.* at 765.

<sup>9</sup> *Id.* at 766.

<sup>10</sup> Of course, some commentators disagree with the description of arbitration as “lawless.” *E.g.*, William W. Park, *The Specificity of International Arbitration: The Case for FAA Reform*, 36 *VAND. J. TRANSNAT’L L.* 1241, 1290 n.217 (2003) (“The assertion that arbitrators are allowed to be lawless is at odds with the existence of ‘manifest disregard of the law’ as a standard for judicial review, and is inconsistent with the provisions of many arbitration rules.”).

<sup>11</sup> Some include procedural differences between arbitration and litigation as part of the “lawlessness” of arbitration. *E.g.*, McConaughay, *supra* note \_\_\_, at 454 (including “its

arbitrators are not required to follow the law in making their awards.<sup>12</sup> Courts regularly state that arbitrators need not follow the law,<sup>13</sup> and commentators have described the arbitration process (in the United States at least) as involving decisions based on equity and fairness rather than legal obligation.<sup>14</sup> A second meaning is that parties to arbitration agreements – or more precisely, businesses that include arbitration agreements in their standard form contracts with consumers and employees – use arbitration to avoid

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procedural irregularity” as element of “international arbitration’s lawlessness”). I limit my focus here to the application of substantive law in arbitration.

<sup>12</sup> E.g., Brunet, *supra* note \_\_, at 1484.

<sup>13</sup> Stephen J. Ware, *Default Rules from Mandatory Rules: Privatizing Law Through Arbitration*, 83 MINN. L. REV. 703, 720 n.82 (1999) (citing cases).

<sup>14</sup> Paul D. Carrington & Paul H. Haagen, *Contract and Jurisdiction*, 1996 SUP. CT. REV. 331, 344-45:

Commercial arbitration, at least as it is practiced in America, is a method of dispute resolution, but not necessarily a method of enforcing legal rights.... A Latin phrase sometimes employed to describe the spirit of much American commercial arbitration is *ex aequo et bono* – a resolution is sought that is equitable, minimizes harm to either party, and enables potential adversaries to maintain a valuable commercial relationship; the role of such an arbitrator is said in Europe to be that of an *amiable compositeur*. It is said of the American commercial arbitrator that he “may do justice as he sees it, applying his own sense of the law and equity to the facts as he finds them to be and making an award reflecting the spirit rather than the letter of the agreement.”

application of legal rules protecting consumers and employees. Because arbitrators need not follow the law, businesses can avoid consumer and employee protection rules<sup>15</sup> (“self-deregulate,” to use Paul Carrington’s phrase) by having disputes resolved in arbitration instead of court.<sup>16</sup> A third meaning is that arbitration impedes the creation of law by the courts. When disputes are arbitrated rather than litigated, the outcome may be unreasoned and unpublished arbitration awards rather than published and precedential court opinions.

This article examines the empirical evidence underlying these various views of arbitral lawlessness. It considers what we know about three related empirical questions: (1) do arbitrators follow the law in making their awards? (2) do businesses provide for arbitration to avoid mandatory legal rules?; and (3) to what extent does arbitration interfere with the development of the law? Certainly much more research needs to be done. But, perhaps surprisingly, the available empirical evidence to date provides at best weak support for the view that arbitration is “lawless.”<sup>17</sup> There is evidence that arbitrators do not treat statutory issues in as much detail as courts, but little other evidence that arbitrators definitively differ from judges in their attitudes

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<sup>15</sup> The mandatory rules can be either statutory or derived from the common law. *See* Ware, *supra* note \_\_\_, at 732-33.

<sup>16</sup> Paul D. Carrington, *Unconscionable Lawyers*, 19 GA. ST. U. L. REV. 361, 370 (2002).

<sup>17</sup> Of course, juries frequently are criticized as “lawless,” so maybe these results are not so surprising after all. Robert P. Burns, *The Lawfulness of the American Trial*, 38 AM. CRIM. L. REV. 205, 205 (2001) (“Much of the recent criticism of the American trial focuses on its perceived ‘lawlessness.’ Commentators have accused juries of making decisions based on emotion and prejudice, all the way up to explicit nullification.”).

and practices toward legal issues.<sup>18</sup> Studies find no indication that parties agree to arbitrate to avoid mandatory legal rules, even when they have the opportunity and incentive to do so.<sup>19</sup> Finally, whether arbitration interferes with the development of the law is extremely difficult to evaluate. Certainly many arbitration awards are not published; but there is some evidence that awards that are published serve as precedent (persuasive rather than binding) in subsequent arbitrations.<sup>20</sup>

A few qualifications: First, this article does not attempt to canvass the theoretical arguments in support of the assertions of arbitral lawlessness. In my view, those arguments are largely indeterminate because of the difficulty of evaluating reputational constraints on arbitral decision making.<sup>21</sup> Nor does this article consider the normative issue of whether arbitrators should follow the law – i.e., whether the benefits of the asserted “lawlessness” of arbitration outweigh the costs.<sup>22</sup> Finally, it does not analyze how to make it more likely that arbitrators

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<sup>18</sup> See *infra* text accompanying notes \_\_\_-\_\_.

<sup>19</sup> See *infra* text accompanying notes \_\_\_-\_\_.

<sup>20</sup> See *infra* text accompanying notes \_\_\_-\_\_.

<sup>21</sup> See *infra* text accompanying notes \_\_\_-\_\_.

<sup>22</sup> E.g., McConnaughay, *supra* note \_\_, at 459 (“‘Lawlessness’ in international commercial arbitration ... has virtues as well as risks”); Ware, *supra* note \_\_, at 711 (“Contracting out of law through arbitration agreements does not necessarily mean that such law will be under-enforced in the sense that plaintiffs ‘do worse’ in arbitration than they would have done in court. In some cases, arbitrators reach a more ‘pro-plaintiff’ result than a court would have reached ....”).

follow the law. Others already have made important efforts in this regard.<sup>23</sup> Instead, this article focuses on what the available empirical evidence suggests about the “lawlessness” of arbitration.

## **I. Do Arbitrators Follow the Law?**

Stephen J. Ware states flatly: “[A]rbitrators often do not apply the law.”<sup>24</sup> There certainly is reason to wonder. An arbitrator’s authority is based on contract, so that arbitrators have limited incentive to consider the effects of their awards on third parties. If faced with a choice between a decision preferred by the parties or one that follows the law, arbitrators have an incentive to choose the former.<sup>25</sup> In addition, many arbitration awards contain no statement of reasons, so that it is difficult if not impossible for courts to determine whether in fact the arbitrators have

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<sup>23</sup> See, e.g., Andrew T. Guzman, *Arbitrator Liability: Reconciling Arbitration and Mandatory Rules*, 49 DUKE L.J. 1279 (2000) (imposing liability on arbitrators for failing to follow law); Eric A. Posner, *Arbitration and the Harmonization of International Commercial Law: A Defense of Mitsubishi*, 39 VA. J. INT’L L. 647 (1999) (random selection of awards for review); see also Michael Abramowicz, *Predictive Decisionmaking*, 92 VA. L. REV. 69, 118 (2006) (random selection of awards for traditional adjudication, coupled with multiplier to fee or penalty).

<sup>24</sup> Ware, *supra* note \_\_\_, at 725.

<sup>25</sup> Carrington & Haagen, *supra* note \_\_\_, at 346 (“Even International Chamber of Commerce arbitrators are dependent for their careers, to a degree that no judges are, on the acceptability of their awards to the parties, and perhaps especially on their acceptability to parties who are ‘repeat players.’ This circumstance creates pressure on arbitrators to appear to be considerate of the interests of all parties, even those who have sorely abused the rights of others.”).

followed the law.<sup>26</sup> Finally, court review of arbitration awards is largely on procedural grounds. In the United States, the only substantive ground for vacating an award is if it is made in “manifest disregard of the law.”<sup>27</sup> Thus, even if a court determines that the arbitrators did not follow the law, in most cases the court will uphold the award.<sup>28</sup>

On the other hand, some commentators argue that arbitrators in fact ordinarily do follow the law. According to Alan Scott Rau:

Now I imagine it is fair to say that arbitrators usually do try their best to model their awards on what courts would do in similar cases – and that as often as not they succeed in doing so. That is at least what the scanty empirical evidence seems to suggest, and it corresponds as well to a plausible account of the likely

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<sup>26</sup> EDWARD BRUNET & CHARLES B. CRAVER, *ALTERNATIVE DISPUTE RESOLUTION: THE ADVOCATE’S PERSPECTIVE* 324 (1997). By comparison, reasoned awards are the norm in international arbitration. See CHRISTOPHER R. DRAHOZAL & RICHARD W. NAIMARK, *TOWARDS A SCIENCE OF INTERNATIONAL ARBITRATION: COLLECTED EMPIRICAL RESEARCH* 255 (2005).

