THE AMERICAN REVIEW OF INTERNATIONAL ARBITRATION

2011 / Vol. 22 No. 2

WHY ARBITRATE?
SUBSTANTIVE VERSUS PROCEDURAL THEORIES OF PRIVATE JUDGING

*Christopher R. Drahozal**

INTRODUCTION

The standard view is that parties agree to arbitration – to use private judges rather than public court judges to resolve their disputes – because arbitration is a process that improves upon the court system for dispute resolution. On this view, arbitration may be preferred to litigation because it is cheaper and faster;[1] because it enables parties to pick a decision maker (the arbitrator) who is an expert in the field;[2] or because it provides a neutral forum (a reason most commonly cited for international disputes);[3] among other reasons. Some commentators, however, have argued that parties use arbitration for substantive reasons – to "ensur[e] that the contracting parties' preferred substantive law is applied."[4] For example, Lisa Bernstein concluded from reviewing a sample of trade association arbitration awards that the commercial parties opted for arbitration to have their disputes resolved by decision makers who applied more formalistic rules of decision than courts would have applied.[5] Others have argued that an important reason parties use arbitration for international disputes is the ability to have arbitrators apply a-national rules of decision instead of national law.[6]

---

* John M. Rounds Professor of Law and Associate Dean for Research and Faculty Development, University of Kansas School of Law. This paper was prepared for the Osler, Hoskin & Harcourt LLP Distinguished Lecture in Business Law, Queen's University School of Law, Kingston, Ontario. I appreciate the very helpful questions and comments from those who attended the lecture, with special thanks to Josh Karton.

[1] *E.g.*, Richard W. Naimark & Stephanie E. Keer, *International Private Commercial Arbitration: Expectations and Perceptions of Attorneys and Business People: A Forced-Rank Analysis*, 30(5) INT'L BUS. LAWYER 203, (2002) *reprinted in* CHRISTOPHER R. DRAHOZAL & RICHARD W. NAIMARK, TOWARDS A SCIENCE OF INTERNATIONAL ARBITRATION: COLLECTED EMPIRICAL RESEARCH 43, 45 (2005).

[2] ERIN A. O'HARA & LARRY E. RIBSTEIN, THE LAW MARKET 91-92 (2009).

[3] *E.g.*, CHRISTIAN BÜHRING-UHLE, ARBITRATION AND MEDIATION IN INTERNATIONAL BUSINESS (1996), *reprinted in* DRAHOZAL & NAIMARK, *supra* note 1, at 25, 33.

[4] Bruce L. Benson, *To Arbitrate or to Litigate: That is the Question*, 8 EUROPEAN J.L. & ECON. 91, 92 (1999).

[5] Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765, 1775-76 (1996).

[6] Klaus Peter Berger et al., *The CENTRAL Enquiry on the Use of Transnational Law in International Contract Law and Arbitration*, *in* THE PRACTICE OF TRANSNATIONAL LAW 91, 104 (Klaus Peter Berger ed., 2001), *reprinted in* DRAHOZAL & NAIMARK, *supra* note 1, at 207, 221-22.

The American Review of International Arbitration (ARIA), v22/no 2, 163-186, copyright 2011 ©JurisNet LLC

This article examines why it is that parties agree to arbitrate. Or more specifically, it examines whether parties agree to arbitrate for procedural reasons or for substantive reasons. Of course, these categories of reasons are not mutually exclusive. Parties may agree to arbitrate for both procedural and substantive reasons, and some reasons may be both procedural and substantive (depending on how procedure and substance are defined).[7] Moreover, the reasons parties agree to arbitrate likely vary across types of parties and types of contracts. Just as there is no single reason why parties agree to arbitrate, there is no single answer to whether they agree to arbitrate for procedural or substantive reasons. But there may be more common reasons and less common reasons, and it is the relative frequency of the reasons that I explore here.

My focus in this article is on commercial arbitration, by which I mean non-specialized arbitration between private parties, as distinct from trade association arbitration.[8] Much less information is available on trade association arbitration than on commercial arbitration. Conversely, the controversies over why parties arbitrate tend to involve commercial arbitration (including consumer and employment arbitration) rather than trade association arbitration. I do not mean to downplay the importance of trade association arbitration and will reference it on occasion. Instead, both my interest and the availability of data lead me to focus this article elsewhere.

Empirical evidence, of course, is subject to a number of limitations: Are the data collected accurately? Is the sample representative? and so on.[9] Most of the data on the extent to which parties agree to arbitrate (surveys aside) are from U.S. sources and deal with U.S. contracts (or at least contracts with at least one American party).[10] Accordingly, one must be wary of the representativeness of the data for contracts involving non-American parties.

One other note – my aim in this article is not to address whether parties should use arbitration clauses in general or in particular types of contracts. Rather, my aim is try to figure out why they do so. One way, of course, is to ask parties why they use arbitration clauses. Some of what I discuss is based on survey results. But people do not always act the way they say they do, and do not always act for the reasons they say. Certainly there are empirical issues for which surveys are a better way (or perhaps the only way) to collect the desired information. But to the

---

[7] I recognize the difficulty of distinguishing procedure from substance. I rely on the distinction as one developed by others. *See* Benson, *supra* note 4, at 92.

[8] Christopher R. Drahozal, *Private Ordering and International Commercial Arbitration*, 113 PENN. ST. L. REV. 1031, 1032-33 (2009) (drawing the same distinction); *see also id.* at 1045-48. This definition also would exclude religious arbitration, for example. *See, e.g.*, Michael A. Helfand, *Religious Arbitration and the New Multiculturalism: Negotiating Conflicting Legal Orders*, 86 N.Y.U. L. REV. ___ (forthcoming 2011).

[9] DRAHOZAL & NAIMARK, *supra* note 1, at 8-11.

[10] S*ee infra* text accompanying notes 18-44. Not all studies are so limited, of course. *E.g.*, Stephen R. Bond, *How to Draft an Arbitration Clause (Revisited)*, 1(2) ICC INT'L CT. ARB. BULL. 14 (1990), *reprinted in* DRAHOZAL & NAIMARK, *supra* note 1, at 65, 67.

extent possible, I prefer observational data (data derived from observing what people do) over survey data, and much of the discussion that follows reflects that preference.

The initial question, of course, is to what extent do parties agree to arbitrate their disputes? That question is the topic of Part I. Part II discusses a range of reasons that parties might have for agreeing (or not agreeing) to arbitrate disputes, and attempts to classify the reasons as substantive or procedural (or some combination thereof). Finally, Part III examines the available empirical evidence on the relative frequency of substantive versus procedural reasons for arbitration.

I. HOW FREQUENTLY DO CONTRACTS INCLUDE ARBITRATION CLAUSES?

Before we consider why parties agree to arbitrate, an initial question is whether and when they do so. The default form of dispute resolution is litigation.[11] Parties resolve their disputes in court unless they agree otherwise. Arbitration is often described as an alternative means of dispute resolution. Instead of parties relying on a public court judge to issue a final and binding decision, they hire an arbitrator (or arbitrators) to do so. By agreeing to arbitrate, parties override the litigation default rule.

