

# **JUDICIAL BENCHBOOK**

## **ARBITRATION AND MEDIATION PRACTICE AND PROCEDURE**

A Project of the  
*Institute for Advanced Dispute Resolution*  
*At William Mitchell College of Law*

Sponsored by the  
*National Arbitration Forum*

# JUDICIAL BENCHBOOK: ARBITRATION AND MEDIATION PRACTICE AND PROCEDURE

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*The information contained in this Benchbook is intended to provide useful information regarding the subject covered but may not contain all relevant information or recent changes to the law and is not intended to be legal advice.*

## INTRODUCTION

Arbitration and mediation have become an integral part of the American civil justice system. Judges, lawyers, and parties are using arbitration, mediation, and other ADR methods to resolve civil disputes and to provide Americans with affordable access to effective civil justice. Court-mandated arbitration and mediation help resolve many litigation cases. A growing number of businesses, consumers, employers, employees, companies, and individuals are using private arbitration and mediation to resolve their disputes. Arbitrators and mediators commonly assist the judiciary with resolving disputes efficiently and inexpensively.

This Arbitration and Mediation Benchbook contains useful information for the judiciary regarding arbitration and mediation procedures and issues. Sections of the Benchbook summarize the applicable law, explain the controlling federal court decisions governing arbitrations in state and federal court, describe the Federal Arbitration Act and the state arbitration laws for all fifty states, and contain useful, proposed mediation orders.

Blending modern ADR with traditional litigation has created a public/private partnership. Mediators act as settlement officers resolving civil lawsuits. Arbitrators act as magistrates in deciding disputes. Judges can review these procedures and awards to ensure compliance with applicable law.

Arbitration and mediation significantly benefit the judicial system, in addition to substantially benefiting disputing parties. ADR procedures greatly relieve the excessive burdens placed on court systems and significantly reduce the heavy civil caseloads experienced by judges. This Benchbook provides judges with information they need when they review arbitration clauses, mediated settlement agreements, and arbitration awards.

Current arbitration and mediation legal developments are explained at [www.adrinstitute.org](http://www.adrinstitute.org), a website that provides free, up-to-date reports on ADR law. Additional complimentary and updated copies of this Benchbook can be obtained by e-mailing the Institute of Advanced Dispute Resolution at the William Mitchell College of Law, [adrinstitute@wmitchell.edu](mailto:adrinstitute@wmitchell.edu).

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## **SECTION 1--ARBITRATION INTRODUCTION**

### **1.1 ARBITRATION LAW SUMMARY**

**Arbitration Laws.** The Federal Arbitration Act (FAA) and United States Supreme Court decisions are the primary sources of arbitration law. These laws govern all arbitrations involving interstate commerce, which includes all arbitration agreements except those that are solely intrastate in nature. State arbitration statutes and state decisional law apply to these intrastate cases, of which there are relatively few in number.

**Interstate Commerce.** The extent of interstate commerce is very broad and virtually covers all commercial and consumer arbitrations. State court and federal court judges must apply federal arbitration law to the enforcement of these arbitration agreements and awards.

**Controlling Federal Law.** Federal law in effect controls state arbitration decisions in cases involving interstate commerce. State judges are bound to follow and apply the federal law in reviewing arbitrations in these cases.

**Preemptive Federal Law.** Federal arbitration law preempts contrary or restrictive state statutes and state judicial decisions. Over the past decades, federal law, legislation, and court decisions have become the controlling source of arbitration law. State legislation that contravenes federal arbitration law has been declared unenforceable. State trial court and appellate decisions that have not followed or applied federal law have been reversed. The United States Supreme Court has repeatedly held that federal law is supreme over interstate commerce arbitrations.

**Promotion of Arbitration.** State and federal courts and legislatures strongly favor and promote the use of arbitration. Court mandated and legislatively mandated

arbitration is used by many states to resolve disputes. The primary responsibility of state courts is to review arbitration agreements and awards to make sure they comply with the federal law and any applicable state laws.

**Initial Judicial Avoidance.** The purpose of arbitration is to permit parties to proceed to an affordable, efficient, and fair resolution of a dispute. The mere fact that a court is asked to initially review the propriety of an arbitration agreement or procedures denies parties this right and unnecessarily creates added expenses and delays. This initial review is very limited.

**Limited Initial Review.** In initially reviewing arbitration agreements, state courts are limited to determining: (1) whether the parties agreed to arbitrate their dispute and (2) whether the arbitration agreement complies with applicable state contract law. As to the first issue, if interstate commerce is involved or if the parties agreed that the Federal Arbitration Act governs their agreement, the FAA, and not state arbitration statutes, governs the arbitration. As to the second issue, general contract law can only be applied to the agreement and not any specific state laws governing arbitration. For example, if a state statute prohibited arbitration in certain types of contracts or required that an arbitration agreement be set out in bold type, that state statute would be preempted by the FAA, which does not limit arbitration agreements. For another example, a state court could review an arbitration agreement between a business and a consumer to determine if it is so oppressive procedurally and substantively as to be unconscionable. These issues may arise in a motion to compel, stay, or deny an arbitration proceeding.

**Reformation of Arbitration Agreement.** If part of an arbitration agreement or procedure is determined to be unenforceable or illegal, then that portion is to be stricken or eliminated and the case returned to the arbitration process. Courts should respect the parties' decision to arbitrate and only remove improper contract

provisions. After reforming the agreement, the judge returns the case to the arbitrator. Arbitration review is a process calling upon courts to reform an arbitration agreement or process only if mandated to do so.

**Final Judicial Review.** Arbitration awards and proceedings may be reviewed by courts to determine whether the award is valid and the process is proper. The grounds for this review may be limited as the court has to defer to the broad discretion of the arbitrator on factual findings. The review may be de novo if the agreement of the parties or the arbitration code of procedure requires the arbitrator to apply and follow the applicable substantive law. There are specific statutory grounds under the FAA applicable to modify or vacate an award. Some reviews may be limited to determining whether the award does not constitute a manifest disregard of justice.

## **1.2 ARBITRATION ADMINISTRATION**

### **Arbitration Administrators**

Arbitrations are commonly administered by a reputable, national provider of arbitration services that provides the parties with an arbitrator and a set of arbitration rules. The parties select one or more of these providers in their arbitration clauses. The three national providers of arbitration services are the National Arbitration Forum (also known as the Forum or NAF), the American Arbitration Association (AAA), and Judicial Arbitration and Mediation Services (JAMS). Each arbitration provider follows due process standards established to provide and maintain fair, efficient, and effective arbitration administration.

### **Arbitration Rules of Procedure**

Each arbitration administrator has an established set of detailed procedural rules governing arbitrations. These codes have been in operation for years and have been reviewed and approved in many judicial decisions. The Forum rules provide for:

claims, responses, discovery (including depositions, interrogatories, and document production), full participatory hearings before an arbitrator, issuance of prompt awards, and an affordable fee schedule, which has been described as a model for fair cost and fee allocation. Green Tree Financial v. Randolph, 531 U.S. 79 (2000). All the providers have adopted these due process procedures to make sure that arbitration rules are fair and reasonable. AAA and the other providers work with ABA sections, bar association committees, and groups of businesses and individuals developing and revising rules and procedures.

### **Arbitrators**

Each provider has a national panel of arbitrators in every state who conduct arbitrations anywhere in America as well as all over the world. These arbitrators are highly experienced and are selected for a case based on their impartiality and expertise. Forum arbitrators include former judges, experienced lawyers, and tenured law professors. JAMS arbitrators are former judges. Each arbitration administrator has adopted standards to avoid conflicts of interests and a code of ethics for arbitrators.

## **1.3 VALID AGREEMENTS TO ARBITRATE**

### **Assessing Validity**

In determining the validity of an agreement to arbitrate, courts apply ordinary state-law principles that govern the formation of contracts. Pursuant to Section 2 of the FAA, arbitration agreements shall be valid, irrevocable, and enforceable, save upon such grounds that exist at law or in equity for the revocation of any contract. Federal and state courts determining the validity of an agreement to arbitrate should apply ordinary state-law principles that govern the formation of contracts. 9 U.S.C. § 2. Although courts may not invalidate arbitration agreements under state laws applicable only to arbitration provisions, general contract defenses such as fraud, duress, or unconscionability, grounded in state contract law, may invalidate

arbitration agreements. Doctor's Associates, Inc. v. Casarotto, 116 S.Ct. 1652 (1996).

### **Applying General Contract Principles**

Traditional contract theory requires an offer. An offer is defined as a “manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that [an] assent to that bargain is invited and will conclude it.” Owen v. MBPXL Corporation, 173 F.Supp.2d 905, 921 (N.D. Iowa 2002). Arbitration agreements, like contracts in general, require that a definite offer be clearly communicated to the offeree. Next, the offeree must accept the offer. Usually, the offeree will manifest his assent expressly or in a manner that the offeror may reasonably infer that offeree accepts the offer. Lastly, in order for the agreement to be enforceable there must be consideration. Consideration is defined as a bargained-for exchange whereby the promisor receives some benefit or the promisee suffers a detriment. Specht v. Netscape Communications Corporation, 306 F.3d 17, 18 (2nd Cir. 2002). In the context of arbitration agreements, courts have generally found that mutual promises to submit to arbitration constitute sufficient consideration. Gibson v. Neighborhood Health Clinics Inc., 121 F.3d 1126, 1130 (7<sup>th</sup> Cir. 1997). Where any of the traditional elements of the contract are lacking, courts have found arbitration agreements invalid and refused to compel arbitration.

### **Adhesion Contract Principles**

Contracts of adhesion that include arbitration agreements are commonly valid, enforceable agreements, unless they are determined to be unconscionable. Doctor's Associates, Inc. v. Casarotto, 116 S.Ct. 1652, 1656 (1996). An adhesion contract generally is a contract prepared by one party with greater bargaining authority and is submitted to the other party as a take it or leave it agreement. Adhesion contracts are generally enforceable under contract law. These types of contracts are common in business, consumer, employment, and other transactions and relationships and have

been accepted by the courts as valid, binding contracts unless they are grossly unfair. Arbitration clauses are often included in adhesion contracts and are as valid and enforceable as the adhesion contract itself. Claiming that an arbitration agreement is unenforceable and unconscionable because it is an adhesion contract is an invalid claim. Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991). If the entire adhesion contract were declared invalid, the arbitration clause of that purported contract would likewise be invalid.

### **Invalid Arbitration Contract Provisions**

Section 2 of the FAA provides that a written arbitration provision in any contract involving commerce “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.” 9 U.S.C. § 2. “The text of § 2 declares that state law may be applied ‘if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally.’” As a result, “generally applicable contract defenses, such as fraud, duress, or unconscionability may be applied to invalidate arbitration agreements without contravening § 2.” Doctor’s Associates, Inc. v. Casarotto, 116 S.Ct. 1652, 1656 (1996).

State laws concerning unconscionability may support a challenge to the validity of an arbitration agreement. In a claim of unconscionability, courts generally conduct a two-part inquiry considering: (1) whether the terms of the agreement are so one-sided and unreasonably favorable to the stronger party and (2) whether the stronger party, generally the drafter of the agreement, had exerted overwhelming bargaining power over the other party. Harris v. Green Tree Financial Corp., 183 F.3d 173, 181 (3<sup>rd</sup> Cir. 1999). These two elements are generally referred to as substantive and procedural unconscionability, respectively, and are both required in order for a claim of unconscionability to be upheld. Morrison v. Circuit City Stores, Inc., 317 F.3d 646, 666 (6<sup>th</sup> Cir. 2003); Ting v. AT&T, 319 F.3d 1126, 1148 (9<sup>th</sup> Cir. 2003).

Analysis of procedural unconscionability centers primarily upon whether an agreement is an unfair and invalid contract of adhesion. Determining substantive unconscionability, by contrast, involves a more in-depth analysis of those factors that may make the arbitration agreement unfair or unreasonable. Some of these factors include, but are not limited to: lack of mutuality, unfair fee assessment provisions, and severe limitations on remedies. Ting v. AT&T, 319 F.3d 1126, 1148-1151 (9<sup>th</sup> Cir. 2003); Paladino v. Avnet Computer Techs. Inc., 134 F.3d 1054, 1059 (11<sup>th</sup> Cir. 1998).

## **SECTION 2--STATE ARBITRATION STATUTES AND CONFIRMATION PROCEDURES**

This Section includes a citation to the state arbitration act in effect in your state. State law applies to intrastate arbitration agreements and awards; federal law applies to interstate arbitration agreements and awards. Section 3 of this *Benchbook* explains the sources of applicable law including federal law. Sections 4, 5, and 6 of this *Benchbook* explain arbitration motions, judicial review, and confirmation procedures.

## **SECTION 3--ARBITRATION PROCEDURES**

### **3.1 SOURCES OF GOVERNING LAW**

Three sources of law govern the arbitration process:

- A. The arbitration agreement
  - B. The arbitration forum rules
  - C. The applicable substantive law
- 
- A. **Arbitration Agreement.** The arbitration agreement is a contractual agreement, the terms of which determine the scope of the arbitration. Absent some ambiguity in the terms of the agreement at issue, it is the language of the contract that defines the scope of disputes subject to arbitration pursuant to the Federal Arbitration Act (FAA). E.E.O.C. v. Waffle House, Inc., 122 U.S. 754, 762 (2002). The written agreement may be a few sentences or a few pages in length. Section 2 of the FAA provides that a written arbitration provision in any contract involving commerce “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.” 9 U.S.C. § 2.
  
  - B. **Arbitration Rules.** Typically, the arbitration agreement will require arbitration to be conducted under the auspices of an independent body. The arbitration provider will incorporate by reference rules of procedure that will govern the arbitration process. For example, one such well-known independent body is the National Arbitration Forum (NAF). Rule 1(A.) of the NAF’s

Code of Procedure states that “...this Code governs their arbitration proceedings, unless the Parties agree to other procedures.” National Arbitration Forum, Code of Procedure, Rule 1(A.). Thus, in the usual case, the provisions found in the arbitration provider’s Code of Procedure will govern the arbitration process unless the parties agree otherwise.

- C. **Applicable Law.** The arbitration agreement may include a choice of law provision, or the applicable law governing the arbitration agreement will determine what law governs. When a general choice-of-law provision is included in a contract involving interstate commerce, the FAA will govern the arbitration of the contract absent specific intent by the parties to the contrary. When no choice-of-law clause is present, and a state law that impacts the arbitrability of a claim is sought to be enforced, the FAA will preempt state laws that are inconsistent with the FAA’s policy favoring the enforcement of arbitration agreements according to their terms. Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 62 (1995). States only have the power to invalidate arbitration agreements based on general principles that exist at law or in equity for the revocation of any contract generally. The resulting goal is to enforce the terms of the arbitration agreement as the parties intended. Thus, the Mastrobuono court provides the default rule--absent express intent to the contrary, the FAA will govern the arbitration provision in a contract involving interstate commerce. The Mastrobuono default rule was created to fashion a rule that could be consistently applied when the intent of the parties is unclear or the contract is silent with respect to which law should govern.