<sup>27</sup> *Wilko v. Swan*, 346 U.S. 427, 436-37 (1953); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 942 (1995) (dicta) ; see Michael A. Scodro, *Deterrence and Implied Limits on Arbitral Power*, 55 *DUKE L.J.* 547, 566-68 (2000) (discussing history and acceptance of manifest disregard ground for judicial review of arbitral awards).

<sup>28</sup> *E.g.*, *Duferco Int’l Steel Trading v. T. Klaveness Shipping A/S*, 333 F.3d 383, 389 (2d Cir. 2003) (“since 1960 we have vacated some part or all of an arbitral award for manifest disregard in the following four out of at least 48 cases where we applied the standard”); *Dawahare v. Spencer*, 210 F.3d 666, 670 (6<sup>th</sup> Cir.), *cert. denied*, 531 U.S. 878 (2000) (identifying only two U.S. court of appeals cases vacating awards for manifest disregard of the law).

nature of arbitrator incentives. What courts and codes have previously said is a natural starting point, after all – while inertia often does the rest – to the point that deciding in conformity with these rules of law will often simply appear to the arbitrator to be the path of least resistance. It is also most likely to be congruent with the ex ante expectations of contracting parties, who – behind the proverbial veil of ignorance – may not have supposed that in drafting an arbitration clause, they were entirely surrendering the right to have their conduct judged by external legal standards. Above all perhaps, arbitrators may be expected to act in such a way as to maximize the likelihood that their awards will be enforceable in all jurisdictions where review is likely – a vacated or unrecognized award being a fiasco, a sign of fecklessness or irresponsibility that hardly enhances market credibility.<sup>29</sup>

In addition, Donald Donovan and Alexander Greenawalt argue that, at least in international arbitration, administering institutions act as a further constraint on the selection of arbitrators who might ignore mandatory rules of national law.<sup>30</sup> They conclude that “[a]lthough we cannot

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<sup>29</sup> Alan Scott Rau, *The Culture of American Arbitration and the Lessons of ADR*, 40 TEX. INT’L L.J. 449, 514-15 (2005).

<sup>30</sup> Donald Francis Donovan & Alexander K.A. Greenawalt, *Mitsubishi After Twenty Years: Mandatory Rules Before Courts and International Arbitrators*, in *PERVASIVE PROBLEMS IN INTERNATIONAL ARBITRATION* 11, 36-38 (Loukas A. Mistelis & Julian D.M. Lew eds. 2006):

We are skeptical that this theory [that appointing authorities have an incentive to select otherwise neutral arbitrators who exhibit a particular bias against mandatory rules per se] presents a credible picture of the world of

exclude out of hand the theoretical possibility that international arbitration of mandatory rules might lead to under-enforcement of those rules, we do not believe that the proposition can be established by reference to theoretical economic incentives alone.”<sup>31</sup>

I agree. Ultimately, the claim, at least as stated by Ware, is an empirical one – not merely that arbitrators might not follow the law, or that any mistakes they might make will not be corrected, but that they “often do not apply the law.”<sup>32</sup> Of course, what one means by “often”

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international arbitration as it actually operates. It begins with a simple theoretical assumption – that in certain cases some parties at the time of contracting will have some unquantified incentive to avoid application of mandatory rules. But the mere fact that this may be the case does not yield the assumption that this impulse has sufficient weight to drive the economics of appointing authorities to the point that these institutions will exhibit systemic bias in favor of appointing arbitrators who will both entertain and deny meritorious mandatory rules claims, or that a steady supply of arbitrators exists who both fit this specific bill and meet the qualifications more generally demanded of arbitrators.

*But see* David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33, 61 (“Even the independent arbitration companies have an economic interest in being looked on kindly by large institutional corporate defendants who can bring repeat business.”).

<sup>31</sup> Donovan & Greenawalt, *supra* note \_\_\_, at 38.

<sup>32</sup> Ware, *supra* note \_\_\_, at 725.

varies depending on the context and the individual.<sup>33</sup> Thus, a more precise statement of the question is: “how often” do arbitrators not follow the law?<sup>34</sup> The empirical evidence on this point – which consists of cases analyses, surveys of arbitrators, and reversal rates of arbitration awards and court decisions – is varied but ultimately inconclusive.

One initial point: statements in court opinions that arbitrators need not follow the law are not (despite some suggestion to the contrary<sup>35</sup>) empirical descriptions of what arbitrators do. Indeed, one would have to wonder how courts could obtain empirical insights into arbitral

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<sup>33</sup> Michaela Wänke, *Conversational Norms and the Interpretation of Vague Quantifiers*, 16 APPL. COGNIT. PSYCH. 301, 301 (2002) (“Vague quantifiers are quite vague. One respondent’s interpretation of what ‘fairly often’ means exactly and into how many hours or instances this translates does not necessarily correspond to that of another respondent ....”); see also Norman M. Bradburn & Carrie Miles, *Vague Quantifiers*, 43 PUB. OPIN. Q. 92, 92 (1979) (“we know little about the characteristics of such quantifying adverbs”).

<sup>34</sup> Another uncertainty is what it means to “follow the law” or “apply the law” in a decision. Do arbitrators not follow the law when they fail to apply legal precedent by mistake, or only when they knowingly disregard the precedent that a court would follow. Can courts of last resort ever fail to “follow the law” given that no higher court can reverse their decision? The jurisprudential question is well beyond the scope of this paper, although I have a few comments on the point *infra* note \_\_.

<sup>35</sup> *Id.* at 720 & n.82 (“Even courts have explicitly acknowledged that arbitrators often do not apply the law”).

decision making denied to everyone else.<sup>36</sup> Instead, such statements are about the scope of judicial review of arbitral awards. If the parties' contract requires the arbitrators to follow law, then courts are to review the arbitrators' legal rulings de novo.<sup>37</sup> In cases in which the arbitrators need not follow the law, which is the default rule in American law, then courts apply the usual deferential standard of review. Similarly, the Supreme Court's repeated admonition that "there is no reason to assume at the outset that arbitrators will not follow the law"<sup>38</sup> is not an empirical statement that arbitrators ordinarily do follow the law. Rather, it rejects any assumption that arbitrators do not apply the law as a basis for refusing to enforce arbitration agreements, instead reserving the issue for judicial review after the award is made.<sup>39</sup>

#### A. Case Analyses

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<sup>36</sup> Even if a particular court reviewed a steady stream of arbitration awards that did not apply the law (of which there is no evidence), the court is unlikely to have reliable information on whether such awards occur often – relative to the universe of arbitration awards (many of which never end up in court). Certainly to the extent court opinions make what seem to be empirical assertions about arbitral decision making, *see id.*, they provide no indication of the empirical basis for those assertions.

<sup>37</sup> Christopher R. Drahozal, *Contracting Around RUAA: Default Rules, Mandatory Rules, and Judicial Review of Arbitral Awards*, 3 PEPP. DISP. RESOL. L.J. 419, 431-33 (2003).

<sup>38</sup> *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 232 (1987).

<sup>39</sup> *Id.* ("although judicial scrutiny of arbitration awards necessarily is limited, such review is sufficient to ensure that arbitrators comply with the requirements of the statute").