My focus is on pre-dispute agreements to arbitrate (agreements entered into before a dispute arises) rather than on post-dispute agreements, for a simple reason: the substantial majority of arbitration proceedings arise out of pre-dispute agreements. This appears to be true pretty much across the board – for consumer arbitrations,[12] employment arbitrations,[13] and international arbitrations.[14] This result is not surprising. It is much easier for parties to agree to arbitrate before a dispute arises.[15] At that time, the stakes of the dispute (indeed, whether there will be a dispute) are uncertain. The parties may be unsure whether they will be a

---

[11] Stephen J. Ware, *Employment Arbitration and Voluntary Consent*, 25 HOFSTRA L. REV. 83, 135 n.270 (1996).

[12] Christopher R. Drahozal & Samantha Zyontz, *Private Regulation of Consumer Arbitration*, 79 TENN. L. REV. app. 3(A) (forthcoming 2011) ("[V]irtually all of the 301 cases in the case file sample – 290 (or 96.3%) – arose out of pre-dispute agreements; 11 (or 3.7%) arose out of post-dispute agreements to arbitrate.").

[13] 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, 319 (2003) ("AAA found only 6% (69/1148) of their 2001 employment arbitrations were the result of post-dispute agreements. In 2002, the frequency of post-dispute agreements was even lower, 2.6% (29/1124).").

[14] Bond, *supra* note 10, at 65, 67 ("Of the cases submitted to the ICC Court, only four [of 237, or 1.7%] in 1987 and six [of 215, or 2.8%] in 1989 resulted from a compromis, that is, an agreement to submit an already-existing dispute to arbitration").

[15] Christopher R. Drahozal, *"Unfair" Arbitration Clauses*, 2001 U. ILL. L. REV. 695, 748-50.

claimant or a respondent if a dispute arises. They are still negotiating the contract, and they may be able to trade off other terms of the deal against the means of dispute resolution to reach agreement.

Once a dispute arises, however, all that changes. The parties now have a dispute, the stakes are relatively clear, and the position of the parties (as claimant or respondent) will be set. No longer can they trade off other terms of their deal against the means of dispute resolution. When the parties negotiate after a dispute has arisen, it may make more sense simply to settle the dispute outright rather than to agree to arbitrate it.[16]

So what do the data show about how often parties enter into pre-dispute arbitration agreements? The available studies can be grouped into four types: inter-industry studies, which examine the use of arbitration clauses across industries; inter-firm studies, which examine the use of arbitration clauses across firms in a single industry; intra-firm studies, which examine the use of arbitration clauses in different types of contracts within a firm or firms; and intra-contract studies, which examine the use of carve-outs or exclusions from arbitration clauses in a single type of contract.[17] Not surprisingly, these different types of studies reveal that the use of pre-dispute arbitration clauses varies widely, depending on the type of contract.

A. *Inter-Industry Studies*

The first type of study compares the use of arbitration clauses across industries. For example, Theodore Eisenberg and Geoffrey Miller examined a sample of contracts collected from securities filings with the U.S. Securities & Exchange Commission.[18] The contracts were of a number of types – such as merger agreements, bond indentures, and underwriting agreements – and from a wide range of industries. Their findings are reprinted in Table 1.

---

[16] Which is not to say that parties never agree to arbitrate after a dispute arises, just that they are much less likely to do so.

[17] Christopher R. Drahozal & Quentin R. Wittrock, *Is There a Flight from Arbitration?*, 37 HOFSTRA L. REV. 71, 77 n.28 (2008).

[18] Theodore Eisenberg & Geoffrey P. Miller, *The Flight from Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in the Contracts of Publicly Held Companies*, 56 DEPAUL L. REV. 335, 348 (2007).

Table 1. Arbitration Clause Use in Material Corporate Contracts — by Type of Contract[19]

	% with Arbitration Clauses	Sample Size
Mergers	19.0%	n=411
Bond Indentures	0.7%	n=155
Settlements	16.7%	n=72
Securities Purchase	11.7%	n=460
Licensing	33.3%	n=48
Asset Sale Purchase	19.4%	n=314
Credit Commitments	2.3%	n=216
Underwriting	0.3%	n=351
Pooling & Servicing	0.0%	n=173
Security Agreements	5.4%	n=37
Trust Agreements	0.0%	n=48

Eisenberg and Miller found "a surprisingly low frequency of arbitration clauses" in the contracts they studied.[20] The overall rate at which the material contracts used arbitration clauses was only 10.6%. The rate for international contracts was higher (20.2%),[21] but still relatively low, at least compared to what some commentators have suggested.[22] Even among the types of material contracts they studied, the rate of arbitration clauses varied widely. Some contracts never (e.g., pooling and servicing contracts) or almost never (e.g., bond indentures) included arbitration clauses. Others (such as licensing agreements) more commonly used arbitration clauses, although still less than half the time. Based on Eisenberg and Miller's findings, some commentators have concluded that "[i]n practice, arbitration does not seem to compete strongly with well-functioning public courts"[23] and that, "given their choice,

[19] *Id.* at 351.
[20] *Id.* at 335.
[21] *Id.* at 351.
[22] *E.g.*, KLAUS PETER BERGER, INTERNATIONAL ECONOMIC ARBITRATION 8 & n.62 (1993) ("About ninety percent of international economic contracts contain an arbitration clause") (citing ALBERT JAN VAN DEN BERG, ARBITRAGERECHT 134 (1988)).
[23] Jens C. Dammann & Henry B. Hansmann, *Globalizing Commercial Litigation*, 94 CORNELL L. REV. 1, 31 (2008).

most businesses that negotiate contracts would prefer a judicial dispute resolution system over arbitration."[24]

In addition to the Eisenberg and Miller study, a number of studies have looked at the use of arbitration clauses in particular types of contracts or industries. Table 2 collects the results of a number of those studies and summarizes their results. Again, the use of arbitration clauses varies widely by type of contract – from never (e.g., consumer food and entertainment contracts) to a substantial majority of the time (e.g., consumer financial services contracts; international joint venture contracts).[25]

Table 2. Arbitration Clause Use in Consumer and Other Contracts[26]

	% with Arbitration Clauses	Sample Size
Consumer – Housing and Home Services[27]	37.1%	n=35
– Transportation	50.0%	n=20
– Health Care	35.3%	n=17
– Food & Entertainment	0.0%	n=20
– Travel	13.6%	n=22
– Financial	69.2%	n=26
– Retail Services	30.0%	n=10
– Software License Agreements[28]	6.0%	n=259

[24] William J. Woodward, Jr., *Saving the Hague Choice of Court Convention*, 29 U. PA. J. INT'L L. 657, 669 (2008). For a critique of these broad readings of the Eisenberg and Miller study, see Christopher R. Drahozal & Stephen J. Ware, *Why Do Businesses Use (or Not Use) Arbitration Clauses?*, 25 OHIO ST. J. ON DISP. RESOL. 433 (2010).

[25] Some of the variation may be due to changes in the use of arbitration clauses over time, because the studies summarized in Table 2 were not all conducted in the same year. However, Drahozal and Wittrock, *supra* note 17, at 95, found essentially no change in the aggregate use of arbitration clauses in franchise agreements between 1999 and 2007. *See also infra* text accompanying notes 34-35. The extent to which the use of arbitration clauses in other industries changed over time is uncertain.

[26] This table is an updated and revised version of the table that appears in Christopher R. Drahozal, *Is Arbitration Lawless?*, 40 LOY. L.A. L. REV. 187, 210-12 (2006).