### **3.2 ARBITRATOR OR JUDGE DECISIONS**

Just as the arbitrability of the merits of a dispute depend upon whether the parties agreed to arbitrate that dispute, determining who has the primary power to decide arbitrability turns upon what the parties agreed about that matter. In general, if the parties agreed to submit the arbitrability question itself to arbitration, then the arbitrator will decide questions of arbitrability. First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 943 (1995). However, where parties do not agree to submit the arbitrability question to the arbitrator or it is unclear, gateway questions concerning arbitrability are for judicial determination. Procedural questions of arbitrability are presumptively for the arbitrator and not the judge to decide.

The Supreme Court has determined that “arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.” Steelworkers v. Warrior & Gulf Nav. Co., 363 U.S. 574, 582 (1960). Although the Court has also long recognized and enforced a “liberal federal policy favoring arbitration agreements,” it has made clear that there is an exception to this policy. Moses H. Cone Memorial Hospital v. Mercury Constr. Corp., 460 U.S. 1, 24-25 (1983). The question whether the parties have submitted a particular dispute to arbitration, i.e., the question of arbitrability, is “an issue for judicial determination unless the parties clearly and unmistakably provide otherwise.” AT & T Technologies, Inc. v. Communications Workers, 475 U.S. 643, 649 (1986). The Court has found narrow circumstances where contracting parties would likely have expected a court to have decided the gateway matter and, consequently, where reference of the gateway dispute to the court avoids the risk of forcing parties to arbitrate a matter that they may well not have agreed to arbitrate. Thus, a gateway dispute about whether the parties are bound by a given arbitration clause raises a “question of arbitrability” for a court to decide. Howsam v. Dean Witter Reynolds,

Inc., 123 S.Ct. 588, 592 (2002).

At the same time the Supreme Court has found questions of arbitrability not applicable in other circumstances where parties would likely expect that an arbitrator would decide the gateway matter. In general, “procedural questions which grow out of the dispute and bear on its final disposition” are presumptively not for the judge, but for an arbitrator, to decide. Howsam v. Dean Witter Reynolds, Inc., 123 S.Ct. 588, 592 (2002). As further support, the Howsam Court went on to quote portions of the Revised Uniform Arbitration Act of 2000 (RUAA) which states that “in the absence of an agreement to the contrary, issues of substantive arbitrability...are for a court to decide and issues of procedural arbitrability, i.e., whether prerequisites such as time limits, notice, laches, estoppel, and other conditions precedent to an obligation to arbitrate have been met, are for the arbitrators to decide.” Howsam, 123 S.Ct. at 590 (quoting RUAA § 6(c), comment 2).

Furthermore, if parties agreed to submit the arbitrability question itself to arbitration then the court’s standard for reviewing the arbitrator’s decision about that matter should not differ from the standard that courts apply when they review any other matter that parties have agreed to arbitrate. AT & T Technologies, Inc. v. Communications Workers, 475 U.S. 643, 649 (1986). Thus, the reviewing court should give considerable leeway to the arbitrator, setting aside his or her decision only in certain narrow circumstances. If, on the other hand, the parties did not agree to submit the arbitrability question itself to arbitration, then the court should decide that question just as it would decide any other question that the parties did not submit to arbitration, namely, independently. These two answers flow inescapably from the fact that arbitration is simply a matter of contract between the parties. Arbitration is a way to resolve those disputes, but only those disputes that the parties have agreed to submit to arbitration. First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 943 (1995).

### **3.3 ARBITRATION ORDERS**

There are a number of events that may require a court to become involved with an arbitration proceeding. The general rule is that arbitrations proceed without judicial involvement and that the appropriate time for a court to become involved is after an award has been entered and a party seeks an order confirming, modifying, or vacating an award. Some events may require earlier judicial involvement.

#### **3.3.1 Appointment of Arbitrator**

It is common and the best practice for the parties to identify an arbitration provider that will make an arbitrator available. “[T]he power and authority of the arbitrators in an arbitration proceeding is dependent on the provisions under which the arbitrators were appointed.” Szuts v. Dean Witter Reynolds, Inc., 931 F.2d 830, 831 (11th Cir. 1991). Parties to an arbitration agreement may determine by contract the method for appointment of arbitrators. Some parties will name a specific arbitrator in an agreement. The FAA expressly provides that where a method for appointment is set out in the arbitration agreement, the agreed upon method of appointment “shall be followed.” 9 U.S.C. § 5.

If the parties fail to designate a provider, arbitrator, or selection process and cannot agree on an arbitrator, it is the obligation of the court to appoint an arbitrator and refer the case to that arbitrator. The Federal Arbitration Act, which generally controls all state court proceedings, provides “...the court shall designate and appoint an arbitrator or arbitrators or umpire, as the case may require, who shall act under the said agreement with the same force and effect as if he or they had been specifically named therein...” 9 U.S.C. § 5. The judge is not to hear the case nor decline to appoint an arbitrator.

Several courts relying on § 5 have determined that “[a]rbitration awards made by arbitrators not appointed under the method provided in the parties’ contract must be vacated.” Cargill Rice, Inc. v. Empresa Nicaraguense Dealimentos Basicos, 25 F.3d 223, 226 (4th Cir.1994). Thus, “[i]n order to enforce an arbitration award, the arbitrator must be chosen in conformance with the procedure specified in the parties’ agreement to arbitrate.” However, “a ‘trivial departure’ from the parties’ agreement may not bar enforcement of an award.” R.J. O’Brien & Associates, Inc. v. Pipkin, 64 F.3d 257, 263 (C.A.7 (Ill.), 1995).

### **3.3.2 Subpoenas**

Arbitrators have the power to issue subpoenas. The subpoena assures arbitrators the power to compel attendance of parties and nonparties (and the production of documents). Arbitral subpoena power is statutorily derived from federal law under § 7 of the Federal Arbitration Act, which provides in relevant part:

The arbitrators . . . may summon in writing any person to attend before them or any of them as a witness and in a proper case to bring with him or them any book, record, document, or paper which may be deemed material as evidence in the case. . . . Said summons . . . shall be served in the same manner as subpoenas to appear and testify before the court; if any person or persons so summoned to testify shall refuse or neglect to obey said summons, upon petition the United States district court for the district in which such arbitrators . . . are sitting may compel the attendance of such person or persons before said . . . arbitrators, or punish said person or persons for contempt in the same manner provided by law for securing the attendance of witnesses or their punishment for neglect or refusal to attend in the courts of the United States.

FAA references to a summons should be read as meaning a subpoena. Although arbitrators do not have the power to enforce a subpoena by issuing an order compelling a witness to attend, any person refusing or neglecting to obey such summons may be ordered to do so by a federal or state court or punished for contempt by a federal or state court enforcing the FAA or the equivalent state statute (in the same manner as provided by law for securing the attendance of witnesses, or their punishment for neglect or refusal to attend, in the U.S. district courts). Only a judge can issue an order holding a witness in contempt for the failure to appear as a result of arbitral subpoena. However, parties may submit a request to a judge to enforce an arbitration subpoena, and judges routinely issue contempt orders. In re Security Life Ins. Co. of America, 228 F.3d 865 (8<sup>th</sup> Cir. 2000).

### **3.3.3 Legal and Equitable Powers**

Arbitrators generally have the same power in issuing awards that judges have in issuing judgments. Arbitrators can issue monetary awards and injunctive relief. National Arbitration Forum, Code of Procedure, Rules 20, 37. As an example, the broad equitable powers of an arbitrator extend to granting specific performance under a contract. Arbitration awards ordering specific performance will be upheld where specific performance is agreed to by the arbitral parties pre-dispute even where that same court would not normally order specific performance in a non-arbitration setting involving a similar contractual agreement. “It would be quite remarkable if, after these parties had agreed that arbitrators might award specific performance and after arbitrators had so ordered, the courts would, frustrate the whole arbitration process by refusing to confirm the award.” Grayson-Robinson Stores, Inc. v. Iris Construction Corp., 202 N.Y.S. 2d 303, 305 (1960).

### **3.3.4 Other Orders**

Ordinarily, arbitrations are to proceed without judicial involvement. If a party seeks the assistance of a court regarding an arbitration issue, the general rule is that a court does not have the power to interfere with an arbitration.

## **SECTION 4--ARBITRATION CONFIRMATION PROCEDURES**

The most common and frequent arbitration request before a judge is a confirmation request. A party who received a favorable arbitration decision seeks a ruling confirming that award into a civil judgment. This is a routine proceeding.

Arbitration awards are convertible into civil judgments for enforcement purposes. The losing party to an arbitration typically will comply with the award and pay the awarded amount. But some losing parties will not comply or pay, and the winning party needs a civil judgment to enforce the award.

All state and federal jurisdictions have statutes authorizing the confirmation of an arbitration award. The concept and process is similar to the enforcement of full faith and credit given to a civil judgment issued by another state or federal court. The judge accepts the arbitration award and issues a civil judgment based on that award. Pursuant to the Federal Arbitration Act (FAA or “the Act”), and the laws of all fifty states, confirmation of an arbitration award in a court of competent jurisdiction gives the award the effect of a court judgment. The confirmation of an arbitration award allows the judgment to be judicially enforced in any of the ways normally available for a civil judgment.

Whether confirmation is sought in state or in federal court, the FAA governs the enforceability and rules surrounding confirmation of arbitration awards in cases involving interstate commerce. If confirmation is sought for an arbitration agreement involving intrastate activities (which is rare), state law would apply.

### **4.1 THE CONFIRMATION PROCESS**

Confirmation proceedings are usually summary in nature and necessitate little in the

way of judicial intervention in order to convert an arbitration award into a judgment of the court.

“Unlike the usual civil appeal, where the successful party is usually defending the lower court’s decision on the merits, an action for confirmation under 9 U.S.C. § 9 is intended to be a summary proceeding that merely makes the arbitrators’ award a final, enforceable judgment of the court.” Menke v. Monchecourt, 17 F.3d 1007, 1009 (7th Cir. 1994) (citing Florasynt, Inc. v. Pickholz, 750 F.2d 171, 176 (2nd Cir. 1986)).

“Courts are bound by the arbitrator’s findings of fact and do not function as appellate courts or courts of review, but serve only to enforce the arbitrator’s award.” Int’l Brotherhood of Electrical Workers, Local 429 v. Toshiba Am. Inc., 879 F.2d 208, 209 (6th Cir. 1989) (citing United Steelworkers of Am. v. Enterprise Wheel & Car Corp., 363 U.S. 593 (1960)).

The general default rule under the FAA is that unless grounds for vacation, modification or correction are established, the award must be confirmed. Orion Shipping & Trading Co. v. Eastern States Petroleum Corp. of Panama, S.A., 312 F.2d 299, 301 (C.A.N.Y. 1963).

“[T]he confirmation of an arbitration award is a summary proceeding that merely makes what is already a final arbitration award a judgment of the court.” Yusuf Ahmed Alghanim & Sons v. Toys “R” Us, Inc., 126 F.3d 15, 23 (2nd Cir. 1997) (quoting Florasynt, Inc. v. Pickholz, 750 F.2d 171, 176 (2nd Cir. 1984)).

Pursuant to Section 6 of the FAA, “[a]ny application to the court hereunder shall be made and heard in the manner provided by law for the making and

hearing of motions...” 9 U.S.C. § 6 (2000).

## **4.2 CONFIRMATION PROCEDURES**

The precise procedures vary slightly from state to state, and even within a state. There is no need for a confirmation request to be filed as a lawsuit mandating pleading service requirements or a lawsuit-filing fee. The procedure is to be summary and not a lawsuit proceeding. *Menke v. Monchefort*, 17 F.3d 1007 (7<sup>th</sup> Cir. 1994); *Florasynth, Inc. v. Pickholz*, 750 F.2d 171 (2<sup>nd</sup> Cir. 1986). The most common procedures are:

1. A motion or petition that establishes the identity of the parties, a description of the arbitration agreement, and a statement of the relief sought;
2. The presentation of the arbitration award submitted by the moving or petitioning party;
3. Some jurisdictions may require a separate affidavit setting forth the facts of the arbitration agreement, the arbitration hearing, and the arbitration award;
4. Many courts require the party seeking confirmation to submit a proposed order which the judge may sign to confirm the arbitration award;
5. Some jurisdictions may also require a memorandum of law to support the request for confirmation.

*See* Daniel D. Derner & Roger S. Haydock, *Confirming An Arbitration Award*, 23

Wm. Mitchell L. Rev. 879, 885-89 (1997).

### **4.3 SECTION 9 OF THE FEDERAL ARBITRATION ACT**

Section 9 of the FAA supplies the statutory authority for parties to confirm an arbitration award in court, it provides in relevant part that:

If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, and shall specify the court, then at any time within one year after the award is made any party to the arbitration may apply to the court so specified for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified, or corrected. If no court is specified in the agreement of the parties, then such application may be made to the United States court in and for the district within which such award was made.

9 U.S.C. § 9 (2000).

Some courts have required that an agreement to arbitrate must include language that establishes the parties' agreement to have a judgment entered in court upon an award. This requirement is also known as the "consent to entry of judgment" and is covered by language in the arbitration agreement, express or implied, that the parties agree that any court with jurisdiction may enforce an any arbitration award.

### **4.4 TIMING OF CONFIRMATION AWARD**

Pursuant to § 9 of the FAA, parties may confirm an award any time within one year

after the award is made. Some courts have interpreted this provision as a statute of limitations, while some other courts have interpreted this provision as merely permissive and not tantamount to a statute of limitations. *See In re Consolidated Rail Corp.*, 867 F.Supp. 25, 28 (D.D.C. 1994); *But see Paul Allison, Inc. v. Minikin Storage of Omaha, Inc.*, 452 F.Supp. 573, 574 (1978). An award that is not covered by the FAA, but by state law, is governed by the applicable state statute of limitations.

#### **4.5 VENUE OF AWARD CONFIRMATION**

The FAA, 9 U.S.C. §§ 10-11, states that “...the United States court in and for the district wherein the award was made may make an order [modifying, correcting, or vacating] the award upon the application of any party to the arbitration...” The United States Supreme Court has interpreted this provision holding that the language is permissive and is not restrictive, and the statute allows a motion to confirm where the award was issued or where proper under the general venue statute of the Federal Rules of Civil Procedure. *Cortez Byrd Chips, Inc. v. Bill Harbert Construction Co.*, 529 U.S. 193 (2000). In finding that the venue provisions of the FAA, which include § 9, are permissive, the Supreme Court continued to uphold its long line of cases favoring arbitration and the enforcement of agreements to arbitrate. Arbitration awards sought to be confirmed in state courts need to comply with the applicable state venue provisions that generally permit an award to be confirmed where the hearing was held, or where the award was made, or where the respondent/defendant is living, doing business, or has property.