Certainly there is anecdotal evidence that arbitrators do not always follow the law – in the form of arbitral decisions that differ from what commentators believe courts would have decided on the same facts. Paul Kirgis cites *DiRussa v. Dean Witter Reynolds, Inc.*<sup>40</sup> – in which the Second Circuit concluded that the arbitrators had incorrectly applied the law but refused to vacate the award because it was not in manifest disregard of the law – as illustrating the point.<sup>41</sup> Commentators likewise have described awards by securities arbitration panels that were apparently contrary to settled law.<sup>42</sup> But of course anecdotes, even if they demonstrate that some arbitrators fail to apply the law, cannot show how often such failures occur – relative to total number of arbitration awards.

A study by Patricia A. Greenfield of a sample of labor arbitration awards provides mixed evidence on the extent to which arbitrators follow the law. Greenfield reviewed 106 labor arbitration awards from 1980 to 1985 in which parties had asserted an unfair labor practice claim with the National Labor Relations Board.<sup>43</sup> She found that arbitrators cited the relevant statutes

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<sup>40</sup> See *DiRussa v. Dean Witter Reynolds, Inc.*, 121 F.3d 818 (2d Cir. 1997), cert. denied, 522 U.S. 1049 (1998).

<sup>41</sup> Paul F. Kirgis, *The Contractarian Model of Arbitration and Its Implications for Judicial Review of Arbitral Awards*, 85 ORE. L. REV. \_\_, \_\_ (forthcoming 2006).

<sup>42</sup> Black & Gross, *supra* note \_\_, at 1040 (“arbitration panels, on more than an occasional basis, are reaching decisions favorable to investors even where the ‘law is clear’ that there is no basis for imposing liability on the broker”); see also Johnson, *supra* note \_\_, at 140 (“limited evidence on the ground suggests that SRO panels may not in fact apply the law”).

<sup>43</sup> Patricia A. Greenfield, *How Do Arbitrators Treat External Law?*, 45 IND. & LAB. REL. REV. 683, 687 (1992).

in 51.9% of the awards, did not cite relevant statutes in 36.8% of the awards, and expressly refused to consider the statutory issues in 7.5% of the awards.<sup>44</sup> Arbitrators were much more likely to cite relevant statutes when the parties raised the issue in their pleadings; the arbitrators considered the statutory issue in only 15.4% of the cases in which parties did not raise it.<sup>45</sup> Although arbitrators cited statutes more frequently than she expected, Greenfield found that “arbitrators’ consideration of the statutory issues [was] often cursory and conclusory, almost an afterthought to the contractual issue.”<sup>46</sup> As a result, she concluded that “few arbitrators consider statutory rights fully and in detail.”<sup>47</sup> Greenfield’s analysis does not purport to determine whether fuller consideration of statutory issues would have changed the result in any of the cases. But it does raise questions about the extent to which arbitrators follow the law: if the arbitrators did not carefully analyze the statutory issue, how could they have any confidence that they had followed the law in making their award?<sup>48</sup>

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<sup>44</sup> *Id.* at 689.

<sup>45</sup> *Id.* at 690.

<sup>46</sup> *Id.* at 694.

<sup>47</sup> *Id.*

<sup>48</sup> A survey by Harry T. Edwards of members of the National Academy of Arbitrators echoes some of Greenfield’s findings:

The evidence as to whether and how many arbitrators are professionally competent to decide legal issues in cases involving claims of employment discrimination is at best mixed. Furthermore, ... the evidence from the survey suggests that even when arbitrators are professionally competent to decide legal issues and when the arbitration process is adequate to allow for full consideration

On the other hand, Donovan & Greenawalt point to the absence of challenges to international arbitration awards for failure to apply the law as evidence that international arbitrators do not frequently disregard U.S. law.<sup>49</sup> They cite “what may seem a stunning statistic”: “In the two decades since *Mitsubishi [Motors Corp. v. Soler Chrysler-Plymouth, Inc.]*, it appears that U.S. courts have decided only a single case in which a party has complained about an international tribunal’s application of a statutory claim implicating a U.S. mandatory rule.”<sup>50</sup> Given the incentive of losing parties to raise any good faith ground for challenging an award,<sup>51</sup> and the dicta in the Supreme Court’s

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of legal questions arising pursuant to Title VII, still many arbitrators believe that they have no business interpreting or applying a public statute in a contractual grievance dispute.

Harry T. Edwards, *Arbitration of Employment Discrimination Cases: An Empirical Study*, in *ARBITRATION – 1975*, at 59, 82 (Barbara D. Dennis & Gerald G. Somers, eds. 1975). Unlike the Mentschikoff and Thomson surveys discussed *infra* text accompanying notes \_\_\_-\_\_\_, the Edwards survey did not ask arbitrators whether in fact they applied the law in making their awards.

<sup>49</sup> Donovan & Greenawalt, *supra* note \_\_\_, at 38.

<sup>50</sup> *Id.* The case was *Abbot Laboratories v. Baxter Int’l, Inc.*, 2002 U.S. Dist. LEXIS 5475 (N.D. Ill. Mar. 26, 2002), *aff’d*, 315 F.3d 829 (7th Cir. 2003), which on its facts “does not suggest that arbitrators will be poor stewards of U.S. public policy.” Donovan & Greenawalt, *supra* note \_\_\_, at 39.

<sup>51</sup> Donovan & Greenawalt, *supra* note \_\_\_, at 39 (“One might be tempted to argue that the lack of relevant case law results directly from the strictness of *Mitsubishi* itself: if a U.S. court can do no more than verify that the arbitrators decided a mandatory rules question, what point is

*Mitsubishi* decision suggesting that courts would review whether arbitrators applied the law when deciding whether to enforce the award,”<sup>52</sup> the absence of such challenges suggests one of two things: either that U.S. mandatory rules claims do not play a major role in international arbitrations or that arbitrators do a reasonably good job in adjudicating such claims.<sup>53</sup> The losing parties who did not challenge international

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there in seeking to overturn a bad decision? But that argument is not convincing given the time that has elapsed and the debate (however unjustified) that has surrounded the decision.”).

<sup>52</sup> *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 638 (1985) (“Having permitted the arbitration to go forward, the national courts of the United States will have the opportunity at the award-enforcement stage to ensure that the legitimate interest in the enforcement of the antitrust laws has been addressed.... While the efficacy of the arbitration process requires that substantive review at the award enforcement stage remain minimal, it would not require intrusive inquiry to ascertain that the tribunal took cognizance of the antitrust claims and actually decide them.”).

<sup>53</sup> Donovan & Greenawalt, *supra* note \_\_\_, at 41: They explain:

To the extent that there was a substantial demand among parties to international transactions to waive the application of U.S. mandatory rules, and to the extent that arbitration was viewed as a means of achieving that waiver, one would have expected *Mitsubishi* to result in an increase of arbitration agreements designed specifically to remove enforcement of mandatory rules from the courts. The fact that the case law does not reveal any such trend suggests that one or both of the necessary preconditions have not been met.

*Id.*

arbitration awards thus are like Sherlock Holmes’s “dog that did not bark”:<sup>54</sup> their lack of complaint about arbitrators’ failure to apply the law provides some basis for inferring that there was no such failure.

## **B. Surveys of Arbitrators.**

Others have pointed to surveys of arbitrators as evidence that arbitrators often do not follow the law in their awards. A 1961 survey by Soia Mentschikoff found that 80 per cent of the arbitrators surveyed “thought that they ought to reach their decisions within the context of the principles of substantive rules of law, but almost 90 per cent believed that they were free to ignore these rules whenever they thought that more just decisions would be reached by doing so.”<sup>55</sup> She described the results as “curiously parallel to the attitudes that seem to be implicit in our appellate courts.”<sup>56</sup>

A more recent survey of construction arbitrators, published by Dean B. Thomson in 1994, asked respondents whether they “always follow the law in formulating [their] awards.”<sup>57</sup> Of those responding, 72 percent (149 of 207) answered “yes” while 20 percent (42 of 207) answered “no” (8% did not answer the question).<sup>58</sup> Respondents were given the option of explaining their

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<sup>54</sup> Arthur Conan Doyle, *Silver Blaze*, in *THE COMPLETE SHERLOCK HOLMES* 335, 347 (1930).