[27] Linda J. Demaine & Deborah R. Hensler, *"Volunteering" to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience*, 67 LAW & CONTEMP. PROBS. 55, 63-64 tbl. 2 (2004). The data for consumer contracts listed in this table are from the Demaine and Hensler article, except when otherwise indicated.

[28] Florencia Marotta-Wurgler, *Unfair Dispute Resolution Clauses: Much Ado About Nothing?*, *in* BOILERPLATE: THE FOUNDATIONS OF MARKET CONTRACTS 45 (Omri Ben-Shahar ed., 2007).

Employment – Law Firms[29]	10.0%	n=200
– CEOs[30]	50.5%	n=551
Franchising[31]	43.7%	n=71
Domestic Joint Venture Agreements[32]	47.6%	n=21
International Joint Venture Agreements[33]	71.0%	n=31

B. *Inter-Firm Studies*

Inter-firm studies compare the use of arbitration clauses by different firms in the same industry. For example, Drahozal and Wittrock compared the dispute resolution clauses in a sample of franchise agreements for the same franchisors in 1999 and 2007. Their results are summarized in Table 3. They found that just under half of the leading franchisors studied included arbitration clauses in their franchise agreements (meaning that just over half did not), and that the frequency of use was essentially unchanged over the time period studied.[34]

Table 3. Arbitration Clauses in Franchise Agreements, 1999 and 2007[35]

	Arbitration Clause	No Arbitration Clause
Franchisors (1999)	32 (45.1%)	39 (54.9%)
Franchisors (2007)	31 (43.7%)	40 (56.3%)

Of course, if every firm in the industry uses (or does not use) arbitration clauses, an inter-firm study of that industry will not provide useful information.

---

[29] Brett A. Smith & Joshua L. Schwarz, *Keeping Lawyers Out of Court? A Survey of the Prevalence of Compulsory Arbitration Agreements in Law Firms*, 7 EMP. RTS. & EMP. POL'Y J. 183, 197-98 tbls. 1 & 2 (2003).

[30] Randall Thomas, Erin O'Hara, & Kenneth Martin, *Arbitration Clauses in CEO Employment Contracts: An Empirical and Theoretical Analysis*, 63 VAND. L. REV. 959, 981 tbl. 2A (2010); *see also* Stewart J. Schwab & Randall S. Thomas, *An Empirical Analysis of CEO Employment Contracts: What Do Top Executives Bargain For?*, 63 WASH. & LEE L. REV. 231, 234 (2006) (41.6% of executive employment contracts included arbitration clause).

[31] Drahozal & Wittrock, *supra* note 17, at 95.

[32] Drahozal & Ware, *supra* note 24, at 466.

[33] *Id.*; *see also* DRAHOZAL & NAIMARK, *supra* note 1, at 59 (finding that 88.2% of sample of international joint venture agreements included arbitration clauses).

[34] Drahozal & Wittrock, *supra* note 17, at 95.

[35] *Id.*

But even industries in which the use of arbitration clauses is perceived to be ubiquitous may have a surprising degree of variation across firms. An example is the credit card industry in the United States, which is commonly identified as an industry in which virtually all consumer contracts include arbitration clauses.[36] When measured by the volume of credit card loans, that generalization was largely correct, at least as of 2009, as shown in Table 4: over 95% of the dollar value of credit card loans outstanding was subject to the use of arbitration clauses as of December 31, 2009. (That percentage has declined significantly since then.) But when measured by the number of issuers, the ratio is nearly reversed: over 80% of credit card issuers in the United States do not include arbitration clauses in their cardholder agreements.[37]

Table 4. Market Share (Based on Outstanding Card Balances) and Number of Credit Card Issuers Using Arbitration Clauses in Cardholder Agreements[38]

	Arbitration Clause	No Arbitration Clause
Credit Card Loans Outstanding (000)	$632,040,638 (95.1%)	$32,694,072 (4.9%)
Number of Issuers	51 (17.1%)	247 (82.9%)

C. *Intra-Firm Studies*

Intra-firm studies examine the use of arbitration clauses by the same firm to resolve different types of disputes. The leading study of this type is by Eisenberg, Miller, and Sherwin, who compared the use of arbitration clauses in material corporate contracts, executive employment contracts, and consumer form contracts used by a sample of consumer financial services companies and telecommunications providers.[39] On the assumption that arbitration was faster and

---

[36] Samuel Issacharoff & Erin F. Delaney, *Credit Card Accountability*, 73 U. CHI. L. REV. 157, 158 n.6 (2006) (referring to "the few credit card companies that do not compel arbitration"); *Symposium: The Fifth Annual Emory Bankruptcy Developments Journal Symposium: Panel Three*, 24 BANK. DEV. J. 309, 314 (2008) (Robert Meade, Vice President, American Arbitration Association) ("[E]verybody knows that if you have a credit card in your wallet, there's an arbitration clause").

[37] The reason is that most credit card issuers are credit unions, which typically do not include arbitration clauses in their contracts and which have a much smaller volume of credit card loans outstanding than banks. *See* Christopher R. Drahozal & Peter B. Rutledge, Arbitration and Consumer Credit 20 (July 6, 2011).

[38] *Id*. at 20 & tbl. 3.

[39] Theodore Eisenberg, Geoffrey P. Miller, & Emily Sherwin, *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J.L. REFORM 871 (2008).

cheaper than litigation, they hypothesized that "companies would consistently contract for dispute resolution through arbitration in all types of contracts and disputes."[40] In fact, as shown in Table 5, they found a sharp discrepancy between material corporate contracts (of which barely 6% included arbitration clauses), standard form consumer contracts (of which over 75% included arbitration clauses), and CEO employment contracts (of which over 90% included arbitration clauses).

Table 5. Arbitration Clause Use by Telecommunications and Consumer Finance Companies, by Contract Type[41]

	Arbitration Clause	No Arbitration Clause
Material Corporate	9 (6.1%)	138 (93.9%)
Consumer	20 (76.9%)	6 (23.1%)
CEO Employment	13 (92.9%)	1 (7.1%)
Total	42 (23.7%)	145 (76.3%)

D. *Intra-Contract Studies*

The final type of study looks at the use of arbitration to resolve different disputes arising under the same contract, what I call intra-contract studies. Not all contracts that include arbitration clauses provide for the use of arbitration to resolve all types of disputes. Instead, some contracts carve out certain classes of disputes from arbitration.[42] In other words, the contract itself provides for arbitration of some types of disputes but not of other types. For example, in a sample of franchise agreements, Drahozal and Wittrock found that the most common type of carve-out was for trademark disputes (excluded from arbitration in over 71% of franchise agreements with arbitration clauses in 2007).[43] Other common carve-outs were for claims for provisional remedies and claims seeking injunctive relief. The most common carve-outs and their frequency are listed in Table 6.

---

[40] *Id.* at 878.

[41] *Id.* at 883.

[42] Donald Lee Rome, *Preserving Rights — and ADR — by Knowing When to Use a "Carve Out"*, ALT. TO HIGH COST LITIG., Jan. 1998, at 6, 6; Terry L. Trantina, *An Attorney's Guide to Alternative Dispute Resolution (ADR)*, *in* ARBITRATION OF CONSUMER FINANCIAL DISPUTES 29, 43-45 (PLI Corp. Law Practice Course, Handbook Series No. 1102, 1999).

[43] Drahozal & Wittrock, *supra* note 17, at 114.