## **SECTION 5--JUDICIAL REVIEW OF ARBITRATION AWARDS**

Judicial review of arbitration awards is limited because the benefits of arbitration are derived, in part, from the finality of the arbitrator's decision. The grounds for judicial review of arbitration awards are very narrow and are set forth in the Federal Arbitration Act (FAA) and similar state statutes. Because of this limited review, the delays and costs of protracted appellate procedures, so common to litigation, are avoided in arbitration. There are limited reasons to support a judge changing an arbitration award. The power of a judge to vacate or modify an arbitration award is explained in § 5.1. The extent of the power of a judge to change an arbitration award is likewise limited. The extent depends upon the applicable arbitration rules.

### **5.1 DE NOVO REVIEW**

A judge can review the law applied to the arbitration by an arbitrator *de novo* if the arbitrator is obligated to follow the law. For example, the National Arbitration Forum rules require an arbitrator to follow the law. National Arbitration Forum, Code of Procedure, Rule 1, 20 (July 1, 2003). In such a case, if the arbitrator failed to apply or interpret the proper law, a judge could change the award and apply the correct law.

Where the parties agree that arbitrators must follow the law when rendering decisions and making awards, the reviewing court retains limited authority to vacate an arbitrator's award. Section 10 of the FAA lists the circumstances in which a court has the authority to vacate an award, including certain types of misconduct by the arbitrator or where the arbitrator "exceeded [his] powers." 9 U.S.C. § 10(a)(4).

## **5.2 COMPLIANCE WITH APPLICABLE LAW**

A judge can rule on a motion to modify or vacate, as explained in § 5.1, which operates as judicial review of an arbitration award.

## **5.3 MANIFEST DISREGARD OF THE LAW**

The courts have granted enormous deference to awards made by arbitrators when the parties have empowered the decision makers with broad authority. Over the course of reviewing arbitration awards, courts have developed an additional standard of limited review to protect some of the parties' legal rights in the most extreme circumstances. The Third Circuit characterized this court-created standard as an "additional, nonstatutory [basis]" to vacate an award, even though the arbitrator had unlimited power. RPS v. Kayser, 257 F.3d 287, 292 n.2 (3rd Cir. 2001); Carte Blanche (Singapore) v. Carte Blanche (Int.), 888 F.2d 260, 265 (2d Cir. 1989). The 10<sup>th</sup> Circuit stated that the court reviews an award to determine if arbitrators "exceeded their power or acted in manifest disregard of the law." Bowen v. Amoco Pipeline Co. 254 F.3d 925, 932 (C.A.10 (Okla.), 2001).

A successful challenge under the "manifest disregard of the law" standard depends upon the challenger's ability to show that the award is "(1) unfounded in reason and fact; (2) based on reasoning so palpably faulty that no judge, or group of judges, ever could conceivably have made such a ruling; or (3) mistakenly based on a crucial assumption that is concededly a non-fact." Local 1445, United Food and Commercial Workers v. Stop & Shop Cos., 776 F.2d 19, 21 (1st Cir. 1985). Put similarly, "as long as the arbitrator is even arguably construing or applying the contract and acting within the scope of his authority," a court's conviction that the arbitrator made a serious mistake or committed grievous error will not furnish a satisfactory basis for undoing the decision. United Paperworkers International Union

v. Misco, Inc., 484 U.S. 29, 38 (1987).

## **5.4 OTHER REASONS**

Ordinarily, a judge cannot review the factual findings or determinations of an arbitrator or mixed issues of law and fact decided by an arbitrator. And, typically a judge cannot review the discretion exercised by an arbitrator because it is not reviewable. The clearly erroneous and abuse of discretion standards are usually not applicable in the judicial review of arbitration cases.

## **SECTION 6--ARBITRATION MOTIONS**

### **6.1 MOTIONS TO MODIFY/VACATE**

#### **6.1.1 Motion to Modify**

A party to an arbitration award may seek to have a judge modify the award. Federal law under the Federal Arbitration Act, Section 11, usually governs determining whether an award can be modified. Even if other grounds existed under a state statute or judicial opinion, the only grounds that could be a basis for modification of an award involving interstate commerce are those listed in the federal statute, which preempts all state statutes.

The general rule is that completed arbitration awards are not to be modified, changed, or supplemented. However, ambiguities may be clarified, and mistakes, apparent on their face, may be corrected. La Vale Plaza, Inc. v. R. S. Noonan, Inc., 378 F.2d 569 (3d Cir. 1967). The grounds for modification or correction are straightforward and aim at effectuating the intent of the arbitrator and promoting justice between the parties.

Under the FAA, 9 U.S.C. § 11, the limited grounds for modification are:

- A. Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award.
- B. Where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the

matter submitted.

- C. Where the award is imperfect in matter of form not affecting the merits of the controversy.

Although the exercise of this power by the court is discretionary, this power is not used to review or set aside the arbitrator's findings with respect to law or fact. WE Hedger Transp. Corp. v. James Richardson & Sons, Ltd., 305 U.S. 657 (1939); Chilean Nitrate & Iodine Sales Corp v. Amicizia Societa Navegazione, 363 U.S. 843 (1960).

### **6.1.2 Motion to Vacate**

A party to an arbitration award may seek to have a judge vacate the award. The applicable law determining whether an award can be vacated is usually the federal law under the FAA, 9 U.S.C. § 10. Generally, courts give great deference to an arbitration award that draws its essence from the parties' contract and are reluctant to vacate awards unless made in clear violation of a proscription found in statute, contract, applicable rules, the parties' stipulation, or a court order. Even if other grounds existed under a state statute or judicial opinion, the only grounds that could be a basis for vacation of an award involving interstate commerce are those listed in the federal statute, which preempts all state statutes.

Extensive judicial review undermines the goals of the arbitration process. A court's role is limited to reviewing awards. Trial judges reviewing an arbitration award are more deferential to an arbitrator than an appellate court would be to a trial judge. This deference preserves arbitration as a "commercially useful alternative method of dispute resolution" preventing it from becoming a burdensome, additional step in the judicial system. Flexible Mfg. Systems Pty. Ltd. v. Super Products Corp., 86 F.3d 96 (7<sup>th</sup> Cir. 1996).

Judicial review of arbitration awards under the FAA is limited. Booth v. Hume Publishing, Inc., 902 F.2d 925, 932 (11th Cir.1990). The FAA presumes that arbitration awards will be confirmed, 9 U.S.C.A. § 9 and enumerates only four specific bases for vacatur. In addition to these four statutory grounds for vacatur, courts have recognized two additional non-statutory bases upon which an arbitration award may be vacated. First, an arbitration award may be vacated if it is arbitrary and capricious. Ainsworth v. Skurnick, 960 F.2d 939, 941 (11th Cir. 1992); Raiford v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 903 F.2d 1410, 1413 (11th Cir. 1990). Second, an arbitration award may be vacated if enforcement of the award is contrary to public policy. Delta Air Lines, Inc. v. Airline Pilots Ass'n, 861 F.2d 665, 671 (11th Cir. 1988).

In addition to the two non-statutory bases for vacation mentioned above, the FAA, 9 U.S.C.A. § 10(a), provides vacation for the following reasons:

1. Where the award was procured by corruption, fraud, or undue means.
2. Where there was evident partiality or corruption in the arbitrators, or either of them.
3. Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party may have been prejudiced.
4. Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

Courts play a limited role in reviewing arbitral awards, limited to whether the arbitrators did the job they were told to do and not whether they did it well, correctly, or reasonably, but simply whether they did it. United Paperworkers Intern. Union, AFL-CIO v. Misco, Inc., 484 U.S. 29 (1987).

## **6.2 MOTION TO COMPEL**

Two types of motions relating to arbitration that may be brought are a motion to compel and a motion to stay or deny arbitration. Both a motion to stay and a motion to compel may be brought contemporaneously or in response to each other. One party will demand arbitration while the other balks. The granting of one motion is, in effect, the denial of the other motion. A party may also seek to have a court issue an order stopping an arbitration from proceeding. This motion may be designated as a motion to stay or deny and the grounds may be similar.

### **6.2.1 Motion to Compel Procedure**

A party to an arbitration agreement may seek an order compelling a case to be arbitrated when the opposing party refuses or fails to participate in arbitration. If the contractually adopted arbitration rules allow for default proceedings and a respondent fails to participate, then the adopted rules control and arbitration proceeds. However, if the rules are silent about default proceedings and the arbitration agreement doesn't address this circumstance, then a petitioner must seek an order to compel arbitration. Section 4 of the FAA provides the relevant authority:

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court . . . for an order directing that such

arbitration proceed in the manner provided for in such agreement. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement.

9 U.S.C.A. § 4.

Upon hearing a motion to compel arbitration, the court must determine whether the parties have entered into a valid agreement to arbitrate and, if so, whether the existing dispute falls under the coverage of the agreement. Fleetwood Enterprises, Inc. v. Gaskamp, 280 F.3d 1069, 1073 (5th. Cir. 2002); Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 626 (1985). If the court finds that the parties have entered into a valid agreement to arbitrate under applicable contract law and the dispute falls under the coverage of the agreement, the FAA compels judicial enforcement of the arbitration agreement. A motion to compel arbitration should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of interpretation that covers the dispute, with all doubts being resolved in favor of coverage. Zandford v. Prudential-Bache Securities, Inc., 112 F.3d 723 (4<sup>th</sup> Cir. 1997).

### **6.2.2 Grounds for Motion to Compel**

**Failure to Arbitrate.** If respondent has failed, neglected, or refused to arbitrate under the parties' written agreement, the petitioner may request a court to direct that arbitration be held in accord with the arbitration agreement. PacifiCare Health Systems, Inc. v. Book, 123 S.Ct. 1531, 1533 (2003).

**No arbitrator agreed upon.** If the arbitration agreement does not specify an arbitration provider or an arbitrator and the parties have failed to agree on an arbitrator, it is up to a court to appoint an arbitrator and compel arbitration as intended by the parties.

## **6.3 MOTION TO STAY OR DENY ARBITRATION**

### **6.3.1 Motion to Stay**

A party to an arbitration agreement may seek an order staying the arbitration because the party wants to try the case in court and not before an arbitrator or for a variety of other reasons. A motion to stay an arbitration will only be granted when a petitioner demonstrates a likelihood of proving that a dispute is not arbitrable, irreparable harm if the arbitration proceeds, and that a preliminary injunction is not against the public interest. American Life Ins. Co. v. Parra, 25 F.Supp.2d 467, 479 (D.Del. 1998).

### **6.3.2 Grounds for a Motion to Stay or Deny**

**Dispute is not arbitrable.** There exist only a few, narrow grounds to declare an arbitration agreement unenforceable and that the dispute is not arbitrable. When a party seeks to stay an arbitration on the basis that the dispute is not arbitrable under the parties' contract, the United States Supreme Court has held the FAA "establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration..." Moses H. Cone Memorial Hosp. v. Mercury Const. Corp., 460 U.S. 1, 23 (1983).

**No agreement to arbitrate.** Obviously, the parties must have agreed to arbitrate in order for arbitration to occur. The contract may be an adhesion contract or a bargained for contract. Section 1 explained these contract principles. If there is no

apparent agreement, a party may seek an appropriate order.

**Parties have been litigating the dispute and waived their right to arbitrate.** If parties to an arbitration agreement decide not to arbitrate the dispute, they could litigate it in court. If one of the parties initially decides to litigate instead, or overlooks or ignores an arbitration agreement, an issue arises whether that party has waived the right to arbitrate. Generally, the parties have to be significantly engaged in litigation for a lengthy period of time to have waived the right to arbitrate. In one case, a court compelled parties to arbitrate after both parties engaged in significant litigation efforts. Over a nine month period, the defendants had filed a counterclaim, answered plaintiffs' interrogatories, filed interrogatories, and brought a motion for production, and plaintiffs had propounded interrogatories, made production requests, noticed two depositions, and filed motions to compel on their discovery motions. The court decided that defendants had not substantially invoked the litigation machinery so as to waive right of arbitration under the parties' agreement. American Dairy Queen Corp. v. Tantillo, 536 F.Supp. 718 (M.D.La. 1982).

### **6.3.3 Motions to Deny**

A party may attempt to avoid arbitration by bringing a motion asking a court to declare an arbitration agreement invalid, an arbitration proceeding unconscionable, an arbitration award unenforceable. The court needs to determine whether the grounds for these motions to deny arbitrations are valid or invalid. Courts have rejected a variety of assertions claiming that an arbitration not proceed and have accepted some as appropriate. Reasons advanced by parties in an effort to stay or deny arbitration that have been rejected by the courts include the following:

**I didn't sign it.** A party may be bound by an agreement to arbitrate even in absence of a signature. McAllister Bros., Inc. v. A & S Transp. Co., 621 F.2d 519 (C.A.N.Y.,

1980); Genesco, Inc. v. T. Kakiuchi & Co., Ltd., 815 F.2d 840 (C.A.N.Y., 1987). Although the Federal Arbitration Act (FAA) requires a preexisting agreement to arbitrate, the FAA does not require that every party personally sign the written arbitration provision. Johnson v. Polaris Sales, Inc., 2003 WL 1790747 (D.Me. 2003).

**I changed my mind.** Contract law principles apply to the enforcement of an arbitration agreement. Nur v. K.F.C., USA, Inc., 142 F.Supp.2d 48, 51 (D.D.C. 2001). A party cannot choose to ignore a contract obligation, including an arbitration provision.

**I didn't understand it.** Under basic contract law, “[o]ne who signs a contract which he had an opportunity to read and understand is bound by its provisions.” Paterson v. Reeves, 304 F.2d 950, 951 (C.A.D.C. 1962). A party is charged with knowledge of the terms of its arbitration agreement, from the time of the agreement, unless there is evidence of fraud, deceit, or misrepresentation. Barber & Ross Co. v. Cornell & Co., 242 F.Supp. 825, 826 (D.C.D.C. 1965).

**It is not enforceable.** Whether a party agreed to arbitrate a particular dispute is an issue for judicial determination to be decided as a matter of contract. See AT&T Technologies, Inc. v. Communications Workers of Am., 475 U.S. 643, 648-49 (1986). In so deciding, the court should apply “ordinary state-law principles that govern the formation of contracts.” First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 944 (1995). However, the Supreme Court has emphasized that “it should be kept in mind that ‘questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration.’” Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 26 (1991) (quoting Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983)). Pursuant to that liberal policy, any doubts concerning the scope of arbitrable issues should be resolved in favor of

arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability. Moses H. Cone, 460 U.S. at 24-25.

**I am being denied a trial.** Parties can choose arbitration instead of litigation and a bench or jury trial. The federal policy favoring the effective and efficient resolution of disputes through arbitration applies with equal strength to claims created by contract or by statute. “By 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.” Mitsubishi Motors Corp. v. Soler ChryslerPlymouth, Inc., 473 U.S. 614, 628 (1985). Parties may demand their constitutional right to a jury trial, however they also have a right to contract for another way to seek relief. Johnson v. West Suburban Bank, 225 F.3d 266 (3<sup>rd</sup> Cir. 2000).

