

## Contract and Procedure

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Christopher R. Drahozal and Peter B. Rutledge, *Contract and Procedure*, 94 Marq. L. Rev. 1103 (2011).  
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# CONTRACT AND PROCEDURE

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*This paper examines both the theoretical underpinnings and empirical picture of procedural contracts. Procedural contracts may be understood as contracts in which parties regulate not merely their commercial relations but also the procedures by which disputes over those relations will be resolved. Those procedural contracts regulate not simply the forum in which disputes will be resolved (arbitration vs. litigation) but also the applicable procedural framework (discovery, class action waivers, remedies limitations, etc.). At a theoretical level, this paper explores both the limits on parties' ability to regulate procedure by contract (at issue in the Supreme Court's recent *Rent-A-Center* decision) and the scope of an arbitrator's ability to fill gaps in parties' procedural contracts (at issue in the Supreme Court's recent *Stolt-Nielsen* decision). At an empirical level, this paper taps a largely unexplored database of credit card contracts available from the Federal Reserve in order to examine actual practices in the use of procedural contracts.*

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We would like to thank participants at the annual Emory/UGA Works in Progress Workshop, as well as Eric Tuchmann and Steve Ware, for helpful comments and discussions. Thanks also to Bernard Persky and Nina Pillard for their help in tracking down the *Stolt-Nielsen* arbitration award. Annie Booton provided superb research assistance. Dean Rebecca White graciously provided financial support for this project. Cindy Wentworth helped with completion of the manuscript.

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## I. INTRODUCTION

Fifteen years ago, in their seminal article *Contract and Jurisdiction*, Paul Carrington and Paul Haagen lamented the explosion of devices that manipulated jurisdiction by contract. In their view, various devices, including forum selection clauses and arbitration clauses, enabled sophisticated parties to lock-in significant tactical advantages (especially over their less sophisticated counter-parties) through the enforceable

designation of an exclusive forum before a dispute ever arose.<sup>1</sup> While Carrington's and Haagen's lament garnered significant academic support,<sup>2</sup> judicial tides turned in the other direction. Courts largely accepted these contractual forum selection devices, subject to a narrow range of exceptions.<sup>3</sup> Although the authors' critique has recently gained new traction in legislative corridors,<sup>4</sup> including most recently the 2010 financial reform law,<sup>5</sup> it is no exaggeration to say that, with little exception, parties presently can largely control jurisdiction by contract.

If judicial battles over contract and jurisdiction have subsided, the larger contest is far from over. Rather, we have entered an era in which the battles are fought not over parties' ability to control jurisdiction by contract but, instead, over their ability to control procedure by contract. In her important article, *Procedure as Contract*, Judith Resnik identified one manifestation of this modern phenomenon—bargaining over procedural rights after litigation commences (such as vacatur of orders following settlement).<sup>6</sup> Here, we address a related but underexplored manifestation—bargaining over procedural rights even before a dispute arises, a form of bargaining catalyzed by the judicial acceptance of

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1. See Paul D. Carrington & Paul H. Haagen, *Contract and Jurisdiction*, 1996 SUP. CT. REV. 331, 351–61.

2. See, e.g., Charles L. Knapp, *Taking Contracts Private: The Quiet Revolution in Contract Law*, 71 *FORDHAM L. REV.* 761 *passim* (2002); Richard C. Reuben, *Public Justice: Toward a State Action Theory of Alternative Dispute Resolution*, 85 *CAL. L. REV.* 577 *passim* (1997); Richard E. Speidel, *Contract Theory and Securities Arbitration: Whither Consent?*, 62 *BROOK. L. REV.* 1335 *passim* (1996); Jean R. Sternlight, *Rethinking the Constitutionality of the Supreme Court's Preference for Binding Arbitration: A Fresh Assessment of Jury Trial, Separation of Powers, and Due Process Concerns*, 72 *TUL. L. REV.* 1 *passim* (1997).

3. See, e.g., *Krenkel v. Kerzner Int'l Hotels Ltd.*, 579 F.3d 1279, 1281 (11th Cir. 2009) (holding that forum selection clauses are presumptively enforceable); *Richardson v. Palm Harbor Homes, Inc.*, 254 F.3d 1321, 1324 (11th Cir. 2001) (finding that arbitration agreements are presumptively enforceable); *Marra v. Papandreou*, 216 F.3d 1119, 1126 (D.C. Cir. 2000) (holding that forum selection clauses are presumptively enforceable); *Harris v. Green Tree Fin. Corp.*, 183 F.3d 173, 178 (3d Cir. 1999) (finding that arbitration agreements are presumptively enforceable).

4. See 21st Century Department of Justice Appropriations Authorization Act, Pub. L. No. 107-273, § 11028, 116 Stat. 1758, 1835–36 (amending 15 U.S.C. § 1226(a)(2) (2006)); John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, § 670(a), 120 Stat. 2083, 2266 (amending 10 U.S.C. § 987(f)(4) (2006)); Food, Conservation, and Energy Act of 2008, Pub. L. No. 110-246, § 11005, 122 Stat. 1651, 2119 (codified at 7 U.S.C. § 197c(a) (Supp. III 2007–2010)); Department of Defense Appropriations Act, 2010, Pub. L. No. 111-118, § 8116(a), 123 Stat. 3409, 3454–55 (2010) (“Franken Amendment”).

5. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 921, 1028, 1414(e), 124 Stat. 1376, 1841, 2003–04, 2151 (2010).

6. Judith Resnik, *Procedure as Contract*, 80 *NOTRE DAME L. REV.* 593, 650 (2005).

arbitration over the last several decades.<sup>7</sup> We refer to such pre-dispute agreements as “procedural contracts.”

“Procedural contracts” take various forms. They may incorporate by reference the rules of arbitral institutions, which, in Resnik’s terms, function like “mini-codes of civil procedure.”<sup>8</sup> Alternatively (and increasingly), they also may be explicit terms of the parties’ contract, decoupled from the rules of an administering institution. Because the rules of most arbitral institutions operate as default rules that can be overridden by the express terms of the parties’ arbitration agreement—subject to the willingness of institutions to administer arbitrations under the agreed terms<sup>9</sup>—these explicit terms represent private procedural codes that arbitrators are duty-bound to apply unless they (or courts) declare them unenforceable.

The terms of procedural contracts vary widely. One current, hotly contested term is a prospective waiver of the ability to pursue a claim on a class wide basis.<sup>10</sup> When these waivers seek to preclude class actions in court, they are known as “class-action waivers”; when they seek to preclude arbitration from proceeding on a class wide basis, they are

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7. Others have examined the ability to customize the litigation process by contract. See, e.g., Michael L. Moffitt, *Customized Litigation: The Case for Making Civil Procedure Negotiable*, 75 GEO. WASH. L. REV. 461 (2007); Linda S. Mullenix, *Another Choice of Forum, Another Choice of Law: Consensual Adjudicatory Procedure in Federal Court*, 57 FORDHAM L. REV. 291 (1988); Henry S. Noyes, *If You (Re)Build It, They Will Come: Contracts to Remake the Rules of Litigation in Arbitration’s Image*, 30 HARV. J.L. & PUB. POL’Y 579 (2007); Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814, 856–78 (2006); Elizabeth Thornburg, *Designer Trials*, 2006 J. DISP. RESOL. 181; see also David Marcus, *The Perils of Contract Procedure: A Revised History of Forum Selection Clauses in the Federal Courts*, 82 TUL. L. REV. 973 (2008). In the context of arbitration agreements, a few articles have addressed procedural contracts though without the degree of empirical evidence or normative argument we address here. See David Horton, *Arbitration as Delegation*, 86 N.Y.U. L. REV. (forthcoming 2011) (manuscript at 41–53, on file with authors) [hereinafter Horton, *Arbitration as Delegation*]; available at <http://ssrn.com/abstract=1665565> (arguing that FAA was an unconstitutional delegation of procedural rule-making authority); David Horton, *The Shadow Terms: Contract Procedure and Unilateral Amendments*, 57 UCLA L. REV. 605, 646–53 (2010) (opposing unilateral modification of the procedural terms of arbitration clauses) [hereinafter Horton, *The Shadow Terms*]; Meredith R. Miller, *Contracting out of Process, Contracting out of Corporate Accountability: An Argument Against Enforcement of Pre-Dispute Limits on Process*, 75 TENN. L. REV. 365, 371 (2008) (opposing procedural contracts in arbitration agreements).

8. Resnik, *supra* note 6, at 597.

9. See the discussion of the Due Process Protocols, *infra* text accompanying note 71.

10. For an insightful discussion of the developments in this area, see generally Richard A. Nagareda, *The Litigation-Arbitration Dichotomy Meets the Class Action*, 86 NOTRE DAME L. REV. (forthcoming 2011) (manuscript at 1–2, on file with authors), available at [http://ssrn.com/abstract\\_id=1670722](http://ssrn.com/abstract_id=1670722).

known as “class-arbitration waivers.”<sup>11</sup> Examples of other terms include contractual limits on the availability of discovery, contractually imposed limitations periods, formulas allocating dispute resolution costs, limitations on remedies, provisions reallocating the power to assess the enforceability of an arbitration agreement, and efforts to alter the standard of judicial review of an arbitration award.<sup>12</sup>

Viewing these developments through the lens of contract enables us to tap into the rich literature on contract theory and, thereby, facilitates systematic thinking about procedural contracts. As with any agreement, procedural contracts raise important questions, both positive and normative. Positive questions include: To what extent do parties actually attempt to regulate their disputes through procedural contracts? Why do parties sometimes leave particular procedural questions unresolved in their contracts despite incentives to address them? When a procedural contract is silent as to a particular matter, how do decision makers (such as arbitrators) fill the gap?<sup>13</sup> Normative questions include: Should there be limits on parties’ freedom to enter into procedural contracts? Assuming that limits should exist, what blend of oversight achieves the optimal degree of regulation? What are the limits on arbitrators’ authority to fill the gaps in procedural contracts? What is the proper role of courts in policing arbitrators’ gap-filling authority?

The answers to these questions implicate important stakes. For example, critics of class-action and class-arbitration waivers argue that these waivers can operate as exculpatory clauses,<sup>14</sup> effectively eliminating any incentive for individual litigants to bring lawsuits when their damages are nugatory. By contrast, defenders argue that they represent an invaluable tool to control the runaway costs of aggregate litigation and, by reducing a company’s expected dispute resolution

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11. See Myriam Gilles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373, 376 n.15 (2005) (distinguishing between “collective action waivers” and “class action waivers”).

12. See Ramona L. Lampley, *Is Arbitration Under Attack?: Exploring the Recent Judicial Skepticism of the Class Arbitration Waiver and Innovative Solutions to the Unsettled Legal Landscape*, 18 CORNELL J. L. & PUB. POL’Y 477, 504 (2009); Miller, *supra* note 7, at 381–99 (discussing use of collective action waivers, limits on discovery, and shorter limitations periods).

13. This assumes, of course, that silence in a procedural contract is properly conceptualized as a gap that the arbitrator is authorized to fill (as opposed to a deliberate omission designed to strip the arbitrator of the power to enter a particular procedural order). We address this idea in greater detail in Part III, *infra*.

14. See, e.g., Samuel Issacharoff & Erin F. Delaney, *Credit Card Accountability*, 73 U. CHI. L. REV. 157, 169 (2006); Miller, *supra* note 7, at 367–68.

costs, benefit individuals in the form of lower prices (or, in the context of employment contracts, higher wages).<sup>15</sup> In light of these deep underlying policy disagreements, courts unsurprisingly have reached conflicting conclusions over the enforceability of procedural contracts containing these terms.<sup>16</sup>

For similar reasons, procedural contracts have caught the Supreme Court's attention in recent years. The current era of the Court's jurisprudence on procedural contracts can be traced to the Court's 1995 decision in *First Options of Chicago, Inc. v. Kaplan*, which addressed the parties' ability to allocate contractually the power to determine the enforceability of an arbitration clause.<sup>17</sup> More recently, two decisions from October Term 2009 have tackled additional issues in the law governing procedural contracts. *Rent-A-Center, West, Inc. v. Jackson*, building on *First Options*, addressed whether a court has the power to rule on an unconscionability challenge to an arbitration agreement even when the parties' contract vests that power in the arbitrator.<sup>18</sup> *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.* addressed whether the arbitrator can order class arbitration when the arbitration agreement neither explicitly authorizes nor explicitly prohibits such a device.<sup>19</sup>

Using *Rent-A-Center* and *Stolt-Nielsen* as the springboards for our discussion, we undertake a systematic examination of the positive and normative questions underpinning procedural contracts.<sup>20</sup> In brief, our

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15. See Stephen J. Ware, *The Case For Enforcing Adhesive Arbitration Agreements— with Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM. ARB. 251, 253–54 (2006).

16. See, e.g., *In re Am. Express Merchs. Litig.*, 634 F.3d 187, 199 (2d Cir. 2011) (holding class arbitration waiver unenforceable because it precludes claimants from vindicating their statutory rights); *Kristian v. Comcast Corp.*, 446 F.3d 25, 61 (1st Cir. 2006); *Ting v. AT&T*, 319 F.3d 1126, 1150 (9th Cir. 2003) (holding class arbitration waiver unconscionable); *Discover Bank v. Superior Court*, 113 P.3d 1100, 1110 (Cal. 2005); *Kinkel v. Cingular Wireless LLC*, 857 N.E.2d 250, 274–75 (Ill. 2006).

17. 514 U.S. 938, 942 (1995). Others date the incentive to design procedural contracts to the Supreme Court's 2003 decision in *Bazzele*. See Miller, *supra* note 7, at 374. But we believe that *First Options* created the necessary conditions nearly a decade earlier and believe that the empirical research offered here supports that view. See *infra* note 35 and accompanying text.

18. 130 S. Ct. 2772, 2775 (2010).

19. 130 S. Ct. 1758, 1764 (2010). This article was already in press when the Supreme Court issued its opinion in *Concepcion*. See *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011). Although we reserve detailed analysis of *Concepcion* for future work, we do note that the Court's decision is consistent with our analysis here. See *infra* text accompanying notes 225–27.

20. For an excellent analysis of the decisions in *Rent-A-Center* and *Stolt-Nielsen*, see generally Thomas J. Stipanowich, *Revelation and Reaction: The Struggle to Shape American*

argument consists of four propositions:

- First, parties, particularly sophisticated parties drafting form contracts with unsophisticated parties, are increasingly entering into procedural contracts. (Hereinafter we call this the exercise of “procedural contractual freedom.”) Over time, the terms of these procedural contracts are becoming more detailed, although interesting variations appear in the use of certain terms. For example, while the use of class-arbitration waivers has grown, the use of discovery limits remains surprisingly static.
- Second, while a variety of mechanisms might be used to regulate procedural contracts, a blend of private self-regulation and case-by-case judicial oversight likely offers the optimal regime. We evaluate this regime as compared to more paternalistic forms of regulation such as oversight by administrative agencies or outright statutory bans.
- Third, arbitrators have not developed a consistent method for determining how to fill procedural gaps—such as the availability of class relief—in arbitration.
- Fourth, while perhaps adopting the correct gap-filler in *Stolt-Nielsen*, the Supreme Court overstepped in that case when it trimmed arbitrators’ gap-filling authority to render procedural rulings in the face of silent agreements.

This argument unfolds in three parts. Part I surveys the history of procedural contracts. It then turns to the empirical record, examining data on changes in franchise arbitration clauses over time to illustrate how some procedural contracts have evolved. Finally, Part I examines why some parties, even when presented with this opportunity, have declined to undertake it.

Part II examines the theoretical issues at the core of *Rent-A-Center*—namely the scope of parties’ freedom to enter into procedural contracts. *Rent-A-Center* concerned the use of a particular term that allocates to the arbitrator the exclusive authority to resolve challenges to the enforceability of the arbitration agreement. Part II draws on several data sources, including one that, to our knowledge, has not



previously been examined in the arbitration literature—namely the Federal Reserve Board’s recently created and incredibly rich database of credit card agreements, set up under the Credit Card Accountability Responsibility and Disclosure Act of 2009,<sup>21</sup> to examine the frequency with which parties employ this term across different types of agreements. It also examines the potential impact of *Rent-A-Center* for a wider array of arbitration agreements that do not explicitly reallocate the power to rule on the enforceability of the arbitration agreement but arguably do so implicitly through incorporation of arbitral rules. Part II then turns to the normative question lying at the heart of *Rent-A-Center*—namely the proper limits on procedural contractual freedom. It introduces several possible models—including self-regulation, judicial oversight, administrative regulation, and legislative action. It defends a blend of self-regulation and case-by-case judicial oversight as the optimal form of regulation and responds to several potential objections to this approach.

Part III examines the theoretical issues at the core of *Stolt-Nielsen*—namely how arbitrators fill gaps in the parties’ procedural contract. *Stolt-Nielsen* concerned a particular type of gap—the agreement’s silence as to the availability of class arbitration. Examining awards in class arbitrations administered by American Arbitration Association, Part III finds that arbitrators have not developed a consistent method for filling procedural gaps in an arbitration agreement when the agreement does not expressly address class arbitration. Part III then turns to the normative question lying at the heart of *Stolt-Nielsen*—the proper scope of an arbitrator’s gap-filling authority. We argue that the Court took too crabbed a view of the arbitrator’s gap-filling authority. After examining the implications of the Court’s decision beyond the issue of class arbitration, we urge courts to construe the decision narrowly in order to reaffirm a more deferential approach to an arbitrator’s gap-filling authority.

The conclusion explores the implications of this analysis for issues currently before the Court and Congress. As to the judicial agenda, the grant of *certiorari* (and recent decision) in *AT&T Mobility LLC v. Concepcion* signals the Court’s continued interest in procedural contracts.<sup>22</sup> *Concepcion* presents difficult issues of FAA preemption and highlights the interaction between procedural contract freedom and

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21. Pub. L. No. 111-24, 123 Stat. 1734 (2009).

22. *Laster v. AT&T Mobility LLC*, 584 F.3d 849 (9th Cir. 2009), *cert. granted sub nom. AT&T Mobility LLC v. Concepcion*, 130 S. Ct. 3322 (2010).

judicial oversight—themes central to our analysis. Our analysis suggests that the issue was more difficult than the majority admitted but, ultimately, supports the majority's conclusion that the FAA preempts judicial doctrines finding arbitration clauses unconscionable based on the mere presence of a class-arbitration waiver. As to the Congressional agenda, several recent enactments and pending bills signal a continued legislative interest in procedural contracts. The recently enacted financial reform bill prohibits arbitration of certain claims created by the statute and authorizes several federal agencies (including the newly created Bureau of Consumer Financial Protection) to prohibit or regulate arbitration agreements in certain industries.<sup>23</sup> Even more sweepingly, the Arbitration Fairness Act would completely prohibit pre-dispute arbitration agreements in consumer and employment contracts.<sup>24</sup> Our analysis suggests that Congress may have acted hastily when it adopted the anti-arbitration provisions in the financial reform bill and should proceed cautiously before further restricting procedural contractual freedom.

## II. PROCEDURAL CONTRACTS: HISTORY AND TRENDS

This part does two things. First, it examines the history of efforts to control procedure through contract. Second, it provides an empirical snapshot of the trends in efforts to control procedure through contract.

### A. History

The history of contract and procedure in the United States can be divided into three eras: (1) prior to the FAA's enactment (until 1925), (2) following the FAA's enactment during the era of non-arbitrability (from 1925 until the mid-1980s), and (3) following the demise of the non-arbitrability doctrine until the present day (from the mid-1980s to the present day).<sup>25</sup>

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23. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 921, 1028, 1414(e), 124 Stat. 1376, 1841, 2003-04, 2151 (2010).

24. See S. 987, 112th Cong. § 3 (2011); H.R. 1873, 112th Cong. § 3 (2011).

25. For alternative surveys of the history, see Horton, *The Shadow Terms*, *supra* note 7, at 611-23; Marcus, *supra* note 7, at 988-1015. We acknowledge that the second era may be appropriately dated to the early 1970s when decisions like *Bremen* and *Scherck* laid the intellectual groundwork for the demise of the non-arbitrability doctrine. See Carrington & Haagen, *supra* note 1, at 352, 364. Nonetheless, we date the end of the second era at the middle of the 1980s, for that is when the "international commerce" rationale for *Bremen* and *Scherck* dropped out, and their underlying principles crept into purely domestic disputes. That was the critical move which enabled procedural contracts to proliferate. See Resnik, *supra* note 6, at 620.