Table 6. Common Exceptions to Arbitration (Carve-Outs) in Franchise Agreements with Arbitration Clauses, 1999 and 2007[44]

	1999	2007
Trademark Disputes	19 (67.9%)	20 (71.4%)
Provisional Remedies	12 (42.9%)	14 (50.0%)
Injunctive Relief	11 (39.3%)	14 (50.0%)
Money Due	8 (28.6%)	10 (35.7%)
Covenants Not to Compete	7 (25.0%)	8 (28.6%)
Immediate Termination of Franchise	3 (10.7%)	6 (21.4%)
Confidential Information	3 (10.7%)	6 (21.4%)
Repossession of Property	4 (14.3%)	4 (14.3%)

* * * * *

At bottom, there are clear differences among types of contracts in the extent to which they provide for arbitration. The rest of this article examines why that might be so.

II. WHY (AND WHY NOT) ARBITRATE?

So why do parties agree to arbitrate? And, perhaps as importantly, why do parties not agree to arbitrate? This part considers those two questions in turn.

A. *Why Arbitrate?*

I start with the distinction between "procedural theories" and "substantive theories" for why parties agree to arbitrate. Procedural theories are theories that explain the use of arbitration based on the process used to resolve the dispute. Substantive theories are theories that explain the use of arbitration based on the rules of decision applied in resolving the dispute.[45] The distinction is not one that

---

[44] *Id.*

[45] Benson, *supra* note 4, at 92 ("To the degree that arbitration might be considered in

I originated,[46] nor is the line always easy to draw. But given the emphasis on substantive theories by some commentators,[47] I maintain the distinction here.

I would classify the following as examples (not an all-inclusive list, by any means) of procedural theories for why parties agree to arbitrate:

(1) Parties agree to arbitrate because arbitration reduces the process costs of resolving disputes. The "prevailing wisdom" – oft-touted in briefs and court opinions[48] – is that arbitration "is usually cheaper and faster than litigation."[49] The empirical evidence is inconclusive on whether arbitration is, in fact, cheaper and faster.[50] But if arbitration is faster than litigation, that alone may make it cheaper, at least in some cases. Moreover, the relative informality of the arbitration process – including the fact that arbitration often has less discovery than litigation – certainly may hold down costs in arbitration.[51] By comparison, in some respects, arbitration is more expensive than litigation. Parties in arbitration have to pay the arbitrators and have to pay for the service of administering the arbitration, both of which typically increase with the size and complexity of the case.[52] (By comparison, in court, parties pay only a low, flat filing fee.[53]) So for arbitration to be cheaper than litigation, the process cost savings must exceed the costs to the parties of paying the arbitrators and any administrator.

(2) Parties agree to arbitrate because arbitration is faster than litigation. As noted above, this also is part of the prevailing wisdom.[54] The greater flexibility and simplicity of arbitration may result in a faster dispute resolution process.

---

law and economics literature it is typically treated as a procedural choice for resolution of contract disputes . . . and it clearly is true that arbitration may be chosen for any of a number of procedural reasons. . . . [H]owever: arbitration may also provide a mechanism for ensuring that the contracting parties' preferred substantive law is applied.").

[46] *See id.*

[47] *See supra* text accompanying notes 4-6.

[48] *See* Eisenberg, Miller, & Sherwin, *supra* note 39, at 878.

[49] Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 280 (1995) (quoting H. R. Rep. No. 97-542, at 13 (1982)); Kathryn A. Sabbeth & David C. Vladeck, *Contracting (Out) Rights*, 36 FORDHAM URB. L.J. 803, 827 (2009) (describing "prevailing wisdom" as "that arbitration is faster and cheaper than litigation," but criticizing research on which that view might be based).

[50] Christopher R. Drahozal, *Arbitration Costs and Forum Accessibility: Empirical Evidence*, 41 U. MICH. J.L. REFORM 813, 826-31 (2008) (describing studies).

[51] 3 IAN R. MACNEIL ET AL., FEDERAL ARBITRATION LAW 34.1, at 34.2 (1994 & Supp. 1999) ("Limitations on discovery . . . remain one of the hallmarks of American commercial arbitration, including arbitration under the FAA. Avoidance of the delay and expense associated with discovery is still one of the reasons parties choose to arbitrate.") (footnotes omitted).

[52] Drahozal, *supra* note 50, at 817-21.

[53] *E.g.*, 28 U.S.C. § 1914(a) ($350 fee for filing case in U.S. federal court).

[54] *See supra* text accompanying notes 48-49.

Moreover, parties can use arbitration to avoid a queue of previously filed cases. By picking an arbitrator without a backlog of cases, the parties may be able to obtain a faster outcome than in court. The lack of an appeals process may also make arbitration faster than litigation. While arbitration awards can be challenged in court, the grounds for setting aside an award are much more limited than the grounds for reversing a trial court's decision.[55] On the other hand, use of an arbitration clause may result in a party challenging the enforceability of the arbitration agreement itself, so that parties end up litigating about whether they have to arbitrate in the first place.[56]

(3) Parties agree to arbitrate because they want arbitrators rather than juries to resolve their disputes. A commonly given reason for the use of arbitration clauses in consumer and employment contracts is that businesses wish to avoid juries: the use of arbitration clauses "provides much-needed protection from the unpredictability of jury awards, which, in recent years, have been known to reach astronomical heights – awards that appear inappropriate even to the most objective observer."[57] Note that the low percentage of material corporate contracts that include arbitration clauses does not necessarily indicate that those parties prefer juries to arbitrators. To the extent that the most important legal remedies in disputes arising under those contracts are injunctions and other forms of equitable relief,[58] juries would not be available in federal court, so that the parties are choosing between judges and arbitrators, not juries and arbitrators.[59]

(4) Parties agree to arbitrate because they can choose experts in the subject matter of the dispute as arbitrators.[60] Most judges in public courts are generalists who are assigned randomly to cases. The parties have little ability to pick a judge who is knowledgeable about their business.[61] By comparison, in arbitration, parties can choose their decision maker. If they wish, they can

---

[55] *See* 9 U.S.C. § 10.

[56] Drahozal & Wittrock, *supra* note 17, at 82.

[57] *E.g.*, Martin J. Oppenheimer & Cameron Johnson, *A Management Perspective: Mandatory Arbitration Agreements Are an Effective Alternative to Employment Litigation*, DISP. RESOL. MAG., Fall 1997, at 19; *see* Christopher R. Drahozal, *A Behavioral Analysis of Private Judging*, 67 LAW & CONTEMP. PROBS. 105, 107 (2004) ("arbitrators may be less susceptible to at least some cognitive illusions than are jurors").

[58] *E.g.*, Theodore Eisenberg & Geoffrey Miller, *Ex Ante Choices of Law and Forum*, 59 VAND. L. REV. 1975, 1982 (2006) ("disputes in merger contracts will often be resolved through equitable relief (for example, a motion for preliminary injunction)").

[59] U.S. Const., Amend. VII.

[60] Naimark & Keer, *supra* note 1, *reprinted in* DRAHOZAL & NAIMARK, *supra* note 1, at 45.

[61] An exception is when parties are able to have their dispute resolved in a specialized business court. *See* Christopher R. Drahozal, *Business Courts and the Future of Arbitration*, 10 CARDOZO J. ON CONFL. RESOL. 491 (2009).

choose a generalist decision maker, a specialist decision maker, or (using a three-arbitrator tribunal) a tribunal that combines generalists and specialists.