<sup>55</sup> Soia Mentschikoff, *Commercial Arbitration*, 61 *COLUM. L. REV.* 847, 861 (1961).

<sup>56</sup> *Id.*

<sup>57</sup> Dean B. Thomson, *Arbitration Theory and Practice: A Survey of AAA Construction Arbitrators*, 23 *HOFSTRA L. REV.* 137, 154 (1994).

<sup>58</sup> *Id.* at 154.

answers. Thomson notes: “Of the 33 who explained their ‘no’ answer, 11 stated they did not know the law and therefore could not follow it. Another 11 said they would not follow the law if it led to an inequitable result.”<sup>59</sup>

Professors Ware and Rau discuss these survey findings in their writings. Ware cites these surveys as reflecting a “widespread belief among arbitrators that they are under no duty to apply the law.”<sup>60</sup> By comparison, after considering both of the above studies, Rau states the conclusion quoted in full above:<sup>61</sup> “I imagine it is fair to say that arbitrators usually do try their best to model their awards on what courts would do in similar cases – and that as often as not they succeed in doing so. That is at least what the scanty empirical evidence seems to suggest ....”<sup>62</sup> Rau notes in particular Mentschikoff’s comment that her results were “curiously parallel to the attitudes that seem to be implicit in our appellate courts,”<sup>63</sup> and adds that the study was conducted “at a time long before it became commonplace to entrust arbitrators with questions of mandatory, regulatory law” – suggesting that perhaps a similar survey would have different results today.<sup>64</sup> Rau also points out that construction arbitrators often sit in panels of three including at least one lawyer, so that one arbitrator may be familiar with the law even if another is not.

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<sup>59</sup> *Id.* at 155.

<sup>60</sup> Ware, *supra* note \_\_, at 721.

<sup>61</sup> See *supra* text accompanying note \_\_.

<sup>62</sup> Rau, *supra* note \_\_, at 514.

<sup>63</sup> *Id.* at 514 n.268 (quoting Mentschikoff, *supra* note \_\_, at 861).

<sup>64</sup> *Id.*

I have three additional comments on these survey results. First, the surveys provide little or no evidence on how frequently arbitrators fail to apply the law in their awards. Neither of the surveys asked the arbitrators how often they applied or did not apply the law. The survey of construction arbitrators, for example, only asked whether the arbitrator “always” followed the law.”<sup>65</sup> An arbitrator who did not follow the law in making an award only once in his or her career would answer the same as an arbitrator who never followed the law. The survey provides no way to distinguish between those two cases.

Second, the answers by arbitrators cannot be evaluated in an absolute sense but only relative to other legal decision makers. How would jurors or judges answer a similar question?<sup>66</sup> Surveys of prospective jurors reveal a significant willingness to disregard the law in reaching a verdict. In the *National Law Journal/DecisionQuest 2000 Juror Outlook Survey*, 45 percent of all respondents, and 69 percent of persons aged 18-24, “agreed that in reaching a verdict, jurors should disregard a judge’s instructions if they believe justice will best be served by doing so.”<sup>67</sup> Studies of judicial attitudes towards following the law strike me as revealing views similar to

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<sup>65</sup> Thomson, *supra* note \_\_, at 154.

<sup>66</sup> This question necessarily reflects the view that judges, despite their law-making powers, can, in fact, “fail to follow the law” in the sense the phrase is applied to arbitrators by basing decisions on factors other than precedent.

<sup>67</sup> Executive Summary, *2000 Annual Juror Outlook Survey Conducted by DECISIONQUEST and the NATIONAL LAW JOURNAL* (Sept. 22-24, 2000), at 4, available at <[http://dqadmin.com/viewer.php?filename=2000\\_AJOS\\_web1.pdf](http://dqadmin.com/viewer.php?filename=2000_AJOS_web1.pdf)>; see also *Jurors to Lawyers: Dare to Be Dull*, NAT’L L.J., Oct. 23, 2000, at A-1 (reporting results of survey).

those reflected in the surveys of arbitrators. J. Woodford Howard, Jr., found in his interviews with federal court of appeals judges that 91.4 percent (32 of 35) believed that precedent was “very important” in reaching decisions when the precedent was “clear and relevant”; but 48.6 percent (17 of 35) also ranked as “very important” their “[p]ersonal views of justice in the case.”<sup>68</sup> When precedent was “absent or ambiguous,” 74.3 percent (26 of 35) listed the “[d]ictates of justice” as “very important” while 68.6 percent (24 of 35) similarly ranked the “[c]losest precedent in [the] circuit.”<sup>69</sup> David E. Klein in his more recent interviews with court of appeals’ judges made similar findings: while 62.5 percent (15 of 24) of the judges listed making “legally correct decisions” as “very important,” 25.0 percent (6 of 24) likewise ranked “good/just outcomes” as “very important as well.”<sup>70</sup> When the two goals conflict, Klein explained, some judges “deny any legitimacy” to the judge’s personal views of justice, but “[m]ost fell toward the middle of the continuum” giving some weight to both goals.<sup>71</sup>

Third, as a general matter, people’s responses to survey questions about why they do what they do must be taken with a grain of salt. People do not always understand why they act or do what they say they do. Presumably that is true of arbitrators (and judges) as well. As Klein has stated, “[j]udges cannot be expected to understand their own motivations perfectly or to

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<sup>68</sup> J. WOODFORD HOWARD, JR., COURTS OF APPEALS IN THE FEDERAL JUDICIAL SYSTEM 164 table 6.2 (1981).

<sup>69</sup> *Id.* at 165 table 6.3

<sup>70</sup> DAVID E. KLEIN, MAKING LAW IN THE UNITED STATES COURT OF APPEALS 22 table 2.1 (2002).

<sup>71</sup> *Id.* at 22.

report them with undiluted candor.”<sup>72</sup> Academics examining the determinants of actual judicial decisions have found that while legal considerations “clearly explain[] a significant part” of decision making by court of appeals judges, “judicial ideology is also consistently a significant determinant of some decisions.”<sup>73</sup> At bottom, while the surveys of arbitrators provide some reason to think that arbitrators do not always follow the law in their awards, it is hard to know whether that happens “often” or more often than in the courts.

### **C. Reversal Rates.**

Finally, the extent to which arbitration awards (or by analogy court decisions) are reversed on review might provide some indication of the extent to which arbitrators fail to follow the law: frequent reversals of arbitration awards would suggest that arbitrators often do not apply the law. But of course such consideration is complicated by the deference usually given by courts to the merits of arbitration awards.

Michele Hoyman and Lamont E. Stallworth used the opportunity provided by the Supreme Court’s decision in *Alexander v. Gardner-Denver Co.*<sup>74</sup> to compare arbitrator adjudications of statutory claims to decisions by courts and agencies reviewing the same claims

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<sup>72</sup> *Id.* at 138.

<sup>73</sup> Frank B. Cross, *Decisionmaking in the U.S. Circuit Courts of Appeals*, 91 CALIF. L. REV. 1457, 1514 (2003); *see also* CASS R. SUNSTEIN ET AL., ARE JUDGES POLITICAL? (2006). *See generally* JEFFREY A. SEGAL & HAROLD J. SPAETH, THE SUPREME COURT AND THE ATTITUDINAL MODEL REVISITED (2002) (examining attitudinal model as explaining U.S. Supreme Court decision making).