## 1. Pre-1925

Prior to the twentieth century, opportunities to control procedure by contract were largely non-existent. Courts viewed such pre-dispute agreements (whether forum selection clauses or arbitration clauses) with suspicion, characterizing them as contracts that sought to “oust” courts of jurisdiction and, consequently, violated public policy.<sup>26</sup> During this era, a party could control procedure only through forum shopping. By filing a case in a particular forum (or seeking to have a case removed or transferred to another forum), a party could influence the procedural rules governing the dispute.

This type of crude procedural manipulation via forum shopping differed from the sorts of devices described in the introduction (like class-arbitration waivers) in two critical respects. First, parties enjoyed far less autonomy—while they might choose from among different systems of procedure (by, for example, filing in state court rather than federal court), they had relatively little influence over the procedures within a particular forum. Second, the decision over the applicable procedure was not the result of pre-dispute bargaining between the parties. Except in a rare case where one party chose not to object to its adversary’s chosen forum, the applicable procedures for a dispute were more the product of one party’s prevailing in a forum-shopping fight than the product of a bilateral agreement between disputants.

## 2. The Non-Arbitrability Era

The enactment of the Federal Arbitration Act and the growing judicial acceptance of forum selection clauses expanded opportunities for controlling procedure through contract, but doctrines continued to impose constraints. By putting arbitration agreements on the same footing as contracts generally, the Federal Arbitration Act heralded the possibility that parties, on a pre-dispute basis, could remove their disputes from the courts and resolve them instead before private bodies. To the extent the rules of those bodies allowed parties to design the system for resolving disputes, the Federal Arbitration Act created the possibility for parties to control procedure contractually too.

Yet the nonarbitrability doctrine supplied an important constraint on this newfound power. Under that doctrine, many disputes arising under federal statutes such as the securities laws, the antitrust laws, and

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26. For a fuller discussion of this era, see Carrington & Haagen, *supra* note 1, at 339–44; Peter B. Rutledge, *Whither Arbitration?*, 6 GEO. J.L. & PUB. POL’Y 549, 552 (2008).

the civil rights laws were deemed to be nonarbitrable.<sup>27</sup> The underlying theory was that arbitration of such disputes was inconsistent with Congress's intent in creating a cause of action under those statutes. Consequently, claims arising under those laws would remain in court, where opportunities to influence procedure by contract remained limited, not unlike the prior era when contractual forum clauses were altogether unenforceable.

This bifurcation of arbitral disputes and nonarbitrable ones—which largely prevailed from 1925 (the year of the FAA's enactment) until the 1970s and 1980s (when the nonarbitrability doctrine began to crumble)—had important consequences. Specifically, it meant that the parties exercised their newfound power to contract for procedure around particular types of claims, namely contract, tort, and other common-law claims that did not run afoul of the nonarbitrability doctrine's limits. To the extent federal statutory claims presented unique procedural challenges (on matters such as attorneys' fees, discovery, and class actions), parties had no incentive to invest much time or attention in these matters.

### 3. Demise of the Non-Arbitrability Doctrine

Things changed in the 1970s and 1980s as the nonarbitrability doctrine crumbled, and most claims (including federal statutory ones) became arbitrable.<sup>28</sup> The opportunities to control procedure by contract expanded. The proliferation in the types of arbitrable claims created greater opportunities to regulate procedure by contract. To the extent these newly arbitrable claims presented unique procedural challenges (for example, class actions, attorney's fees, discovery), parties now had an incentive—which they lacked in the earlier era that limited arbitration to nonstatutory claims—to use their new contractual freedom to regulate such matters.

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27. *E.g.*, *Wilko v. Swan*, 346 U.S. 427, 438 (1953) (“[W]e decide that the intention of Congress concerning the sale of securities is better carried out by holding invalid such an agreement for arbitration . . .”).

28. In addition to the demise of the non-arbitrability doctrine, the scope of Congress's power to regulate interstate commerce expanded dramatically from 1925, when the FAA was enacted, to the 1970s and 1980s. This expansion correspondingly increased the contracts to which the FAA applied. *See* Christopher R. Drahozal, *In Defense of Southland: Reexamining the Legislative History of the Federal Arbitration Act*, 78 NOTRE DAME L. REV. 101, 127–30 (2002).

The steady erosion in the non-arbitrability doctrine paralleled the Court's growing judicial acceptance of forum selection clauses.<sup>29</sup> While these two strands of jurisprudence shared a common solicitude for freedom of contract, their implications differed sharply. Enforceable forum selection clauses enhanced parties' abilities to site a case in a court that had a favorable set of procedural rules (much like the crude form of forum shopping described above) and, unlike that crude system, enabled explicit pre-dispute bargaining over that forum. Once that forum was fixed contractually, however, most rules of civil procedure limited the parties' ability to contract around its provisions. (To borrow a gastronomic analogy, a party might pick from among several restaurants but could not control what would be on the menu.)

In contrast to forum selection clauses, arbitration clauses have a more profound effect on the procedure by which disputes are resolved. Unlike rules of civil procedure, which function largely like mandatory rules (around which parties cannot contract), most arbitral rules function like default rules (generally subject only to the mandatory rules of the arbitral forum). They generally provide that the arbitrator will conduct the proceedings in a manner consistent with the parties' agreement and, only when such agreement is lacking, may exercise his or her discretion. To the extent arbitral rules regulate some aspect of an arbitration, they often also contain a provision stating that the rules can be modified by the agreement of the parties. The net effect of such rules, which have no perfect analogue in most rules of civil procedure for court systems, is to create far greater potential for parties to regulate by contract the procedures by which their dispute will be resolved.<sup>30</sup>

This newfound opportunity to control procedure by contract has raised a host of challenging questions for the Supreme Court. Some questions concern the limits on the parties' freedom of contract. In addition to *Rent-A-Center*, cases like *Gilmer* (involving a broadside

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29. See, e.g., *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 594 (1991); *Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 19–20 (1972).

30. We stress no "perfect" analogue because certain features of garden-variety civil litigation are subject to agreement by the parties. For example, parties may enter into joint stipulations under which they agree to fashion discovery along certain lines, or they may agree on certain substantive questions, thereby eliminating the need for jury determination. The critical difference between these devices and the devices that we describe here is that procedural contracts like joint stipulations occur after the dispute has arisen (where both parties have more information about the nature of the dispute) whereas the devices that interest us here can be designed at the pre-dispute stage (where parties have relatively less information about the course of any dispute). For a thoughtful analysis of this "relatively unexplored" field, see Scott & Triantis, *supra* note 7, at 857–78.

attack on arbitral procedures), *Randolph* (involving the enforceability of fee-splitting rules in arbitration), and *Hall Street* (involving the enforceability of contractually expanded judicial review of awards)<sup>31</sup> fall in this category.<sup>32</sup> A separate set of questions concerns the proper default rules where the parties' contract is silent. In addition to *Stolt-Nielsen*, cases like *First Options* (involving the default allocation of authority between courts and arbitrators), *Howsam* (involving the allocation of authority to decide whether limitations periods have lapsed), *Cardegna* (involving the default allocation of authority to decide legality challenges to the underlying contract) and *Bazzle* (like *Stolt-Nielsen*, involving an agreement that was silent about the availability of class arbitration) fall into this category.<sup>33</sup> We return to these themes in Parts II and III. For now, we simply wish to lay out how doctrinal evolutions enabled these current battles over procedure by contract. In the remainder of this Section, we show empirically how parties are exercising this freedom and also consider explanations for why parties sometimes fail to do so.

### B. Trends

The preceding subsection explained how the Court's doctrine has evolved so as to create conditions under which parties could—and, indeed, had an incentive to—control procedure by contract.<sup>34</sup> Here, we examine the extent to which parties have responded to those incentives.<sup>35</sup> Our hypothesis is that over time, arbitration clauses,

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31. Expanded review, however, unlike the other issues, is new only in the form it takes—i.e., clauses drafted specifying the grounds courts were to apply in reviewing arbitration awards. An alternative form of expanded review—restricting the arbitrators' authority to make errors of law—has been around for a long time, and, indeed, predates enactment of the FAA. See Christopher R. Drahozal, *Contracting Around Hall Street*, 14 LEWIS & CLARK L. REV. 905, 914–15 (2010).

32. See *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 578 (2008); *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 82 (2000); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 29–33 (1991).

33. *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 443 (2006); *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444, 447 (2003); *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 83 (2002); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 942 (1995).

34. For an explanation of why parties choose arbitration as an option generally, see generally Christopher R. Drahozal & Keith N. Hylton, *The Economics of Litigation and Arbitration: An Application to Franchise Contracts*, 32 J. LEGAL STUD. 549 (2003); Christopher R. Drahozal & Stephen J. Ware, *Why Do Businesses Use (or Not Use) Arbitration Clauses?*, 25 OHIO ST. J. ON DISP. RESOL. 433 (2010); Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX. L. REV. 1581 (2005).

35. During oral argument in *Bazzle*, Justice Stevens predicted that the Court's view on an arbitrator's authority to order class arbitration lacked "any real future significance,

particularly in contracts between sophisticated and unsophisticated parties, have become more complex, seeking to regulate the procedure in arbitration in more and more detail.

The empirical evidence tracking changes in arbitration clauses over time is limited. Most studies examine the provisions of arbitration clauses at a particular point in time, rather than measuring changes in those provisions over time. One exception is data on the terms of arbitration clauses in franchise agreements in 1999 and 2007, as reported by Drahozal and Wittrock.<sup>36</sup> The sample consists of 28 form franchise agreements, filed by franchisors with the Minnesota Department of Commerce and collected in 1999 and 2007, that included an arbitration clause in both years. A clear advantage of the dataset is that it examines the same franchisors in each year, enabling a comparison of changes in the arbitration clauses over time.

Franchise agreements, of course, are only one type of contract, and they are not necessarily representative of other types of contracts, such as, for example, employment, consumer, and business contracts. Thus, franchisees, unlike consumers and most employees, are running businesses, albeit often (although not always) small businesses. Conversely, franchise agreements typically are standard form contracts presented on a take-it-or-leave-it basis—i.e., are not fully negotiable between the franchisor and the franchisee. Moreover, the timing of the dataset is not perfect. We would expect to see the move to more detailed arbitration clauses to have begun before 1999, so if anything our results likely understate the degree of change in terms. With those qualifications, Table 1 summarizes the results.<sup>37</sup>

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because isn't it fairly clear that all the arbitration agreements in the future will prohibit class actions?" Transcript of Oral Argument at 55, *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444 (2003) (No. 02-634). In fact, the empirical results of our research suggest that, more broadly, this sort of procedural contracting was already well underway by the time of *Bazzle*, but that, conversely, it has not become ubiquitous, as Stevens suggested.

36. Christopher R. Drahozal & Quentin R. Wittrock, *Is There a Flight from Arbitration?* 37 HOFSTRA L. REV. 71, 90–94 (2008).

37. *Id.* at 103 tbl.8, 104 tbl.9, 106 tbl.10, 108 tbl.11, 110 tbl.12, 111 tbl.13, 112 tbl.14, 113 tbl.15. Bold type highlights those types of contract provisions that are more common in 2007 than in 1999.

| Table 1. Percentage of Franchise Agreements that Include Specified Provisions in Arbitration Clauses (n=28) |              |              |
|---|--------------|--------------|
|   | 1999         | 2007         |
| <b>Number of arbitrators</b>  | <b>50.0%</b> | <b>60.7%</b> |
| Discovery   | 21.4%        | 21.4%        |
| Judicial review   | 10.7%        | 10.7%        |
| <b>Class arbitration or consolidation</b>   | <b>64.3%</b> | <b>89.3%</b> |
| Location  | 96.4%        | 96.4%        |
| <b>Costs</b>  | <b>75.0%</b> | <b>85.7%</b> |
| <b>Time limits for filing claims</b>  | <b>42.9%</b> | <b>67.9%</b> |
| <b>Restrictions on punitive damages</b>   | <b>75.0%</b> | <b>85.7%</b> |

Table 1 illustrates several important findings:

Dispute resolution clauses in the franchise agreements in the sample have become more detailed. Tellingly, in no procedural category did we see a decline in the percentage of arbitration agreements regulating the matter. This is consistent with our hypothesis that this current era of contract and procedure has enhanced opportunities for sophisticated parties to regulate the procedures by which disputes are settled.

The greatest increase in procedural terms comes in the use of class-arbitration waivers and time limits. This suggests that control over those mechanisms has grown in importance to the franchisor community, which tracks what we've seen in the business community's views of class actions more generally over the last several decades. More modest increases are seen in provisions controlling the allocation of costs and awards of punitive damages, which were among the more important advantages of arbitration to businesses immediately following the decline of the non-arbitrability era.

Some provisions such as discovery limits are more static over time. This is curious because reduced discovery is often cited as among the more appealing features of arbitration.<sup>38</sup> So why might this occur? Several preliminary hypotheses are possible.

One reason may simply be ignorance. Until parties become accustomed to the opportunities enabled by arbitration clauses, they may have little incentive to invest in sophisticated forms.

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38. See Rutledge, *supra* note 26, at 575.



Another reason may be fear of non-enforceability. With growing reliance on unconscionability (and other) doctrines as a tool for resisting enforcement of arbitration clauses, parties favoring arbitration may be reluctant to build too many procedural advantages into an arbitration clause for fear of jeopardizing its enforceability.<sup>39</sup>

A third reason may be incomplete information. At the time parties draft (and enter into) arbitration agreements, they may be unable to predict with sufficient certainty the expected course of a dispute. Consequently, they may be reluctant to tie their hands over the availability (or unavailability) of a particular procedural right, for fear that in a particular dispute they indeed may want access to that right.

A fourth, slightly more cynical reason may be principal-agent problems. Lawyers drafting arbitration clauses on behalf of their clients may have an incentive to leave certain procedural terms (like discovery) vague.<sup>40</sup> The advantage from the agent's perspective is that the vague term creates the conditions in which disputes over gap-filling inevitably will arise. Those disputes translate into increased fees for the attorney. The difficulty with this explanation, it must be noted, is that it is difficult to explain the variation across procedural terms—by logic of this argument, the attorney would have the incentive to leave other terms (like class arbitration) unresolved as well, yet the evidence suggests they have not done so.

A final reason may be transaction costs. To the extent parties have equal (or approximately equal) sophistication, more detailed procedural contracts potentially become more costly, as each party has a negotiable stake in the bargain. Consistent with the literature on incompletely theorized agreements,<sup>41</sup> one would expect more detailed arbitration clauses where relatively significant differences in bargaining positions exist and relatively less detailed clauses among parties with similar bargaining positions. In Scott and Triantis's terms, the negotiation of procedural contracts between parties of relatively equal bargaining

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39. Where courts find an arbitration clause unenforceable on these grounds, that determination raises a corollary question whether the offending provision is severable or, instead, the entire arbitration clause is invalid. See Miller, *supra* note 7, at 379–80. For a good example of severability analysis, see *Booker v. Robert Half Int'l, Inc.*, 413 F.3d 77 (D.C. Cir. 2005).

40. This hypothesis presupposes, of course, that an outside counsel either drafted the clause or was consulted by the company about how best to draft the clause. The database does not permit independent verification of this premise.

41. See generally Cass R. Sunstein, *Incompletely Theorized Agreements*, 108 HARV. L. REV. 1733 (1995).

power entails relatively greater “front-end costs as transaction costs” than procedural contracts between parties of relatively unequal bargaining power.<sup>42</sup> It bears emphasis that each of the foregoing explanations merely amounts to a hypothesis. The available data do not permit a firm testing of the various hypotheses.

This Part has examined both the history of procedural contracts and the empirical record. The history demonstrates that the demise of the non-arbitrability doctrine has created unprecedented opportunities for parties to regulate procedural rights on a pre-dispute basis. It has given them an incentive to design far more elaborate procedural contracts than during the era when only garden-variety contract claims were arbitrable. The empirical record provides evidence that at least some parties are increasingly exercising their procedural contractual freedom to enter into elaborate agreements regulating the procedure by which their dispute will be resolved. Over time, the most significant movement has been an increase in the use of class-arbitration waivers and contractual limitations periods. Curiously though, discovery has consistently been left unregulated, despite the potential for parties to control the costs of discovery through contractual terms. While several possible hypotheses might explain this curious phenomenon, the necessary data are not yet available to test them. This remains a fertile area for future research.

### III. WHEN THE PROCEDURAL CONTRACT SPEAKS— LIMITS ON FREEDOM

This Part addresses the scope and limits of parties’ procedural contractual freedom, the issue at the core of *Rent-A-Center*.<sup>43</sup> After laying out the particular contract term at issue in *Rent-A-Center*—one that allocated to the arbitrator the exclusive authority to resolve challenges to the enforceability of the arbitration agreement (hereinafter a “delegation provision”)—it canvasses several data sources to determine how frequently parties use delegation provisions. It then takes another cut at the data to examine how parties might achieve the same results as a delegation provision, but through indirect means. This Part then turns to the normative question at the core of *Rent-A-Center*—namely the limits on the parties’ ability to exercise their procedural contractual freedom. After introducing several potential

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42. See Scott & Triantis, *supra* note 7, at 823.

43. We disclose that one of us (Drahozal) provided comments on a draft of the arbitration scholars’ brief in *Rent-A-Center*, but was not a party to the brief.

models of regulation, we defend an approach that relies on a blend of industry self-regulation (through the use of tools like the due process protocols) and case-by-case judicial oversight. This Part concludes by anticipating and responding to several potential criticisms of this approach.

*A. Procedural Contractual Freedom: The Case of Delegation Clauses*

The facts of *Rent-A-Center* illustrate well our point about how sophisticated parties utilize arbitration clauses to control procedures by contract. In that case, Rent-A-Center required its prospective employees, as a condition of employment, to sign a separate five-page arbitration agreement. Among other things, that five-page agreement required the parties to split the arbitration fees and limited the parties' ability to conduct discovery.<sup>44</sup> It also allocated to the arbitrator the "exclusive authority to resolve any dispute relating to the interpretation, applicability, enforceability or formation of [the arbitration agreement] including, but not limited to any claim that all or any part of [the arbitration agreement] is void or voidable."<sup>45</sup>

This last provision was central to the question before the Supreme Court. In light of this provision, who resolved challenges to the unconscionability of the arbitration agreement? The arbitrator or the court? The answer might have turned on a straightforward interpretation of *First Options*—specifically, whether the quoted provision provided the necessary evidence of "clear and unmistakable" intent to allocate the decision to the arbitrator.

While the dissent answered this question with an unambiguous "no,"<sup>46</sup> the majority constructed an entirely novel and unanticipated theory to resolve the case—one neither advanced by the parties nor considered by the courts below. Instead of simply answering the question "yes," the majority reconceptualized the arbitration agreement. Rather than treating the arbitration agreement as a single procedural contract, it described the agreement as embodying two separate contracts—(1) a contract to arbitrate the parties' substantive claims (that is, those arising out of the employment relationship) ("the arbitration agreement") and (2) a separate procedural contract to allocate to the arbitrator the power to resolve challenges to the arbitration agreement (dubbed "the delegation provision" by the

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44. *Rent-A-Center, West, Inc. v. Jackson*, 130 S. Ct. 2772, 2780 (2010).

45. *Id.* at 2775.

46. *Id.* at 2784 (Stevens, J., dissenting).

majority). In the majority's view, since Jackson's unconscionability challenge was directed only at the first contract (the arbitration agreement) and not the second, the challenge was appropriately resolved by the arbitrator, not the court.<sup>47</sup>

This conclusion marked a significant expansion of the "separability" principle—a principle first announced by the Court in *Prima Paint* and one that has become a cornerstone of arbitration, both domestically and internationally.<sup>48</sup> As formulated by *Prima Paint* over four decades earlier, the separability doctrine treats an arbitration clause as a separate contract from the main contract that includes the arbitration clause. Separability permitted the development of a default rule for allocation of authority. Under that default rule, courts resolve challenges to the enforceability of arbitration agreements and arbitrators resolve challenges to the enforceability of the underlying substantive contract.<sup>49</sup> *Rent-A-Center* extended the separability principle by treating the arbitration agreement itself as entailing two separate contracts. This double separability principle enabled a further allocation of power to the arbitrator—now arbitrators could resolve challenges to the arbitration agreement, and courts retained only the competence to resolve challenges directed specifically at the delegation provision.

This extension of the separability doctrine marks a substantial development toward a model of arbitration that allows parties a great deal of procedural contractual freedom (and a concomitant reduction in a court's role to police procedural contracts). While the facts of *Rent-A-Center* are somewhat unusual (as the case involves a separate, detailed arbitration agreement), the decision logically extends to a case where the arbitration agreement is merely a clause within a broader contract (as is often the case, for example, in franchise or consumer credit agreements). The case thus gives rise to the possibility that a single document *qua* agreement will be legally understood to contain at least three separate contracts: (1) the underlying substantive commitments

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47. *Id.* at 2779 (majority opinion).