**I am being denied appellate review.** Arbitration parties have the same opportunity to present a case before an arbitrator as they do before a judge, and courts have the opportunity to review arbitration proceedings as they do with judicial proceedings. The Supreme Court has held that parties are entitled to all of their substantive rights in arbitration. Courts can review arbitration issues. An arbitrator’s rulings on an employee’s statutory discrimination claims were held subject to judicial review and not unenforceable or unconscionable. Cole v. Burns Intern. Sec. Services, 105 F.3d 1465 (C.A.D.C., 1997). Parties have a right to a judicial review of an arbitration award, and a court can under certain circumstances review an arbitrators’ decisions for errors. Lapine Technology Corp. v. Kyocera Corp., 130 F.3d 884, 890 (C.A.9 (Cal.), 1997).

**It is part of an adhesion contract.** Section 1 explained applicable contract law. Other courts evaluating adhesion contract arbitration agreements involving

consumers, employees, and individuals have found them to be readily enforceable. *See* Cole v. Burns Intern. Sec. Services, 105 F.3d 1465, 1482-83 (D.C.Cir. 1997); Benefits Communication Corp. v. Klieforth, 642 A.2d 1299, 1304 (D.C. 1994).

**The arbitrator or arbitral body is going to be biased.** An unbiased process achieves fundamental fairness. Fairness ultimately proceeds from the independence of the decision-maker and the universality of the standards of decision. Arbitrators are independent legal professionals who make decisions governed by the applicable substantive law. Fairness is assured when decisions must be made under the substantive law and are reviewable and reversible by the court for legal error. *See* Watts and Sons, Inc., v. Tiffany & Co., 248 F.3d 577 (7<sup>th</sup> Cir. 2001); Lapine Tech. Corp. v. Kyocera Corp., 130 F.3d 884 (9<sup>th</sup> Cir. 1997); Gateway Tech., Inc. v. MCI Telecomm. Corp., 64 F.3d 993 (5<sup>th</sup> Cir. 1995). There must exist credible evidence of actual bias to declare an arbitration process unfair. The United States Supreme Court established this standard when reviewing an arbitration agreement: In the absence of any credible evidence of actual bias in favor of lenders, we “decline to indulge the presumption that the parties and arbitral body conducting a proceeding will be unable or unwilling to retain competent, conscientious and impartial arbitrators.” Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 30 (1991). Subsequent courts have used this standard to deny a claim of possible bias. Phillips v. Associates Home Equity Services, Inc., 179 F.Supp.2d 840, 845 (N.D. Ill. 2001).

**I am being denied discovery.** Arbitration rules and procedures either specifically authorize discovery requests or allow arbitrators to order discovery at their discretion. National Arbitration Forum Rule 29 - Discovery; David F. Herr and Roger S. Haydock, Discovery Practice at § 10.3 (Aspen, 3d ed). The same useful discovery methods available in litigation, including document production and depositions, may be available in arbitration proceedings. Arbitration agreements that incorporate the rules of an arbitration provider, which provide at least minimal

discovery, are enforceable. Cole v. Burns Intern. Sec. Services, 105 F.3d 1465 (D.C. Cir. 1997).

**Arbitration is too expensive.** Cost is an important component of access to legal decision-making. Arbitrating a dispute is far less expensive than litigating a dispute to resolution. Arbitration is estimated to cost about 25% of an equivalent action in the court system. Arbitration costs will not act to prohibit vindication of individuals' claims. Under appropriate circumstances, a portion of an individual's cost of arbitration must be borne by the businesses or employer, and in some cases, arbitration must be available without cost to indigent individuals. Cole v. Burns Int'l Sec Servs., 105 F.3d 1465, 1483-85 (D.C. Cir. 1997); Green Tree Financial Corp. v. Randolph, 531 U.S. 79 (2000); Nelson v. Insignia/Esg, Inc., 215 F. Supp. 2d 143 (D.C. Cir. 2002); Bradford v. Rockwell Semiconductor Systems, Inc., 238 F.3d 549 (4<sup>th</sup> Cir. 2001); Walton v. Experian, 2003 WL 22110778 (N.D. Ill. 2003).

#### **6.3.4 Motion to Sever**

A court, on its own or in response to a motion brought by a party, has the power to sever unenforceable portions of an arbitration clause or process and order the parties to continue with arbitration. Spinetti v. Service Corp. Intern., 324 F.3d 212 (3<sup>rd</sup> Cir. 2003). Only if the deficiencies are so essential and substantial that it is impossible to continue with arbitration, may courts deny the arbitration.

The severance remedy is favored because it permits the intent of the parties to arbitrate to be enforced while eliminating any unfair provisions. As the courts have concluded, you don't cut down the trunk of a tree because some of the branches are sickly. This is the same remedy applied to the trial of cases in those instances when a litigation or procedure denied a party due process. The courts did not deny parties access to trial, but eliminated the unfair proceeding and ordered the parties to proceed. The same remedy is applicable to arbitration.

## **SECTION 7--FEDERAL LAW**

### **7.1 FEDERAL ARBITRATION ACT**

In 1925, Congress enacted the Federal Arbitration Act (FAA), codified at 9 U.S.C. § 1, et seq. Designed to “overrule the judiciary’s longstanding refusal to enforce agreements to arbitrate,” Section 2 of the FAA provides that “[a] written provision in...a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction...shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.” Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 219 (1985).

The FAA ensures that agreements to arbitrate will be enforced according to their terms. Allied-Bruce Terminix, Cos., Inc. v. Dobson, 513 U.S. 265, 271 (1995). In furtherance of the desire to enforce arbitration agreements, courts have consistently held that “any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration.” Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 25 (1983); Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 626 (1985). This well established line of Supreme Court jurisprudence upholding the validity of arbitration agreements demonstrates the judiciary’s recognition of the crucial role arbitration plays in the American civil justice system.

The ultimate goal of courts is to effectuate the party’s intent to engage in arbitration where the law requires or where the intent is evident from the agreement or clause. The broad authority of the FAA as interpreted by the United States Supreme Court requires courts to honor arbitration clauses and agreements. Courts occasionally

have to interpret the arbitration language to determine its effect.

### **7.1.1 Public Policy of FAA**

Supreme Court jurisprudence over the past few decades has focused on Congressional intent and judicial enforcement of the Federal Arbitration Act. The FAA was intended primarily to overrule decades of hostility toward enforcement of arbitration agreements. See Dean Witter Reynolds, Inc., 470 U.S. at 219. The Act “was designed to allow parties to avoid ‘the costliness and delays of litigation,’ and to place arbitration agreements ‘upon the same footing as other contracts....’” Scherk v. Alberto-Culver Company, 417 U.S. 506, 510-11 (1974) (quoting H.R.Rep.No.96, 68th Cong., 1st Sess., 1, 2 (1924)). Congress, in enacting § 2 of the FAA, “declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration. Congress has thus mandated the enforcement of arbitration agreements.” Southland Corp. v. Keating, 265 U.S. 1, 10 (1984).

Furthermore, the Court in Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc. discussed the importance, as in any contract, of giving effect to the intentions of the parties. Specifically, the Court said that “as with any other contract, the parties’ intentions control, but those intentions are generously construed as to issues of arbitrability.” Mitsubishi Motors Corp., 473 U.S. at 626.

In summary, the public policies surrounding enactment of the FAA are twofold. First, the FAA created a statutory right with which parties could pursue an alternative to costly and lengthy court-based litigation. Second, recognizing the then-existing hostility toward such provisions in contracts, Congress sought to give meaningful effect to the intent of the parties when drafting their agreements. Since

enactment, the FAA has enjoyed widespread judicial approval and expansion of these public policies.

### **7.1.2 Unenforceable Conflicting State Laws**

The law in this area is well established, the general rule being that states may invalidate a contract containing an arbitration provision only on the basis of invalidating contracts generally. States may not single out arbitration provisions on grounds other than those generally available for the invalidation of contracts.

Congress, in § 2 of the FAA, reaffirmed the well-established principle that states may regulate contracts, including arbitration clauses, under general contract law principles. The United States Supreme Court has stated that:

[w]hat States may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause. The Act makes any such state policy unlawful, for that kind of policy would place arbitration clauses on an unequal “footing,” directly contrary to the Act’s language and Congress’ intent.

Allied-Bruce Terminix, Cos., Inc. v. Dobson, 513 U.S. 265, 281 (1995).

From this it is clear that states are free to invalidate contracts including arbitration clauses on grounds that the contract itself is unconscionable or was made under fraud or duress, but may not do so based solely on the mere existence of an arbitration clause in a contract.

The United States Supreme Court also invalidated a state statute that required an

arbitration agreement to be disclosed in a certain fashion. A Montana law declared an arbitration clause unenforceable unless the contract included a notice on the first page typed in underlined, capital letters that the contract is subject to arbitration. Justice Ginsburg, writing for the majority, held that the FAA preempted the Montana statute, because the statute conflicted with the FAA's policy of giving effect to the parties' intent of arbitrating any claims arising between them. The state statute directly conflicted with the "the very purpose of the Act ... ensur[ing] that private agreements to arbitrate are enforced according to their terms." Doctor's Assocs. v. Casarotto, 517 U.S. 681, 687, 688 (1996).

State courts have followed this precedent. The California Code of Civil Procedure enabled parties to a real estate purchase agreement to bring a lawsuit for construction defects in court even if the parties signed an agreement to arbitrate. The California state court concluded that because the purchase agreement involved interstate commerce and the provision of the California Code was a state law applicable only to arbitration agreements in conflict with the FAA, the FAA was applicable and therefore preempted the California Code provision. Basura v. U.S. Home Corp., 98 Cal. App. 4th 1205, 1212-15. This decision is applicable to similar situations that might arise in other states.

## **7.2 UNITED STATES SUPREME COURT DECISIONS**

Decisions of the United States Supreme Court over the past two decades have uniformly developed, promoted, and advanced the use of arbitration clauses and the enforceability of arbitration awards.<sup>1</sup> The Supreme Court has broadly expanded the applicability of arbitration under the Federal Arbitration Act to all types of disputes including traditional commercial cases and extending into consumer, brokerage,

employment, financial document, credit card, and other types of transactions and relationships. Commentators often identify the 1991 Gilmer decision as an early case heralding the expanded use of arbitration. And several subsequent decisions issued in the 1990's and early 2000's continue this expansion of arbitration. But, as with many precedents, earlier cases--some in the mid-1980--laid the groundwork for the growing use of arbitration. To truly understand the evolution of arbitration law, it is helpful to begin with the Supreme Court's initial opposition.

### **7.2.1 The Wrong Track at the Beginning**

The treatment of the Federal Arbitration Act by the U.S. Supreme Court got off on the wrong track with the 1953 decision Wilko v. Swan.<sup>2</sup> In Wilko, the Court examined an agreement between a securities broker and a buyer whereby the parties had agreed to arbitrate controversies arising out of the transaction. The buyer later sued for misrepresentation. The broker brought a motion to stay the lawsuit, pending arbitration. The buyer sought to continue with his suit in federal court arguing that the arbitration clause in the parties' agreement was an unenforceable waiver of his right to bring suit in court under section 14 of the Securities Act.<sup>3</sup>

The Supreme Court bought the buyer's argument, holding the Securities Act conferred on the buyer a right to sue that could not be waived.<sup>4</sup> The Court found the arbitration clause was, therefore, an illegal waiver.<sup>5</sup> Despite the Court's holding, it was the Court's reasoning that caused the real damage to the Federal Arbitration Act.

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<sup>1</sup> This section was compiled with permission from Roger S. Haydock and Jennifer D. Henderson, *Arbitration and Judicial Civil Justice: An American Historical Review and A Proposal For a Private/Arbitral and Public/Judicial Partnership*, 2 Pepp. Disp. Resol. L.J. 141 (2002).

<sup>2</sup> Wilko v. Swan, 346 U.S. 427 (1953).

<sup>3</sup> At that time, section 14 read as follows: "Any condition, stipulation or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void." Wilko, 346 U.S. at 430 n.6.

<sup>4</sup> Id. at 435.

<sup>5</sup> Id.

According to the Court:

[E]ffectiveness in application [of Securities Act provisions advantageous to the buyer are] lessened in arbitration as compared to judicial proceedings. Determination of the quality of a commodity or the amount of money due under a contract is not the type of issue here involved. This case requires subjective findings on the purpose and knowledge of an alleged violator of the Act. They must be not only determined but also applied by the arbitrators without judicial instruction on the law. As their award may be made without explanation of their reasons and without a complete record of their proceedings, the arbitrators' conception of the legal meaning of such statutory requirements as "burden of proof," "reasonable care" or "material fact" cannot be examined. [Moreover], power to vacate an award is limited.<sup>6</sup>

Thus, the Court believed arbitrators would not be sufficiently competent to determine whether the broker had violated the Securities Act by misrepresenting some aspect of the transaction. The Court's negative attitude towards the enforcement of legal rights in arbitration, as expressed in Wilko, took a long time to change, evolving gradually over a period of thirty years.

### **7.2.2 The "Steelworkers Trilogy" of 1960**

Seven years after Wilko, the Supreme Court issued a group of three opinions known as the "Steelworkers Trilogy." These three cases became the framework for the development of federal common law governing labor agreements.

a. United Steelworkers v. American Manufacturing Co.

The first case in the trilogy dealt with the question of when an issue must be submitted to arbitration. In United Steel Workers v. American Manufacturing Co., the Court reviewed the role of the judiciary in the context of collective bargaining and the Labor Management Relations Act (LMRA). As a result, a court's sole function was "confined to ascertaining whether the party seeking arbitration [was] making a claim which on its face [was] governed by the contract."<sup>7</sup> Because the contract at issue provided for arbitration of all claims "arising between the parties as to the meaning, interpretation and application of the provisions of [the] agreement, the Court rejected the company's argument that the employee's claims were frivolous and therefore not arbitrable.<sup>8</sup> According to the Court:

The collective agreement requires arbitration of claims that courts might be unwilling to entertain. In the context of the plant or industry, the grievance may assume proportions of which judges are ignorant. Yet, the agreement is to submit all grievances to arbitration, not merely those that a court may deem to be meritorious . . . .

The courts, therefore, have no business weighing the merits of the grievance, considering whether there is equity in a particular claim, or determining whether there is particular language in the written instrument that will support the claim.<sup>9</sup>

While this opinion seems to depart substantially from Wilko, and indeed it is the beginning of the erosion of the holding in Wilko, the Court seemed to justify its

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<sup>6</sup> Id. at 435-436 (footnotes omitted).

<sup>7</sup> United Steelworkers v. Am. Mfg. Co., 363 U.S. 564, 568 (1960).

<sup>8</sup> Id. at 565 n.1.

<sup>9</sup> Id. at 567-68 (footnotes omitted).

departure from Wilko based in part on the language of the LMRA. At that time, the LMRA provided that “final adjustment by a method agreed upon by the parties is hereby declared to be the desirable method for settlement of grievance disputes arising over the application or interpretation of an existing collective bargaining agreement.”<sup>10</sup> Thus, the statute at issue in this case contained language lending itself to the enforceability of arbitration agreements whereas, at least in the Court’s Wilko opinion, the Securities Act did not.

b. United Steelworkers v. Warrior & Gulf Navigation Co.