<sup>74</sup> 415 U.S. 36 (1974).

de novo.<sup>75</sup> In *Gardner-Denver*, the Supreme Court held that arbitration of a discrimination claim as a grievance in labor union arbitration did not preclude the individual from later asserting the claim in court.<sup>76</sup> As a result, both courts and administrative agencies could review the award on the discrimination claim without the usual deference to the arbitrator's findings. Practitioners surveyed by Hoyman & Stallworth reported handling 1761 discrimination grievances immediately after *Gardner-Denver*, 484 of which were reviewed by the EEOC or a similar state agency and 307 of which were relitigated in court.<sup>77</sup> Of those reviewed, the EEOC or state administrative agency reversed 15.9%; of those relitigated, the court reversed 6.8%.<sup>78</sup> As a percentage of all arbitration awards identified by survey respondents, 4.4% were reversed by administrative agencies and 1.2% were reversed by a court.<sup>79</sup>

By comparison, Paul Kirgis cites reversal rates of district court decisions by the federal courts of appeals as evidence – by analogy – that “arbitrators that attempt to apply the law make relatively frequent mistakes.”<sup>80</sup> He uses civil rights cases as an example, and explains:

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<sup>75</sup> Michele Hoyman & Lamont E. Stallworth, *The Arbitration of Discrimination Grievances in the Aftermath of Gardner-Denver*, ARB. J., Sept. 1984, at 49.

<sup>76</sup> 415 U.S. at 359-60 (permitting “trial de novo” of statutory discrimination claims).

<sup>77</sup> Hoyman & Stallworth, *supra* note \_\_\_, at 54-55.

<sup>78</sup> *Id.* at 55.

<sup>79</sup> Notably, Hoyman and Stallworth did not examine the arbitration awards themselves, but relied on numbers of awards reported by survey respondents. Thus, the precision of their results necessarily depends on the accuracy of the reports by their respondents.

<sup>80</sup> Kirgis, *supra* note \_\_\_, at \_\_\_.

While comprehensive data on reversal rates is not readily available, it appears that between twenty-five and thirty percent of appeals in civil rights cases result in a reversal and/or a remand. Even if many of these reversals are for procedural errors, trial judges must be making significant numbers of legal errors in applying federal civil rights statutes. Arbitrators almost certainly are not better at applying statutes than trial judges. They must make reversible mistakes at least as often.<sup>81</sup>

Kirgis calculated the reversal rate in civil rights cases based on his own Westlaw searches,<sup>82</sup> but the figures are consistent with more general data on reversal rates on appeal.<sup>83</sup>

Certainly, reversal rates of arbitration awards provide more direct evidence of how arbitrators decide than reversal rates of court decisions. Because the incentives of arbitrators differ from the incentives of trial court judges, there is no reason to assume that arbitrators will make errors at the same rate as trial court judges. Arbitrators might, in fact, make fewer mistakes.<sup>84</sup> Moreover, as Kirgis notes,<sup>85</sup> not all reversible errors involve erroneous application of

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<sup>81</sup> *Id.*

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

<sup>83</sup> *E.g.*, BUREAU OF JUSTICE STATISTICS, SPECIAL REPORT: APPEALS FROM GENERAL CIVIL TRIALS IN 46 LARGE COUNTIES, 2001-2005, at 4 table 6 (June 2006) (of appeals resolved on the merits, state appellate court reversed in whole or in part in 32.7%); Jon O. Newman, *A Study of Appellate Reversals*, 58 BROOK. L. REV. 629, 633 (1992) (finding that 27% of appellate decisions in civil cases reversed the district court in whole or in part).

<sup>84</sup> Christopher R. Drahozal, *Judicial Incentives and the Appeals Process*, 51 SMU L. REV. 469, 501-02 (1998); *see also* Christopher R. Drahozal, *A Behavioral Analysis of Private Judging*, 67 LAW & CONTEMP. PROBS. 105 (2004) (comparing effect of behavioral biases on jurors and

substantive legal principles. A recent study of state appeals found that in only 20.5% of state court appeals studied was the “primary” issue the “[m]isapplication of substantive law or evidentiary law to the facts or improper jury instructions on law or evidence.”<sup>86</sup> Instead, the substantial majority of appeals challenged the sufficiency of the evidence in support of the verdict or findings (18.7%), error in granting or denying JNOV or directed verdict (15.6%), improper evidentiary rulings (11.9%), or error in ruling on a new trial motion (10.1%).<sup>87</sup>

Finally, and most importantly, the reversal rate greatly overstates the extent of trial court errors.<sup>88</sup> As with the reversal rate for arbitration awards, the better comparison is the rate of

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arbitrators). Of course, arbitrators might make more mistakes as well – the point simply is that there is no way to know for sure as a matter of theory.

<sup>85</sup> Kirgis, *supra* note \_\_\_, at \_\_\_.

<sup>86</sup> Bureau of Justice Statistics, *supra* note \_\_\_, at 11 app. A; *see also* Newman, *supra* note \_\_\_, at 638 (“of 491 Second Circuit decisions reversing district courts from July 1, 1989 to June 30, 1991, 170 (or 34.6%) involved the “interpretation of a written instrument,” such as a statute, contract, or the U.S. Constitution”).

<sup>87</sup> Bureau of Justice Statistics, *supra* note \_\_\_, at 11 app. A. The report notes that such grounds for appeal “often” raise underlying issues not reflected in the appendix. *Id.*

<sup>88</sup> One might also wonder whom the appeals process benefits. Kevin Clermont and Ted Eisenberg find that “defendants succeed more than plaintiffs on appeal from civil trials,” and conclude that the reason is that “the appellate court is more favorably disposed to the defendant than either the trial judge or the jury.” Kevin M. Clermont & Theodore Eisenberg,

*Plaintiffphobia in the Appellate Courts: Civil Rights Really Do Differ from Negotiable*

reversals as a percent of all decisions, not just those appealed. Because the number of cases with appeals is only a small percentage of all cases terminated in the district courts, the reversal rate for all cases is much less than the 30 percent reported by Kirgis. For example, Second Circuit Judge Jon O. Newman calculated that only 3.99% of all case terminations in 1990-1991 resulted in appeals, so that the reversal rate of all district court cases was 1.08%.<sup>89</sup> Interestingly, this rate is very similar to the reversal rate of arbitration awards by courts found by Hoyman and Stallworth.<sup>90</sup>

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Overall, the evidence on whether arbitrators follow the law in their awards is inconclusive. Certainly there are some cases in which arbitrators do not follow the law, and arbitrators responding to surveys indicate that they do not always follow the law in making their awards. But the evidence does not show the extent to which arbitrators differ from judges in this regard. One respect in which arbitrators may differ from judges is in the depth of their legal analysis: a study of labor arbitration awards finds that analysis of statutes by labor arbitrators often is “cursory and conclusory.” Although the study does not examine whether more thorough analysis would have changed the result in the case, it does give reason to wonder whether that might be the case.

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*Instruments*, 2002 U. ILL. L. REV. 947, 947; *see also* Kevin M. Clermont & Theodore Eisenberg, *Appeal from Judge or Jury: Defendants’ Advantage*, 3 AM. L. & ECON. REV. 125 (2001).

<sup>89</sup> Newman, *supra* note \_\_\_, at 637 & n.7.

<sup>90</sup> *See supra* text accompanying notes \_\_\_-\_\_\_.

## II. Is Arbitration “Self-Deregulation”?

A second question is whether parties provide for arbitration in order to avoid mandatory legal rules – i.e., whether businesses use arbitration, in the words of Paul Carrington, to “self-deregulate.”<sup>91</sup> Carrington explains his view as follows: “It is of course only natural that parties with greater economic power would (if permitted) seek by adhesion contracts to self-deregulate by gaining control of the dispute resolution procedures through the terms of standard form contracts.”<sup>92</sup> He criticizes the Supreme Court’s arbitration cases as “a serious impairment of the tradition of private law enforcement and the creation of a system of self-deregulation comforting to business predators.”<sup>93</sup> The difference between this question and the previous one is that it focuses on the behavior of the parties rather than the behavior of the arbitrators.

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<sup>91</sup> Carrington, *supra* note \_\_\_, at 370; *see also* Schwartz, *supra* note \_\_\_, at 53 (“Pre-Dispute Arbitration Clauses as Corporate Self-Deregulation”). Jean Sternlight has described arbitration as “do-it-yourself” tort reform. Jean R. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 WM. & MARY L. REV. 1, 11 (2000). I take this to be a somewhat broader criticism, including not only the avoidance of substantive law but also procedural differences between arbitration and litigation (such as the lack of class relief). It may be that Carrington intended his phrase “self-deregulation” to include procedural and other differences between arbitration and litigation as well. My focus here, however, is limited solely to the narrower meaning described in the text.