48. See *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 402 (1967); see also Alan Scott Rau, *Everything You Really Need to Know about "Separability" in Seventeen Simple Propositions*, 14 AM. REV. INT'L ARB. 1, 81 & n.193 (2003) (stating that "every modern regime of arbitration—if not indeed every piece of legislation in the civilized world—takes separability as the foundation stone of the entire structure," although recognizing limited exceptions).

49. This statement of the rule is subject to an important qualification. See *infra* note 50 and accompanying text.

(for example, a cell phone for a monthly fee); (2) a bilateral commitment to arbitrate; and (3) a bilateral commitment to arbitrate challenges to contract (2). Only if a challenge were directed at contract (3) could a party resisting arbitration seek refuge in court (subject to an important qualification).<sup>50</sup>

That is the potential impact of *Rent-A-Center*. Whether that impact is widely felt, of course, depends on the frequency with which parties employ such clauses. So we sought to ascertain how often contracts, like the *Rent-A-Center* contract, attempt to allocate competence over challenges to the arbitration agreement exclusively to the arbitrator.

To test this proposition about *Rent-A-Center*'s impact, we consulted three datasets. The first was the franchise dataset, discussed above.<sup>51</sup> The second consisted of arbitration clauses collected from a 2008 sample of joint venture agreements (both domestic and international), submitted as attachments to SEC filings.<sup>52</sup> The third was derived from a new database of credit card contracts made available by the Federal Reserve Board pursuant to the Credit Card Accountability Responsibility and Disclosure Act of 2009.<sup>53</sup> Table 2 summarizes our findings:

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50. Here's the important qualification: if the party challenging the agreement alleges that the parties never formed any of the agreements (for example, due to lack of assent), the court would resolve that jurisdictional issue. *See Granite Rock Co. v. Teamsters*, 130 S. Ct. 2847, 2860 (2010).

51. Data on delegation clauses were not included in the published version of the study. We reviewed the arbitration clauses used in the study for the presence of delegation clauses.

52. For further description of the dataset, see Drahozal & Ware, *supra* note 34, at 465–66 & n.143. Again, data on delegation clauses were not included in the published version of the study, but were, instead, obtained from a review of the arbitration clauses used in the study.

53. Pub. L. No. 111-24, § 204, 123 Stat. 1734, 1746 (2009) (amending 15 U.S.C. § 1632); *see also* 12 C.F.R. § 226.58(c)(2) (2010). The sample we use in this article consists of all credit card agreements that included arbitration clauses as of December 31, 2009, which were submitted by issuers to the Federal Reserve and made available on the Federal Reserve web page as of September 1, 2010. A total of 65 issuers — banks, thrifts, credit unions, and several nonfinancial businesses (retailers that offer credit to their customers) — submitted credit card agreements with arbitration clauses, including the largest credit card issuers that at the time were using arbitration clauses. For our purposes here, we do not distinguish among the different types of issuers.

| Table 2. Delegation Clauses in Arbitration Clauses, by Type of Contract |                   |                        |                 |                      |
|---|-------------------|------------------------|-----------------|----------------------|
| Type of Contract  | Delegation Clause | Anti-Delegation Clause | Class Exception | No Delegation Clause |
| Franchise Agreements (2007)   | 4 (14.3%)         | 2 (7.1%)               | 0 (0.0%)        | 22 (78.6%)           |
| Joint Venture Agreements - Domestic (2008)                              | 1 (11.1%)         | 0 (0.0%)               | 0 (0.0%)        | 8 (88.9%)            |
| Joint Venture Agreements - International (2008)                         | 1 (5.0%)          | 0 (0.0%)               | 0 (0.0%)        | 19 (95.0%)           |
| Credit Card Contracts (2009)  | 31 (49.2%)        | 6 (9.5%)               | 20 (31.7%)      | 6 (9.5%)             |

The findings in Table 2 indicate (not surprisingly) that the use of express delegation clauses varies with the type of contract.<sup>54</sup> They are rarely used in joint venture agreements and used slightly more frequently in franchise agreements.<sup>55</sup> In both instances, though, such clauses appear only in a handful of contracts. By contrast, delegation clauses appear far more frequently (31 of 63, or 49.2%) in the credit card agreements with arbitration clauses gathered from the Federal Reserve database.

Notably, just under ten percent of the credit card arbitration agreements (and just over seven percent of the franchise arbitration agreements) include what we call an “anti-delegation clause”—a provision that reserves decision on the enforceability of the arbitration

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54. In addition, the delegation clauses themselves varied. By no means did all of the clauses include language as clear and definitive as the language in the *Rent-A-Center* clause. Note also that the terms of the arbitration agreement were missing for two of the credit card contracts in the sample which otherwise indicated that disputes were subject to arbitration. As a result, those agreements are not included in the results reported in Table 2.

55. An additional six of the twenty-eight franchise arbitration clauses included language stating that the parties agreed to arbitrate claims that the entire franchise agreement or any provision thereof was invalid. Because those provisions did not specifically refer to the arbitration clause, we did not classify them as delegation clauses.

clause to the court rather than the arbitrators.<sup>56</sup> In addition, over thirty percent of the credit card arbitration agreements (but none of the franchise arbitration agreements) reserved decisions on the validity of any class-arbitration waiver for the court.<sup>57</sup> We suspect that the motivation for these clauses is the desire to preserve the opportunity for immediate, de novo review in the event of an adverse decision (something that a party would not receive if the matter were delegated to the arbitrator). But regardless, such provisions do provide some reason to believe that *Rent-A-Center* will not result in all businesses including delegation clauses in their consumer and employment arbitration clauses.<sup>58</sup>

It is important to stress the limits of the data. We do not have data on employment contracts—the type of contract at issue in *Rent-A-Center*—and we do not claim that our results are representative of all types of contracts. Moreover, the data on some of the types of contracts may be out-of-date. The most recent data we examined (for credit card contracts, as of December 31, 2009), also have the greatest usage of delegation clauses, which may provide some evidence of a trend toward greater use of such clauses (or which may simply reflect a greater usage of delegation clauses in credit card agreements).

Express clauses are not the only means by which parties might reallocate from courts to arbitrators the power to rule on jurisdictional challenges. Another, potentially more important, means would be through incorporation of institutional rules (like the rules of the American Arbitration Association). Such rules often contain language that authorizes the arbitrator to rule on jurisdictional challenges. Rule 7(a) of the AAA Commercial Arbitration Rules is exemplary: “The arbitrator shall have the power to rule on his or her own jurisdiction,

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56. For example, the arbitration clause for the Merrick Bank credit cardholder agreement provided that “[a]ny claim, dispute or controversy (“Claim”) by either you or us against the other arising from or relating in any way to the Agreement or your Account, except for the validity, scope or enforceability of this Arbitration Agreement, shall, at the demand of any party, be resolved by binding arbitration.” Merrick Bank, Merrick Bank Visa or MasterCard Cardholder Agreement ¶ 22 (Dec. 31, 2009) (copy on file with authors).

57. For example, the arbitration clause in the M&I Federal Savings Bank credit cardholder agreement provided that “[a] court with proper jurisdiction and not an arbitrator will determine whether this provision prohibiting class actions, joinder and/or consolidation is valid and effective.” M&I Bank, M&I Bank FSB Pricing Information Addendum ¶ 24 (Dec. 31, 2009) (copy on file with authors).

58. For different views, see Horton, *Arbitration as Delegation*, *supra* note 7, at 46 (“[D]elegation clauses have already become fixtures in consumer and employment contracts.”); Stipanowich, *supra* note 20, at 20 (“In fact, agreements to delegate ‘gateway’ functions to arbitrators are ubiquitous in business contracts.”).

including any objections with respect to the existence, scope or validity of the arbitration agreement.”<sup>59</sup>

Incorporated rules like Rule 7(a) differ from the contract provision in *Rent-A-Center* in one potentially critical respect. Unlike the contract in *Rent-A-Center*, these rules do not affirmatively exclude the jurisdiction of courts over the arbitrability challenge. This raises the question whether an incorporated rule such as AAA Rule 7(a) supplies the necessary “‘clear[] and unmistakabl[e]’ evidence” of the parties’ intent to allocate jurisdictional challenges to the arbitration.<sup>60</sup>

Opinions differ on this point. Federal appellate courts have overwhelmingly concluded that such language satisfies the *First Options* standard and, thereby, strips the court of an up-front authority to rule on a challenge to the arbitration clause.<sup>61</sup> In contrast, the recent Restatement (Third) of the U.S. Law of International Commercial Arbitration has taken the opposite view, concluding that, to satisfy *First Options*, the contract (or institutional rule) must use language designating that the arbitrator’s jurisdiction over such challenges is exclusive.<sup>62</sup> Under the Restatement view, the *Rent-A-Center* language suffices; institutional rules such as AAA Rule 7(a), as presently phrased, do not.

We do not seek here to resolve that doctrinal quibble. Instead, on the assumption that the federal appellate courts state the prevailing law at present, we again consulted the various contract datasets to ascertain how frequently parties are incorporating institutional rules into their arbitration agreements. Table 3 summarizes our findings:

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59. American Arbitration Association, Commercial Arbitration Rules and Mediation Procedures, Rule R-7(a) (June 1, 2009), available at [www.adr.org/sp.asp?id=22440](http://www.adr.org/sp.asp?id=22440).

60. See *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995) (quoting *AT&T Techs., Inc. v. Commc’ns Workers*, 475 U.S. 643, 649 (1986)).

61. See, e.g., *Contec Corp. v. Remote Solution Co.*, 398 F.3d 205, 208 (2d Cir. 2005); *Terminix Int’l Co. v. Palmer Ranch Ltd. P’ship*, 432 F.3d 1327, 1331–32 (11th Cir. 2005); *FSC Secs. Corp. v. Freel*, 14 F.3d 1310, 1312–13 (8th Cir. 1994); *Apollo Computer, Inc. v. Berg*, 886 F.2d 469, 472–73 (1st Cir. 1989).

62. RESTATEMENT (THIRD) OF THE U.S. LAW OF INTERNATIONAL COMMERCIAL ARBITRATION § 5-10 cmt. e & reporter’s note e (Tentative Draft No. 1, 2010). Professor Drahozal is an Associate Reporter for the Restatement. The views stated in this article reflect his personal views and should not be attributed to the other Reporters or the American Law Institute.



| Table 3. Arbitration Provider Specified in Arbitration Clauses,<br>by Type of Contract |  |
|--|--|
| Type of Contract   | Provider   |
| Credit Card (2009)   | AAA – 20 (30.8%)<br>JAMS – 2 (3.1%)<br>NAF <sup>63</sup> – 7 (10.8%)<br>Choice of Provider <sup>64</sup> – 32 (49.2%)<br>None or missing – 4 (6.2%)  |
| Franchise Agreements<br>(2007) <sup>65</sup>   | AAA – 24 (85.7%)<br>JAMS – 1 (3.6%)<br>Choice among providers – 3 (10.7%)  |
| Joint Venture<br>Agreements - Domestic<br>(2008)                                       | AAA – 8 (88.9%)<br>AAA/ICDR – 1 (11.1%)  |
| Joint Venture<br>Agreements -<br>International (2008) <sup>66</sup>                    | AAA – 2 (10.0%)<br>CIETAC – 4 (20.0%)<br>FETACC – 3 (15.0%)<br>HKIAC – 2 (10.0%)<br>IAA – 2 (10.0%)<br>ICC – 1 (5.0%)<br>SIAC – 1 (5.0%)<br>SIAC (UNCITRAL Rules) – 1 (5.0%)<br>Ad hoc (UNCITRAL Rules) – 1 (5.0%)<br>Ad hoc – 3 (15.0%) |

63. In July 2009, the NAF discontinued administering new consumer arbitrations, as part of the settlement of a consumer fraud lawsuit brought by the Minnesota Attorney General. Consent Judgment para. 3, *Minnesota v. Nat'l Arbitration Forum, Inc.*, No. 27-CV-09-18550 (Minn. Dist. Ct. July 17, 2009), available at <http://pubcit.typepad.com/files/nafconsentdecree.pdf>. Shortly thereafter, the American Arbitration Association announced a moratorium on its administration of many (albeit not all) debt collection arbitrations brought by businesses against consumers (but not claims brought by consumers against businesses arising out of the same contracts). American Arbitration Association, Notice on Consumer Debt Collection Arbitrations, available at <http://www.adr.org/sp.asp?id=36427> (last visited May 16, 2011).

64. Of the 32 clauses that listed a choice of providers, 29 (or 90.6%) included the American Arbitration Association as an option. In addition, the other major arbitral institutions administering these sorts of arbitrations (JAMS and NAF) both have provisions in their rules similar to AAA Rule 7(a). Thus, the effect of *Rent-A-Center* on the allocation question potentially will be quite profound.

65. Drahozal & Wittrock, *supra* note 36, at 101 tbl.7.

66. Key to the abbreviations in Table 3: AAA – American Arbitration Association; CIETAC – China International Economic & Trade Arbitration Commission; FETACC – Foreign Economic & Trade Arbitration Commission of China; HKIAC – Hong Kong International Arbitration Centre; IAA – International Arbitration Association; ICC – International Chamber of Commerce; SIAC – Singapore International Arbitration Center; SIAC (UNCITRAL) – administered by Singapore International Arbitration Centre under the UNCITRAL Arbitration Rules; Ad hoc (UNCITRAL) – non-administered arbitration subject to the UNCITRAL Arbitration Rules; Ad hoc – non-administered arbitration subject to various national laws.

As shown in Table 3, the AAA is the most common provider specified in domestic arbitration agreements in the United States. A wider array of providers (not surprisingly) is specified in international arbitration agreements; most, however, have a rule like Rule 7(a) of the AAA Commercial Rules. Thus, to the extent that courts construe the language in the AAA rules consistently with the delegation clause in *Rent-A-Center*, the decision is likely to have far-reaching effects, even without the need for parties to revise their arbitration clauses. To be clear, however, it will only have those effects in cases in which the parties incorporate institutional rules in their arbitration clauses and do not address the delegation issue specifically in their clause. If the parties address the issue, either by expanding or contracting the scope of the arbitrators' authority, the delegation (or anti-delegation) provision will govern rather than the institutional rules.

Based on the growing use of detailed arbitration clauses, we anticipate two developments in the wake of *Rent-A-Center*. First, we expect to see an increased use of detailed delegation clauses such as those at issue in *Rent-A-Center* (in order to avoid the doctrinal question that divides the federal courts from the Restatement), particularly in contracts between sophisticated and unsophisticated parties. But we do not expect delegation clauses to become ubiquitous, given that some sophisticated parties seem to prefer to have courts rather than arbitrators rule on the validity of the arbitration agreement. Second, we expect that opponents of arbitration will seek to develop a jurisprudence attacking the delegation clause (as opposed to the underlying arbitration clause). After *Rent-A-Center*, attacks on that clause remain the only issue unquestionably within the court's domain where parties have delegated to the arbitrator the power to rule on the enforceability of the arbitration agreement.<sup>67</sup>

### *B. Procedural Contractual Freedom: Limits*

*Rent-A-Center* raises important normative questions extending far beyond the narrow issues involving delegation clauses. At a broad level of generality, the case concerns the extent to which the law constrains parties' ability to contract freely for the procedures governing their dispute. Much has been written on the general limits of contractual

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67. See Horton, *Arbitration as Delegation*, *supra* note 7, at 30 (“[P]laintiffs may never be able to prove that a delegation clause is unconscionable. . . . [O]ther than [a handful of] unlikely scenarios, any claim that a delegation clause is unconscionable comes perilously close to being a non-sequitur.”).

freedom, and we do not re-plow that familiar ground. Instead, we examine several possible regulatory models and defend a model that involves a blend of industry self-regulation and case-by-case judicial oversight.

### 1. Industry Self-Regulation

Like many industries, the dispute resolution industry is theoretically capable of self-regulation. In the context of procedures and contract, this self-regulation has taken the form of due process protocols. The protocols and their history have been amply discussed elsewhere,<sup>68</sup> so we summarize them here only to the extent necessary to advance our thesis.

The protocols signify a commitment by certain arbitral institutions (such as the American Arbitration Association and JAMS) that they will only administer arbitrations in certain fields (such as employment, consumer, and health care) if the parties ensure that a minimum set of procedural “rights” are observed. As Paul Verkuil has observed, the choice of terminology (“due process protocol”) is an odd one in light of the conclusion that arbitration does not constitute state action and, as a strictly doctrinal matter, is not subject to constitutional requirements of due process.<sup>69</sup> Nonetheless, the protocols function in a manner not unlike rules of procedural due process, setting forth a series of norms that must be observed in a decision-making process before the results of that process will be legally enforceable.<sup>70</sup> The due process protocol for employment disputes exemplifies the sorts of rights guaranteed to the employee:

- the employee has the right to be represented by a person of her own choosing;
- the employer is encouraged to pay at least a share of the employee’s fees;

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68. Richard A. Bales, *The Employment Due Process Protocol at Ten: Twenty Unresolved Issues, and a Focus on Conflicts of Interest*, 21 OHIO ST. J. ON DISP. RESOL. 165, 168–174 (2005); Margaret M. Harding, *The Limits of the Due Process Protocols*, 19 OHIO ST. J. ON DISP. RESOL. 369, 390–91 (2004); Arnold M. Zack, *Arbitration as a Tool to Unclog Government and the Judiciary: The Due Process Protocol as an International Model*, 7 WORLD ARB. & MED. REP. 10 *passim* (1996); Searle Civil Justice Institute, *Consumer Arbitration Before the American Arbitration Association* 16–24 (Mar. 2009) (copy on file with authors) [hereinafter *Searle Study*].

69. Paul R. Verkuil, *Privatizing Due Process*, 57 ADMIN. L. REV. 963, 985 (2005).

70. The content of some of the protections finds its roots in procedural protections attendant to labor-management arbitrations under collective bargaining agreements. See Harding, *supra* note 68, at 395–96.

- employees should have access to all information reasonably relevant to their claims;
- before selecting an arbitrator, parties should have sufficient information to contact parties who previously have appeared before her;
- arbitrators should have sufficient skill and knowledge;
- arbitrators should be drawn from a diverse background;
- arbitrators should be free of any relationships that would create an actual or apparent conflict of interest;
- the employee is entitled to the same array of remedies in arbitration as she would be entitled to in a judicial proceeding.<sup>71</sup>

In this regard, the protocols function as a type of industry-imposed constraint on parties' freedom to enter into procedural contracts.

## 2. Judicial Oversight

Courts can also regulate the parties' procedural contractual freedom.<sup>72</sup> Doctrinally, they do this in several ways. First, they can rely on Section 2 of the Federal Arbitration Act.<sup>73</sup> The Supreme Court has interpreted Section 2 to mean that courts can refuse to enforce arbitration agreements on the basis of generally applicable contract defenses (like fraud, duress, and unconscionability).<sup>74</sup> Second, with respect to federal statutory claims at least, they can declare that that an arbitral system is inadequate to permit vindication of a party's statutory rights (for example, by holding that an arbitration clause with a fee-shifting provision deters vindication of a statutory right).<sup>75</sup> Finally, they

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71. American Arbitration Association, Employment Due Process Protocol (May 9, 1995), available at <http://www.adr.org/sp.asp?id=28535>.

72. See Lampley, *supra* note 12 *passim*.

73. Federal Arbitration Act, 9 U.S.C. § 2 (2006).

74. See *Rent-A-Center, West, Inc. v. Jackson*, 130 S. Ct. 2772, 2778 (2010).

75. This ground traces to the Court's decision in *Gilmer*. While the Court in *Gilmer* dismissed a host of broad-based procedural attacks on the arbitral process (on matters like arbitrator bias, insufficient discovery, the lack of a written opinion and insufficient remedial powers), it left the door ajar for a more targeted attack on procedures in arbitration. In a statement that would set the stage for the current battles over contract and procedure, the Court, quoting its prior decision in *Mitsubishi*, opined that "so long as the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function." *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 28 (1991) (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 (1985)). Logically, this statement implied

can rely on various doctrines allowing them to vacate (or refuse to enforce) arbitral awards on the basis of some procedural defect in the arbitration (for example, by refusing to enforce an arbitral award when the arbitrators acted with “evident partiality”).<sup>76</sup>

### 3. Statutory Regulation

Legislatures can regulate parties’ procedural contracts.<sup>77</sup> Such regulation might take various forms. One form would be to declare certain disputes non-arbitrable, as Congress previously has done in certain specialized industries such as automobile dealer agreements, consumer financial services contracts with military personnel, poultry wholesale contracts (providing a statutory opt-out from arbitration clauses), employment agreements of defense contractors and most recently, residential mortgages and whistleblower claims in the commodities industry.<sup>78</sup> The previously mentioned Arbitration Fairness Act would broadly adopt this approach by making pre-dispute arbitration agreements unenforceable in consumer and employment agreements.<sup>79</sup> Though not aimed directly at procedural contracts, such legislative action has the indirect effect of constraining parties’ procedural contractual freedom by restoring elements of the second era of contract and procedure.<sup>80</sup> Another form would be to condition the enforcement of arbitral awards on adherence to certain procedures. Section 10 of the FAA does this to a degree by providing that an arbitral

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that when an arbitral forum deprived a litigant of her ability effectively to vindicate her statutory causes of action, that defect could render the arbitration clause unenforceable. For a thoughtful argument that the Court should reorient these categories, see Hiro N. Aragaki, *Arbitration’s Suspect Status*, 159 U. PENN. L. REV. (forthcoming 2011) (on file with author), available at <http://ssrn.com/abstract=1716439>.