(5) Parties agree to arbitrate because they can avoid having disputes resolved in the other party's national courts. This ability to avoid "hometown justice" is commonly cited as a reason parties agree to arbitration in international contracts.[62] The parties can pick a neutral jurisdiction in which to hold the arbitration, or can at least avoid having the national courts of a party resolve the dispute if they hold the arbitration in that party's home country.

(6) Parties agree to arbitrate because the New York Convention (or the Panama Convention) makes it easier to enforce arbitral awards than court judgments.[63] The United States is not a party to a convention on the enforcement of foreign judgments. Instead, in the United States the enforceability of foreign judgments generally is governed by state law, which is largely although not entirely uniform.[64] By comparison, the United States is a party to both the New York and Panama Conventions governing the recognition and enforcement of foreign arbitral awards.[65]

All of these reasons for using arbitration are what I would classify as procedural reasons: they are based on the process for resolving the dispute (or enforcing that resolution) rather than the substantive rule applied to resolve the dispute. Parties choose arbitration because it reduces the costs of resolving disputes, provides a faster process, avoids juries, permits the use of expert decision makers, provides a neutral forum, and enhances the enforceability of the decision – all improvements to the process for resolving disputes.

By comparison, I would classify the following as examples (again, not an all-inclusive list) of substantive theories:

(1) Parties agree to arbitrate because they prefer to have disputes resolved according to formalistic trade rules rather than the more flexible rules

---

[62] William W. Park, *Arbitration Avoids 'Hometown Justice' Overseas*, NAT'L L.J., May 4, 1998, at C18; *see also* Charles N. Brower, *Introduction to* INTERNATIONAL ARBITRATION IN THE 21ST CENTURY: TOWARDS "JUDICIALIZATION" AND UNIFORMITY? ix, x (Richard B. Lillich & Charles N. Brower eds., 1994) ("parties to international transactions choose to arbitrate eventual disputes . . . simply because neither will suffer its rights and obligations to be determined by the courts of the other party's state of nationality").

[63] BÜHRING-UHLE, *supra* note 3, *reprinted in* DRAHOZAL & NAIMARK, *supra* note 1, at 33.

[64] *E.g.*, Cassandra Burke Robertson, *Transnational Litigation and Institutional Choice*, 51 B.C. L. REV. 1081, 1084 n.18 (2010).

[65] See Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38 (New York Convention); Inter-American Convention on International Commercial Arbitration, Jan. 30, 1975, 14 I.L.M. 336 (1975) (Panama Convention).

applicable under national law. In her study of National Grain and Feed Association arbitration awards, Lisa Bernstein found that arbitrators tended to rely on formalistic trade rules rather than more flexible usages of trade – contrary to the usual practice in public courts.[66] Bernstein's studies of trade association arbitrations provide perhaps the clearest evidence in support of a substantive theory of the use of arbitration.[67]

(2) Parties agree to arbitrate because they prefer to have disputes resolved under transnational law rather than national law. Transnational law is one of many labels given to general principles of international commercial law said to be developed by international arbitration awards (and other a-national sources of law); other labels include the *lex mercatoria* and the new Law Merchant.[68] Supporters of transnational law view it as a way for parties to avoid inefficient laws created by national governments and instead to have disputes resolved using more efficient rules created by merchants themselves.[69] On this view, the parties use arbitration for a substantive reason – because of the rules of decision that will be applied to their dispute.

(3) Parties agree to arbitrate because they prefer decision makers who do not follow legal rules at all. Critics of consumer and employment arbitration assert that businesses use arbitration clauses to "self-deregulate" – that they use arbitration clauses to evade the application of legal protections for consumers and employees.[70] While many of the criticisms are directed at the use of arbitration clauses to avoid class relief,[71] others are based on the assumption that arbitrators "do not follow the law."[72] If parties use arbitration to avoid application of the otherwise applicable law, one certainly could say that they are arbitrating for substantive rather than procedural reasons.

---

[66] Bernstein, *supra* note 5, at 1775-76.

[67] Parties to religious arbitrations (which typically arise out of post-dispute arbitration agreements) also agree to arbitrate for substantive reasons — i.e., the application of religious rules to the resolution of their dispute (and procedural reasons as well). Helfand, *supra* note 8, at __ .

[68] Christopher R. Drahozal, *Contracting Out of National Law: An Empirical Look at the New Law Merchant*, 80 NOTRE DAME L. REV. 523, 524 (2005).

[69] *E.g.*, Bruce L. Benson, *The Spontaneous Evolution of Commercial Law*, 55 S. ECON. J. 644, 661 (1989).

[70] Paul D. Carrington, *Unconscionable Lawyers*, 19 GA. ST. U. L. REV. 361 (2002); 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, 53 ("Pre-Dispute Arbitration Clauses as Corporate Self-Deregulation"). The same point has been made about international firms as well. O'HARA & RIBSTEIN, *supra* note 2, at 101-02.

[71] Jean R. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 WM. & MARY L. REV. 1, 11 (2000) (describing arbitration as "do-it-yourself" tort reform).

[72] Carrington, *supra* note 70, at 370.

In some cases, however, substantive and procedural theories blend together. An arbitration process with a biased decision maker – at the extreme, an arbitrator who will always rule in favor of one of the parties without regard to the merits of the case – is indistinguishable from a provision waiving the substantive claim at issue.[73] The arbitration agreement in such a case could be classified as based either on a procedural reason (the nature of the decision maker) or on a substantive reason (contracting out of the governing law).

Other times, parties may agree to arbitrate (or a business may draft a form contract providing for arbitration) to avoid class relief – both class actions in court and class arbitrations.[74] The absence of class relief might make some claims uneconomical to litigate, such that the claims are never brought. Again, it is unclear whether such cases should be classified as procedural or substantive.

At bottom, the literature suggests a wide array of reasons why parties include arbitration clauses in their contracts. The wide array of reasons itself suggests that why parties agree to arbitrate is likely to vary depending on the type of contract or perhaps even the type of dispute. Moreover, the description above of the reasons also suggests that the distinction between substantive theories and procedural theories is a blurry and uncertain one.

B. *Why NOT Arbitrate?*

But it is not enough to consider only why parties might agree to arbitrate. Not all parties include arbitration clauses in their contracts, as the data above indicate.[75] As to those contracts, the question is, "why not?"

One possibility is simply that the benefits of arbitration for those types of contracts are insufficient to overcome the transaction costs of agreeing to arbitrate. As noted above, the usual default means of resolving disputes is litigation.[76] Changing the litigation default rule is not costless, and, in some cases, those transaction costs might exceed any benefits of arbitration – either procedural or substantive. If so, the parties presumably will not agree to arbitrate.

But the literature identifies several particular reasons why parties might prefer litigation to arbitration.

First, and most fundamentally, parties tend to avoid arbitration for high-stakes "bet-the-company" disputes.[77] As noted above, arbitration has no appeals process: parties can challenge awards only on the limited grounds specified in national arbitration laws. But for some disputes, particularly those with high stakes, the absence of an appeals process makes arbitration less attractive rather than more attractive. Parties fear that an aberrational arbitration award might jeopardize the

---

[73] *E.g.*, Keith N. Hylton, *Agreements to Waive or to Arbitrate Legal Claims: An Economic Analysis*, 8 SUP. CT. ECON. REV. 209, 230 (2000).