<sup>92</sup> Carrington, *supra* note \_\_\_, at 370.

<sup>93</sup> Paul D. Carrington, *Self-Deregulation, the “National Policy” of the Supreme Court*, 3 NEV. L.J. 259, 288 (2002-2003).

The evidence that corporate parties use arbitration to avoid mandatory legal rules is rather thin, to say the least. In a 1997 survey of general counsel or chief litigation attorneys of Fortune 1000 companies,<sup>94</sup> 36.9 percent of those responding agreed that their companies used arbitration because it “[a]voids legal precedents.”<sup>95</sup> Conversely, 48.6 percent of the respondents cited the fact that arbitration is “[n]ot confined to legal rules” as a barrier to its use.<sup>96</sup> Most construction company executives responding to a survey by Murray S. Levin and Doug Joyce seemed to believe that arbitrators favored equitable solutions over decisions based on the law. Only seven percent disagreed with the statement that “arbitrators are more concerned with achieving equitable results than with strict adherence to law,” while only seventeen percent agreed that “the fact that arbitrators do not strictly adhere to rules of law negatively affects the fairness of arbitration.”<sup>97</sup> By comparison, in a survey of transactional lawyers by Celeste Hammond, over 70 percent of respondents “expect[ed] that the arbitrator shall apply a ‘rule of law’ in resolving the

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<sup>94</sup> DAVID B. LIPSKY & RONALD L. SEEBER, *THE APPROPRIATE RESOLUTION OF CORPORATE DISPUTES: A REPORT ON THE GROWING USE OF ADR BY U.S. CORPORATIONS* (1998). Seeber & Lipsky reported “a response rate of well over 60 percent” among the Fortune 1000 companies. *Id.* at 8.

<sup>95</sup> *Id.* at 17 table 15.

<sup>96</sup> *Id.* at 26 table 22.

<sup>97</sup> The survey apparently is unpublished, but the results are summarized in Murray S. Levin, *The Role of Substantive Law in Business Arbitration and the Importance of Volition*, 35 AM. BUS. L.J. 105, 160-61 (1997).

dispute.”<sup>98</sup> The studies thus are mixed, although they do reveal a perception among at least some parties that arbitrators do not always follow the law. But whatever the studies may suggest about party perceptions, they provide little evidence on how often parties actually agree to arbitrate for that reason.

Studies examining the use of arbitration agreements, by contrast, fail to find evidence that parties are using arbitration to avoid mandatory legal rules. In the franchising context, Keith Hylton and I examined the factors that explain the use of arbitration clauses in a sample of franchise agreements from major franchisors.<sup>99</sup> A number of states have adopted statutes limiting the grounds on which franchisors can terminate franchisees.<sup>100</sup> If franchisors use arbitration to avoid application of these franchisee protection statutes, one would expect franchisors located in states with such statutes to be more likely to include arbitration clauses in their franchise agreements than those located in states without such statutes. In fact, the study finds the opposite: all else equal, franchisors in states with franchisee protection statutes are *less* likely to include arbitration clauses in their franchise agreements than those in states without such

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<sup>98</sup> Celeste M. Hammond, *The (Pre)(As)sumed ‘Consent’ of Commercial Binding Arbitration Contracts: An Empirical Study of the Attitudes and Expectations of Transactional Lawyers*, 39 J. MARSHALL L. REV. 589, 613 & n.201 (2003). The respondents also believed that arbitrators ordinarily issued reasoned awards and that courts could review awards for legal error. *Id.* at 614-15.

<sup>99</sup> Christopher R. Drahozal & Keith N. Hylton, *The Economics of Litigation and Arbitration: An Application to Franchise Agreements*, 32 J. LEGAL STUD. 549 (2003).

<sup>100</sup> *See id.* at 563-64.

statutes.<sup>101</sup> Franchisors respond to enactment of franchisee protection statutes in other ways, such as by increasing the number of company-owned outlets relative to franchised units, but apparently not by including an arbitration clause in their franchise agreements.<sup>102</sup> While the study certainly is not conclusive,<sup>103</sup> to my knowledge it is the only study to examine systematically the factors explaining the use of arbitration clauses in standard form contracts.

The evidence from international arbitration is similar. No one has yet done the sort of regression analysis that has been done with franchise arbitration.<sup>104</sup> But the reported data reveals that very few parties to international arbitration agreements contract to have their disputes resolved using the *lex mercatoria* or otherwise without the application of national law. Table 1 summarizes data published by the International Court of Arbitration of the International Chamber of Commerce (“ICC”), the “central institution” in international commercial

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<sup>101</sup> *Id.* at 577 (“The estimated marginal effect suggests that if you compare similar franchisors, one based in a state with a franchisee protection statute and the other not, the probability of an arbitration agreement is lowered by .45 for the franchisor located in the state with the protection statute.”).

<sup>102</sup> *Id.*

<sup>103</sup> Larry E. Ribstein, *From Efficiency to Politics in Contractual Choice of Law*, 37 GA. L. REV. 363, 471 n.263 (2003) (“Although the authors concluded that these data indicated that arbitration was being used for purposes other than to avoid restrictive state law, it is at least as likely that arbitration was a last resort substitute for contractual choice of forum in some cases”).

<sup>104</sup> Christopher R. Drahozal, *Arbitration by the Numbers: The State of Empirical Research on International Commercial Arbitration*, 22 ARB. INT’L 291, 305 (2006) (suggesting such a study as a possible topic for future empirical research on international commercial arbitration).

arbitration.<sup>105</sup> In the substantial majority (between 77 and 81 percent) of arbitrations administered by the ICC, parties specify a particular national law to govern their contract. In only two percent of arbitrations (or fewer) did parties contract for application of the *lex mercatoria* or some other a-national rules of decision.<sup>106</sup>

[INSERT TABLE 1 ABOUT HERE]

In a sample of international joint venture contracts, a somewhat higher percentage (4 of 15, or 26.7%) of arbitration clauses referred to either “international legal principles and practices” or “general international commercial practices.”<sup>107</sup> But in every case, the choice of the *lex mercatoria* was to fill gaps in the *absence* of national law, not to supplant existing legal rules.<sup>108</sup> Although parties can contract out of national law in international arbitration, very few appear to do so. In short, studies to date find no evidence that parties seek to contract out of mandatory legal rules by use of arbitration.

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<sup>105</sup> YVES DEZALAY & BRYANT G. GARTH, *DEALING IN VIRTUE: INTERNATIONAL COMMERCIAL ARBITRATION AND THE CONSTRUCTION OF A TRANSNATIONAL LEGAL ORDER* 45 (1996).

<sup>106</sup> Christopher R. Drahozal, *Contracting Out of National Law: An Empirical Look at the New Law Merchant*, 80 NOTRE DAME L. REV. 523, 538-39 (2005).

<sup>107</sup> *Id.* at 540-41.

<sup>108</sup> All of the clauses were in contracts between American and Chinese parties, and three of the four clauses contained language to the effect that transnational law was to apply only “if there is no published and publicly available law in China pertaining to any particular matters relating to this Contract.” *Id.* at 541

### III. Does Arbitration Impede the Development of the Law?

A third respect in which arbitration is asserted to be lawless is that it weakens or interferes with the development of the law. When parties agree to arbitrate, they remove the case from the public court system to a system of private dispute resolution. No court will decide the case, and no court will issue a published opinion to serve as precedent for future decisions. Arbitration awards are unlikely to provide a substitute source of precedent, the argument goes, because they may not contain a statement of reasons and often are unpublished.<sup>109</sup> Moreover, because there is no single unifying decision maker, like a supreme court, conflicting awards may persist. As William M. Landes and Richard A. Posner stated in their classic article on *Adjudication as a Private Good*:

Private production of rules or precedents involves two problems. First, because of the difficulty of establishing property rights in a precedent, private judges may have little incentive to produce precedents.... The second problem with a free market in precedent production is that of inconsistent precedents which could destroy the value of a precedent system in guiding behavior.<sup>110</sup>

Indeed, Judge Posner, in *IDS Life Ins. Co. v. SunAmerica Life Ins. Co.*,<sup>111</sup> described arbitration awards as “more like jury verdicts than like the decisions of courts, and jury verdicts are not given any weight as precedents.”<sup>112</sup>

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<sup>109</sup> Alderman, *supra* note \_\_\_, at 11.