76. See 9 U.S.C. § 10.

77. For a spirited defense of this approach, see Miller, *supra* note 7, at 404–09. See also Horton, *Arbitration as Delegation*, *supra* note 7, at 43–46 (defending congressional control over the enforceability of forum selection clauses); Horton, *The Shadow Terms*, *supra* note 7, at 665–66 & n.364 (defending a legislative ban on unilateral amendments to arbitration agreements).

78. See *supra* notes 4 & 5.

79. See *supra* note 24.

80. See Thomas E. Carbonneau, *Arguments in Favor of the Triumph of Arbitration*, 10 CARDOZO J. CONFLICT RESOL. 395, 399–400 (2009) (noting the tension between the Arbitration Fairness Act and freedom of contract principles); Alicia J. Surdyk, Note, *On the Continued Vitality of Securities Arbitration: Why Reform Efforts Must Not Preclude Pre-dispute Arbitration Clauses*, 54 N.Y.L. SCH. L. REV. 1131, 1143 (2009/10) (“[A]t the most fundamental level, the issue is that the cited provisions of the Arbitration Fairness Act are diametrically opposed to the basic principles underlying the nature of a contractual agreement, namely freedom of contract and certainty of contract.”).

award can be vacated for procedural misconduct by the arbitrator that prejudices a party's rights, as noted above.<sup>81</sup> Finally, a legislature might provide that an arbitration agreement will not be enforceable unless the agreement ensures that certain procedures are observed in the arbitration. So far, Congress has not moved in this direction, although it has considered bills such as the Fair Arbitration Act of 2007 that would have had such an effect.<sup>82</sup>

#### 4. Administrative Regulation

As an alternative to direct statutory language, legislatures can vest administrative agencies with the authority to oversee arbitration agreements and the procedural choices contained therein. In the securities industry, this already occurs to a degree: the Securities and Exchange Commission oversees the development of rules governing disputes in certain investor and employment agreements.<sup>83</sup> Portions of the recently enacted financial reform law embrace this model. That legislation expands the SEC's authority over arbitration agreements and authorizes it to adopt rules banning or regulating the use of arbitration clauses in investment advisory contracts.<sup>84</sup> It also vests the new Consumer Financial Protection Bureau with the authority to promulgate rules regulating the content of arbitration agreements in certain consumer finance contracts (like credit card agreements) and, if appropriate, to prohibit those agreements entirely.<sup>85</sup>

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81. 9 U.S.C. § 10(c).

82. See Fair Arbitration Act of 2007, S. 1135, 110th Cong. (2007). Along similar lines, the American Arbitration Association has proposed codification of the Due Process Protocols. See *The Arbitration Fairness Act of 2007: Hearing on S. 1782 Before the Subcomm. on the Const. of the S. Comm. on the Judiciary*, 110th Cong. 11–12 (2007) (statement of Richard Naimark, Senior Vice President, American Arbitration Association), available at [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110\\_senate\\_hearings&docid=f:42605.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_senate_hearings&docid=f:42605.pdf).

83. See Jill I. Gross, McMahon Turns Twenty: *The Regulation of Fairness in Securities Arbitration*, 76 U. CIN. L. REV. 493, 495 (2008); Constantine N. Katsoris, *Roadmap to Securities ADR*, 11 FORDHAM J. CORP. & FIN. L. 413, 420–24 (2006).

84. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 921(a), 124 Stat. 1376, 1841 (2010) (amending 15 U.S.C. § 78o).

85. *Id.* § 1028, 124 Stat. 2003–04.

## 5. What's the Optimal Approach?

In our view, a blend of industry self-regulation and judicial oversight likely is optimal, at least based on a cost-benefit calculation. Here's why:

First, private regulation can reduce transaction costs. A familiar literature in political science has documented the difficulties of enacting legislation due to the multiple decision points where legislative action may fail (committee, floor vote, conference committee, veto).<sup>86</sup> The protocols avoid these impediments to action by involving a single decision point, namely voluntary assent by the associations themselves. Due to the reduced number of decision points, they are also more easily changed and adapted to evolving circumstances.<sup>87</sup> Administrative regulation avoids some of these barriers but, of course, presupposes a degree of legislative authorization which may be difficult to obtain.

Second, private regulation can offer greater comprehensiveness. In contrast to judicial regulation, private regulation and certain forms of public regulation (both legislative and administrative) can be more comprehensive and more nuanced. Drafters of the protocols can consider the gamut of available data and experience. By contrast, judicial regulators may be constrained by the record evidence offered by the parties.

Third, private regulation is more easily tailored to differing circumstances. Compared to all three forms of public regulation (judicial, legislative, and administrative), the protocol mechanism allows its drafters to tailor the protocols to the particular needs of the regulated industry, as exemplified by the substantive differences between the protocols for employment, consumer, and health care arbitrations. By contrast, the scope of any judicial regulation may be constrained by doctrines such as standing, bars against advisory opinions, and limits on the remedial powers of courts. And legislation that treats all consumer and employment contracts identically (such as by making pre-dispute arbitration agreements in those contracts unenforceable) fails to consider that not all arbitration is alike.<sup>88</sup>

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86. See generally R. DOUGLAS ARNOLD, *THE LOGIC OF CONGRESSIONAL ACTION* (1990); JOHN W. KINGDON, *AGENDAS, ALTERNATIVES, AND PUBLIC POLICIES* (2d ed. 2003).

87. See Harding, *supra* note 68, at 369–73.

88. See Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Arbitrations*, 25 OHIO ST. J. ON DISP. RESOL. 843, 918 (2010) (“These variations suggest the need for a nuanced approach to public policy concerning arbitration.”).

Judicial oversight facilitates this process of adaptation. A rich scholarship has focused the various “feedback loops” between private and public actors in the development of legal norms.<sup>89</sup> The protocols provide courts a workable benchmark by which to evaluate the fairness of other procedures; moreover, hammered out through dialogue between the industry and advocates for employees and consumers, they arguably offer a relatively balanced metric rather than a biased one. Forged through this process, the protocols stimulate a dialogue between courts and the arbitration industry. For example, in *Cole v. Burns International Security Services*, Chief Judge Edwards expressed his disagreement with the employment protocol’s cost-sharing provisions, which sparked a lively debate over whether the protocol or some other approach should be used to ensure the affordability of arbitration for employees with statutory claims.<sup>90</sup> Just as the protocols can influence judicial understanding of fair arbitral procedures, judicial critique can suggest reform pathways to the protocols’ developers.<sup>91</sup>

Fourth, private regulation enhances opportunities for participation by interested groups (or policy entrepreneurs acting on their behalf). As Margaret Harding has observed, the protocol process holds forth the potential for greater participation by interested groups.<sup>92</sup> Whereas access limitations or standing doctrines may limit groups’ ability to influence the outcome of legislative or judicial regulation, the process of

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89. See, e.g., Alex Geisinger, *Are Norms Efficient? Pluralistic Ignorance, Heuristics, and the Use of Norms as Private Regulation*, 57 ALA. L. REV. 1, 24–30 (2005). See generally Eric A. Posner, *The Regulation of Groups: The Influence of Legal and Nonlegal Sanctions on Collective Action*, 63 U. CHI. L. REV. 133 (1996) (discussing “insulation theory” of nonlegal sanctions).

90. 105 F.3d 1465, 1483–1485 (D.C. Cir. 1997). For exemplary literature on the cost-sharing debate, see, for example, Michael H. LeRoy & Peter Feuille, *When Is Cost an Unlawful Barrier to Alternative Dispute Resolution? The Ever Green Tree of Mandatory Employment Arbitration*, 50 UCLA L. REV. 143 (2002); R. Brian Tipton, *Allocating the Costs of Arbitrating Statutory Claims Under the Federal Arbitration Act: An Unresolved Issue*, 26 AM. J. TRIAL ADVOC. 325 (2002). The July 2002 issue of the University of Miami Law Review dedicated an entire symposium to the issue of arbitration cost allocation in the wake of *Green Tree Financial*.

91. This consideration favors industry promulgation of the protocols instead of codification of the Due Process Protocols, as some have proposed. See *supra* note 82. While codification of the protocols could accomplish several of the same ends (and avoid any ambiguity over their legal status, see *infra* note 107), ultimately we fear that a legislative solution would be too blunt and inflexible an instrument. Given the difficulties in enacting legislation, it would be more difficult to amend or modify the codified protocols than it would be to adjust them through the private revisions, something that arbitral institutions do regularly with their own rules.

92. Harding, *supra* note 68, at 371.



protocol development and acceptance suffers from no such inherent limitations. To be sure, the validity of this premise depends on the extent to which the protocols' developers choose to include various groups in the development process.

While we have offered a variety of reasons that support a regulatory approach based on private regulation combined with judicial oversight, we acknowledge several potential criticisms of that approach and address the most significant ones here.

First, our proposed approach might prompt a "race to the bottom."<sup>93</sup> In other words, competition among providers might prompt them to skew their procedural standards in order to cater to the needs of the dominant business interest much like certain states have diluted their standards on matters like corporate law or usury law in order to attract corporate investment.<sup>94</sup> Indeed, some arbitral institutions have been severely criticized for doing precisely this.<sup>95</sup>

However, we believe this criticism overlooks a powerful counter-incentive—namely the bond of the arbitrator and the arbitral institution.<sup>96</sup> Recall that arbitral awards ultimately are subject to judicial oversight in vacatur and enforcement proceedings.<sup>97</sup> This judicial scrutiny provides a compelling counterweight to any incentive that otherwise might incline the arbitrator to favor the repeat player or the party in the superior bargaining position.<sup>98</sup> An arbitrator (or institution) whose awards are routinely set aside will not be in the business for long because neither party has an incentive to invest in a decision maker

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93. See Horton, *The Shadow Terms*, *supra* note 7, at 637–38.

94. See ERIN A. O'HARA & LARRY E. RIBSTEIN, *THE LAW MARKET* 33, 109–13 (2009). Whether there is in fact a "race to the bottom" in corporate law is hotly debated. *Id.* at 245 n.1.

95. See, e.g., JOHN O'DONNELL ET. AL., *PUBLIC CITIZEN, THE ARBITRATION TRAP: HOW CREDIT CARD COMPANIES ENSNARE CONSUMERS* 1–13 (2007) (addressing the National Arbitration Forum).

96. See Stephen J. Choi, *The Problem with Arbitration Agreements*, 36 *VAND. J. TRANSNAT'L L.* 1233, 1235–37 (2003).

97. See Federal Arbitration Act, 9 U.S.C. § 10 (2006); Convention on the Recognition and Enforcement of Foreign Arbitral Awards art. 5, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38. In addition, the arbitration agreements themselves are subject to court oversight prior to the proceeding.

98. Empirical evidence supports this postulate. The available empirical evidence on the "repeat player" effect is mixed at best. To the extent such an effect has been documented, the prevailing view is that repeat players do better in arbitration not because the arbitrators systematically favor them but, instead, because the repeat players' experience enables them to decide which cases to settle (where their adversary's position is strong) and which to contest (where their adversary's position is weak). See Drahozal & Zyontz, *supra* note 88, at 908–16; Rutledge, *supra* note 26, at 565–67.

whose decisions are likely to be invalidated. Thus, while we recognize the intuitive appeal of the race-to-the-bottom argument, we are disinclined to believe it has much bite in this context.<sup>99</sup>

Second, private regulation might reduce transparency.<sup>100</sup> Compared to more regulatory forms of rule development, the protocols are not developed according to any standardized methods by which they are closely scrutinized.<sup>101</sup> In Gillian Metzger's terms, the protocols lack adequate "accountability mechanisms."<sup>102</sup> By contrast, for example, administrative regulation typically would undergo a formal notice-and-comment period followed often by judicial challenge to the reasonableness of the agency's regulation. Likewise, a process of legislative regulation likely would create some sort of legislative record that a court could scrutinize. This criticism is, in our view, overblown. The history of the protocols' development, thoroughly recounted by scholars such as Margaret Harding and Richard Bales, demonstrates that interested groups consistently had a seat at the table as the protocols were developed.<sup>103</sup> Metzger's complaint about the lack of "accountability mechanisms" proves too much—for it would necessitate public oversight of any project of private norm development—something that would be both costly and unworkable.

Third, our proposed approach risks second-best outcomes. As Carrie Menkel-Meadow has explained, private regulation may not achieve as much substantively as direct regulation.<sup>104</sup> This stems from the bargaining toward second-best solutions. For example, as Menkel-

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99. In this regard, we part company with Carrington and Haagen, who contend that 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.'" Carrington & Haagen, *supra* note 1, at 346. This account overlooks the arbitrator's more compelling incentive to develop and maintain a reputational bond for rendering enforceable awards, irrespective of the identity of the prevailing party.

100. On the relationship between arbitration and democratic theory, see generally Richard C. Reuben, *Democracy and Dispute Resolution: The Problem of Arbitration*, 67 *LAW & CONTEMP. PROBS.* 279 (2004) (asking whether arbitration furthers the goals of democratic governance).

101. On the defects in the decision-making process behind the protocols' development, see Leona Green, *Mandatory Arbitration of Statutory Employment Disputes: A Public Policy Issue in Need of a Legislative Solution*, 12 *NOTRE DAME J.L. ETHICS & PUB. POL'Y* 173, 215–22 (1998).

102. Gillian E. Metzger, *Privatization as Delegation*, 103 *COLUM. L. REV.* 1367, 1456–76 (2003).

103. See Bales, *supra* note 68, at 171–72; Harding, *supra* note 68, at 390–91.

104. See Carrie Menkel-Meadow, *Ethics Issues in Arbitration and Related Dispute Resolution Processes: What's Happening and What's Not*, 56 *U. MIAMI L. REV.* 949, 949–951 (2002).

Meadow describes, advocates for the employment protocol necessarily compromised on certain procedural protections in order to obtain the assent of the various industry participants and arbitral institutions. As a consequence of this second-best quality to the protocol-development process, critics have called for strengthened protections.<sup>105</sup> This criticism is both too static and too platonic. It is static because it ignores the fact that the protocols are capable of refinement. Merely because the protocols might have resulted from some sort of compromise at a given point in time does not preclude their refinement at some future point if empirical evidence is put forth that undercuts the premise of a compromise. It is too platonic because it presupposes that, at a given point in time, the drafters of the protocols had the necessary information to deduce the “right” answer to a given question of arbitral procedure and that other regulators would necessarily do better. As we have explained elsewhere, the empirical record on many questions of arbitration is woefully incomplete;<sup>106</sup> in light of that incomplete record, it is simply not realistic to argue that the compromises embedded in the protocols somehow shifted away from demonstrably correct approaches. And the same limitation applies with perhaps greater force to public, as opposed to private, regulatory mechanisms.

Finally, our approach might entail a lack of predictability. Specifically, parties are unable to predict precisely how courts will use the protocols. Some decisions, as noted above, cite the protocols as merely indicative of a professional trend; by contrast, others come close to saying that the failure of an arbitration proceeding to comport with the protocols provides a legal reason for denying enforceability of the arbitration agreement altogether. As Richard Bales has explained, the due process protocols function as guideposts for both employers and the judiciary but no longer provide predictable guidance.<sup>107</sup>

This criticism is a fair one, at least in part. But it overlooks that the protocols are enforced in the first instance by the institutions themselves, which refuse to administer arbitrations under clauses that fail to comply with the protocols.<sup>108</sup> Court review is only a second-line

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105. See, e.g., Bales, *supra* note 68, at 167; Harding, *supra* note 68, at 370–72, 417.

106. See Drahozal & Zyontz, *supra* note 88, at 845; Rutledge, *supra* note 26, at 576.

107. Bales, *supra* note 68, at 167; see also Martin H. Malin, *Ethical Concerns in Drafting Employment Arbitration Agreements After Circuit City and Green Tree*, 41 BRANDEIS L.J. 779, 787–88 (2003).

108. The Searle Study found that “the AAA effectively reviews arbitration clauses for protocol compliance and appropriately responds to clauses that do not comply.” See *Searle Study*, *supra* note 68, at 83–100, 111.

defense. As for the predictability of that court review, the best answer that we can offer (which is not a complete one) is that case-by-case judicial review will help give concrete legal content to the protocols over time. As courts vacate awards due to some deviation from the protocols (or where the protocols themselves contain a defect), such action may well prompt a revision to the protocols. At the same time, as courts confirm awards rendered in accordance with protocol-based procedures, the protocols will develop a type of quasi-legal status that enables them to serve as a benchmark for enforceability of an award.

This Part has examined the exercise of and limits on procedural contractual freedom. Using the delegation clause from *Rent-A-Center* as a point of reference, it demonstrated that the use of such clauses varies widely across types of contracts. It showed further that, when such clauses are absent, the incorporation of institutional rules (such as AAA Rule 7(a)) can achieve the same effect indirectly (at least so long as the view of the federal appellate courts prevails over that of the Restatement (Third) of the U.S. Law of International Commercial Arbitration). As to the normative issues underpinning *Rent-A-Center*, from a cost-benefit perspective, a blend of industry self-regulation and case-by-case judicial oversight offers the best means of policing procedural contractual freedom—such an approach reduces transaction costs, is flexible, is comprehensive, and affords ample opportunities for participation. While the approach is not immune from criticism, most notably fears about unpredictability, those criticisms ultimately can be answered. In the next Part, we turn to a related set of issues—namely cases in which the parties’ procedural contracts are silent.

#### IV. WHEN THE PROCEDURAL CONTRACT IS SILENT— FILLING GAPS AFTER *STOLT-NIELSEN*

Arbitration agreements, like other contracts, can be incomplete. Complete contracting is costly, even when the contracts are standard form contracts drafted by only one party.<sup>109</sup> Although rules promulgated by arbitration providers offer a low-cost way to supplement contract provisions drafted by the parties, even those rules are not complete.

An important function of arbitration statutes—both the Federal

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109. Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 92–93 (1989) [hereinafter Ayres & Gertner, *Filling Gaps*]. See generally Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729 (1992) [hereinafter Ayres & Gertner, *Strategic Contractual Inefficiency*]; Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541 (2003).

Arbitration Act and state arbitration laws—is to fill gaps in arbitration agreements. But the FAA has few clearly identifiable default rules,<sup>110</sup> largely a consequence of its 1925 vintage. And state arbitration laws raise difficult and unsettled issues of FAA preemption, which may limit their usefulness as gap-fillers, and are themselves incomplete.<sup>111</sup>

As a general matter, arbitrators have substantial discretion in filling procedural gaps in the arbitration agreement.<sup>112</sup> But the Supreme Court's recent decision in *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*<sup>113</sup> raises questions about the extent of arbitrator authority to fill gaps. *Stolt-Nielsen* involved class arbitration, a setting in which arbitrators have often faced the necessity of gap-filling. As such, this Part focuses on class arbitration as well. The role of arbitrators in filling procedural gaps, however, is not limited to class arbitration. Other areas in which the question has arisen include consolidation of proceedings, joinder of parties, dispositive motions,<sup>114</sup> and issues of confidentiality, among others.

This part first provides background by tracing the development of

110. See *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 587–88 (2008).

111. Christopher R. Drahozal, *Federal Arbitration Act Preemption*, 79 IND. L.J. 393, 416–20 (2004); William W. Park, *The Specificity of International Arbitration: The Case for FAA Reform*, 36 VAND. J. TRANSNAT'L L. 1241, 1245 n.16 (2003) [hereinafter Park, *FAA Reform*].

112. For example, one commentator has noted:

Arbitrators can conduct proceedings in almost any manner they deem best, as long as they respect the arbitral mission and accord the type of fundamental fairness usually called 'due process' in the United States and 'natural justice' in Britain, which includes both freedom from bias and allowing each side an equal right to be heard.