In this second case of the Steelworkers Trilogy, the Court once again enforced an arbitration clause in a collective bargaining agreement. This time, the Court specifically distinguished Wilko as “irrelevant” to the case at bar.<sup>11</sup> The Court noted the LMRA provided for enforcement of arbitration provisions in collective bargaining agreements:<sup>12</sup>

In the commercial case, arbitration is the substitute for litigation. Here, [in the labor relations context], arbitration is the substitute for industrial strife. Since arbitration of labor disputes has quite different functions from arbitration under an ordinary commercial agreement, the hostility evinced by courts toward arbitration of commercial agreements has no place here. For arbitration of labor disputes under collective bargaining agreements is part and parcel of the collective bargaining process itself.<sup>13</sup>

The Court apparently believed arbitration was more appropriate in the labor

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<sup>10</sup> Id. at 566.

<sup>11</sup> United Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574, 578 (1960).

<sup>12</sup> Id. at 577-78.

<sup>13</sup> Id. at 578.

relation's context than in the commercial realm.

The clause at issue in the collective bargaining agreement purportedly exempted from arbitration “matters which are strictly a function of management.”<sup>14</sup> The district and appellate courts held the activity at issue--the contracting out of work by the employer--qualified as a function of management. The employer's actions were therefore exempt from the mandatory arbitration provisions.<sup>15</sup>

The Supreme Court disagreed, holding activities qualifying as “strictly a function of a management,” must be those activities specifically defined in the collective bargaining agreement to grant management “complete control and unfettered discretion.”<sup>16</sup> Because the collective bargaining agreement did not grant management complete control and discretion over the contracting out of work, the Court held the dispute was arbitrable.<sup>17</sup> In so holding, the Court noted judicial inquiry under the LMRA “must be strictly confined to the question whether the reluctant party did agree to arbitrate the grievance or did agree to give the arbitrator power to make the award he made.”<sup>18</sup> A court should not review the merits of a dispute and “doubts should be resolved in favor of [arbitration].”<sup>19</sup>

c. United Steelworkers v. Enterprise Wheel & Car Corp.

The third case in the Steelworkers Trilogy dealt with enforcement of an arbitrator's award. The lower court had reversed the arbitrator's award, finding the award failed to meet requirements under the collective bargaining agreement, and further finding the collective bargaining agreement had expired, and the award was therefore

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<sup>14</sup> Id. at 576.

<sup>15</sup> Id. at 577.

<sup>16</sup> Id. at 584.

<sup>17</sup> Warrior, 363 U.S. at 585.

<sup>18</sup> Id. at 582.

<sup>19</sup> Id. at 582-83.

unenforceable. The Supreme Court rejected this reasoning because “the federal policy of settling labor disputes by arbitration would be undermined if courts had the final say on the merits of the awards.”<sup>20</sup> While recognizing that an arbitrator’s authority “is confined to interpretation and application of the collective bargaining agreement,” the Court nevertheless recognized that courts must defer to the decision of an arbitrator who does not exceed that authority.<sup>21</sup>

Establishing a rule that is still in force today, the Court held a labor/management agreement award is legitimate (i.e., not subject to judicial review) as long as “it draws its essence from the collective bargaining agreement.”<sup>22</sup> Thus, while the Court in this case found the arbitrator’s opinion and award ambiguous “ambiguity in the opinion accompanying the award, which permits the inference that the arbitrator may have exceeded his authority, is not reason for refusing to enforce the award.”<sup>23</sup> The Court concluded its opinion with this strong statement: “So far as the arbitrator’s decision concerns construction of the contract, the courts have no business overruling him because their interpretation of the contract is different from his.”<sup>24</sup>

With the conclusion of *Steelworkers Trilogy*, the enforceability of contracts to arbitrate and arbitration awards became firmly established in the area of labor relations.

### **7.2.3 Narrowing Wilko--1974**

#### a. Scherk v. Alberto Culver Co.

After the *Steelworkers Trilogy*, arbitration in labor relations gained a stronger

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<sup>20</sup> United Steelworkers v. Enter. Wheel & Car Corp., 363 U.S. 593, 595-96 (1960).

<sup>21</sup> Id.

<sup>22</sup> Id. at 597.

<sup>23</sup> Id. at 598 (emphasis added).

foothold. However, arbitration of commercial disputes, in particular disputes involving claims under the Securities Act, were still subject to the limitations of Wilko. The next major swipe at Wilko came with the Scherk decision in 1974.

In Scherk, a U.S. citizen purchased three enterprises from a German citizen.<sup>25</sup> The German citizen guaranteed in the sales contract that the trademarks associated with the three enterprises were unencumbered.<sup>26</sup> When the U.S. citizen later discovered the trademarks were encumbered, he sued in U.S. federal court.<sup>27</sup> The German citizen, on the other hand, sought to compel arbitration based on the arbitration clause in the contract.<sup>28</sup> Had the plaintiff alleged only breach of contract claims, this case might have gone straight to arbitration. However, the plaintiff (probably with the intent to avoid arbitration) alleged claims under the Securities Act.<sup>29</sup> He claimed the false statements in the sales contract were fraudulent representations violating section 10(b) of the Securities Exchange Act. Thus, the district court and the court of appeals relied on Wilko to hold the arbitration clause unenforceable.<sup>30</sup> The Supreme Court reversed.

First, the Supreme Court noted that Wilko dealt with claims under section 12(2) of the Securities Act of 1933, while this suit alleged claims under the Securities Exchange Act of 1934.<sup>31</sup> The Court noted the remedies provided by the different statutory provisions were not the same.<sup>32</sup> Moreover, the choice of forum under the 1934 Act was not as broad as what was allowed under the Securities Act of 1933.<sup>33</sup> The Court, however, did not base its decision on this distinction and instead accepted

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<sup>24</sup> Id. at 599.

<sup>25</sup> Scherk, 417 U.S. at 508 (1974).

<sup>26</sup> Id.

<sup>27</sup> Id. at 509.

<sup>28</sup> Id.

<sup>29</sup> Id. at 509-10.

<sup>30</sup> Id.

<sup>31</sup> Scherk, 417 U.S. at 510.

<sup>32</sup> Id. at 513-14.

the premise “that the operative portions of the language of the 1933 Act relied upon in Wilko are contained in the Securities Exchange Act of 1934.”<sup>34</sup>

Instead, the Court based its decision on the “significant and, we find, crucial differences between the agreement involved in Wilko and the one signed by the parties here.”<sup>35</sup> The Court emphasized that the agreement in question in this case was “a truly international agreement.”<sup>36</sup> According to the Court:

Such a contract involves considerations and policies significantly different from those found controlling Wilko. In Wilko, quite apart from the arbitration provision, there was no question but that the laws of the United States generally, and the federal securities laws in particular, would govern disputes arising out of the stock purchase agreement . . . . [No] credible claim could have been entertained that any international conflict of laws problems would arise. In this case, by contrast, in the absence of the arbitration provision, considerable uncertainty existed at the time of the agreement, and still exists, concerning the law applicable to the resolution of disputes arising out of the contract.<sup>37</sup>

The Court seemed to indicate that in international commercial cases it is permissible to “substitute” arbitration for litigation.<sup>38</sup>

The Court distinguished Wilko, notwithstanding the fact that “the laws of the state of

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<sup>33</sup> Id. at 514.

<sup>34</sup> Id. at 515.

<sup>35</sup> Id.

<sup>36</sup> Id.

<sup>37</sup> Scherk, 417 U.S. at 515-16.

<sup>38</sup> Warrior, 363 U.S. at 578 (“In the commercial case, arbitration is the substitute for litigation”).

Illinois were explicitly made applicable by the arbitration agreement.”<sup>39</sup> Instead, the Court called the agreement to arbitrate a forum selection clause (i.e., the parties chose arbitration before the International Chamber of Commerce instead of opting into the United States litigation system), whereas the choice of law provision designating Illinois law designated the procedure to be used in resolving the dispute.<sup>40</sup>

b. Prima Paint Corp. v. Flood & Conklin Manufacturing Company

Prima Paint involved another commercial arbitration clause. Two corporations, citizens of different states, entered a consulting agreement that contained an arbitration clause. A year later, one of the parties brought suit in federal court alleging the other party had induced it to “accelerate the execution and closing date of the consulting agreement.”<sup>41</sup> The defendant brought a motion to stay the action, pending arbitration. The plaintiff brought a motion to enjoin arbitration. The district court and the court of appeals held the arbitrator, not the court, should determine whether there had been fraud in the inducement of the contract. The Supreme Court affirmed.

The Court justified its decision based on its belief that the consulting agreement “was inextricably tied to [the] interstate transfer and to the continuing operations of an interstate manufacturing and wholesaling business.”<sup>42</sup> Thus, the Federal Arbitration Act applied.<sup>43</sup> Next the Court noted there was no allegation by the plaintiff that it had been fraudulently induced to enter into the arbitration clause.<sup>44</sup> Instead, the

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<sup>39</sup> Scherk, 417 U.S. at 519 n.13.

<sup>40</sup> Id. at 519.

<sup>41</sup> Prima Paint Corp. v. Flood & Conklin Mfg. Company, 388 U.S. 395, 398-99 n.2 (1967).

<sup>42</sup> Id. at 401.

<sup>43</sup> Id.

<sup>44</sup> Id. at 406.

allegations surrounded the execution and closing of the contract as a whole.<sup>45</sup>

The Court held “the statutory language [of the Federal Arbitration Act] does not permit the federal court to consider claims of fraud in the inducement of the contract generally.”<sup>46</sup> Only if the claim were fraudulent in the inducement of the arbitration clause may a federal court proceed to adjudicate it.<sup>47</sup> Thus, the Court held the avoidance of arbitration would not be justified based on an allegation of fraud in the inducement of a contract simply because it contained an arbitration clause.<sup>48</sup>

#### **7.2.4 The “Second Trilogy”<sup>49</sup> 1983-1985**

After *Scherk* and *Prima Paint*, arbitration of commercial disputes gained a firmer foothold in practice and in the federal common law. Nevertheless, *Wilko* was not overruled. The Court continued to chip away at *Wilko* throughout the 1980’s with a Second Trilogy of significant arbitration holdings.

a. Moses H. Cone v. Mercury Constr. Corp.

The Moses H. Cone case in 1983 involved a dispute between a North Carolina Hospital and the Alabama contractor it hired to construct additions to the hospital building.<sup>50</sup> The contract between the hospital and the contractor appointed the architect to resolve disputes.<sup>51</sup> In the absence of a resolution by the architect within

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<sup>45</sup> Id. at 398-99 n.2.

<sup>46</sup> Id.

<sup>47</sup> Prima Paint, 388 U.S. at 403-04.

<sup>48</sup> Id. at 406.

<sup>49</sup> Hirshman, supra note 49, at 1353 (discussing three significant arbitration decisions of the United States Supreme Court between 1983 and 1985 and referring to them as the “Second Arbitration Trilogy”).

<sup>50</sup> Moses H. Cone Mem’l Hosp. v. Mercury Construction Corp., 460 U.S. 1, 4 (1983).

<sup>51</sup> Id.

a specified period of time, the parties were required to submit disputes to binding arbitration under an arbitration clause in the contract.<sup>52</sup> At one point in the parties' relationship, the hospital refused to pay certain fees claimed by the contractor.<sup>53</sup>

Simultaneously, the hospital brought a declaratory judgment action in state court alleging the contractor had no right to arbitration.<sup>54</sup> The hospital also sought a stay of arbitration.<sup>55</sup> The contractor immediately demanded arbitration and brought a suit in federal court seeking an order compelling arbitration.<sup>56</sup> But the federal district court granted the hospital's motion to stay the federal court action, pending resolution of the state court's declaratory judgment action. The contractor appealed the federal court's order.<sup>57</sup> The Circuit Court of Appeals reversed and issued an order compelling arbitration. The Supreme Court agreed with the Circuit Court, finding that both the state court and the federal court were required to apply the federal substantive law of arbitration since the parties' agreement fell within the scope of the Arbitration Act.<sup>58</sup>

The Supreme Court also agreed that the state court suit and the federal court suit did not necessarily overlap simply because they both dealt with the arbitrability of the dispute.

The state court suit involved the question of whether a stay should be issued under §3 of the Federal Arbitration Act. The federal court suit, on the other hand, involved the question of whether an order to compel arbitration should be issued under §4 of the Federal Arbitration Act. The Court noted:

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<sup>52</sup> *Id.* at 5.

<sup>53</sup> *Id.* at 6.

<sup>54</sup> *Id.* at 7.

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

<sup>56</sup> *Moses H. Cone*, 460 U.S. at 7.

<sup>57</sup> *Id.* at 8.

<sup>58</sup> *Id.* at 24.

But in a case such as this, where the party opposing arbitration is the one from whom payment or performance is sought, a stay of litigation alone is not enough. It leaves the recalcitrant party free to sit and do nothing--neither to litigate nor to arbitrate. If the state court stayed litigation pending arbitration but declined to compel the hospital to arbitrate, [the contractor] would have no sure way to proceed with its claims except to return to federal court to obtain [an order compelling arbitration]-a pointless and wasteful burden on the supposedly summary and speedy procedures prescribed by the Arbitration Act.<sup>59</sup>

Thus, even had the state court made a determination that a stay was appropriate, in this case, a stay would not have been adequate to protect the right to arbitration.<sup>60</sup>

b. Southland Corp. v. Keating

In the second case in the Second Trilogy, the Supreme Court re-emphasized the fact that the Federal Arbitration Act is binding substantive federal law that preempts state law where there is a conflict. Southland Corp. v. Keating, involved a consolidated action by 7-11 store franchisees in California against the owner and franchisor of the 7-11 stores.<sup>61</sup> The franchisees alleged various contract claims and also violations of the disclosure requirements of the California Franchise Investment Law.<sup>62</sup>

Southland, the franchisor, sought to compel arbitration under the arbitration clauses in the contracts with its franchisees.

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<sup>59</sup> Id. at 27.

<sup>60</sup> Id.

<sup>61</sup> Southland Corp. v. Keating, 465 U.S. 1 (1984).

<sup>62</sup> Id. at 4.

The case worked its way up through the California state court system. Eventually, the California Supreme Court ruled the franchisees' claims under the California Franchise Investment Law were not subject to arbitration under the Federal Arbitration Act, but the contract claims were.<sup>63</sup> The Supreme Court reversed in part, holding that even the claims under the California Franchise Investment Law were subject to arbitration.