[74] *See infra* text accompanying notes 106-111.

[75] *See supra* text accompanying notes 18-44.

[76] *See supra* text accompanying note 11.

[77] Drahozal & Ware, *supra* note 24, at 455-56.

continued existence of a company – hence the "bet-the-company" moniker. Parties may prefer that such high-stakes cases be resolved in court, subject to appellate review, rather than in arbitration.

Second, parties may prefer litigation when "the governing law is clear, the contract provisions are well developed, and the underlying facts are unlikely to be disputed."[78] The limited nature of court review in arbitration gives rise to the risk in such cases that "[a]rbitration . . . may appear as an unnecessary invitation to a 'split the difference' award, reminscent of King Solomon's famous threat to cut the baby in two."[79] Conversely, with the law and contract clear and the facts undisputed, the arbitrator's expertise is likely to be of less value.

Third, arbitration is not well suited for cases in which emergency relief may be necessary.[80] Emergency relief (also known as provisional remedies, interim relief, and other combinations of those phrasings) by its nature requires quick action by the decision maker, sometimes on an ex parte basis. But establishing an arbitral tribunal takes time and action by both parties, which can undercut the essential nature of emergency relief. Arbitration providers have responded by creating standing tribunals to address issues of emergency relief. But parties generally have been unwilling to use standing tribunals, suggesting that such tribunals do not resolve concerns about the suitability of arbitration to provide emergency relief.

Fourth, for some types of disputes, the need to enforce an arbitration award may add an additional layer of cost, making arbitration more expensive than litigation.[81] For example, in the vast majority of consumer debt collection cases – both in arbitration and in court – the consumer fails to appear and the business prevails by default.[82] For debt collection cases brought in court, the business can proceed directly to use creditors' remedies, such as garnishment, to recover the debt. For debt collection cases brought in arbitration, however, the business faces

---

[78] *Id.* at 456.

[79] William W. Park, *Arbitration in Banking and Finance*, 17 ANN. REV. BANKING L. 213, 216 (1998); *see also* Dammann & Hansmann, *supra* note 23, at 34. The available empirical evidence does not, however, support the commonly held view that arbitrators "split the difference" in their awards. *See* Stephanie E. Keer & Richard W. Naimark, *Arbitrators Do Not "Split the Baby": Empirical Evidence from International Business Arbitrations*, 18 J. INT'L ARB. 573, 573 (2001), *reprinted in* DRAHOZAL & NAIMARK, *supra* note 1, at 311.

[80] Drahozal & Ware, *supra* note 24, at 456-57.

[81] In addition, a party may incur the costs of enforcing the arbitration agreement. *See supra* text accompanying note 56.

[82] *E.g.*, Christopher R. Drahozal & Samantha Zyontz, *Creditor Claims in Arbitration and in Court*, 7 HASTINGS BUS. L.J. 77, 96 (2011). Technically, an award made by arbitrators in the absence of a party is an ex parte award rather than a default award. *E.g.*, AAA, COMMERCIAL ARBITRATION RULES, Rule R-29 (effective June 1, 2009), *available at* http://www.adr.org/sp.asp?id=22440 ("An award shall not be made solely on the default of a party. The arbitrator shall require the party who is present to submit such evidence as the arbitrator may require for the making of an award.").

another step: it must get the award confirmed in court (i.e., turned into a court judgment) before being able to use creditors' remedies. While confirmation is a simple process it nonetheless is an additional step, which adds to the costs of the process and may make arbitration less attractive than litigation.[83]

Just as the reasons parties agree to arbitrate can be classified as procedural or substantive (or both), the reasons parties might not agree to arbitrate likewise can be classified as either procedural or substantive. The lack of appellate review, limited availability of emergency relief, and the need to confirm an award before being able to use creditors' remedies all are based on procedural characteristics of arbitration rather than the law applicable to resolution of the parties' dispute. By comparison, the clarity of the applicable law and contract provisions would be a substantive reason not to arbitrate.

III. SUBSTANTIVE VERSUS PROCEDURAL THEORIES OF WHY PARTIES ARBITRATE

This part examines the available empirical evidence and its implications for procedural versus substantive theories of why parties arbitrate. It first revisits the studies described above on the use of arbitration clauses[84] and discusses their implications for why parties agree to arbitrate. It then describes more direct evidence dealing with the substantive theories of why parties arbitrate, in particular: (1) whether parties contract in their international arbitration clauses for the use of transnational law rather than national law; and (2) whether arbitrators do or do not "follow the law."

A. *Studies of the Use of Arbitration Clauses*

The authors of a number of the studies discussed in Part I do more than merely describe how frequently parties agree to use arbitration clauses; they also draw implications from the data for why the parties used or did not use arbitration.[85] This section describes some of those implications.

The leading inter-industry study of arbitration clause use is the study by Eisenberg and Miller comparing the use of arbitration clauses in a variety of types of material corporate contracts. As noted above, they found a "surprisingly low frequency of arbitration clauses" in the contracts they studied, which included contracts such as merger agreements and bond indentures. Based on Eisenberg

---

[83] Stephanie Francis Ward, *They Dun Them Wrong: Suits Challenge Use of Mandatory Arbitration Clauses to Pursue Debtors*, ABA J., July 2008, at 16, 18 ("Philadelphia attorney [Alan] Kaplinsky says, 'I think it's a question of cost,' mentioning a credit card client that tried debt collection arbitration and eventually decided the process did not save money. 'The collection costs were just as high if not higher than going through court,' Kaplinsky says.").

[84] *See supra* text accompanying notes 18-44.

[85] *See*, *e.g.*, *supra* text accompanying notes 18-24, 39-41.

and Miller's findings, some have asserted that sophisticated parties simply prefer litigation to arbitration.[86]

But that claim is overbroad. It is true that *for the types of contracts* Eisenberg and Miller studied the parties preferred litigation. But the contracts they studied were contracts for which one would expect parties to prefer litigation. For example, disputes arising out of merger contracts tend to be "bet-the-company" disputes in which emergency relief is often sought – both reasons for parties to avoid arbitration.[87] By comparison, their sample does not include types of contracts in which arbitration clauses tend to be more common – like construction contracts, contracts for the sale of goods, and joint venture agreements.[88] One must be cautious not to draw too strong of conclusions from studies of particular types of contracts, if those contracts are not representative of contracts more generally.

The Eisenberg and Miller study also has other findings relevant to the reasons parties use (or do not use) arbitration clauses. First, Eisenberg and Miller found that parties to international contracts are more likely to use arbitration clauses than parties to domestic contracts, as expected (although, because of the types of contracts they were studying, the use of arbitration clauses in international contracts was low – just over 20%).[89] Second, parties to commercial credit commitments almost never used arbitration clauses (in only 2.3% of the contracts studied),[90] which is consistent with the view that parties are less likely to use arbitration clauses when the law and contract are clear and facts undisputed, as is likely to be the case in disputes arising out of commercial lending arrangements.[91] Third, they found that parties were more likely to use arbitration clauses in contracts with choice-of-law clauses specifying the use of California law, as opposed to Delaware or New York law, and a California place of business, as opposed to almost all other states.[92] The results may reflect the differing desirability of particular state laws (a substantive reason for agreeing to arbitrate),[93] or it may reflect the parties' attempt to avoid California courts for procedural reasons.