William W. Park, *The 2002 Freshfields Lecture—Arbitration's Protean Nature: The Value of Rules and the Risks of Discretion*, 19 ARB. INT'L 279, 281 (2003) [hereinafter Park, *Arbitration's Protean Nature*]; see also William W. Park, *Procedural Default Rules Revisited*, in ARBITRATION INSIGHTS—TWENTY YEARS OF THE ANNUAL LECTURE OF THE SCHOOL OF INTERNATIONAL ARBITRATION, SPONSORED BY FRESHFIELDS BRUCKHAUS DERINGER 360 (Julian D.M. Lew & Loukas A. Mistelis eds., 2007) [hereinafter Park, *Procedural Default Rules Revisited*].

113. 130 S. Ct. 1758 (2010).

114. D. Brian King & Jeffrey P. Commission, Summary Judgment in International Arbitration: The "Nay" Case 4 (2010) (Paper Presented at ABA International Law Spring 2010 Meeting – Common Law Summary Judgment in International Arbitration), available at <http://apps.americanbar.org/intlaw/spring2010/materials/Common%20Law%20Summary%20Judgment%20in%20International%20Arbitration/King%20-%20Commission.pdf> (“[T]he major institutional commercial arbitration rules lack an express grant of power to tribunals summarily to dispose of cases. In the light of this, arbitrators have, for the most part, been reluctant to rely on implicit, gap-filling or inherent powers to introduce such a procedure.”).

the law and practice of class arbitration. It then analyzes the possible doctrinal implications of *Stolt-Nielsen* for arbitrator procedural gap-filling. It next examines the positive question of interest to us—how arbitrators fill procedural gaps in arbitration agreements. Finally, this part considers the normative question of the optimal institutional framework for procedural gap-filling in arbitration.

### A. Background on Class Arbitration

#### 1. From *Bazzle* . . .

Although class arbitration has been around for over 25 years,<sup>115</sup> its use did not become widespread until after the Supreme Court's 2003 decision in *Green Tree Financial Corp. v. Bazzle*.<sup>116</sup> In *Bazzle*, the Court granted certiorari to decide “[w]hether the Federal Arbitration Act . . . prohibits class-action procedures from being superimposed onto an arbitration agreement that does not provide for class-action arbitration.”<sup>117</sup> The South Carolina Supreme Court had held as a matter of South Carolina law that a court could order class arbitration when the arbitration agreement was silent as to class arbitration, and that such a rule was not preempted by the FAA.

The United States Supreme Court reversed and vacated the South Carolina court's ruling, but with no majority opinion for the Court. The plurality opinion, authored by Justice Breyer, concluded that the lower court's decision should be vacated, explaining as follows:

We are faced at the outset with a problem concerning the contracts' silence. Are the contracts in fact silent, or do they forbid class arbitration as petitioner Green Tree Financial Corp. contends? Given the South Carolina Supreme Court's holding, it is important to resolve that question. But we cannot do so . . . because it is a matter for the arbitrator to decide.<sup>118</sup>

Stated otherwise, the South Carolina Supreme Court's decision was based on its view that the arbitration agreement was silent as to class

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115. See Jean R. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 WM. & MARY L. REV. 1, 40–42 & n.149 (2000).

116. 539 U.S. 444 (2003).

117. Petition for Writ of Certiorari at i, *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444 (2003) (No. 02-634).

118. *Bazzle*, 539 U.S. at 447.

arbitration—that there was in fact a gap that it could fill using a state-law gap-filler. If the arbitration agreement precluded class arbitration, there was no basis for the South Carolina court to use a gap-filler (because there was no gap), and its ruling would have been improper. But the issue of whether there was a gap in the arbitration agreement, according to the plurality, was an issue the arbitrator had to decide.<sup>119</sup>

Justice Stevens did not agree with the plurality's rationale (he wrote that “arguably” the arbitrator should have decided the issue, but because the lower court's decision was “correct as a matter of law,” he would simply have affirmed that decision).<sup>120</sup> But he concurred in the judgment vacating the award to provide a controlling judgment of the Court.<sup>121</sup> Three Justices would have reversed the South Carolina court judgment on the ground that the FAA does not permit a court to order class arbitration when the arbitration agreement is silent on the issue.<sup>122</sup> Justice Thomas likewise dissented, but on the ground that the FAA does not apply in state court and so there was no reason to vacate the judgment below.<sup>123</sup>

After the splintered decision in *Bazzle*, several arbitration providers—most prominently the American Arbitration Association—set up processes for administering class arbitrations based on the plurality's decision.<sup>124</sup> The AAA's *Supplementary Rules for Class Arbitrations* set out a multi-step procedure for a class arbitration to follow.<sup>125</sup> First, the arbitrators are to “determine . . . whether the applicable arbitration clause permits the arbitration to proceed on behalf of or against a class” and to issue a clause construction award reflecting their decision.<sup>126</sup> Second, if the arbitrators conclude that the arbitration clause permits class arbitration, they next decide whether class arbitration is appropriate in the case, using standards heavily

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119. Although the case also involved a related arbitration proceeding—i.e., a proceeding in which the arbitrator already had construed the arbitration agreement—the Court held that the arbitrator's determination could have been influenced by the South Carolina court's decision and so vacated the award as well. *Id.* at 453–54.

120. *Id.* at 455 (Stevens, J., concurring in the judgment and dissenting in part).

121. *Id.*

122. *Id.* at 459–60 (Rehnquist, C.J., dissenting).

123. *Id.* at 460 (Thomas, J., dissenting).

124. For example, JAMS also began administering class arbitrations following *Bazzle*. See JAMS, JAMS Class Action Procedures, May 1, 2009, [http://www.jamsadr.com/files/Uploads/Documents/JAMS-Rules/JAMS\\_Class\\_Action\\_Procedures-2009.pdf](http://www.jamsadr.com/files/Uploads/Documents/JAMS-Rules/JAMS_Class_Action_Procedures-2009.pdf).

125. American Arbitration Association, Supplementary Rules for Class Arbitrations, Oct. 8, 2003, available at <http://www.adr.org/sp.asp?id=21936>.

126. *Id.* Rule 3.

influenced by Federal Rule of Civil Procedure 23, and issue a class determination award.<sup>127</sup> Third, if the arbitrators decide that class arbitration is appropriate, they proceed to adjudicate the case on the merits.<sup>128</sup> In between each step, the AAA's rules provide for a short, mandatory stay to permit the losing party to seek court review of the award. The AAA subsequently issued a policy statement in which it stated that it would administer arbitrations on a class basis only if the arbitration agreement specified any set of AAA rules and was "silent with respect to class claims, consolidation, or joinder of claims."<sup>129</sup> If the arbitration agreement by its terms precluded class arbitration, the AAA would not administer the case unless a court ordered arbitration on a class basis.

In an amicus brief filed in the *Stolt-Nielsen* case on September 4, 2009,<sup>130</sup> the AAA provided a useful overview of its class arbitration caseload. Overall, the AAA indicated that it had administered 283 class arbitrations since promulgating its class arbitration rules.<sup>131</sup> Of the 283 cases, 106 (37%) involved consumer claimants and 96 (34%) involved employee claimants, while 81 (28%) were business-versus-business class arbitrations.<sup>132</sup> Arbitrators had issued 135 clause construction awards: 95 (70%) holding that the arbitration clause permitted class arbitration; 7 (5%) holding that the arbitration clause did not permit class arbitration; and 33 (24%) in which the parties stipulated that the arbitration clause permitted class arbitration.<sup>133</sup> A total of 121 cases (42.8%) were still active at the time the brief was filed.<sup>134</sup>

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127. *Id.* Rules 4–5.

128. *Id.* Rule 7.

129. American Arbitration Association, AAA Policy on Class Arbitrations, July 14, 2005, <http://www.adr.org/Classarbitrationpolicy>.

130. *See infra* text accompanying notes 131–134.

131. Brief of American Arbitration Association as Amicus Curiae in Support of Neither Party at 22, *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758 (2010) (No. 08-1198).

132. *Id.* at 23–24. The AAA provided a breakdown of the types of business-versus-business class arbitrations: 21 (7%) franchises; 20 (7%) healthcare; 9 (3%) financial services; and 31 (11%) other. *Id.* at 23.

133. *Id.* at 22. The AAA reported further that arbitrators issued class determination awards in 48 cases: in 24 (50%), the award certified the class; in 18 (38%) the award denied class certification; and in 6 (13%) the parties stipulated to certifying a class. *Id.* At the time the brief was filed, none of the class arbitrations had been resolved on the merits. *Id.* at 23.

134. *Id.* at 22.



## 2. . . . to *Stolt-Nielsen*

The Supreme Court revisited class arbitration in *Stolt-Nielsen S.A. v. AnimalFeeds International, Corp.*<sup>135</sup> in a very different setting from *Bazzle*. The claimants in *Stolt-Nielsen* were all commercial parties, rather than consumers (as in *Bazzle*) or employees. As noted above, although most class arbitrations involve consumer or employee claimants, a sizable percentage involve business claimants.<sup>136</sup> Moreover, in *Stolt-Nielsen* the parties entered into two separate arbitration agreements. One was an arbitration clause in the original contract between the parties; the other was a post-dispute agreement to arbitrate the issue of whether class arbitration was permissible under the original arbitration agreement. In entering into the post-dispute agreement, the parties agreed to follow the AAA class arbitration rules (although not to have the case administered by the AAA), and stipulated that the arbitration clause was “silent” as to class arbitration.<sup>137</sup> In other words, another way that *Stolt-Nielsen* differed from *Bazzle* is that in *Stolt-Nielsen* the parties agreed that the arbitration agreement had a gap.

Relying on other arbitration awards, which had construed “a wide variety of clauses in a wide variety of settings as allowing for class arbitration,” although none “exactly comparable” to the case, the arbitrators concluded that the evidence did not show “that the parties . . . intended to preclude class arbitration.”<sup>138</sup> The district court vacated the award, holding that the arbitrators manifestly disregarded the law by failing to analyze the applicable law. The court of appeals reversed, concluding that the arbitrators had not manifestly disregarded the law because nothing in New York law or maritime law precluded class arbitration.

The Supreme Court reversed the court of appeals, reasoning as follows. First, the Court held that the arbitrators’ clause construction award should be vacated because the arbitrators had exceeded their

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135. 130 S. Ct. 1758 (2010).

136. See *supra* text accompanying note 132.

137. 130 S. Ct. at 1765–66.

138. *AnimalFeeds Int’l Corp. v. Stolt-Nielsen, SA, Partial Final Clause Construction Award* at 5, 7 (Dec. 20, 2005) (ad hoc arbitration award), reprinted in *Petition for a Writ of Certiorari* at app. D, *Stolt-Nielsen S.A. v. AnimalFeeds Int’l Corp.*, 130 S. Ct. 1758 (2010) (No. 08-1198). The award described the “test” as follows: “arbitrators must look to the language of the parties’ agreement to ascertain the parties’ intention whether they intended to permit or to preclude class arbitration.” *Id.* at 4. As described below, the Supreme Court ultimately characterized the arbitrators’ award as based solely on the arbitrators’ own conception of public policy. See *infra* text accompanying notes 139–144.

authority in relying on public policy to determine that class arbitration was appropriate in the case.<sup>139</sup> The Court explained:

Rather than inquiring whether the FAA, maritime law, or New York law contains a “default rule” under which an arbitration clause is construed as allowing class arbitration in the absence of express consent, the panel proceeded as if it had the authority of a common-law court to develop what it viewed as the best rule to be applied in such a situation. . . .

. . . .

. . . [I]nstead of identifying and applying a rule of decision derived from the FAA or either maritime or New York law, the arbitration panel imposed its own policy choice and thus exceeded its powers.<sup>140</sup>

Second, the Court stated that because the award had been vacated, “under § 10(b) of the FAA, we must either ‘direct a rehearing by the arbitrators’ or decide the question that was originally referred to the panel. Because we conclude that there can be only one possible outcome on the facts before us, we see no need to direct a rehearing by the arbitrators.”<sup>141</sup> Accordingly, the Court proceeded to decide itself whether the arbitration clause permitted class arbitration.

Third, because of the consensual nature of arbitration, the Court stated that “a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party *agreed* to do so.”<sup>142</sup> Here, the Court concluded, the parties had not agreed to arbitrate on a class basis, relying almost exclusively on the parties’ stipulation that the contract was silent on class arbitration. According to the Court, “class-action arbitration changes the nature of arbitration to such a degree that it cannot be presumed the parties consented to it by simply agreeing to submit their disputes to an

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139. The Court also held that the award should be vacated as in manifest disregard of the law, although refusing to decide whether that ground actually was available to vacate an award. 130 S. Ct. at 1768 n.3. In other words, the Court simply assumed away a possible argument that AnimalFeeds had in defense of the award (that manifest disregard of the law is not available as a vacatur ground under the FAA), and then proceeded to rely on that very ground (although only in the alternative) as a basis for vacating the award.

140. 130 S. Ct. at 1768–70.

141. *Id.* at 1770.

142. *Id.* at 1775.

arbitrator.”<sup>143</sup> Because the parties had “stipulated that there was ‘no agreement’” to authorize class arbitration, “it follows that the parties cannot be compelled to submit their dispute to class arbitration.”<sup>144</sup>

### B. *Stolt-Nielsen and Arbitrator Procedural Gap-Filling*

Each of these three aspects of the Supreme Court’s decision in *Stolt-Nielsen*—(1) vacating the award for excess of authority; (2) resolving the class arbitration issue itself; and (3) concluding that the parties had not agreed to class arbitration—has potentially important implications for the authority of arbitrators to fill procedural gaps in arbitration agreements.<sup>145</sup> This section considers the doctrinal implications of each

143. *Id.*

144. *Id.* at 1776. On its facts, *Stolt-Nielsen* presented at least two other issues that the Court did not expressly decide. First, the circuits currently are split on whether courts should vacate “non-domestic” awards—awards made in the United States but with an international nexus—using FAA Section 10 or using the grounds set out in Article V of the New York Convention. Compare *Yusuf Ahmed Alghanim & Sons, W.L.L. v. Toys “R” Us, Inc.*, 126 F.3d 15, 23–25 (2d Cir. 1997) (basing decision on Section 10 grounds), with *Indus. Risk Insurers v. M.A.N. Gutehoffnungshütte GmbH*, 141 F.3d 1434, 1441–46 (11th Cir. 1998) (basing decision on Article V grounds). *Stolt-Nielsen* came from the Second Circuit, so not surprisingly the Court of Appeals, consistent with circuit precedent, reviewed the award under Section 10. See *Stolt-Nielsen S.A. v. AnimalFeeds Int’l Corp.*, 130 S. Ct. 1758, 1766 (2010). The Supreme Court did not address the issue, but likewise used the Section 10 vacatur grounds. *Id.* at 1767–68. Second, U.S. courts have not definitively resolved whether partial awards (awards that resolve finally some but not all issues in the arbitration, like the clause construction award in *Stolt-Nielsen*) are subject to vacatur under the FAA. Cf. RESTATEMENT (THIRD) OF THE U.S. LAW OF INTERNATIONAL COMMERCIAL ARBITRATION § 1-1 reporter’s note a (Tentative Draft No. 1, 2010). The Supreme Court expressly rejected the argument that the partial award was not ripe for review under constitutional standards. 130 S. Ct. at 1767 n.2. But it refused to address prudential ripeness, finding it not timely raised. *Id.*

145. One note as a matter of terminology: The Court in *Stolt-Nielsen* seems to reject the idea that the case involves procedure at all. It explains:

The dissent minimizes these crucial differences by characterizing the question before the arbitrators as being merely what “procedural mode” was available to present AnimalFeeds’ claims. If the question were that simple, there would be no need to consider the parties’ intent with respect to class arbitration. But the FAA requires more. Contrary to the dissent, but consistent with our precedents emphasizing the consensual basis of arbitration, we see the question as being whether the parties *agreed to authorize* class arbitration.

*Id.* at 1776 (citations omitted). The Court might be read as saying that the case does not involve arbitral procedure, but rather the jurisdiction of the arbitrators (an arbitrability issue, in the Court’s usual, confusing, parlance). The problem with that view, as the Court itself acknowledged, is that the parties in *Stolt-Nielsen* had expressly agreed in a post-dispute arbitration agreement to arbitrate the issue of whether the original arbitration agreement permitted class arbitration. *Id.* at 1772 (“But we need not revisit that question here because

of those aspects of the opinion in turn.<sup>146</sup>

### 1. Arbitrator Authority to Fill Procedural Gaps

So what does *Stolt-Nielsen* decide about arbitrator authority to fill procedural gaps in the arbitration agreement in the first instance? If the opinion is viewed narrowly, the Court actually may decide very little. Given the Court's emphasis on ensuring that parties not be required to arbitrate if they have not agreed to do so, the *Stolt-Nielsen* opinion might be limited to class arbitration and comparable, essentially jurisdictional, issues.

But the Court's language is much broader. It states:

- “It is only when [an] arbitrator strays from interpretation and application of the agreement and effectively ‘dispense[s] his own brand of industrial justice’ that his decision may be unenforceable.”<sup>147</sup>
- “In that situation, an arbitration decision may be vacated under § 10(a)(4) of the FAA on the ground that the arbitrator ‘exceeded [his] powers,’ for the task of an arbitrator is to interpret and enforce a contract, not to make public policy.”<sup>148</sup>
- “Rather than inquiring whether the FAA, maritime law, or New York law contains a ‘default rule’ under which an arbitration clause is construed as allowing class arbitration in the absence of express consent, the panel proceeded as if it had the authority of a common-law court to develop what it viewed as the best rule to be applied in such a situation.”<sup>149</sup>

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the parties' supplemental agreement expressly assigned this issue to the arbitration panel, and no party argues that this assignment was impermissible.”). As a result, the Court could not treat the arbitrators' decision as one involving the arbitrators' jurisdiction, because the parties had clearly given the arbitrators jurisdiction to decide the issue.

Instead, the Court's discussion of the “procedural mode” of the arbitration (or the lack thereof) in *Stolt-Nielsen* was in the part of the opinion dealing with the proper default rule. *Id.* at 1775. In essence, the Court was holding that the default rule in *Stolt-Nielsen* was no class arbitration, and rejecting an alternative default that the issue was within the arbitrators' usual discretion over procedural issues.

146. For other analyses of *Stolt-Nielsen*, see generally William G. Whitehill, *Class Actions and Arbitration Murky Waters: Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*, 4 WORLD ARB. & MED. REV. 1 (2010); Stipanowich, *supra* note 20, at 5–15.

147. *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 130 S. Ct. 1758, 1767 (2010) (alteration in original) (quoting *Major League Baseball Players Ass'n v. Garvey*, 532 U.S. 504, 509 (2001) (per curiam)).

148. *Id.*

149. *Id.* at 1768–69.

What the Court means by “the best rule to be applied in such a situation” is not clear, but it sure sounds like how one would describe a default rule developed by a common-law court. On this reading, the Court in *Stolt-Nielsen* concludes that arbitrators can look to statutory or court-developed rules to fill gaps in contracts, but cannot formulate gap-fillers in the same way as a common law court can—and, indeed, an arbitral award will be vacated if the arbitrators do so.

Such a view of arbitrator authority seems out of line with the models of arbitrator authority previously relied on by the Court. In the non-arbitrability era of U.S. arbitration law (and before),<sup>150</sup> courts viewed arbitration as a process in which the arbitrator could essentially do what he or she thought was fair between the parties. Carrington and Haagen described this model of arbitration as follows:

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.”<sup>151</sup>

Some commentators (including Carrington and Haagen) rely on this “*amiable compositeur*” model of arbitration to criticize the use of arbitration to resolve statutory claims, describing arbitration as “a method of dispute resolution, but not necessarily a method of enforcing legal rights.”<sup>152</sup>

With the demise of the non-arbitrability doctrine (or, rather, as part of that demise), the Supreme Court moved to what might be called a “legal” model of the arbitration process. Under this model, arbitration is an appropriate setting for the resolution of statutory claims because “[b]y agreeing to arbitrate a statutory claim, a party does not forego the

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150. See *supra* notes 26–27 and accompanying text.

151. Carrington & Haagen, *supra* note 1, at 345.

152. *Id.* at 344.

substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum.”<sup>153</sup> The Court presumes that outcomes in arbitration and litigation will not necessarily differ, and refuses to question whether the resolution of statutory claims by arbitrators inherently differs from the resolution of such claims by judges.