The significance of *Southland Corp.* is that it established the supremacy of federal law over arbitration contracts. According to the Court, there are “only two limitations on the enforceability of arbitration provisions governed by the [FAA].”<sup>64</sup> First, the arbitration provision “must be part of a written maritime contract or a contract ‘evidencing a transaction involving commerce.’”<sup>65</sup> Second, “such clauses may be revoked upon ‘grounds as exist at law or in equity for the revocation of any contract.’”<sup>66</sup> The Court pointed out the FAA contained no provision indicating the FAA’s “broad principle of enforceability is subject to additional limitations under State law.”<sup>67</sup>

This clear reading of the FAA together with the legislative history of the statute led the Court to declare California’s law preempted by the FAA.<sup>68</sup>

c. Dean Witter Reynolds, Inc. v. Byrd

In the third case of the “Second Trilogy,” the Supreme Court once again faced the Wilko issue of whether securities law claims would be governed by the Federal

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<sup>63</sup> Id. at 5.

<sup>64</sup> Id. at 10-11.

<sup>65</sup> Id. (quoting § 2 of the FAA).

<sup>66</sup> Id.

<sup>67</sup> Southland Corp., 465 U.S. at 11.

<sup>68</sup> Id. at 16.

Arbitration Act.<sup>69</sup> The plaintiff, an investor, sued his broker in federal court, alleging violations of both federal securities laws and New York state securities laws.<sup>70</sup> Once again, the contract between the investor and the broker contained an arbitration clause purporting to make arbitrable any dispute related to the contract.<sup>71</sup>

One of the reasons the Supreme Court granted certiorari in *Byrd* was to resolve a conflict among the federal circuits about how to handle pendant state securities law claims. Prior to this case, federal courts had used Wilko to justify their refusal to compel arbitration of pendant state court securities-related claims. The federal courts reasoned that this “Intertwining Doctrine” was necessary to avoid overlapping proceedings and collateral estoppel issues raised by arbitration awards.<sup>72</sup>

With respect to the legislative history, the Court noted: The problems Congress faced were therefore twofold: the old common law hostility toward arbitration, and the failure of state arbitration statutes to mandate enforcement of arbitration agreements. To confine the scope of the [FAA] to arbitrations sought to be enforced in federal courts would frustrate what we believe Congress intended to be a broad enactment appropriate in scope to meet the large problems Congress was addressing.

In *Byrd*, the broker brought a motion to compel arbitration of the investor’s state law claims, notwithstanding the Intertwining Doctrine. The district court and the court of appeals denied the broker’s motion.<sup>73</sup> The Supreme Court reversed.<sup>74</sup>

In terminating the Intertwining Doctrine, the Supreme Court determined that, while it may be more efficient to treat state and federal securities claims similarly, Congress’

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<sup>69</sup> See Dean Witter Reynolds v. Byrd, 470 U.S. 213 (1985).

<sup>70</sup> Id. at 214.

<sup>71</sup> Id. at 215.

<sup>72</sup> Id. at 216-17.

<sup>73</sup> Id. at 215-16.

<sup>74</sup> Id. at 217.

primary goal with the Federal Arbitration Act was to ensure the enforceability of contracts to arbitrate.<sup>75</sup> Moreover, the Intertwining Doctrine provided a means whereby parties could avoid arbitration of securities claims by simply tying state law claims to federal claims.<sup>76</sup> Therefore, the Court reasoned the Intertwining Doctrine must be eliminated. After Byrd, securities claims arising under state law may not be brought when they are arbitrable under an arbitration agreement. Notwithstanding the holding in Byrd, Wilko, although weakened, still governed the arbitrability of federal securities laws claims.

### 7.2.5 Wilko Finally Falls

While the Court did not overrule Wilko in Byrd, the writing was on the wall. The Court obviously no longer believed that arbitrators were unable to understand complicated legal claims like securities claims. Nevertheless, Wilko was standing in the way of the expansion of arbitration. It had to go.

The “doctrine of intertwining” was the approach used by several circuits to deny arbitration of the arbitrable claims and try all the claims together in federal court. The doctrine was used “when arbitrable and nonarbitrable claims [arose] out of the same transaction and [were] sufficiently intertwined factually and legally.”

#### a. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.

The issue in Mitsubishi Motors was whether claims arising under U.S. antitrust laws and “encompassed within a valid arbitration clause in an agreement embodying an international commercial transaction” were arbitrable under the FAA and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (“the

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<sup>75</sup> Byrd, 470 U.S. at 219.

<sup>76</sup> Id. at 219-20.

Convention”).<sup>77</sup>

The dispute arose between a Japanese car manufacturer and one of its dealers in Puerto Rico. The sales agreement provided for the arbitration of “all disputes, controversies or differences which may arise . . . out of or in relation to . . . the Agreement or for the breach thereof.”<sup>78</sup> As a result, the Japanese manufacturer brought an action to compel arbitration. The dealer counterclaimed under the U.S. antitrust laws. Prior to this case, courts had followed the Second Circuit’s opinion that, in accordance with Wilko, claims under U.S. antitrust laws were “of a character inappropriate for enforcement by arbitration.”<sup>79</sup> Nevertheless, the district court ordered arbitration based on its belief that Scherk required arbitration because of the international character of the dispute.<sup>80</sup> The First Circuit Court of appeals reversed, in part, holding the antitrust claims were not subject to arbitration.<sup>81</sup>

The Supreme Court decided all of the claims--even the antitrust claims--were arbitrable. In so ruling, the Court emphasized there is nothing in the FAA implying a “presumption against arbitration of statutory claims.”<sup>82</sup> Instead, “as with any other contract, the parties’ intentions control, but those intentions are generously construed as to issues of arbitrability.”<sup>83</sup> When a court finds the parties intended to arbitrate a statutory claim, a court should examine the applicable statute to determine whether Congress intended to prohibit arbitration. The Court noted:

We must assume that if Congress intended the substantive protection afforded by a given statute to include protection against waiver of the

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<sup>77</sup> Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 616 (1985).

<sup>78</sup> Id. at 617.

<sup>79</sup> See American Safety Equip. Corp. v. J.P. McGuire & Co., 391 F.2d 821 (2nd Cir. 1968).

<sup>80</sup> Id.

<sup>81</sup> Id. at 623.

<sup>82</sup> Id. at 625.

<sup>83</sup> Id. at 626.

right to a judicial forum, that intention will be deducible from text or legislative history. Having made the bargain to arbitrate, the party should be held to it unless Congress itself has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue. Nothing, in the meantime, prevents a party from excluding statutory claims from the scope of an agreement to arbitrate.<sup>84</sup>

The implication is that broad arbitration agreements will, after Mitsubishi Motors, be deemed to include statutory claims unless those agreements expressly exclude statutory claims from their scope, or unless Congress has expressly prohibited arbitration of those claims in the relevant statute or legislative history. Nevertheless, the Court in this case justified its decision to compel arbitration based on the holding in Scherk. That is, the international nature of the dispute compelled enforcement of the arbitration agreement as a forum selection clause.<sup>85</sup> Once again, Wilko was not overruled.

b. Shearson/American Express, Inc. v. McMahon

The holding in Wilko took another hit with the release of the Supreme Court's opinion in Shearson/American Express v. McMahon.<sup>86</sup> Once again, securities brokers sought to compel arbitration of customers' claims made under the Securities Exchange Act (SEA).<sup>87</sup> The brokers also sought to arbitrate claims filed by the

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<sup>84</sup> Id. at 628. Interestingly, the Court cited Wilko to support its conclusions, although the Court acknowledged the outdated hostility towards arbitration expressed in Wilko at 626-27 ("we are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution").

<sup>85</sup> Mitsubishi Motors, 473 U.S. at 630: [W]e conclude that concerns of international comity, respect for the capacities of foreign and transnational tribunals, and sensitivity to the need of the international commercial system for predictability in the resolution of disputes require that we enforce the parties' agreement, even assuming that a contrary result would be forthcoming in a domestic context.

<sup>86</sup> Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987).

<sup>87</sup> Id. at 223.

customers under the Racketeer Influenced and Corrupt Organizations Act (RICO).<sup>88</sup> In holding both the SEA and the RICO claims arbitrable, the Court reinforced the use of its two-step analysis to determine the arbitrability of disputes.<sup>89</sup>

The first analysis performed by the Court was to determine whether the scope of the arbitration agreement was meant to include the statutory claims at issue.<sup>90</sup> Because the agreements provided for the arbitration of “any controversy arising out of or relating to” the accounts, transactions or the agreement itself, the claims fell within the scope of the agreement.<sup>91</sup>

The second, more difficult question was whether Congress intended to exempt claims under the SEA or RICO from the FAA. The task of finding the claims exempted was made more difficult by the Court’s holding in Wilko that the Securities Act prohibited arbitration because it voided agreements waiving obligations under that statute. The SEA contained a similar prohibition on “waiver.”<sup>92</sup>

The Court nevertheless held in McMahon that arbitration of claims under the SEA was permitted and not prohibited by Congress because the “waiver” only applied to obligations arising under the SEA, and not the jurisdiction of the federal courts.<sup>93</sup> As such, the parties were permitted to agree to adjudicate disputes over SEA obligations in an arbitration proceeding and were not required to use the federal courts to resolve

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<sup>88</sup> Id.

<sup>89</sup> Id.

<sup>90</sup> Id. at 226 (stating the “duty to enforce arbitration agreements is not diminished when a party bound by an agreement raises a claim founded on statutory rights”).

<sup>91</sup> Id. at 223.

<sup>92</sup> “Section 29(a) of the Exchange Act declares void ‘any condition, stipulation, or provision binding any person to waive compliance with any provision of the Act.’” McMahon, 482 U.S. at 227 (citing 15 U.S.C. § 78cc(a)).

<sup>93</sup> Id. at 228-29.

those disputes.<sup>94</sup>

But how did the Court get around the holding in Wilko that the analogous waiver provision in the Securities Act did prohibit arbitration? First, the Court noted the holding in Wilko:

can only be understood in the context of the Court’s ensuing discussion explaining why arbitration was inadequate as a means of enforcing ‘the provisions of the Securities Act, advantageous to the buyer.’ The conclusion in Wilko was expressly based on the Court’s belief that a judicial forum was needed to protect the substantive legal rights created by the Securities Act.<sup>95</sup>

At the time that Wilko was decided, “the plaintiff’s waiver of the ‘right to select the judicial forum’ was unenforceable only because arbitration was judged inadequate to enforce the statutory” obligations created under the Securities Act.<sup>96</sup> Specifically, the Court stated:

What the anti-waiver provision of § 29(a) forbids is enforcement of agreements to waive “compliance” with the provisions of the statute. But § 27 [the jurisdiction provision] itself does not impose any duty with which persons trading in securities must “comply.” By its terms, § 29(a) only prohibits waiver of the substantive obligations imposed by the Exchange Act. Because § 27 does not impose any statutory duties, its waiver does not constitute a waiver of “compliance with any provision” of the Exchange Act under § 29(a).

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<sup>94</sup> Id.

<sup>95</sup> Id. at 228 (citing Wilko, 346 U.S. at 435).

Next, with Wilko's "context" in mind, the Court launched into a discussion about how much the perception towards arbitration had changed since 1953. The Court acknowledged "it is difficult to reconcile Wilko's mistrust of the arbitral process with the Court's subsequent decisions involving the Arbitration Act."<sup>97</sup> First, courts generally recognized that arbitrators are competent to handle complex factual and legal issues without direction or instruction from the court.<sup>98</sup> Second, arbitration procedures had been "streamlined" to the extent that courts no longer fear that arbitration unfairly limits substantive rights of claimants.<sup>99</sup> Finally, judicial review of arbitration awards, while limited, was still sufficient to ensure that arbitrators comply with the law.<sup>100</sup> These were all reasons relied on in Wilko that the Court in McMahon believed were no longer relevant. In sum, "even if Wilko's assumptions regarding arbitration were valid at the time Wilko was decided, most certainly they do not hold true today for arbitration procedures subject to the SEC's oversight authority."<sup>101</sup>

While McMahon did not expressly overrule Wilko, the stage was now set for Wilko's demise.

c. Rodriguez de Quijas v. Shearson/American Express, Inc.

Just two years after McMahon, the question inevitably arose whether agreements to arbitrate claims under the Securities Act would now be permitted. That is, would Wilko hold up against a direct challenge? The case of Rodriguez de Quijas involved claims by customers against their brokers under both the Securities Act and the

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<sup>96</sup> Id. at 228-29 (citing Wilko, 346 U.S. at 435).

<sup>97</sup> McMahon, 482 U.S. at 231-32.

<sup>98</sup> Id. at 229.

<sup>99</sup> Id.

<sup>100</sup> Id.

<sup>101</sup> Id. at 233.

Securities Exchange Act.<sup>102</sup> The Supreme Court granted certiorari after the Fifth Circuit decided all claims were arbitrable because decisions subsequent had reduced the Wilko holding to “obsolescence.”<sup>103</sup>

While the Supreme Court agreed Wilko should be overruled, it cautioned the courts of appeals to leave it to the Court to make that pronouncement.<sup>104</sup> “We do not suggest that the Court of Appeals on its own authority should have taken the step of renouncing Wilko. If a precedent of this Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, the Court of Appeals should follow the case which directly controls, leaving to this Court the prerogative of overruling its own decisions.” After this brief lecture, the Court, in the next sentence states: “We now conclude that Wilko was incorrectly decided . . . .”<sup>105</sup>

The Court agreed with the Fifth Circuit that Wilko was, indeed, obsolete. Finally, after almost forty years, the Court overruled Wilko and set the stage for the expanded use of arbitration. In overruling Wilko, the Court acknowledged it was “not obviously correct” in its interpretation that the Securities Act prohibited waiver of a judicial forum.<sup>106</sup> Relying on the reasoning in McMahon, the Court noted that Wilko’s reasoning may have been justified at one time, given the context in 1953. However, “[t]o the extent that Wilko rested on suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be complainants, it has fallen far out of step with our current strong endorsement of the federal statutes favoring this method of resolving disputes.”<sup>107</sup>

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<sup>102</sup> Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 478-79 (1989).

<sup>103</sup> Id. at 479 (citing Rodriguez de Quijas v. Shearson/Lehman Bros., Inc., 845 F.2d 1296, 1299 (5th Cir. 1988)).

<sup>104</sup> Id. at 484.

<sup>105</sup> Id.

<sup>106</sup> Id. at 480.

<sup>107</sup> Rodriguez de Quijas, 490 U.S. at 481.

In addition, “it also would be undesirable for the decisions in Wilko and McMahon to continue to exist side by side.”<sup>108</sup> To leave both decisions intact would create confusion and inconsistency in precedent. After all, the “waiver” provision construed in the SEA in McMahon is “in every respect the same as that in” the Securities Act.<sup>109</sup> Thus, the inconsistency between McMahon and Wilko “is at odds with the principle that the 1933 and 1934 Acts should be construed harmoniously.”<sup>110</sup>

### **7.2.6 The Third Trilogy - The 1990s – Continued Expansion of Arbitration**

Wilko was the mountain preventing expansion of the arbitration expressway. Overruling Wilko left the road wide open for the further development of arbitration to resolve disputes. As a result, a trilogy of cases in the 1990’s (the Third Trilogy) continued to recognize and enforce a strong “federal policy favoring arbitration.”<sup>111</sup>

#### **a. Gilmer v. Interstate/Johnson Lane Corp.**

Beginning with Gilmer v. Interstate/Johnson Lane Corp., the Court began to clarify some of the unanswered questions left by its previously inconsistent arbitration policy.<sup>112</sup> The arbitration clause in Gilmer was contained in a securities broker’s application for registration with the New York Stock Exchange.<sup>113</sup> When, at the age of 62, the broker was fired, he filed claim with the EEOC, and then filed suit-

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<sup>108</sup> Id. at 484.