<sup>110</sup> William M. Landes & Richard A. Posner, *Adjudication as a Private Good*, 8 J. LEGAL STUD. 235, 238-39 (1979).

<sup>111</sup> 136 F.3d 537 (7th Cir. 1998) (Posner, C.J.).

<sup>112</sup> *Id.* at 543.

I pass over the numerous normative issues involved, such as: How much law is enough law? Is publicly made law superior to privately made law? To what extent can legislatures and regulatory agencies satisfactorily fill in for “lost” judicial decisions? and so forth. Instead, I address only the available empirical evidence – such as it is. I recognize the difficulty of quantifying or even measuring the development of the law and the extent to which arbitration may interfere with that development. The discussion that follows necessarily is subject to such difficulties.

Initially, the impact of arbitration must be evaluated, not in the abstract, but against the alternatives. Most cases in court do not make it to trial, much less appeal.<sup>113</sup> Cases that settle do not create law, unless the court rules on a motion to dismiss or summary judgment motion before the settlement. Nor do jury verdicts, although the judge’s instructions or an opinion on appeal might.<sup>114</sup> Moreover, the vast majority of cases, including most of those appealed, present

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<sup>113</sup> Marc Galanter, *The Vanishing Trial: An Examination of Trials and Related Matters in Federal and State Courts*, 2 J. EMP. LEGAL STUD. 459 (2004); Marc Galanter & Mia Cahill, “*Most Cases Settle*”: *Judicial Promotion and Regulation of Settlements*, 46 STAN. L. REV. 2339, 1339-40 (1994) (noting that roughly two-thirds of cases settle and many others are resolved prior to trial).

<sup>114</sup> Recall Judge Newman’s study of Second Circuit appeals from 1990-1991, which found that only 3.99 percent of case terminations gave rise to an appeal. Newman, *supra* note \_\_\_, at 637 & n.7.

essentially factual disputes rather than disputes over unsettled issues of law.<sup>115</sup> Thus, it is the rare case that contributes to the development of the law in a significant way.<sup>116</sup>

The extent to which arbitration results in legal issues being excluded from the public courts depends on the extent to which parties include arbitration clauses in their contracts (or draft standard form contracts that include arbitration clauses). It is, of course, possible that parties may agree to arbitrate after a dispute arises, and thus remove an issue from court at that time. But the use of post-dispute arbitration agreements is rare relative to the use of pre-dispute arbitration agreements.<sup>117</sup> Thus, the key measure is the proportion of a particular type of contract that includes pre-dispute arbitration clauses.

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<sup>115</sup> See, e.g., BUREAU OF JUSTICE STATISTICS, *supra* note \_\_\_, at 11 app. A (in only 20.5% of state court appeals studied was “primary” issue on appeal the “[m]isapplication of substantive law or evidentiary law to the facts or improper jury instructions on law or evidence.”). The same is true for cases in arbitration. See Thomas E. Carbonneau, *Arbitral Law-Making*, 25 MICH. J. INT’L L. 1183, 1205 (2004) (“A perusal of recent employment arbitration awards revealed that the vast majority of awards are purely factual determinations.... About seven percent of awards are the equivalent of substantial judicial opinions on employment law.”); Hoyman & Stallworth, *supra* note \_\_\_, at 53 (84 percent of arbitration awards involved “factual claims of discrimination”).

<sup>116</sup> Of course, even cases presenting factual issues can contribute to the development of the law by clarifying the application of the law in particular factual circumstances.

<sup>117</sup> Stephen R. Bond, *How to Draft an Arbitration Clause (Revisited)*, ICC INT’L CT. ARB. BULL., Spring 1990, at 14, 15 (“Of the cases submitted to the ICC Court, only four [out of 237] in 1987 and six [out of 215] in 1989 resulted from a *compromis*, that is, an agreement to submit

Table 2 summarizes the available empirical evidence. Almost 90 percent of a sample of international joint venture contracts included arbitration clauses, the highest percentage of any type of contract listed.<sup>118</sup> By comparison, the next highest is consumer financial contracts, of which 69.2 percent included an arbitration clause (and over 30 percent did not). But certain types of consumer financial contracts (and consumer contracts generally) may include arbitration clauses at an even higher rate than the category as a whole. Certainly that is true for brokerage contracts,<sup>119</sup> and may be true for insurance and credit card contracts as well.<sup>120</sup> Conversely, Table

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an already-existing dispute to arbitration. The other cases arose from *clauses compromissoires*, that is, an arbitration clause agreeing to submit future disputes to arbitration.”); Lewis L. Maltby, *Out of the Frying Pan, into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 WM. MITCHELL L. REV. 313, \_\_\_ (2003) (“Analysis of data from the American Arbitration Association (‘AAA’) reveals that post-dispute agreements to arbitrate employment disputes are rare, despite the widespread availability of this option. Only about 6% of all employment arbitration comes from post-dispute agreements.”).

<sup>118</sup> This figure is consistent with other estimates in the literature. *See, e.g.*, KLAUS PETER BERGER, INTERNATIONAL ECONOMIC ARBITRATION 8 & n.62 (1993) (“About ninety percent of international economic contracts contain an arbitration clause”).

<sup>119</sup> All four investment contracts in the study included arbitration clauses, *see* Linda J. Demaine & Deborah R. Hensler, “Volunteering” to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer’s Experience, 67 LAW & CONTEMP. PROBS. 55, 63 table 2 (2004), which is not surprising given the ubiquitous use of arbitration in the securities industry.

<sup>120</sup> *See id.* (finding 82.4 percent (14 of 17) of various types of insurance contracts and 76.5 percent (13 of 17) of various types of credit card contracts included arbitration clauses).

2 shows that some types of consumer contracts almost never include arbitration clauses. Thus, the extent to which arbitration removes cases from the court system varies by type of contract, but for most types of contracts at least some disputes likely will continue to end up in court. Only in relatively limited areas does it appear that arbitration might completely remove cases from the courts.

[INSERT TABLE 2 ABOUT HERE]

I know of no empirical evidence on the extent to which arbitration awards are reasoned or what proportion of reasoned awards are published. In international arbitration, the expectation is that awards will be reasoned,<sup>121</sup> and a nonrandom but growing sample of awards is published.<sup>122</sup> Labor arbitration awards and securities arbitration awards likewise are published,<sup>123</sup> as are employment awards in arbitrations administered by the American Arbitration Association (“AAA”).<sup>124</sup> All filings, including awards, under the AAA Class Arbitration Procedures are

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<sup>121</sup> *E.g.*, UNCITRAL Arbitration Rules, art. 32(3) (requiring arbitrator to state reasons for the award).

<sup>122</sup> Drahozal, *supra* note \_\_\_, at 294.

<sup>123</sup> *E.g.*, NASD Code of Arbitration Procedure, Rule 10330(e) & (f) (all awards shall state a summary of issues and be made publicly available). For employment discrimination claims, the award must also set out “a statement regarding the disposition of any statutory claim(s).” *Id.* Rule 10214. One certainly might wonder whether such awards would contain sufficient reasoning to serve as precedents.

<sup>124</sup> American Arbitration Association, Employment Arbitration Rules, Rule 39(b) (effective July 1, 2006) (award “shall be publicly available, on a cost basis); *see* AAA Employment

publicly available,<sup>125</sup> as are filings and awards in NAFTA investor-state arbitrations.<sup>126</sup> But the default rule under the AAA Commercial Arbitration Rules is that no reasons need be given for the award, and as a general matter commercial arbitration awards are not published.<sup>127</sup>

Interestingly, those areas in which the use of arbitration is most widespread – international contracts and securities disputes – seem to have greater public availability of awards than some other areas.