The Court in *Stolt-Nielsen* appears to adopt a hybrid model, rejecting both of these prior models of the arbitration process. Under *Stolt-Nielsen*, arbitrators are not free to follow their own views of public policy (or “industrial justice,” using the labor arbitration terminology). They cannot act as *amiable compositeurs*. Yet they lack the authority of common law courts to formulate default rules. Apparently, arbitrators can interpret contracts and follow statutory or court-developed default rules, but lack the same authority to develop common-law default rules as judges.<sup>154</sup>

In so holding, the Court effectively set out an institutional hierarchy for arbitrators in determining the appropriate procedural default rule. Initially, of course, if the parties expressly agree to permit a particular procedure, there is no need to turn to a default rule at all.<sup>155</sup> The parties’ arbitration agreement controls the issue, as long as the agreement is not illegal.<sup>156</sup>

The parties’ agreement certainly includes any specific procedural provisions they set out in their arbitration clause or other written arbitration agreement. It also would include the provisions of any institutional rules that the parties incorporate by reference into their arbitration agreement. Finally, customary practice in the particular type of arbitration—usage of trade in UCC parlance—also can be part of the

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153. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991) (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985)).

154. Obviously, each of these models, like all models, oversimplifies reality. The cases in the different eras reflect some aspects of both models, not any one exclusively. But the models do, we believe, help in portraying how the Supreme Court seems to have viewed arbitration in the different eras, and how *Stolt-Nielsen* opinion seems to take yet another approach.

155. Although it is very unusual for pre-dispute arbitration agreements to provide for class arbitration, such agreements do exist. *E.g.*, *Drahozal & Wittrock*, *supra* note 36, at 109.

156. Certainly if federal law precludes a particular arbitration procedure, the mandatory rule of federal law would override the parties’ agreement. *E.g.*, 15 U.S.C. § 1226(a)(3) (2006) (“[T]he arbitrator shall provide the parties to such contract with a written explanation of the factual and legal basis for the award.”). If state law prohibits a particular arbitration procedure, the mandatory rule of state law would override the parties’ agreement only if the state law is not preempted by the FAA.

parties' agreement.<sup>157</sup> The Court noted the seeming lack of any custom authorizing class arbitration in the admiralty context in *Stolt-Nielsen*. But in other contexts, and as to other procedures, there may in fact be a customary practice that becomes part of the parties' agreement.<sup>158</sup>

But if the parties have not agreed to a particular procedure—i.e., there is in fact a gap in the contract (as the parties stipulated in *Stolt-Nielsen*)—the decision suggests its own list of permissible sources to fill the gap. At the top of the list is the legislature—Congress, by enacting the FAA, and state legislatures (subject to as yet undecided issues of FAA preemption) might have enacted a provision setting out a default rule. In *Stolt-Nielsen*, the Court faulted the arbitrators for not looking to either the FAA or applicable state law for determining the default rule. In addition, presumably court decisions adopting gap-fillers would be a permitted source of gap-fillers. Those decisions, whether interpreting the state arbitration statute or relying on the common law authority of judges to fashion gap-fillers, would also be part of state law.

What is not permitted under *Stolt-Nielsen*, however, is for the arbitrators themselves to determine the default rule in the manner of a common law judge.<sup>159</sup> In this respect, the case represents a bit of a watershed decision because, with few exceptions, most courts (in the United States and elsewhere) have not vacated arbitral awards on the basis of a procedural determination by the arbitrator as to a matter where the agreement was silent.<sup>160</sup>

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157. U.C.C. § 1-303(c) (2010).

158. There also is a hierarchy of terms within these sources of the parties' agreement. Presumably the express terms of the arbitration clause govern over the institutional arbitration rules and customary practice, and the institutional rules govern over customary practice. One caveat is that the arbitration institution itself is a contracting party, so that courts should be cautious not to impose the terms of the parties' arbitration clause onto a nonconsenting institution.

159. Although *Stolt-Nielsen* did not deal with a decision by the arbitrators on the merits of the case, its rationale—that arbitrators lack the authority of common law courts to make decisions on the basis of public policy—raises questions about arbitrators' authority to fill gaps in contracts and statutes on substantive issues. The Court has repeatedly stated that “[b]y agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum.” *E.g.*, *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991) (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985)). But if arbitrators lack the gap-filling authority of common law courts, might not parties be forgoing substantive rights by agreeing to arbitration?

160. Until *Stolt-Nielsen*, there were two primary exceptions to this general trend. First, courts sometimes vacated awards when a procedural decision by the arbitrator interfered with a party's opportunity to be heard (such as a refusal by the arbitrator to continue a hearing in order to accommodate the schedule of a key witness). *See, e.g.*, *Tempo Shain Corp. v. Bertek*,

## 2. Arbitrator Authority after a Court Vacates an Award

After vacating the award, the *Stolt-Nielsen* Court set out what it saw as its options for proceeding—either remand the matter to the arbitrators or decide the matter itself—and attributed those options to Section 10(b) of the FAA.<sup>161</sup> But in doing so, the Court badly misconstrued Section 10(b).<sup>162</sup> That section provides that “[i]f an award is vacated and the time within which the agreement required the award to be made has not expired, the court may, in its discretion, direct a rehearing by the arbitrators.”<sup>163</sup> Thus, Section 10(b) permits a court after vacating an award, at its option (and if timely), to direct a rehearing by the original arbitrators.<sup>164</sup>

Section 10(b) is necessary because, ordinarily, when arbitrators issue their award, their authority to take further actions ends—they become, in the Latin, *functus officio*.<sup>165</sup> Unless the parties agree otherwise, or an arbitration statute directs them to continue, the arbitrators have no authority to reopen the matter.<sup>166</sup> Unlike trial courts, arbitrators cannot entertain petitions for rehearing on the merits of an award. And they certainly do not stand ready for a case to be remanded to them if their award is vacated by a court. As a result, Section 10(b) provides

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Inc., 120 F.3d 16, 17–18 (2d Cir. 1997). This ground finds firm foundation in both the FAA and most other country’s arbitral laws, which expressly list it among the possible grounds for vacatur. See Federal Arbitration Act, 9 U.S.C. § 10(a)(3) (2006); U.N. Comm’n on Int’l Trade Law [UNCITRAL], *Model Law on International Commercial Arbitration*, art. 36 (1985) (amended 2006). Second, courts occasionally (but rarely) have vacated or refused to enforce awards where the arbitrator rendered fundamentally inconsistent procedural orders (the classic case is one in which the arbitrator informed a party that it need not present certain evidence, and then found against that party due to its failure to supply that evidence). Cf. *Iran Aircraft Indus. v. Avco Corp.*, 980 F.2d 141, 146 (2d Cir. 1992) (refusing to enforce award under analogous provisions of Article V of the New York Convention).

161. 130 S. Ct. at 1770. Nothing in the opinion limits the Court’s holding on this issue to procedural gap-filling. Given, however, that the decision conflicts with a number of the Court’s prior opinions, one possible way to avoid the conflict would be to limit *Stolt-Nielsen*’s holding in this respect to procedural gap-filling, or perhaps even class arbitration issues.

162. Justice Ginsburg made this point in dissent, albeit only briefly. *Id.* at 1782 (Ginsburg, J., dissenting).

163. Federal Arbitration Act, 9 U.S.C. § 10(b) (2006). The *Stolt-Nielsen* Court does not address the timing requirement in the statute, but nothing in the arbitration clause or the AAA Class Arbitration Rules specify a time in which a clause construction award must be made.

164. *Id.*

165. Black’s Law Dictionary defines “functus officio” as “without further authority or legal competence because the duties and functions of the original commission have been fully accomplished.” BLACK’S LAW DICTIONARY 743 (9th ed. 2009).

166. *E.g.*, GARY B. BORN, INTERNATIONAL COMMERCIAL ARBITRATION 2517 (2009) (identifying as exceptions minor matters such as clerical errors).



necessary authority for a court to remand a case to the arbitrators for a rehearing.

But, contrary to the Court's assertion in *Stolt-Nielsen*, Section 10(b) says nothing about a court having the option to go ahead and decide an issue for itself if it does not remand to the arbitrators, whether only one outcome is possible or not. Rather, the Court's assertion of such an option is flatly contrary to established law<sup>167</sup>—and, indeed, contrary to the Court's own decision in *Major League Baseball Players Ass'n v. Garvey*, cited by the Court elsewhere in its *Stolt-Nielsen* opinion,<sup>168</sup> in which the Court summarily reversed a lower court for doing exactly what the Court did in *Stolt-Nielsen*.<sup>169</sup>

Certainly, Section 10(b) does not require a court to remand a case to the arbitrators.<sup>170</sup> Instead, the court's other option is simply to do nothing after vacating an award. If the parties' first effort to arbitrate

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167. *Id.* at 2699–2700 (“[T]he annulment of an award should have no effect on the parties’ underlying agreement to arbitrate. That agreement subsists even if an arbitral tribunal engaged in procedural misconduct or manifestly misapplied the law.”); GARY B. BORN, INTERNATIONAL COMMERCIAL ARBITRATION: COMMENTARY AND MATERIALS 710–11 (2d ed. 2001) [hereinafter BORN (2001)] (“When a court vacates an arbitral award on one of the grounds (other than lack of an arbitration agreement or non-arbitrability) set forth in § 10, it may not also resolve the merits of the parties’ dispute. That dispute generally remains subject to the parties’ underlying arbitration agreement and therefore cannot be litigated (save where the award was vacated on the grounds that no valid arbitration agreement covered the parties’ dispute).”); JULIAN D.M. LEW ET AL., COMPARATIVE INTERNATIONAL COMMERCIAL ARBITRATION ¶ 25-61, at 682 (2003) (“If an award is set aside for reasons other than invalidity of the arbitration agreement, the agreement would survive the award and the parties would still be bound to have their disputes settled by arbitration.”); IAN R. MACNEIL ET AL., FEDERAL ARBITRATION LAW § 42.1.1.1, at 42:2 to 42:3 (1994) (“Where the award is vacated and not remanded, . . . [m]ost often the parties are left legally where they were before the arbitration, that is to say unresolved disputes exist subject to an arbitration clause. Thus the parties may or may not negotiate in hopes of settlement, but if they do not settle and one party wants to pursue the dispute, the forum for doing so will normally remain arbitration.”); *see also* UNIF. ARB. ACT § 12(c) (amended 1956); UNIF. ARB. ACT § 23(c) (2000).

168. *Stolt-Nielsen S.A. v. AnimalFeeds Int’l Corp.*, 130 S. Ct. 1758, 1767 (2010).

169. 532 U.S. 504, 511–12 (2001) (per curiam) (“[E]stablished law ordinarily precludes a court from resolving the merits of the parties’ dispute on the basis of its own factual determinations, no matter how erroneous the arbitrator’s decision. Even when the arbitrator’s award may properly be vacated, the appropriate remedy is to remand the case for further arbitration proceedings.”); *see also* *United Paperworkers Int’l Union v. Misco, Inc.*, 484 U.S. 29, 40 n.10 (1987) (“Even in the very rare instances when an arbitrator’s procedural aberrations rise to the level of affirmative misconduct, . . . the court should simply vacate the award, thus leaving open the possibility of further proceedings if they are permitted under the terms of the agreement.”).

170. *See* Peter Bowman Rutledge et al., *United States*, in PRACTITIONER’S HANDBOOK ON INTERNATIONAL COMMERCIAL ARBITRATION 877, 935–36 (Frank-Bernd Weigand ed., 2d ed. 2009).

their dispute fails because a court vacates the award, the parties are free to arbitrate again, before a different set of arbitrators, to see if those arbitrators can make an enforceable award. The parties still have an arbitration agreement, and the dispute is still subject to that agreement. For all of the Supreme Court's stated concern in *Stolt-Nielsen* (and in *Rent-A-Center* as well) for respecting the parties' agreement to arbitrate, it wholly disregards that agreement in deciding itself whether the parties agreed to class arbitration.

The only exception to this well-established approach is if the ground on which the award was vacated casts doubt on the enforceability of the arbitration agreement. Thus, if a court vacates an award on the ground that the arbitrators exceeded their authority because the parties had never agreed to arbitrate the matter, or because the claim could not be arbitrated as a matter of federal law, then the arbitration agreement would not constrain the court from deciding the issue itself.<sup>171</sup> But that was not the case in *Stolt-Nielsen*. The arbitration agreement at issue was the second, supplemental agreement to arbitrate, and nothing in the Court's decision cast the slightest doubt on the enforceability of that agreement.

At bottom, the Court's decision to determine the default rule itself wholly disregards the parties' agreement to have the arbitrators resolve that issue. Fortunately, only rarely do courts vacate arbitration awards, so that the opportunities for courts to disregard arbitration agreements because they find the issue to be arbitrated "clear" are uncommon. But the decision in *Stolt-Nielsen* is a dramatic departure from prior precedent even as to that unusual of an occurrence.

### 3. Default Rule of "No Class Arbitration"

At its heart, *Stolt-Nielsen* was about gap-filling—determining the appropriate default rule when the arbitration agreement is silent about class arbitration. The Supreme Court held that the default rule is that class arbitration is not permitted, explaining that class arbitration is sufficiently different from individual arbitration that the parties must agree as a contractual matter to override that default rule.

Here, again, the *Stolt-Nielsen* Court's decision that arbitrators lack the authority to fashion default rules has important implications for the types of default rules that will result. The FAA was enacted in 1925, and lacks many of the detailed gap-filling provisions of more modern

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171. BORN (2001), *supra* note 167, at 710–11; MACNEIL, *supra* note 167, at 42:3 to 42:4.

arbitration statutes. And even modern arbitration statutes lack gap-fillers on some issues, such as, for example, class arbitration. By limiting arbitrators to statutory gap-fillers (or court decisions, if any), *Stolt-Nielsen* may result in arbitrators adopting what might be called “negative gap-fillers”: when the governing legal authorities are silent on a particular procedure, that silence will preclude arbitrators from adopting the procedure.

Perhaps courts will limit *Stolt-Nielsen* to class arbitration. Most arbitration rules, which are incorporated by reference into the parties’ agreement, grant arbitrators broad discretion to manage the arbitration proceeding.<sup>172</sup> In other areas, such rules might be construed to grant arbitrators authority to fill procedural gaps. With respect to class

decision in *Stolt-Nielsen*, with its restriction on arbitrator authority to formulate gap-fillers, makes the issue that much more salient.

*C. How Do Arbitrators Decide Whether Parties Have Agreed to Class Arbitration?*

The positive question we are interested in is how arbitrators decide whether parties have agreed to regulate a procedural matter in their contract—in other words, is there a gap, and, if so, how is it filled? On what evidence do arbitrators rely, and to what sources do arbitrators turn, in filling procedural gaps?

At a more practical level, the most immediate question after *Stolt-Nielsen* is—what is left of class arbitration? Given the Court’s decision in *Stolt-Nielsen*, how likely are arbitrators to find that the parties have agreed to have the arbitration proceed on a class basis? In *Stolt-Nielsen*, the Court did not answer the question of what sort of evidence would be sufficient to show that the parties agreed to class arbitration. As the Court stated: “We have no occasion to decide what contractual basis may support a finding that the parties agreed to authorize class arbitration.”<sup>178</sup> But the Court made clear that the mere fact that the parties agreed to arbitrate does not, itself, constitute an agreement to class arbitration.<sup>179</sup> So what evidence might suffice—and, equally importantly—how available is such evidence likely to be?

To get some insight into the answers to both sets of questions, we looked at class arbitration proceedings administered by the AAA under its class arbitration rules. As noted by the Supreme Court in *Stolt-Nielsen*, the AAA makes available on its web page information on class arbitration proceedings it administers, including clause construction awards issued by arbitrators in the proceedings.<sup>180</sup> We divide our analysis into pre-*Stolt-Nielsen* and post-*Stolt-Nielsen* cases and awards.

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*See also infra* text accompanying notes 225–27.

178. 130 S. Ct. 1758, 1776 n.10 (2010).

179. *Id.* at 1775 (“An implicit agreement to authorize class-action arbitration, however, is not a term that the arbitrator may infer solely from the fact of the parties’ agreement to arbitrate.”).

180. American Arbitration Association, Searchable Class Arbitration Docket, <http://www.adr.org/sp.asp?id=25562> (last visited May 16, 2011) [hereinafter AAA, Searchable Docket]. Although the parties in *Stolt-Nielsen* agreed to follow the AAA class arbitration rules, the AAA itself did not administer the arbitration and so filings in the case are not available on the AAA web page. Instead, the award in the *Stolt-Nielsen* case is reprinted in an Appendix to the Petition for Certiorari. *See supra* note 138.

### 1. Pre-*Stolt-Nielsen* Awards

We collected a random sample of the clause construction awards available on the AAA web site as of July 1, 2010, and reviewed the arbitrators' reasoning in those cases.<sup>181</sup>

The awards followed four main approaches in analyzing whether the arbitration agreement "permitted" class arbitration, as specified in the AAA class arbitration rules.<sup>182</sup> A small number of awards (2 of 22, or 9.1%) relied on express language in the arbitration agreement that the arbitrators interpreted as authorizing class arbitration. The language required some interpretation (that is, it did not state that "this agreement authorizes arbitration to proceed on a class basis," for example). But the reading adopted by the arbitrators did not appear to be unreasonable, and was based on language unique to the agreement at issue. These awards, while decided before *Stolt-Nielsen*, likely would survive application of the Court's analytical framework in that case.

At the other extreme, a greater number of awards (9 of 22, or 41.0%) concluded that the arbitration agreement did not forbid class arbitration, sometimes bolstered by construing the agreement against the party that drafted it. This analysis pretty clearly would not be sufficient to satisfy the standard adopted by the Supreme Court in *Stolt-Nielsen*. The arbitrators concluded only that the agreement did not preclude class arbitration, not that the agreement authorized it.

A possible explanation for the reasoning in this group of awards is that the issue presented in *Bazzle* differed from the issue presented in *Stolt-Nielsen* (and most commonly addressed by arbitrators proceeding under the AAA class arbitration rules). The *Bazzle* plurality directed the arbitrators to decide whether the arbitration agreement in that case forbade class arbitration.<sup>183</sup> If it did, then the South Carolina Supreme Court's attempt to use a state-law gap-filler was inappropriate because there was no gap to fill. By contrast, in *Stolt-Neilsen* and cases like it, the arbitrators are affirmatively deciding whether class arbitration can proceed. Finding that the arbitration clause does not forbid class arbitration is only a partial answer to that question and unlikely to be

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181. Our sample consists of twenty-four clause construction awards chosen at random from the clause construction awards available on the AAA web page. Of the twenty-four awards, twenty-two (or 91.7%) concluded that the arbitration clause permitted class arbitration and two (or 8.3%) concluded that the arbitration clause did not permit class arbitration. The results in the text are based on the twenty-two awards concluding that the arbitration clause permitted class arbitration.

182. See *supra* text accompanying notes 125–26.

183. See *supra* text accompanying notes 117–23.

sufficient in the post-*Stolt-Nielsen* world.

A slightly stronger case can be made for another group of awards (8 of 22, or 36.4%), in which the arbitrators (unlike those in *Stolt-Nielsen*, at least in the Supreme Court's view) in fact did construe the arbitration agreement. The analysis in these awards began with the broad language of the arbitration agreement, providing that "any dispute" was subject to arbitration. The arbitrators reasoned that "any dispute" would include disputes being arbitrated on a class basis. Because the parties could have, but did not, exclude class arbitration proceedings from the broad "any dispute" provision (unlike, in many cases, some other types of disputes, which were expressly excluded from the clause), the awards concluded that arbitration could proceed on a class basis.

Although the reasoning of the arbitrators avoided the basis on which the Court vacated the award in *Stolt-Nielsen* (i.e., the arbitrators interpreted the agreement rather than relying on their own conceptions of public policy), the standard applied by the arbitrators does not satisfy *Stolt-Nielsen*. A general arbitration clause, according to the *Stolt-Nielsen* Court, does not authorize class arbitration because class arbitration differs too much from individual arbitration. It is not clear whether awards such as these would be vacated under *Stolt-Nielsen*. But the arbitrators' analysis is insufficient under that case.

A final group of awards, relatively small in size (3 of 22, or 13.6%), took an approach that might satisfy *Stolt-Nielsen*, subject to one unknown. After concluding that the arbitration agreements did not forbid class arbitration (i.e., that there was a gap), these awards looked to state law (usually either California or South Carolina) to fill that gap. Under the law of those states, unlike the FAA as interpreted by the Supreme Court in *Stolt-Nielsen*, the default rule was that class arbitration was permitted. As such, the awards avoided the basis for vacatur in *Stolt-Nielsen* by looking to state law gap-fillers rather than the arbitrators' own conception of public policy. The unknown, on which the Court granted certiorari in *Bazzle* and did not address either in that case or in *Stolt-Nielsen*, is whether the FAA preempts those state law gap-fillers.<sup>184</sup> If so, then the analysis in these awards, too, would fail.