<sup>109</sup> Id. at 482.

<sup>110</sup> Id. at 484.

<sup>111</sup> McMahon, 482 U.S. at 226.

<sup>112</sup> Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991).

<sup>113</sup> Id. at 23. The application contained a clause whereby the broker “agreed to arbitrate any dispute, claim or controversy’ arising between him and [his employer] ‘that is required to be arbitrated under the rules, constitutions or by-laws of the organizations with which I register.”

claiming violations of the Age Discrimination in Employment Act (ADEA).<sup>114</sup> The employer argued the ADEA claim was subject to arbitration, and the Supreme Court agreed.

While it was clear that the scope of the arbitration clause was broad enough to encompass the ADEA claim, and there was nothing in the text or legislative history to indicate Congress had intended to exempt ADEA claims from arbitration, the broker argued there was an inherent conflict between arbitration the purpose of the ADEA which prohibited making those claims subject to compulsory arbitration.<sup>115</sup> The Court, however, disagreed with this argument.

First, EEOC's administration of the ADEA would not be hindered, in the Court's opinion, by the enforcement of agreements to arbitrate ADEA claims.<sup>116</sup> The employee was not prevented from filing a charge with the EEOC, and the EEOC could still investigate on its own, even in the absence of a claim by the employee.<sup>117</sup> Moreover, "nothing in the ADEA indicates that Congress intended that the EEOC be involved in all employment disputes."<sup>118</sup>

Second, the ADEA does not guarantee a judicial forum, and the procedures available in an arbitration forum are sufficient to provide relief.<sup>119</sup> For example, the extent of discovery allowed in an arbitration setting provides an adequate means for the plaintiff to develop his case.<sup>120</sup> There is no evidence that an ADEA claim is more complicated than other types of claims making arbitration inadequate. In addition,

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<sup>114</sup> *Id.*

<sup>115</sup> *Id.* at 26-27. Gilmer conceded that nothing in the text of the ADEA or its legislative history explicitly precluded arbitration.

<sup>116</sup> *Id.* at 28.

<sup>117</sup> *Id.* at 28-29.

<sup>118</sup> *Gilmer*, 500 U.S. at 28.

<sup>119</sup> *Id.* "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." (quoting *Mitsubishi Motors*, 473 U.S. at 614).

the Court noted that arbitrators have the power to grant equitable relief and are required to issue written opinions. Thus, the types of relief and review contemplated in the ADEA are still available in an arbitration forum.<sup>121</sup> Finally, the Court rejected that notion that arbitrators would be biased and noted that the NYSE's arbitration rules provided protections in the unusual circumstance where a plaintiff believed bias to be an issue.<sup>122</sup>

The Gilmer Court reviewed the major complaints and concerns that had been voiced by those opposed to arbitration, and that had been raised in the lower courts. Of all the U.S. Supreme Court arbitration cases, Gilmer is perhaps the seminal case heralding a new era for arbitration. The Court's decision in Gilmer closed almost all of the loopholes that had been used to avoid enforcement of arbitration agreements and made clear that arbitration agreements between businesses and individuals are readily enforceable. The Court's next opinion closed another loophole with its broad construction of the language of the FAA and further expanded the horizons for arbitration agreements.

b. Allied-Bruce Terminix Cos., Inc. v. Dobson

Since the Court's decision in Southland Corp. v. Keating, state arbitration laws in conflict with the FAA were meant to be preempted by the federal law.<sup>123</sup> Yet, in the eleven years since that decision, several state courts navigated around Southland Corp.<sup>124</sup> by construing the language of the FAA narrowly, avoiding conflict and thereby avoiding preemption of the state law.<sup>125</sup> Under that narrow construction of

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<sup>120</sup> Id. at 31.

<sup>121</sup> Id. at 31-32.

<sup>122</sup> Id. at 30.

<sup>123</sup> Southland Corp. v. Keating, 465 U.S. 1 (1984).

<sup>124</sup> The Dobsons, with the support of 20 attorneys general requested in this case that the Court overrule Southland Corp. The Court refused. Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. at 272.

<sup>125</sup> Id. at 269.

the FAA, the parties to the contract must have contemplated a connection between their contract and interstate commerce.<sup>126</sup> But under a broader reading of the FAA, a contract is arbitrable if it involves interstate commerce in fact. The parties’ “contemplations,” under the broader construction, are irrelevant.<sup>127</sup>

In light of the FAA’s stated purpose to end the hostility towards arbitration agreements and to put them on the same footing with other contracts, the Court held the broader construction of the statute was the correct construction.<sup>128</sup> Before making its determination, the Court closely examined the language of the FAA, which governs “a contract evidencing a transaction involving commerce.”<sup>129</sup> First, the Court construed the words “involving commerce” to mean “affecting commerce.”<sup>130</sup> This was evidence, in the Court’s eyes, that Congress intended to exercise expansive powers over arbitration contracts.<sup>131</sup> Next, the Court construed the language “evidencing a transaction” such that a contract involving interstate commerce in fact was sufficient to “evidence a transaction” governed by the FAA.<sup>132</sup>

With evidence of congressional intent to extend federal power over contracts affecting interstate commerce, the Court had no trouble finding the FAA governed this contract between a nationwide termite company and Alabama homeowners.<sup>133</sup> Moreover, because the FAA conflicted with the Alabama statute that would have invalidated the arbitration clause, the FAA preempted the Alabama law.<sup>134</sup> The U.S. Supreme had now resolved any further doubts about the ultimate reach of the FAA in governing arbitration agreements and signaled a further advancement in the use of

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<sup>126</sup> Id. at 278.

<sup>127</sup> Id.

<sup>128</sup> Id. at 271-73.

<sup>129</sup> Id. at 273.

<sup>130</sup> Dobson, 513 U.S. at 273.

<sup>131</sup> Id. at 273-75.

<sup>132</sup> Id. at 277-78. “[W]e conclude that the first interpretation (“commerce in fact”) is more faithful to the statute than the second (“contemplation of the parties”).”

<sup>133</sup> Id. at 281-82.

arbitration agreements between businesses and consumers.

c. Doctor's Associates, Inc. v. Casarotto

Any doubt that remained about the Court's resolve to support the holding in Southland Corp. was extinguished with the 1996 decision in Doctor's Associates v. Casarotto.<sup>135</sup> The Court remanded Casarotto for reconsideration after issuing its opinion in Dobson.<sup>136</sup> Nevertheless, the Montana Supreme Court affirmed its previous decision that the FAA did not preempt a Montana statute, which required a specific type of notice on arbitration contracts.<sup>137</sup>

Once again, the Court disagreed with the state court. The argument in this case was not over the tenuousness of the interstate commerce connection (as in Dobson), but rather concerned the fact that Montana's statute singled out arbitration contracts from other contracts.<sup>138</sup> Under the FAA, arbitration contracts must be placed on the same footing as all other contracts.<sup>139</sup> Thus, Montana's statute conflicted with the FAA and was preempted. Another loophole was successfully closed.

### **7.2.7 The End of The Century – Arbitration Becomes Widely Accepted**

The opinions during the past decade, as indicated by the Third Trilogy, strengthened the enforceability of arbitration contracts under the FAA. These cases made clear that arbitration is an acceptable, and perhaps preferable, way for parties to choose to

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<sup>134</sup> Id. at 269-70.

<sup>135</sup> Doctor's Associates v. Casarotto, 517 U.S. 681 (1996).

<sup>136</sup> Doctor's Associates v. Casarotto, 515 U.S. 1129 (1995).

<sup>137</sup> Casarotto, 517 U.S. at 684. The statute stated, "[n]otice that a contract is subject to arbitration . . . shall be typed in underlined capital letters on the first page of the contract; and unless such notice is displayed thereon, the contract may not be subject to arbitration."

<sup>138</sup> Id. at 687 (holding the special notice requirement is generally not applicable to contracts).

have their disputes resolved. The Supreme Court upheld arbitration agreements between businesses and customers, employers and employees, and corporations and individuals. The war over the availability and use of arbitration was over, and arbitration prevailed with the real winners being the parties who select arbitration instead of litigation to resolve their disputes.

Arbitration contracts of all types of agreements and involving all types of parties are being readily enforced with the reliability of other contracts. As a result, arbitration clauses in all types of contracts are becoming more and more common, but, not without challenges. The attacks have changed in their focus. The attacks can no longer claim arbitration is disfavored, a bad idea, or un-American. Federal and state courts have followed the precedent and lead of the U.S. Supreme Court and recognized that arbitration can be used by parties to replace lawsuits. The attacks now focus on the procedural details of the available arbitration process to ensure its fairness to all parties. A number of cases in the early 2000's present examples of the ways businesses are using arbitration contracts, and the Supreme Court's view on whether those uses are legitimate.

#### A. The New Millennium - Arbitration For All

##### 1. Green Tree Financial Corp. v. Randolph

Green Tree Financial Corp. v. Randolph involved consumer claims under the Truth in Lending Act (TILA) and the Equal Credit Opportunity Act (ECOA).<sup>140</sup> Previous cases had also dealt with individuals who were not sophisticated users of litigation or arbitration. The consumer party in this case agreed to an adhesion contract drafted

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<sup>139</sup> Id. “By enacting § 2, we have several times said, Congress precluded States from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed ‘upon the same footing as other contracts.’”

<sup>140</sup> Green Tree Financial Corp. v. Randolph, 531 U.S. 79 (2000).

by a large financial company. The arbitration agreement challenged by the consumer was contained in her mobile home financing agreement.<sup>141</sup> The consumer alleged that agreement was, in itself, a violation of her rights under the ECOA because she could not afford to pursue arbitration and therefore was prohibited from pursuing her statutory rights under the TILA.<sup>142</sup> Randolph claimed TILA violations relating to excessive finance charges.<sup>143</sup>

The first issue the Court had to face was whether the district court's order compelling arbitration was a final order and therefore immediately appealable.<sup>144</sup> Section 16 of the FAA contained two provisions that may have governed this issue. On the one hand, no appeal could be taken from an interlocutory order compelling arbitration.<sup>145</sup> On the other hand, an appeal could be taken from "a final decision with respect to an arbitration that is subject to [the FAA]."<sup>146</sup> The Court reasoned that the decision "end [ed] the litigation on the merits and [left] nothing more the court to do but execute the judgment."<sup>147</sup> Thus, the Court agreed with the Eleventh Circuit that the order compelling arbitration and dismissing all claims with prejudice was a final decision and was therefore immediately appealable.<sup>148</sup>

The second issue considered by the Court was whether the lack of reference to arbitration costs in the arbitration agreement precluded enforcement of the agreement.<sup>149</sup> Randolph argued the risk of prohibitive arbitration costs would force her to forgo her claims against Green Tree and therefore preclude her from

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<sup>141</sup> Id. at 83. The agreement provided "that all disputes arising from, or relating to, the contracts, whether arising under case law or statutory law, would be resolved by binding arbitration."

<sup>142</sup> Id.

<sup>143</sup> Id. Randolph "brought the action on behalf of a similarly situated class." The trial court denied Randolph's motion to certify a class.

<sup>144</sup> Randolph, 531 U.S. at 81-82.

<sup>145</sup> Id. at 83 (citing 9 U.S.C. § 16(b)(3)).

<sup>146</sup> Id.

<sup>147</sup> Id.

<sup>148</sup> Randolph, 531 U.S. at 83.

<sup>149</sup> Id. at 84.

“vindicating her federal statutory rights in the arbitral forum.”<sup>150</sup> The Court agreed this was a danger.<sup>151</sup> However, Randolph failed to produce sufficient evidence of the costs she would actually incur in arbitrating her claims.<sup>152</sup> In fact, there was no evidence that she would have incurred any costs at all.<sup>153</sup> Based on this fact, the Court refused to invalidate the arbitration agreement. “The ‘risk’ that Randolph will be saddled with prohibitive costs is too speculative to justify the invalidation of an arbitration agreement.”<sup>154</sup>

Whether or not an arbitration process is so prohibitively expensive, as a legal and practical matter, may only be readily proven after arbitration, and not before. The arbitration agreement itself may require the business to pay all or most of the arbitration fees. Or the rules of the arbitration administrator may require the business to pay most of the costs or allow an indigent consumer a waiver of fees. Justice Ginsburg, even in dissent, noted that models of fair fee allocation exist.

All of the Justices in the Green Tree Court held that arbitration is a legitimate, acceptable method for businesses and consumers to resolve their differences. The importance of the Green Tree decision extends far beyond what the Court directly held. Critics of arbitration attacked it as being unfair to parties to adhesion contracts, to consumers who have to do business with corporations, and to individuals who have a right to a civil jury trial lawsuit, and these challenges were advanced in Green Tree. The Supreme Court’s decision in Green Tree rejects these attacks and challenges and recognizes that arbitration is readily enforceable if it is fair, affordable, and accessible.

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<sup>150</sup> Id.

<sup>151</sup> Id.

<sup>152</sup> The Court re-emphasized the burden is on the party resisting arbitration to prove why arbitration is not appropriate. Randolph produced no information to provide a “sufficient basis for concluding that [she] would in fact have incurred substantial costs in the event her claim went to arbitration.” Id. at 85 n.6.

<sup>153</sup> Id.

<sup>154</sup> Randolph, 531 U.S. at 85.

## 2. Circuit City Stores, Inc. v. Adams

After Randolph, the Court granted certiorari on Circuit City Stores, Inc. v. Adams to determine the scope of the FAA as it applies to contracts for employment.<sup>155</sup> Specifically, section 1 of the FAA exempts “contracts of employment of seamen, railroad employees, or other class of workers engaged in foreign or interstate commerce.”<sup>156</sup> Nine of the federal circuit courts of appeal construed this clause to exempt only employment contracts of transportation workers; the Ninth Circuit alone held the provision exempted all contracts of employment from arbitration under the Federal Arbitration Act. The Supreme Court agreed with all the other circuits and disagreed with the Ninth, and narrowly construed the exemption in section 1 such that only transportation workers’ contracts are exempt.<sup>157</sup>

The Court gave two primary reasons for its decision. First, the Court addressed Adams’ argument that, under section 2 of the FAA, an employment contract was not a “contract evidencing a transaction involving interstate commerce.”<sup>158</sup> According to Adams, the word transaction extended the FAA only to commercial contracts, and therefore, the FAA did not apply to employment contracts.<sup>159</sup> The Court easily rejected this argument, noting “if all contracts are beyond the scope of the [FAA] under the section 2 coverage provision, the separate exemption for ‘contracts of employment of seamen, railroad employees, or any other class of workers engaged in . . . interstate commerce’ would be pointless.”<sup>160</sup>

Next, Adams compared the language “engaged in commerce” to the language

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<sup>155</sup> Circuit City Stores, Inc. v. Adams, 121 S.Ct. 1302 (2001).