When arbitration awards are published, there is evidence that the awards do serve as precedent in future arbitration proceedings, although only as persuasive rather than binding authority. Christopher J. Bruce examined labor arbitration in the United States and Canada and found that the “evidence ... overwhelmingly supports the contention that a private arbitration system is able to produce consistent, precedential rulings.”<sup>128</sup> He found that arbitrators and

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Awards Database <[www.adr.org/AAA Awards](http://www.adr.org/AAA Awards)> (including AAA employment arbitration awards since Jan. 1999).

<sup>125</sup> American Arbitration Association, Supplementary Rules for Class Arbitrations, Rule 9(a) (effective Oct. 8, 2003); *see* <[www.adr.org/Classarbitrationpolicy](http://www.adr.org/Classarbitrationpolicy)>.

<sup>126</sup> *See* Christopher S. Gibson & Christopher R. Drahozal, *Iran-U.S. Claims Tribunal Precedent in Investor-State Arbitration*, 23 J. INT’L ARB. \_\_\_\_ (forthcoming 2006).

<sup>127</sup> American Arbitration Association, Commercial Arbitration Rules, Rule R-42(b) (effective Sept. 15, 2005) (arbitrators need not give reasons for their award).

<sup>128</sup> Christopher J. Bruce, *The Adjudication of Labor Disputes as a Private Good*, 8 INT’L REV. L. & ECON. 3, 9 (1988).

publishers made awards available to the public and that decisions of arbitrators were consistent and predictable – at least sufficiently so that users did not demand an appellate authority.<sup>129</sup>

In addition, arbitration awards by the Iran-United States Claims Tribunal regularly are cited both by lawyers and by arbitration tribunals in investor-state arbitration proceedings;<sup>130</sup> indeed, the practice of citing prior awards appears to be a general one in international commercial arbitration.<sup>131</sup> But unlike Bruce’s characterization of the labor arbitration market, users of international arbitration have expressed concern about the consistency of precedents in international arbitration. For example, commentators have pointed to conflicting awards on particular issues made by investor-state arbitration tribunals,<sup>132</sup> and some have called for the creation of an appellate international arbitration court to review conflicting awards by arbitral tribunals.<sup>133</sup>

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<sup>129</sup> *Id.* at 9-10.

<sup>130</sup> Gibson & Drahozal, *supra* note \_\_, at \_\_.

<sup>131</sup> See Carbonneau, *supra* note \_\_, at 1204-05 (“A process of *stare decisis* has emerged regarding transborder arbitral awards,” citing in particular the Court of Sports Arbitration).

<sup>132</sup> *E.g.*, Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 *FORDHAM L. REV.* 1521, 1558-82 (2005) (finding inconsistencies in “the *Lauder* arbitrations, the *SGS* arbitrations, and a series of cases under NAFTA”).

<sup>133</sup> See *id.* at 1606-10 (describing proposals); see also Charles N. Brower, *A Crisis of Legitimacy*, *NAT’L L.J.*, Oct. 7, 2002, at B9; Howard M. Holtzmann, *A Task for the 21st Century: Creating a New International Court for Resolving Disputes on the Enforceability of Arbitral Awards*, in *THE INTERNATIONALISATION OF INTERNATIONAL ARBITRATION: THE LCIA*

Again, the normative question of the costs and benefits of such a proposal is beyond the scope of this article. The point instead is twofold: first, the available evidence suggests that some system of precedent is likely to develop when arbitration awards are published; and, second, the evidence as yet is inconclusive as to whether the precedent produced by an arbitration system is sufficiently consistent to provide the certainty needed by parties.

## **Conclusion**

Commentators mean various things when they describe arbitration as “lawless.” One meaning is simply that arbitrators need not and sometimes (or often) do not follow the law in their decisions. Another meaning is that parties use arbitration to avoid application of mandatory legal rules. A third meaning is that arbitration diverts cases from the public court system and hence impedes the development of law by the courts. It certainly is plausible that arbitration is “lawless” in each of these senses. On occasion arbitrators do not apply the law. Some parties probably do provide for arbitration to avoid mandatory legal rules. Courts issue fewer precedents because cases are decided in arbitration instead. But anecdotes provide a highly incomplete view of arbitration’s asserted lawlessness.

The empirical evidence discussed in this article provides a fuller picture of arbitration, one that is at best inconclusive about the extent to which arbitration is “lawless.” The attitudes of arbitrators toward following the law do not appear all that different from the attitudes of judges (much less jurors), although the analysis of legal issues in a sample of labor arbitration awards

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CENTENARY CONFERENCE 109 (Martin Hunter et al. eds., 1995); Stephen M. Schwebel, *The Creation and Operation of an International Court of Arbitral Awards*, in THE INTERNATIONALISATION OF INTERNATIONAL ARBITRATION, *supra*.

was “cursory and conclusory.” Reversal rates of arbitration awards (even when reviewed de novo) are similar to reversal rates of trial court decisions on appeal – and relatively low. The only studies of why parties agree to arbitrate find no indication that they do so to avoid application of mandatory rules of law. Finally, the effect of arbitration on the development of the law is likely limited to certain substantive areas (in industries with extensive use of arbitration clauses), and even then published arbitration awards may serve as persuasive precedent in some cases. Clearly more research is needed to evaluate the extent to which arbitration actually is “lawless.” The research to date, however, suggests that perhaps arbitration is less lawless than is sometimes feared.

**Table 1. Applicable Law in ICC Arbitration Clauses<sup>134</sup>**

	2001	2002	2003	2004	2005
National Law	77%	79.4%	80.4%	79.1%	79.3%
Other Rules	1%	2.3%	1.2%	1.3%	1.7%
Applicable Law Not Specified	22%	18.3%	18.3%	19.6%	19.0%

<sup>134</sup> 2001-2005 Statistical Reports, ICC INT'L CT. ARB. BULL., Spring 2002-2006.

**Table 2. Use of Pre-Dispute Arbitration Clauses by Type of Contract**

Industry	Percentage of Contracts with Arbitration Clause	Sample Size
Consumer – Housing and Home Services <sup>135</sup>	37.1%	n=35
Consumer – Retail Services	30.0%	n=10
Consumer – Transportation	50.0%	n=20
Consumer – Health Care	35.3%	n=17
Consumer – Food & Entertainment	0%	n=20
Consumer – Travel	13.6%	n=22
Consumer – Financial	69.2%	n=26
Employment – Law Firms <sup>136</sup>	10%	n=200
Employment – CEOs <sup>137</sup>	41.6%	n=375

<sup>135</sup> The source for all of the entries in the table for arbitration clauses in consumer contracts is Linda J. Demaine & Deborah R. Hensler, “Volunteering” to Arbitrate Through Pre-dispute Arbitration Clauses: The Average Consumer’s Experience, 67 LAW & CONTEMP. PROBS. 55, 63 table 2 (2004).

<sup>136</sup> Brett A. Smith & Joshua L. Schwarz, *Keeping Lawyers Out of Court? A Survey of the Prevalence of Compulsory Arbitration Agreements in Law Firms*, 7 EMPL. RTS. & EMPLOY. POL’Y J. 183, 197-98 & table 2 (2003).

<sup>137</sup> Stewart J. Schwab & Randall S. Thomas, *An Empirical Analysis of CEO Employment Contracts: What Do Top Executives Bargain For?* 33 (Vanderbilt Law & Economics Research Paper No. 04-12) (Apr. 9, 2004).

Franchising <sup>138</sup>	56%	n=125
International Joint Ventures <sup>139</sup>	88.2%	n=17

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<sup>138</sup> Combines results from Christopher R. Drahozal, “*Unfair*” *Arbitration Clauses*, 2001 U. ILL. L. REV. 695, 727, with results from William L. Killion, *An Informal Study of Arbitration Clauses Reveals Surprising Results*, 22 FRANCHISE L.J. 79, 79 (2002).

<sup>139</sup> CHRISTOPHER R. DRAHOZAL & RICHARD W. NAIMARK, *TOWARDS A SCIENCE OF INTERNATIONAL ARBITRATION: COLLECTED EMPIRICAL RESEARCH* 59 (2005).