Overall, then, the AAA's clause construction awards prior to *Stolt-Nielsen* did not take a consistent approach to filling procedural gaps in arbitration agreements. Despite their substantial agreement as to outcome (that the arbitration agreements permitted class arbitration),

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184. See *supra* text accompanying notes 110–11.

the rationales underlying the awards differ in important ways, such that only some are likely to survive after *Stolt-Nielsen*.

One additional note: keep in mind that the AAA will not administer class arbitrations when the arbitration clause includes a class-arbitration waiver, unless a court has ordered the dispute to arbitration.<sup>185</sup> So in none of the cases in the sample did the arbitration agreement include an enforceable class-arbitration waiver.<sup>186</sup> One would think that the existence of a class-arbitration waiver would be pretty good evidence that the parties have not agreed to class arbitration—even if the waiver is later held unconscionable or otherwise unenforceable by a court.<sup>187</sup> On the other hand, arbitrators might still be able to rely on state law gap-fillers in such cases, unless those gap-fillers are preempted by the FAA as construed in *Stolt-Nielsen*.

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185. See *supra* text accompanying note 129. In a handful of awards, a court had ordered the case to arbitration on the ground that the class-arbitration waiver in the agreement was unenforceable, or at least that the arbitrators had to decide that issue.

186. Note that the available empirical evidence suggests that the use of class-arbitration waivers varies significantly depending on the type of contract at issue:

A report recently released by the Consumer Arbitration Task Force of the Searle Civil Justice Institute addresses precisely that question. The data show that many consumer arbitrations administered by the American Arbitration Association arise out of contracts that do not preclude class relief in arbitration. . . . The two types of businesses with the highest usage of class arbitration waivers—both with 100% of the cases in the sample arising out of clauses including class arbitration waivers—were credit card issuers (26 of 26) and cell phone companies (5 of 5) . . . . By comparison, the use of class arbitration waivers was mixed in car sales contracts (34 of 64, or 53.1%) and contracts with home builders (11 of 17, or 64.7%). And the use of class arbitration waivers was nonexistent in real estate brokerage agreements and in the contract of the single casualty insurer in the sample. Indeed, the substantial majority of cases (190 of 299, or 64.5%) in the sample did not arise out of an arbitration clause with a class arbitration waiver. While the results are limited to AAA consumer arbitrations, they nonetheless identify a significant set of consumer arbitration clauses that do not include class arbitration waivers.

Drahozal & Ware, *supra* note 34, at 472–73 (footnotes omitted).

187. E.g., *Fensterstock v. Educ. Fin. Partners*, 611 F.3d 124, 141 (2d Cir. 2010):

Our conclusion that a given agreement is invalid and unenforceable does not mean that the parties in fact reached the opposite agreement. Thus, excising the Note’s class action and class arbitration waiver clause leaves the Note silent as to the permissibility of class-based arbitration, and under *Stolt-Nielsen* we have no authority to order class-based arbitration.

*Id.*

## 2. Post-*Stolt-Nielsen* Cases and Awards

As of January 1, 2011, over eight months had passed since the decision in *Stolt-Nielsen*. Subsequent events provide even better insights into the likely effect of the case on the future of class arbitration and on how arbitrators are likely to fill gaps in arbitration agreements. Two points are noteworthy.

First, filings of new class arbitration cases before the AAA appear to have almost completely dried up. Based on cases posted on the AAA's class arbitration web site, only one new class arbitration claim was filed with the AAA in the eight months after the Supreme Court's decision in *Stolt-Nielsen*.<sup>188</sup> By comparison, at least five cases were filed during the first four months of 2010 and at least thirty-three cases were filed during 2009.<sup>189</sup>

Second, as of January 1, 2011, arbitrators have filed awards construing arbitration agreements in eight cases since the Supreme Court's decision in *Stolt-Nielsen*.<sup>190</sup> In five of those eight awards (62.5%

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188. See Employment Arbitration Rules, Demand for Arbitration, *Schuh v. Johnny Utah 51 LLC* (Am. Arb. Ass'n July 23, 2010), available at <http://adr.org/si.asp?id=6226>. Between January 1, 2011, and April 12, 2011, two additional class arbitration claims were posted to the AAA's web site. One was a class counterclaim that had been filed on March 26, 2010. See Demand for Class Arbitration, *JP Morgan Chase Bank N.A. v. Bhakti, LLC*, Case No. 71 148 00796 09 (Am. Arb. Ass'n Mar. 26, 2010), available at <http://www.adr.org/si.asp?id=6338>. In the second, the class arbitration demand was signed by plaintiff's counsel on April 26, 2010, the day before *Stolt-Nielsen* was decided, and received by the AAA on April 28, 2010, the day after *Stolt-Nielsen* was decided. Commercial Arbitration Rules, Demand for Arbitration, *Garrett-Scheier v. Muller Auto. Group, Inc.*, Case No. 11 155 00892 10 (Am. Arb. Ass'n Apr. 28, 2010), <http://www.adr.org/si.asp?id=6339>. The case was later suspended for nonpayment of fees. Suspension Order of the Arbitrator, *Garrett-Scheier v. Muller Automotive Group, Inc.*, Case No. 11 155 00892 10 (Am. Arb. Ass'n Dec. 9, 2010) (Bissell, Arb.), <http://www.adr.org/si.asp?id=6340>. Given the long lags in posting these class arbitration demands, it may be that the apparent dearth of filings since *Stolt-Nielsen* reflects posting delays rather than an actual decline in case filings. At the very least, we cannot exclude that possibility from the information available on the AAA's web site.

189. Authors' calculations based on data collected from the AAA's Searchable Class Action Docket. AAA, Searchable Docket, *supra* note 180. Even that number was a decrease from previous years. William K. Slate II & Eric P. Tuchmann, *Class Action Arbitrations*, 11 INT'L ARB. L. REV. 50, 53 (2008) (reporting data "for the period October 8, 2003 through January 1, 2008") ("Filings by year are as follows: 2003, 6 cases filed; 2004, 65 cases; 2005, 47 cases; 2006, 58 cases; 2007, 41 cases.").

190. *SWLA Hosp. Assocs. v. Corvel Corp.*, Case No. 11 193 02760 06 (Am. Arb. Ass'n Sept. 3, 2010) (Gary, Moreland, & Baker Arbs.) (dissenting opinion by Baker), <http://adr.org/si.asp?id=6212>; *Demetriou v. EarthLink, Inc.*, Case No. 11 117 00273 10 (Am. Arb. Ass'n Sept. 1, 2010) (Hare, Arb.), <http://adr.org/si.asp?id=6349>; *Spradlin v. Trump Ruffin Tower I, LLC*, Case No. 11 115 Y 01846 09 (Am. Arb. Ass'n Aug. 10, 2010) (LaMothe, Arb.), <http://adr.org/si.asp?id=6232>; *Clark v. CHDP Condo, LLP*, Case No. 11 115 Y 01921 09 (Am. Arb. Ass'n July 21, 2010) (Hendrick, Harr, & Dreier Arbs.),



of the time), the arbitrator(s) construed the arbitration clause as authorizing class arbitration.<sup>191</sup> The percentage of awards permitting class arbitrations to proceed has declined substantially following *Stolt-Nielsen*.<sup>192</sup> Moreover, the analysis in the awards changed as well, focusing much more on state law and contract language and much less on awards in prior cases (which almost never are discussed in the post-*Stolt-Nielsen* awards).<sup>193</sup> It is unclear whether the analysis in the awards will stand up to review in courts that are applying *Stolt-Nielsen*.<sup>194</sup> But if nothing else the awards provide some evidence that class arbitration might persist after *Stolt-Nielsen*.

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<http://adr.org/si.asp?id=6254>; Owens v. Auto. Prot. Corp., Case No. 11 188 01140 05 (Am. Arb. Ass'n July 19, 2010) (Green, Arb.), <http://adr.org/si.asp?id=6221>; Mensch v. Alta Colleges, Inc., Case No. 11 516 00995 09 (Am. Arb. Ass'n July 16, 2010) (Baker, Arb.), <http://adr.org/si.asp?id=6146>; Benson v. CSA-Credit Solutions of America, Inc., Case No. 11-160-M-02281-08 (Am. Arb. Ass'n July 6, 2010) (Meyerson, Arb.), <http://adr.org/si.asp?id=6139>; Knudsen v. North Motors, Inc., Case No. 11 155 02699 09 (Am. Arb. Ass'n May 18, 2010) (Daerr-Bannon, Arb.), <http://www.adr.org/si.asp?id=6236>; see also Smith & Wollensky Rest. Group, Inc. v. Passow, No. 10-11498-EFH, 2011 U.S. Dist. LEXIS 4495, at \*2 (D. Mass. Jan. 18, 2011) (stating that, after *Stolt-Nielsen*, arbitrator had reaffirmed clause construction award finding that parties had agreed to class arbitration) (decision reaffirming award not available on AAA web page).

191. Knudsen, at 1; Benson, at 8; Owens, at 56; SWLA, at 1; Demetriou, at 1.

192. See *supra* note 181.

193. One award rejects reliance on prior arbitration awards as evidence of a custom or usage of class arbitration in the industry. Mensch, at 30.

194. We do not analyze post-*Stolt-Nielsen* court cases in detail here. That said, it is worth noting that courts have dealt with the availability of class arbitration in varied ways since *Stolt-Nielsen*, including some courts that have refused to vacate clause construction awards finding that the parties had agreed to class arbitration (and some that have vacated such awards). For exemplary cases, see *Dealer Computer Services, Inc. v. Dub Herring Ford*, 623 F.3d 348, 349–50 (6th Cir. 2010) (affirming district court's dismissal of motion to confirm class certification award for lack of jurisdiction); *Fensterstock v. Education Finance Partners*, 611 F.3d 124, 141 (2d Cir. 2010) (holding that parties did not agree to class arbitration, based in part on unconscionable class-arbitration waiver); *Smith & Wollensky Rest. Group, Inc. v. Passow*, No. 10-11498-EFH, 2011 U.S. Dist. LEXIS 4495, at \*3–4 (D. Mass. Jan. 18, 2011) (refusing to vacate clause construction award finding that parties had agreed to class arbitration); *Jock v. Sterling Jewelers, Inc.*, 725 F. Supp. 2d 444, 449–50 (S.D.N.Y. 2010) (memorandum order indicating that court would follow *Stolt-Nielsen* and vacate clause construction award permitting class arbitration); *Jock v. Sterling Jewelers, Inc.*, No. 08 Civ. 2875 (JSR), 2010 U.S. Dist. LEXIS 80896, at \*4 (S.D.N.Y. Aug. 6, 2010) (vacating clause construction award for reasons stated in prior memorandum order), and *La. Health Serv. Indem. Co. v. Gambro A B*, No. 05-1450, 2010 U.S. Dist. LEXIS 135579, at \*22 (W.D. La. Dec. 21, 2010) (refusing to vacate clause construction award finding that parties had agreed to class arbitration).

*D. What is the Optimal Institutional Approach to  
Procedural Gap-Filling in Arbitration?*

The normative questions raised by *Stolt-Nielsen* are twofold. First, and more narrowly, did the Court properly determine that the default rule should be that arbitration on a class basis is not permitted? Second, and more generally, what is the optimal authority of arbitrators to develop default rules—i.e., should they be restricted to statutory or court-developed gap-fillers or permitted to develop default rules in the same manner as common law courts? We address those issues in turn, after first describing the standard normative analysis of default rules.

1. Normative Analysis of Default Rules

The normative analysis of arbitrator gap-filling tracks to a substantial degree the normative analysis of default rules more generally. In simplest terms, because the rules are default rules, an important part of identifying the optimal rule is identifying the rule that will cause parties to incur the lowest transacting costs—the rule that most parties would otherwise have contracted for, so that they do not have to incur the costs of bargaining around the default.<sup>195</sup>

Such a majoritarian theory of default rules is based on a particular view of contractual incompleteness. The implicit assumption of such a theory, as Ian Ayres and Robert Gertner explain, is that contracts are incomplete because the transaction costs of bargaining for complete contracts are too high.<sup>196</sup> Ayres and Gertner identify a variety of considerations in determining the appropriate default rule based on “minoritarian” rather than majoritarian considerations: “different private costs of contracting around”; “different private costs of failing to contract around”; “different public costs of filling gaps”; and “ignorance of the law.”<sup>197</sup> Thus, for example, the public costs of filling gaps are higher when the gap-filler is a default standard rather than a default rule.<sup>198</sup> Or, when some parties are less likely to contract around the default than others (such as when one party is less well informed about the law than the other), all else equal “lawmakers should tend to favor

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195. For further discussion, see generally Ayres & Gertner, *Filling Gaps*, *supra* note 109, at 87; Ayres & Gertner, *Strategic Contractual Inefficiency*, *supra* note 109, at 729.

196. Ian Ayres & Robert Gertner, *Majoritarian vs. Minoritarian Defaults*, 51 STAN. L. REV. 1591, 1592 (1999).

197. *Id.* at 1593.

198. *Id.* at 1596; see Francesco Parisi, *Rules Versus Standards*, in ENCYCLOPEDIA OF PUBLIC CHOICE 510, 510 (Charles K. Rowley & Friedrich Schneider eds., 2004) (defining rules and standards).

as defaults the preferred rules of contractors who have a relatively low propensity to contract around other defaults.”<sup>199</sup>

A final<sup>200</sup> (and somewhat related) consideration is the tailoring of the gap-filler: as George Geis asks, “[s]hould lawmakers pick just one simple default rule for an entire legal system, or should they design more complex default rules to offer customized legal treatment for different markets—or even for different parties?”<sup>201</sup> A single simple default rule would have the lowest public cost of promulgating the gap-filler in the first instance. But if the optimal majoritarian default would differ systematically for discrete market segments, it may be that a more complex default rule, one that varied across the markets, might reduce the transacting costs of the parties (who otherwise would have to contract around the rule) so as to outweigh the increased public costs of adopting a more tailored rule.

## 2. Default Rules and Class Arbitration

As for the “no class arbitration” default rule adopted in *Stolt-Nielsen*, it arguably is defensible as a majoritarian default, at least for commercial contracts. As discussed above, while class arbitration has been around for a long time, only in recent years has it become at all common (if sixty-five cases a year counts as being common).<sup>202</sup> Although they do exist, express contract provisions permitting arbitration on a class basis are rare.<sup>203</sup> By comparison, many contracts—particularly those in industries in which class actions are common—include class-arbitration waivers, seeking to preclude arbitration from proceeding on a class basis. By contrast, as illustrated in the previous section, arbitrators almost unanimously filled gaps prior to *Stolt-Nielsen* by holding that class arbitration was permissible, and continue to do so in a significant proportion of cases even after *Stolt-Nielsen*.<sup>204</sup> But those

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199. Ayres & Gertner, *supra* note 196 at 1602–03.

200. An additional issue we do not address here is what Professor Ayres calls “altering rules”—“the necessary and sufficient conditions for contracting around a default.” Ian Ayres, *Menu Matter*, 73 U. CHI. L. REV. 3, 6 (2006). *Rent-A-Center*, for example, might be understood as addressing what is necessary for parties to contract around the default allocation of authority between courts and arbitrators.

201. George S. Geis, *An Experiment in the Optimal Precision of Contract Default Rules*, 80 TUL. L. REV. 1109, 1110 (2006); *see also* Ian Ayres, *Preliminary Thoughts on Optimal Tailoring of Contractual Rules*, 3 S. CAL. INTERDISC. L.J. 1, 1–3 (1993).

202. *See* Slate & Tuchmann, *supra* note 189, at 53 (reporting AAA class arbitration caseloads for 2003–2008).

203. *See supra* note 155.

204. *See supra* text accompanying notes 182–94.

awards often did not attempt to determine what the parties would have contracted for in a world of no transaction costs, and were limited to cases in which the parties' arbitration agreement was silent as to class arbitration (thus providing only a partial look at parties' contracting practices). Plus, most, although not all, awards were in disputes between sophisticated and unsophisticated parties, not between two commercial parties. Accordingly, at least for commercial contracts, a default rule of no class arbitration would seem to be the optimal default, consistent with *Stolt-Nielsen*.

For consumer and (most) employment contracts, the analysis is more complicated. It is more difficult to draw inferences from standard form contracts about the optimal majoritarian default, and consumers and employees are less likely to contract around a default rule than commercial parties. The costs to businesses of contracting around a default rule that permitted class arbitration would be relatively low—since the contracts typically are standard form contracts prepared by the business, which may well be revised periodically for other reasons as well. And a default rule permitting class arbitration could be tailored fairly easily to groups such as consumers and some employees by limiting *Stolt-Nielsen* to contracts between sophisticated parties.

On the other hand, to the extent businesses perceive that reducing the risk of class actions is a reason to use arbitration clauses, they will quickly contract around a default rule permitting class arbitration—incurring the transaction costs (however slight) of doing so. If, in fact, for policy reasons class relief should be available for consumers and employees in arbitration, implementing that policy choice will likely need to be done by a mandatory rule, rather than a default rule.<sup>205</sup>

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205. Some have suggested that the decision in *Stolt-Nielsen* will increase the likelihood that Congress will enact the Arbitration Fairness Act. *E.g.*, Vinson & Elkins LLP, Supreme Court Strikes Down Arbitrators' Decision Allowing Class Action Arbitration (Apr. 28, 2010), <http://www.vinson-elkins.com/resources/SupremeCourtStrikesArbitratorsDecisionAllowingClassArbitration.aspx> (last visited May 16, 2011); James P. Duffy IV & Ian Mahoney, *Stolt-Nielsen v. AnimalFeeds International: Supreme Court Raises the Hurdle for Class Action Arbitration*, May 3, 2010, <http://www.dlapiper.com/stolt-nielsen-v-animalfeeds-international:supreme-court-raises-the-hurdle-for-class-action-arbitration>. As a policy matter, however, even if *Stolt-Nielsen* is extended to consumer and employment contracts, it would at most justify a much narrower statutory change, such as a mandatory rule permitting class arbitration or the exclusion of class actions from arbitration.

### 3. Default Rules and Arbitrator Gap-Filling

The broader implications of *Stolt-Nielsen*, however, are more troubling for arbitration law. If the case is applied to limit the procedural gap-filling authority of arbitrators in areas beyond class arbitration, parties will incur added costs of contracting around the resulting negative default rules, as well as the costs of greater uncertainty about the enforceability of their arbitration agreements and awards.

In recent years, several commentators have argued for vesting less procedural discretion in adjudicators (including both judges and arbitrators), an approach that would seem consistent with the Court's decision in *Stolt-Nielsen*. Robert G. Bone challenges the "pervasive assumption that expert trial judges can do a good job of tailoring procedures to individual cases [a]s empirically unsupported and at best highly questionable."<sup>206</sup> Instead, he argues for a greater use of rules restricting judicial discretion—not "deliver[ing] a knock-out punch to discretion," but contending that rule makers should balance the costs and benefits of discretion, "taking account of *all* of the costs of case-specific discretion and *all* the benefits of limiting discretion in various ways, and that they should publicly justify the choices they make."<sup>207</sup>

William M. Park similarly argues for restricting procedural discretion, this time specifically for arbitrators. He states that "the benefits of arbitrator discretion are overrated; flexibility is not an unalloyed good; and arbitration's malleability often comes at an unjustifiable cost."<sup>208</sup> He proposes what he calls a "Rules Rich" rather than a "Rules Light" approach: "Rather than a blank page to be completed by arbitrators, institutional provisions could contain specific protocols that the arbitrator would be required to apply unless modified by the agreement of all parties."<sup>209</sup>

In essence, Professor Bone and Professor Park advocate a shift from default standards to default rules governing court and arbitral procedure, at least in particular circumstances.<sup>210</sup> The effect of the

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206. Robert G. Bone, *Who Decides? A Critical Look at Procedural Discretion*, 28 CARDOZO L. REV. 1961, 1963 (2007).

207. *Id.* at 1965.

208. Park, *Arbitration's Protean Nature*, *supra* note 112, at 283.

209. *Id.* at 289.