Inter-firm studies, which compare the use of arbitration clauses across firms in a single industry, provide some insights on the use of arbitration clauses as well.

---

[86] *See supra* text accompanying notes 23-24.

[87] Drahozal & Ware, *supra* note 24, at 462. Indeed, SEC regulations require businesses only to file material contracts that are not made in the ordinary course of business; the regulations expressly exclude from the filing requirement – and thus the Eisenberg and Miller sample – contracts "such as ordinarily accompan[y] the kind of business" conducted by the filing company. 17 C.F.R. § 229.601(b)(10).

[88] Drahozal & Ware, *supra* note 24, at 463-66.

[89] Eisenberg & Miller, *supra* note 18, at 351.

[90] *Id.*

[91] *See supra* text accompanying notes 78-79.

[92] Eisenberg & Miller, *supra* note 18, at 358-61.

[93] *Id.* at 358.

But again, one must be cautious not to extrapolate unjustifiably from one industry to another.

In one inter-firm study, Drahozal and Wittrock found little change in the use of arbitration clauses from 1999 to 2007.[94] They did, however, find changes in some of the terms of the arbitration clauses. Over the period studied, the percentage of franchise arbitration clauses that included class arbitration waivers (clauses that preclude the availability of class relief in arbitration) increased, from 53.6% in 1999 to 78.6% in 2007.[95] This result suggests that some franchisors use arbitration clauses, at least in part, to reduce the risk of class relief, which is consistent with other findings described below.[96] At the same time, franchisors shifted from contract provisions requiring three-arbitrator tribunals to ones requiring sole arbitrators, as shown in Table 7. In specifying the number of arbitrators, parties face a trade-off between reduced cost (paying one arbitrator is less expensive than paying three) and increased risk of an aberrational award (using one arbitrator is generally perceived as increasing the risk of an aberrational outcome).[97] While not necessarily indicating that the franchisors use arbitration to reduce process costs, this shift does suggest that, once having decided on arbitration, franchisors are increasingly taking steps that reduce costs, even at the expense of an increased risk of an aberrational award.

Table 7. Number of Arbitrators Specified in Franchise Arbitration Clauses[98]

	1999	2007
One Arbitrator	6 (21.4%)	13 (46.4%)
Three Arbitrators	8 (28.6%)	4 (14.3%)
No Number Specified	14 (50.0%)	11 (39.3%)

Drahozal and Hylton, using the data on franchise agreements from 1999, found that franchise agreements with arbitration clauses were more likely to include punitive damages waivers, suggesting that the franchisors were using arbitration clauses to reduce the risk of punitive damages awards.[99] In addition, they found no relationship between the use of arbitration clauses and the

[94] *See supra* text accompanying notes 34-35.
[95] Drahozal & Wittrock, *supra* note 17, at 108 tbl. 11.
[96] *See infra* text accompanying notes 106-111.
[97] Drahozal & Wittrock, *supra* note 17, at 102-03.
[98] *Id.* at 103 tbl. 8.
[99] Christopher R. Drahozal & Keith N. Hylton, *The Economics of Litigation and Arbitration: An Application to Franchise Contracts*, 32 J. LEGAL STUD. 549 (2003).

franchisor's location in a state with a franchisee protection statute – a statute that provides various protections for franchisees, including making it more difficult for franchisors to terminate franchisees.[100] Stated otherwise, the study found no evidence that franchisors used arbitration clauses to avoid legal protections for franchisees.

Randall Thomas, Erin O'Hara, and Kenneth Martin studied the use of arbitration clauses in executive employment contracts, using data from corporate SEC filings.[101] They found that the most important determinants of whether the parties agreed to an arbitration clause, in addition to whether the business included an arbitration clause in a prior executive employment contract, were "measures of firm performance and risk."[102] Thus, CEOs and firms in industries undergoing rapid change were more likely to use arbitration clauses because, they hypothesized, it is a faster method of dispute resolution than litigation and "[s]peed is important to CEOs in rapidly changing industries."[103] Moreover, low profitability firms are more likely to include arbitration clauses in their CEO contracts because they are likely to be "more concerned about the high costs of litigation" and "anticipate a greater likelihood of disputes arising out of the employment relationship that are not the fault of either party."[104]

In an as-yet unpublished study, Drahozal and Rutledge look at the use of arbitration clauses in a newly available sample of credit cardholder agreements. A key determinant of whether the credit card issuer included an arbitration clause in its cardholder agreement is whether it was an (investor-owned) bank or a (mutually-owned) credit union, as shown in Table 8.[105] Interpreting that finding is difficult, however, because it could be consistent with the view that credit unions have less incentive than banks to hold down dispute resolution costs (a procedural reason for using arbitration) as well as the view that credit unions have less incentive to engage in conduct that might give rise to class actions (a reason for arbitration that might be either procedural or substantive). An additional finding of the Drahozal and Rutledge study is that issuers located in jurisdictions that have held class arbitration waivers unenforceable are less likely to use arbitration clauses.[106] This finding further highlights the link between the use of arbitration clauses and the desire of some businesses to avoid class relief.

---

[100] *Id.* at 582.

[101] Thomas, O'Hara, & Martin, *supra* note 30, at 977-78.

[102] *Id.* at 998.

[103] *Id.* at 987.

[104] *Id.* at 989.

[105] The finding holds even after controlling for a number of other possible explanatory factors. Drahozal & Rutledge, *supra* note 37, at 22 & tbls. 4 & 5.

[106] *Id.* at 21.

Table 8. Bank and Credit Union Issuers Using Arbitration Clauses in Cardholder Agreements[107]

	Arbitration Clause	No Arbitration Clause
Banks	43 (50.0%)	43 (50.0%)
Credit Unions	8 (3.8%)	204 (96.2%)

As discussed above, Eisenberg, Miller, and Sherwin's intra-firm study of the use of arbitration clauses by consumer financial services and telecommunications firms found that such firms were much more likely to use arbitration clauses in their consumer contracts than in their material corporate contracts.[108] They also found a strong correlation between the use of arbitration clauses in various types of consumer contracts and the use of class arbitration waivers.[109] Accordingly, they concluded that "from the perspective of corporate self-interest, concern over class actions remains the most likely explanation for the prevalence of arbitration clauses in consumer agreements."[110] Again though, one must be cautious not to extrapolate this conclusion beyond the industries studied.[111]

Finally, intra-contract studies, which examine carve-outs from arbitration clauses, also provide some insights into the reasons parties do not arbitrate. The most common carve-outs in franchise agreements, for example, are for trademark disputes, provisional relief, and claims seeking injunctive relief. These carve-outs are consistent with several of the procedural reasons for not using arbitration clauses. For franchisors, their trademark is central to the business; trademark disputes have the potential to be "bet-the-company" cases, for which one would expect litigation to be preferable.[112] In addition, preliminary relief is important in trademark disputes, and, again, arbitration is less well suited for granting such relief than courts. The carve-out for preliminary relief is not surprising for the same reason. Finally, the carve-out for injunctive relief has two possible

---

[107] *Id.* at 20 & tbl. 3.

[108] *See supra* text accompanying notes 39-41.

[109] Eisenberg, Miller, & Sherwin, *supra* note 39, at 884.

[110] *Id.* at 894.