210. Professor Bone offers five reasons why the terms of arbitration agreements should not be taken as evidence in favor of case-specific discretion in litigation: (1) even if discretion is appropriate for arbitrators, it might not be appropriate for judges; (2) parties might not include detailed provisions in their arbitration clauses because arbitrators might "follow some

Supreme Court's decision in *Stolt-Nielsen* may be similar, to the extent that the result is an increase in negative default rules—rules that preclude exercises of arbitrator authority because the FAA does not address a particular issue.<sup>211</sup> The normative effects of such a shift reflect a tradeoff between the costs of more precise arbitration rules (the cost of drafting with greater precision; the cost of unanticipated exceptions arising that are not dealt with by the rules; and the cost of more awards being overturned due to the failure to comply with the more precise rules) and the costs of greater procedural discretion on the part of arbitrators (the cost arbitrators incur in deciding how to apply the vague standards; the cost of changes in party behavior due to uncertainty as to how arbitrators will apply those standards; and the cost of disappointed party expectations about the procedural process in arbitration).<sup>212</sup>

Determining the optimal degree of discretion given that tradeoff is difficult in the abstract, and depends on empirical issues such as the frequency with which certain issues arise in arbitration (the more frequently issues arise, the lower the drafting costs of rules relative to the enforcement costs of arbitrators applying standards).<sup>213</sup> That said, we are skeptical that an eighty-five-year-old arbitration statute—which sets default rules only by its failure to address certain procedural issues—better strikes that balance than arbitration institutions through

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customary protocol, such as the procedures specified by the American Arbitration Association or industry arbitration guidelines”; (3) parties might not include detailed contractual provisions not because such provisions are inefficient, but because attempting to negotiate such provisions might interfere with making a deal at all; (4) “even in international arbitration, parties often agree on procedures *after the dispute arises*, especially in large-stakes arbitrations with sophisticated counsel and skilled arbitrators”; and (5) lawyers, acting with bounded rationality, might underestimate the risk of a dispute and spend insufficient time contracting for detailed procedures that might actually be beneficial to their clients. Bone, *supra* note 206, at 1979 n.80. Some of these reasons overlap with the reasons we identified for why parties—even sophisticated parties drafting standard form arbitration agreements—might not include detailed provisions governing discovery and the like. See *supra* text accompanying notes 38–42. And other reasons, while likely true (such as a growing use of more detailed customary procedural rules such as the International Bar Association's Rules on the Taking of Evidence in International Arbitration, see Park, *Procedural Default Rules Revisited*, *supra* note 112, at 361–62), do not support the use of negative default rules of the sort likely to result from *Stolt-Nielsen*.

211. See *supra* text accompanying note 172..

212. This tradeoff is a variation on the familiar analysis of rules versus standards. For a detailed analysis, see generally Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 560 (1992); Parisi, *Rules Versus Standards*, *supra* note 198, §§ 2.1–2.2. See also Schwartz & Scott, *supra* note 109, at 594–609 (criticizing use of default standards in modern contract law).

213. Parisi, *supra* note 198, § 2.

their rules or parties through their arbitration clauses.<sup>214</sup>

As such, we think to some degree that the market has spoken in favor of more, rather than less, procedural discretion for arbitrators. Most arbitration rules give arbitrators broad procedural discretion, and few contain express rules on joinder, consolidation, dispositive motions, and confidentiality—much less class arbitration.<sup>215</sup> Arbitration institutions review their rules on a regular basis, with no evidence of a shift toward procedural specificity. It is true that groups such as the International Bar Association have adopted more specific procedural rules that parties sometimes incorporate into their contracts.<sup>216</sup> Moreover, arbitration agreements have become more detailed over time, at least in standard form contracts between sophisticated and unsophisticated parties. Even so, the available empirical evidence does not provide a basis for adopting negative default rules of the sort that may result from *Stolt-Nielsen*. While we do not claim that market acceptance, even among sophisticated parties, indicates that an approach necessarily is efficient, the substantial competition among arbitration institutions—particularly, but not exclusively, in the market for international arbitration<sup>217</sup>—provides some assurance that default rules significantly limiting arbitrator discretion would impose net costs rather than net benefits on parties.

In short, our normative analysis supports limiting the Court's decision in *Stolt-Nielsen* to class arbitration and not applying it to constrain the procedural gap-filling powers of arbitrators more generally.

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214. Note that Professor Park argues for arbitration institutions to change their standard form rules, not for national legislation restricting the discretion of arbitrators. See Park, *Arbitration's Protean Nature*, *supra* note 112, at 289. In effect, he is participating in the market to make it perform better, rather than seeking a legislative change because the market is not functioning well.

215. See *supra* text accompanying notes 172–73.

216. E.g., INTERNATIONAL BAR ASSOCIATION, IBA GUIDELINES ON CONFLICTS OF INTEREST IN INTERNATIONAL ARBITRATION 3–5 (May 22, 2004), <http://www.ibanet.org/Document/Default.aspx?DocumentUid=E2FE5E72-EB14-4BBA-B10D-D33DAFEE8918>; INTERNATIONAL BAR ASSOCIATION, IBA RULES ON THE TAKING OF EVIDENCE IN INTERNATIONAL ARBITRATION 2–3 (May 29, 2010), <http://www.ibanet.org/Document/Default.aspx?DocumentUid=68336C49-4106-46BF-A1C6-A8F0880444DC>.

217. Christopher R. Drahozal, *Commercial Norms, Commercial Codes, and International Commercial Arbitration*, 33 VAND. J. TRANSNAT'L L. 79, 98–110 (2000); Peter B. Rutledge, *Toward a Contractual Approach for Arbitral Immunity*, 39 GA. L. REV. 151, 161–65 (2004).

## V. CONCLUSION: POSSIBLE RETURN TO CONTRACT AND JURISDICTION

The greater judicial solicitude for arbitration agreements that took root in the early 1970s and fully blossomed by the late 1980s has created unprecedented opportunities for parties to enter into “procedural contracts.” Those contracts cover matters far beyond designation of the applicable law or exclusive forum. Whether through explicit terms or incorporation of arbitral rules, they also address an array of procedural matters such as collective litigation, discovery, limitations periods, available remedies, and the allocation of power between courts and arbitrators. When used actively, they can shape the outcome of a dispute; when ignored, they arguably create gaps that arbitrators must fill subject, potentially, to judicial review.

This paper has undertaken a systematic examination of these procedural contracts, along both positive and normative lines. As a positive matter, we have seen that some parties are increasingly exercising their freedom to enter into procedural contracts, though they appear more inclined to leave some procedural terms like discovery unregulated. We also found that, despite the regular need for arbitrators to exercise their gap-filling authority, they have not developed a consistent method for filling gaps in procedural contracts, at least as to the availability of class arbitration. As a normative matter, we have favored a system of oversight that relies on a blend of industry self-regulation and case-by-case judicial scrutiny, over more blunt approaches such as regulation by an administrative agency or outright statutory prohibitions. Finally, we also have misgivings about the Supreme Court’s heavy-handedness in *Stolt-Nielsen*. While that decision can in principle be limited to the precise issue of an arbitrator’s authority to order class arbitration in the face of a silent agreement, it certainly opens the door for significant post-award litigation over other gap-filling determinations by the arbitrator.

In this conclusion, we trace the implications of our findings for two pending matters, one on the judicial agenda and one on the legislative agenda. The first is *AT&T Mobility LLC v. Concepcion*, pending before the Supreme Court; the second is the Arbitration Fairness Act.

### A. AT&T Mobility LLC v. Concepcion

*Concepcion* concerns a nettlesome question under Section 2 of the Federal Arbitration Act—namely whether the FAA preempts a state court’s finding that the presence of a class-arbitration waiver in an



arbitration clause renders the clause unenforceable? The underlying argument runs as follows: class-arbitration waivers typically are contained in contracts between parties of unequal bargaining positions (a consumer or employee and a company). The class-arbitration waiver represents an effort by the company to preclude class arbitration against the company and, thereby, discourages an injured customer from pursuing her claim at all. Consequently, the class-arbitration waiver effectively functions like an exculpatory clause. For these reasons, the argument concludes, the class-arbitration waiver is unconscionable. Because unconscionability is a “ground for the revocation of any contract” under Section 2, the clause is also unenforceable.

Viewed through the lens of this paper, *Concepcion* presents the sort of normative question that we explored in Part II, namely the limits on the parties’ freedom to enter into procedural contracts. At one level, the argument advanced in *Concepcion* fits comfortably within the normative framework that we defend—namely as a form of case-by-case judicial oversight through the use of generally applicable contract doctrines under Section 2. At another level, however, *Concepcion* illustrates how such a framework might be abused.<sup>218</sup>

To understand why, imagine if a state legislature enacted a law that declared arbitration clauses invalid when they prevented parties from participating in class actions in court. Such a statute would be preempted because it would invalidate all arbitration clauses—all arbitration clauses prevent parties from participating in class actions in court.<sup>219</sup> The result would be the same, one would think, regardless of whether the state law provided more broadly that all clauses that prevent parties from participating in class actions in court are preempted (which would apply also to class-action waivers).<sup>220</sup> Nor should it matter that the state rule was implemented by courts under the guise of unconscionability—the rule would be preempted nonetheless.<sup>221</sup>

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218. At this point in the paper, it is appropriate to disclose that one of us (Rutledge) served as counsel to an *amicus curiae* in several cases, including one pending before the Florida Supreme Court (*Pendergast v. Sprint-Nextel*), in which an argument along these lines was advanced. The other of us (Drahozal) provided comments on a draft of the law professors’ amicus brief in *Concepcion*, although he was not a party to the brief.

219. See, e.g., *Doctor’s Assocs., Inc. v. Casarotto*, 517 U.S. 681, 683–86 (1996); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 268–70, 271–72 (1995).

220. Drahozal, *supra* note 111, at 408–10.

221. See, e.g., *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987). Counsel for *Concepcion* conceded as much before the Supreme Court. Transcript of Oral Argument at 39, *AT&T Mobility LLC v. Concepcion*, No. 09-893 (U.S. argued Nov. 9, 2010) (“[I]s the rule tantamount to a rule of non-enforceability of arbitration agreements[?]”).

The reason *Concepcion* is a difficult case is that the state unconscionability rule there invalidates class-arbitration waivers, and not all arbitration clauses include class-arbitration waivers.<sup>222</sup> That said, if the state legislature enacted a statute invalidating arbitration clauses that included class-arbitration waivers, there is a good doctrinal argument that the state statute would be preempted. Moreover, as a theoretical matter, such a law would run afoul of our own framework which favors case-by-case judicial oversight over blunt legislative prohibitions.

The use of the unconscionability doctrine in *Concepcion* still appears to be indistinguishable from the above-described (albeit narrower) legislative prohibition. It still attempts to accomplish indirectly, through twisting the unconscionability doctrine, what the FAA may preclude state legislatures from doing directly.<sup>223</sup> Not only is such an outcome illogical, it is decidedly undemocratic. It licenses judges (who may or may not be elected) to announce rules under the guise of generally applicable state contract law that democratically elected state legislators themselves could not. Moreover, because all this occurs under the guise of generally applicable contract law, such arguments—unless policed—run the risk of distorting contract doctrines more generally.<sup>224</sup>

There is a counterargument that some members of the Court appeared sympathetic to during oral argument in *Concepcion*: that as long as the state court would invalidate other waivers of class relief (or exculpatory clauses) as unconscionable, the use of the unconscionability

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222. See *supra* note 186.

223. Thus, it is not alone enough that the court uses a generally applicable contract law defense such as unconscionability. It must apply that defense in the same way to arbitration agreements as it applies the defense to other contract provisions. For an easy example of a court applying a general contract law defense differently to arbitration clauses than to other contract clauses, see Arkansas' development of a special mutuality requirement for arbitration clauses that is not applicable to other contract provisions. Drahozal, *supra* note 111, at 411 n.138.

224. Recent research indicates that the litigation over the enforceability of arbitration has come to dominate the development of general principles of contract law. According to one recent study, "battles over arbitration clauses likely constitute a plurality of all contract cases." Horton, *The Shadow Terms*, *supra* note 7, at 658; see also Aaron-Andrew P. Bruhl, *The Unconscionability Game: Strategic Judging and the Evolution of Federal Arbitration Law*, 83 N.Y.U. L. REV. 1420, 1449–50 (2008). Some research suggests that litigation over the enforceability of arbitration agreements accounts for the development of most unconscionability law, a sharp change from the state of affairs twenty-five years ago. See Susan Randall, *Judicial Attitudes Toward Arbitration and the Resurgence of Unconscionability*, 52 BUFFALO L. REV. 185, 185–189 (2004). Recent evidence suggests that this volume of litigation has begun to abate, perhaps as the doctrinal gaps are filled. See Bruhl, *supra*, at 1489.

doctrine to invalidate class-arbitration waivers should not be preempted. Ironically, it is *Stolt-Nielsen*, rather than the Supreme Court's prior preemption cases, that underscores the weakness with this argument. In *Stolt-Nielsen*, the Court held that class arbitration is sufficiently different from individual arbitration that an individual arbitration clause cannot be construed as permitting class arbitration.<sup>225</sup> Yet, when courts hold class-arbitration waivers unconscionable, they are essentially turning individual arbitration clauses into class arbitration clauses, changing the fundamental nature of what the parties agreed to. A state statute to that effect would be preempted under most theories of FAA preemption;<sup>226</sup> a state court decision applying unconscionability doctrine to that same end should be preempted as well.<sup>227</sup>

By this, we do not mean to jettison the doctrinal framework that has built up around Section 2. There certainly is a principled way whereby courts can apply Section 2's "generally applicable" contract defense standard to arbitration clauses. Yet *Concepcion* demonstrates that with respect to certain more malleable defenses, like unconscionability and public policy, there exists a risk that anti-arbitration courts will contort those doctrines to achieve a particular policy outcome. Unless checked, that approach would simply return us to the era of "judicial hostility toward arbitration agreements" that the FAA sought to end.

In sum, while *Concepcion* is a hard case, in the end we believe that the analysis offered in this paper suggests that the petitioners had the better of the argument and that the Supreme Court rightly rejected the back-door attempt to embed a prohibition against class arbitration waivers—i.e., to change the nature of the arbitration proceeding to which the parties agreed—in unconscionability doctrine.

### B. *The Arbitration Fairness Act*

For the last several years, members of Congress, especially the recently-defeated Senator Russell Feingold, have introduced the Arbitration Fairness Act.<sup>228</sup> The bill is relatively simple to understand.

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225. See *supra* notes 177–44 and accompanying text.

226. Drahozal, *supra* note 111, at 422–23.

227. Questions by Justices Ginsburg and Alito seemed to suggest this possibility during oral argument in *Concepcion*. Transcript of Oral Argument at 40–47, *AT&T Mobility LLC v. Concepcion*, No. 09-893 (U.S. Nov. 9, 2010).

228. Here, it is appropriate to disclose that we both have testified in congressional hearings about the bill. Rutledge has testified against the bill. *Arbitration Fairness Act of 2007: Hearing on H.R. 3010 Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 110th Cong. 95–113 (2007) (statement of Peter Rutledge), available

At bottom, it prohibits pre-dispute arbitration clauses in consumer and employment agreements (the bill contains partial definitions of those agreements which need not concern us here).<sup>229</sup> An earlier version of the bill also provided that courts, not arbitrators, will resolve any challenges to the arbitration agreement (apparently overruling *Prima Paint* and the *First Options* “clear and unmistakable” standard). In its current form, the bill operates retroactively—insofar as it applies to disputes that arise after the date of its enactment, irrespective of when the parties entered into the arbitration agreement.

Viewed through the lens of this paper, the Arbitration Fairness Act also presents the sort of normative question that we explored in Part II, namely the limits on the parties’ freedom to enter into procedural contracts. In contrast to *Concepcion*, the consequences are far different. The vesting of exclusive authority in courts to resolve challenges to the arbitration agreement curtails the parties’ freedom as to a particular provision of their procedural contracts (namely the allocation issue discussed in the context of *Rent-A-Center*). The outright ban on certain types of pre-dispute arbitration agreements does not attack procedural contracts directly. Of course, indirectly, the ban hampers the development of procedural contracts by preventing parties from agreeing, on a pre-dispute basis, to resolve their disputes extrajudicially (much like the non-arbitrability doctrine, discussed in Part I, did, only more broadly).

The Arbitration Fairness Act admittedly presents different sets of concerns about inroads on contractual freedom from those we identified

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at <http://judiciary.house.gov/hearings/pdf/Rutledge071025.pdf>; *The Arbitration Fairness Act of 2007: Hearing on S. 1782 Before the Subcomm. on the Const. of the S. Comm. on the Judiciary*, 110th Cong. 7–9 (2007) (statement of Peter Rutledge), [http://judiciary.senate.gov/hearings/testimony.cfm?id=3055&wit\\_id=6831](http://judiciary.senate.gov/hearings/testimony.cfm?id=3055&wit_id=6831). Drahozal testified in the context of presenting the findings of the Searle Civil Justice Institute’s study on consumer arbitration. *Arbitration or ‘Arbitrary’: The Misuse of Arbitration to Collect Consumer Debts: Hearing Before the Subcomm. on Domestic Policy of the H. Comm. on Oversight and Gov’t Reform*, 111th Cong. (2009) (statement of Christopher R. Drahozal), available at <http://oversight.house.gov/images/stories/Hearings/pdfs/20090722Drahozal.pdf>; *Federal Arbitration Act: Is the Credit Card Industry Using it to Quash Legal Claims?: Hearing Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 111th Cong. 121–38 (2009) (statement of Christopher R. Drahozal).

229. Defenders of the bill argue that they do not oppose arbitration, but merely binding pre-dispute arbitration agreements. They contend that, if arbitration really does offer comparative advantages over other forms of dispute resolution, then those advantages will remain after an actual dispute has arisen and, under the Act, parties remain free to enter into post-dispute arbitration agreements. For an argument that the promise of post-dispute arbitration is illusory, see generally Peter B. Rutledge, *Who Can Be Against Fairness? The Case Against the Arbitration Fairness Act*, 9 CARDOZO J. CONFLICT RESOL. 267 (2008).

in *Concepcion*. It does not raise the same legitimacy concerns because the bill, if enacted, would be the result of a legislative process. Nor does the bill distort the development of more general contract law; it simply modifies the Section 2 standard.

Nonetheless, under the normative framework we have developed here, we think that Congress should not adopt it. At bottom, the bill, however well-intentioned, works too great an inroad on contractual freedom without there being a sufficiently compelling empirical case for some offsetting benefit.<sup>230</sup> The bill puts all employment and consumer agreements on the same plane without considering whether the need for regulation might vary across types of agreement or within subcategories of a single agreement. Thus, we doubt that a highly paid corporate executive whose contract contains an arbitration agreement needs the same degree of paternalistic regulation as a line employee.<sup>231</sup> As the protocols demonstrate, industry self-regulation (coupled with judicial oversight) affords a greater opportunity to adapt rules to these nuances and avoids the meat-cleaver approach exemplified by the bill.

A further flaw in the bill is that, if enacted, it would hinder the sort of reexamination that should occur in light of new empirical evidence. As we have explained in great detail elsewhere, the empirical record on arbitration remains incomplete, though important gaps are being filled. If the bill is enacted, the risk is that Congress will naturally turn to other matters, and occasions for reexamination will be scant. By contrast, through industry self-regulation such as the protocols, the industry itself has a natural incentive regularly to reexamine whether the protocols sufficiently take into the account the extant empirical evidence. This helps to avoid risks that awards might be declared unenforceable, an outcome that arbitral institutions have a natural incentive to avoid.<sup>232</sup>

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230. For discussions of the state of empirical literature on the issues surrounding the Arbitration Fairness Act, see generally Drahozal & Zyontz, *supra* note 88, at 847–62; Peter B. Rutledge, *Arbitration Reform: What We Know and What We Need to Know*, 10 CARDOZO J. CONFLICT RESOL. 579 (2009).

231. See E. Gary Spitko, *Exempting High-Level Employees and Small Employers from Legislation Invalidating Pre-dispute Employment Arbitration Agreements*, 43 U.C. DAVIS L. REV. 591, 593–600 (2009).

232. A good example of this phenomenon is the debate in the 1990s over the allocation of arbitration costs. See *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79 (2000); *Cole v. Burns Int'l Sec. Servs.*, 105 F.3d 1465 (D.C. Cir. 1997).

*C. Looking Ahead*

This Article has offered a systematic treatment of procedural contracts and placed them in the context of contemporary judicial and congressional debates. Much work, however, remains to be done, particularly on the empirical side. Specifically, over the long-run, scholars should attempt to develop more sophisticated data sets on the terms of procedural contracts, especially datasets like the franchise database that permit comparisons of how the use of such terms evolves over time. Furthermore, it is hoped that additional arbitration associations, not just the American Arbitration Association, will make available databases of arbitration awards so scholars can investigate further how arbitrators exercise their gap-filling authority in the face of silent procedural contracts. Finally, future research should unpack the causes behind some of the curious trends that our empirical research uncovered such as the surprisingly high frequency with which parties leave certain terms, like discovery, unregulated in their procedural contracts.