[111] Drahozal & Ware, *supra* note 24, at 476 ("the available empirical evidence identifies a number of other industries in which businesses include arbitration clauses in their contracts but do not use class arbitration waivers"); Drahozal & Zyontz, *supra* note 12, at app. 3(B) figure 3 (reporting varying use of class arbitration waivers by type of contract in AAA consumer arbitrations).

[112] Eileen Davis, *ADR Well-Suited to Handle Franchise Cases*, 10 ALT. TO HIGH COST LITIG. 131, 131 (1992) ("The most common exceptions [to arbitration] are disputes involving the franchisor's trademark, which is the lifeblood of the business. Given the lack of appeal in most arbitrations, the risk that an arbitrator might wrongly determine the mark to be generic or invalid is too high.").

implications: (1) to the extent it is aimed at preliminary injunctions, the likely explanation is the same as above;[113] (2) to the extent this carve-out is aimed at other forms of injunctive relief, it suggests that avoiding jury trials is at least a partial reason for the use of arbitration clauses in franchise agreements, because a jury trial would not be available for actions for injunctive relief (and hence the franchisor does not provide for such disputes to be arbitrated).[114]

Overall, these studies suggest that procedural reasons for using arbitration clauses predominate, although none of the studies identifies cost or speed as a reason parties agree to arbitrate. The studies provide little evidence in support of substantive theories. One possible exception is that for some types of consumer contracts, the studies do suggest that businesses use arbitration clauses to reduce the risk of class relief (which might be classified as either a procedural or a substantive reason for using arbitration).

B. *Studies of Substantive Reasons for the Use of Arbitration Clauses*

Other empirical studies have addressed more directly the importance (or lack thereof) of substantive reasons for parties to use arbitration clauses. For example, Lisa Bernstein's study of grain and feed arbitration – finding that industry arbitrators tend to decide based on formalistic trade rules rather than more flexible trade usages – provides support for the importance of substantive theories in trade association arbitration. But trade association arbitration is sufficiently distinct from commercial arbitration that the evidence does not necessarily apply to commercial arbitration.[115]

Empirical studies have also examined the use of transnational law (the *lex mercatoria*) in international commercial arbitration. A survey by Klaus Peter Berger and others at the Center for Transnational Law ("CENTRAL") found that a "surprising[ly] . . . high percentage" of the survey respondents – international arbitrators, in-house counsel, law professors, and practicing attorneys – "were aware of the use of transnational commercial law" in their practices.[116] The percentages ranged from 32% who were aware of transnational law being used in contract negotiations and drafting to 42% who were aware of its use in arbitration proceedings, with a third to a quarter of those aware of multiple cases.[117] An important weakness of the CENTRAL survey (in addition to the question of whether the survey respondents were representative of the relevant population), however, is that it makes no attempt to measure the relative importance of transnational law. The survey questions ask only about the absolute number of cases, not the relative number of cases. Without some measure of the total

---

[113] *See supra* text accompanying note 80.
[114] *See supra* text accompanying note 59.
[115] Drahozal, *supra* note 8, at 1032-33.
[116] Berger et al., *supra* note 6, at 104.
[117] *Id.* at 103-05.

number of cases with which the survey respondents were familiar, it is difficult to evaluate the relative importance of transnational law.

By comparison, observational data suggests that relative to national law, few parties specify the use of transnational law in their arbitration clauses. Table 9 summarizes the applicable law chosen by parties in international arbitrations administered by the International Chamber of Commerce, a leading provider of international arbitration services. Only rarely do ICC arbitration clauses provide for the use of a-national sources of law. The vast majority instead specify national law to govern the parties' disputes.[118] Moreover, in a sample of international joint venture contracts, when the arbitration clause provided for the use of transnational law, it did so almost exclusively when there was "no published and publicly available" national law on an issue – i.e., to supplement rather than displace national law.[119] The same limited reliance on transnational law also appears to hold for arbitration awards.[120]

Table 9. Applicable Law in ICC Arbitration Clauses[121]

	2005	2006	2007	2008	2009
National Law	79.3%	82.7%	79.3%	84.0%	86.8%
Other Rules	1.7%	2.0%	0.5%	3.0%	1.2%
Applicable Law Not Specified	19.0%	15.3%	20.2%	13.2%	12.0%

Finally, while it is commonly asserted that arbitrators "do not follow the law,"[122] the empirical evidence is much less conclusive. After surveying the relevant studies, I stated my view as follows:

---

[118] *See also* Drahozal, *supra* note 8, at 1038-39; Drahozal, *supra* note 68, at 536-44; *see also* Felix Dasser, *Mouse or Monster? Some Facts and Figures on the Lex Mercatoria*, *in* GLOBALISIERUNG UND ENTSTAATLICHUNG DES RECHTS 129, 139-45 (Reinhard Zimmermann ed., 2008). It may be that parties chose arbitration to facilitate the use of a particular national law, which would itself be a substantive reason for arbitration. *See supra* text accompanying notes 92-93. But the ICC data do not permit testing that possibility.

[119] Drahozal, *supra* note 68, at 540-42.

[120] Dasser, *supra* note 118, at 144-45 & 157 Annex (finding a total of only 38 arbitration awards "covering a time frame of more than half a century" in which the tribunal applied transnational law in the absence of an agreement by the parties); Felix Dasser, Lex Mercatoria – *Critical Comments on a Tricky Topic*, *in* RULES AND NETWORKS: THE LEGAL CULTURE OF GLOBAL BUSINESS TRANSACTIONS 189, 191-97 (Richard P. Appelbaum et al. eds., 2001).

[121] *2005-2009 Annual Statistical Reports*, ICC INT'L CT. ARB. BULL. (2006-2010).

[122] Stephen J. Ware, *Default Rules from Mandatory Rules: Privatizing Law Through Arbitration*, 83 MINN. L. REV. 703, 725 (1999) ("[A]rbitrators often do not apply the

> Overall, the evidence on whether arbitrators follow the law is inconclusive. . . . 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 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.[123]

These findings thus provide little support for the view that parties use arbitration clauses to avoid application of otherwise applicable substantive law. Overall, the studies do not exclude the possibility that substantive reasons explain the use of arbitration clauses, but certainly provide little evidence in support of it.

CONCLUSION

Parties use arbitration clauses in their contracts for a variety of reasons – some that might be characterized as procedural and others that might be characterized as substantive. Procedural reasons focus on how the arbitral process differs from the litigation process: it may be faster, cheaper, and avoid "hometown justice," for example. Substantive reasons focus on the rules of decision in arbitration versus litigation: parties may want decision makers who apply more formalistic rules or rules (such as transnational law) that are distinct from national laws, for example.

Of course, parties can agree to arbitrate for both procedural and substantive reasons, and some reasons are difficult to classify as either procedural or substantive. But subject to those quite serious limitations, the available empirical evidence suggests that procedural reasons are more important (in many contexts at least) than substantive reasons in explaining why parties agree to arbitrate. The one exception is that in some U.S. consumer contracts, one reason that businesses use arbitration clauses is to reduce the risk of class relief (a reason that could be classified as either substantive or procedural). Otherwise, there is little empirical evidence that substantive reasons (such as avoiding otherwise applicable law or providing for the use of transnational law) are important reasons why parties use arbitration clauses.

---

law"). *But see* Alan Scott Rau, *The Culture of American Arbitration and the Lessons of ADR*, 40 TEX. INT'L L.J. 449, 514 (2005) ("[I]t 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").

[123] Drahozal, *supra* note 26, at 203, 214.