<sup>156</sup> 9 U.S.C. § 1.

<sup>157</sup> Adams, 121 S.Ct. at 1306.

<sup>158</sup> Id. at 1308.

<sup>159</sup> Id.

<sup>160</sup> Id.

“involving commerce” to argue that Congress intended to exempt all employment contracts “affecting commerce.”<sup>161</sup> The Court also rejected this argument, using the maxim ejusdem generis, to restrict the meaning of the employment contract exemption. According to the Court:

Unlike the “involving commerce” language in § 2, the words “any other class of workers engaged in . . . commerce” constitute a residual phrase, following, in the same sentence, explicit reference to “seamen” and “railroad employees.” Construing the residual phrase to exclude all employment contracts fails to give independent effect to the statute’s enumeration of the specific categories of workers which precedes it . . .<sup>162</sup>

According to the Court, Congress intended the exemption to include employment contracts of seamen, railroad workers, and other transportation workers who, like seamen and railroad workers, are also engaged in commerce.

The Court went on to state that, even without ejusdem generis, engaged in commerce does not, on its face, mean the same thing as affecting commerce or involved in commerce. Instead, “the specific phrase ‘engaged in commerce’ [is] understood to have a more limited reach.”<sup>163</sup> Therefore, even were the phrase not a residual phrase, qualified by the specific references to seamen and railroad workers, on its face, the phrase does not show congressional intent to exercise the full reach of its power to

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<sup>161</sup> *Id.* at 1308. Remember that, in *Dobson*, the Court construed “involving commerce” to mean “affecting commerce” and that meant Congress intended to exercise its commerce powers to their fullest extent. See *Dobson*, 513 U.S. at 273-75. Adams’ argument, therefore, was that Congress intended to exempt all employment contracts “affecting commerce” i.e., all employment contracts.

<sup>162</sup> Ejusdem Generis is “the statutory canon that ‘where general words follow specific words in a statutory enumeration, the general words are construed to embrace only objects similar in nature to those objects enumerated by the preceding specific words.’” *Adams*, 121 S. Ct. at 1308-09.

<sup>163</sup> *Id.* at 1309.

exempt employment contracts from the FAA.<sup>164</sup>

In Adams, the Court once again construed the FAA such that more contracts, rather than fewer, fell within its scope. Instead of exempting all employment contracts from the reach of the FAA, the Court's construction of that Act exempts only the employment contracts of transportation workers.

### 3. Equal Opportunity Commission v. Waffle House

The Supreme Court in Equal Opportunity Commission v. Waffle House examined whether the Equal Opportunity Commission could seek remedies against an employer where the employee signed an arbitration agreement with the employer.<sup>165</sup> The Court decided that the EEOC could seek injunctive, monetary, and other relief against the employer even though the employee had agreed to arbitrate.<sup>166</sup>

The employer argued that the EEOC should not be able seek relief through litigation if the employer and employee had an enforceable agreement to arbitrate disputes between them. The EEOC, on the other hand, argued it had the statutory right to seek relief in court despite the existence of a private arbitration agreement. Circuit decisions were split on this issue.<sup>167</sup> The Fourth Circuit reached a compromise position and decided the EEOC had the power to seek injunctive relief in the public interest, but could not seek victim-specific relief.<sup>168</sup>

The Supreme Court found the EEOC had clear statutory authority to seek redress for patterns and practices of employment discrimination and held it could therefore bring

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<sup>164</sup> Id.

<sup>165</sup> 9 U.S.C. § 2.

<sup>166</sup> Equal Opportunity Commission v. Waffle House, 122 S.Ct. 754 (2002).

<sup>167</sup> Id. at 765.

<sup>168</sup> Id. at 759.

cases in the public interest.<sup>169</sup> The Court based its decision on two primary factors. First, the EEOC brings suit in its own name and has complete mastery of the case; the employee has no independent cause of action and no control over the case.<sup>170</sup> Second, the EEOC was not a party to the arbitration agreement.<sup>171</sup> For these reasons, the Court determined that the Federal Arbitration Act did not preclude the EEOC from litigating these issues: the Court held the EEOC could seek all types of relief in public interest cases.<sup>172</sup>

Waffle House is harmonious with previous employment arbitration cases. Following its precedent in Gilmer and Circuit City, the Supreme Court in Waffle House upheld the enforceability of the arbitration agreement between the employee and the employer.<sup>173</sup> These decisions allow an employee to seek private remedies in arbitration if an enforceable arbitration agreement exists, but still allow the EEOC to choose to litigate, or presumably to join, an arbitration proceeding if the parties agree.

Waffle House did not decide related questions such as whether the EEOC could proceed with litigation if the employee had arbitrated previously or had settled an arbitration case.<sup>174</sup> The Court clearly stated it was only deciding a very narrow issue, which may account for the 6 to 3 majority decision.<sup>175</sup>

Waffle House supports the continued use and expansion of arbitration by employers.

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<sup>169</sup> Id. at 762.

<sup>170</sup> Id. at 765.

<sup>171</sup> Waffle House, 122 S. Ct. at 763.

<sup>172</sup> Id. at 764.

<sup>173</sup> Id. at 765.

<sup>174</sup> In February 2002, shortly after Waffle House was decided, the Ninth Circuit invalidated the arbitration agreement in Circuit City on grounds that it was unconscionable. Circuit City v. Adams, 279 F.3d 889, 896 (9th Cir. 2002).

<sup>175</sup> Waffle House, 122 S. Ct. at 766. An employee cannot obtain double recovery, so it would seem that an employee could seek monetary relief in arbitration. However, the Court did not decide whether the EEOC could seek injunctive relief in court.

For example, critics of arbitration point out that the use of arbitration clauses may eliminate the opportunity to seek class-wide relief via a class action. Now it is clear the EEOC can seek class relief in those situations where the public interest will be served. Individual employees can readily and effectively seek remedies for their individual claims in arbitration, and classes of employees can obtain relief through a lawsuit brought by the EEOC. This bifurcated approach makes for good social and public policies.

#### 4. The Citizens Bank v. Alafabco, Inc.

The Federal Arbitration Act generally applies to transactions “involving [interstate] commerce.”<sup>176</sup> The phrase “involving commerce” was held by the Supreme Court to mean the functional equivalent of the phrase ‘affecting commerce,’ which normally signals Congress’ intent to exercise its commerce power to the full.<sup>177</sup> The Court applied the overarching public policy of the FAA to interpret the Act broadly as to overcome judicial hostility towards the enforcement of agreements to arbitrate as a baseline for interpreting the phrase ‘involving commerce.’ Holding that a contract need only involve “commerce in fact,” the Court rejected any requirement that at the time of contracting the parties must have “contemplated substantial interstate activity.”<sup>178</sup>

In Citizens Bank v. Alafabco, the Court considered whether the parties’ debt-restructuring agreement was “a contract evidencing a transaction involving commerce” within the meaning of the FAA.<sup>179</sup> In a rare per curiam opinion, the Court held that there was a sufficient nexus with interstate commerce to make enforceable, pursuant to the FAA, an arbitration provision included in that

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<sup>176</sup> 9 U.S.C. § 2.

<sup>177</sup> Allied-Bruce Terminix, Cos., Inc. v. Dobson, 513 U.S. 265, 272-275 (1995).

<sup>178</sup> Id.

<sup>179</sup> Citizens Bank v. Alafabco, Inc., 123 S.Ct. 2037, 2038 (U.S.Ala.2003).

agreement. The Court reasoned agreements executed in Alabama by Alabama residents were nonetheless contracts evidencing transactions involving commerce, given that one of parties to the contracts had engaged in business throughout the southeastern United States using loans renegotiated and redocumented in debt-restructuring agreements, given that restructured debt was secured by inventory assembled from out-of-state parts and raw materials, and given the broad impact of commercial lending on the national economy. Thus, the Court reconsidering the interstate commerce requirement concluded as it did in Allied-Bruce Terminix, that contracting parties need not contemplate substantial interstate activity at the time of the making of the agreement. Rather, a contract need only involve commerce in fact to invoke the protection of the FAA.<sup>180</sup>

As an aside, courts are unwilling to force parties to adhere to the provisions of the FAA when it is clear that the parties intended otherwise. The Supreme Court held that even where there was a clear and incontrovertible involvement of interstate commerce in an agreement between two parties, the FAA would not serve to preempt a California state law that runs contrary to the FAA where the parties specifically agreed to arbitrate in accordance with California law.<sup>181</sup> The Court noted that a primary purpose of the FAA was to ensure that private agreements to arbitrate are enforced according to their terms, even if the resulting arbitration proceedings were stayed where the FAA would otherwise compel arbitration.<sup>182</sup>

To summarize, it is not necessary for the parties to specifically invoke the FAA in their agreement by way of specific reference to the Federal Arbitration Act. The mere involvement of interstate commerce in a contract is sufficient to automatically

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<sup>180</sup> Id.

<sup>181</sup> Volt Information Sciences v. Board of Trustees of the Leland Stanford Junior University, 489 U.S. 468, 479 (1989).

<sup>182</sup> Id.

invoke the FAA's protections against state anti-arbitration legislation.<sup>183</sup> Furthermore, there is no specific requirement that the parties expressly include the FAA in their agreement or contemplate substantial interstate commerce at the time of making said agreement. Lastly, courts routinely apply the FAA in cases where there is no mention of the Act.

#### 5. PacifiCare Health Systems, Inc. v. Book

In Pacificare Health Systems, Inc. v. Book, the Court ruled that when parties agree to arbitrate, their disputes should be sent to arbitration, and that arbitrators--rather than courts--should resolve questions of ambiguous contract language concerning legal damages and remedies.<sup>184</sup> Book is yet another in a long line of cases where the Court has enforced pre-dispute agreements to arbitrate. Significantly, the Book Court, citing its "presumption in favor of arbitration," also ruled that contractual ambiguities by themselves do not render agreements to arbitrate unenforceable.<sup>185</sup> This holding confirms that pre-dispute agreements to arbitrate should be upheld--and parties should arbitrate their claims--where part of an agreement is found to be unconscionable.

#### 6. Green Tree Financial Corp. v. Bazzle

The Supreme Court reversed South Carolina's class arbitration decision that held absent the agreement of the parties' class arbitration that derived from an agreement to arbitrate in an adhesion contract between a financial company and a consumer could not be imposed.<sup>186</sup> Delivering the opinion of the court, Justice Breyer wrote, "Under the terms of the parties' contracts [which were silent as to class-wide

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<sup>183</sup> Allied-Bruce Terminix, Cos., Inc. v. Dobson, 513 U.S. 265 (1995); Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52 (1995).

<sup>184</sup> PacifiCare Health Systems, Inc. v. Book, 123 S.Ct. 1531 (2003).

<sup>185</sup> Id.

arbitration], the question—whether the agreement forbids class arbitration—is for the arbitrator to decide.”

The Bazzle opinion implies that arbitration agreements that explicitly limit or permit class treatment are valid. If, as the Court said, arbitrators can interpret ambiguous clauses to either prohibit or permit class treatment, an arbitration agreement that expressly prohibits or mandates class-wide arbitration should be enforced according to its terms under the Federal Arbitration Act with no interpretation by an arbitrator.

Federal courts have consistently held that parties to an arbitration agreement have waived any right to class adjudication.<sup>187</sup> A California state appellate court recently held that parties to an arbitration agreement had a right to class treatment.<sup>188</sup> However, that case was later contradicted by another California appellate court.<sup>189</sup>

## B. Arbitration is Here to Stay For Good

It took over seventy-five years from the passage of the FAA for the United States to come to where arbitration is clearly favored, and contracts to arbitrate are reliable and enforceable.<sup>190</sup> Judicial opinions over that time reflect the clear support of Congress, through the Federal Arbitration Act, and the United States Supreme Court, of the expanded use and continued growth of arbitration as an accessible, affordable, and fair way to resolve disputes and provide civil justice relief for everyone in our society. Congress has not amended the FAA in any way that might limit or discourage the use of arbitration. The enactment of many federal laws providing

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<sup>186</sup> Green Tree Financial Corp. v. Bazzle, No. 02-634, 2003 WL 21433403 (U.S. June 23, 2003).

<sup>187</sup> Gammaro v. Thorp Consumer Discount Co., 828 F. Supp. 673 (D. Minn. 1993), app. dism'd 15 F. 3d 93 (8th Cir. 1994); Champ v. Siegel Trading Company, 55 F.3d 269 (7th Cir. 1995); Johnson v. West Suburban Bank, 225 F.3d 366, 377, n.4 (3rd Cir. 2000); cert. denied, 121 S. Ct. 1081 (2001).

<sup>188</sup> Szetela v. Discover Bank, 118 Cal.Rptr.2d 862 (Cal. Ct. App. 2002).

<sup>189</sup> Discover Bank v. Superior Court, 129 Cal.Rptr.2d 393 (Cal. Ct. App. 2003).

<sup>190</sup> Waffle House, 122 S. Ct. at 766.

parties with statutory causes of action and various forms of relief are allowed to be brought in arbitration.<sup>191</sup> In other ways Congress has encouraged the use of ADR methods, including arbitration and mediation, instead of litigation to resolve cases.<sup>192</sup>

The Supreme Court decisions explained in this section represent all the important arbitration cases since 1960. And all of these cases have resulted in opinions that promote, support, or expand the use of arbitration. Of the twenty-four different Justices who have been members of the Court over this period of time, all twenty-four were members of the majority upholding arbitration in at least one case during their tenure, and most of them were members of the majority a number of times. In general, they all agreed that arbitration was a reasonable, enforceable method for many parties to resolve their disputes; in particular, some of them disagreed with the procedures under review in the particular cases.

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<sup>191</sup> Johnson v. W. Suburban Bank, 225 F.3d 266 (3d Cir. 2000); Stout v. Byrider, No. 99-3854, 2000 WL 1269402 at 7 (6th Cir., Sept. 8, 2000); Bette J. Roth, et al., The Alternative Dispute Resolution Guide, §§ 15.1-15.13 (West Group 1999).

<sup>192</sup> Federal Civil Justice Reform Act.

## **SECTION 8—ARBITRATION ARTICLES AND STUDIES**

The following are summaries of empirical studies regarding arbitration conducted in a variety of settings, as well as studies analyzing Americans' general perceptions about arbitration. These studies help to demonstrate the overall efficiencies and fairness of arbitration when compared with traditional methods of litigation.

### **Comparing Litigation and Arbitration of Employment Disputes: Do Plaintiffs Better Vindicate Their Rights In Litigation?**

**Michael Delikat & Morris M. Kleiner**

American Bar Association Litigation Section *Conflict Management* Vol. 6, Issue 3 – Winter, 2003

This study compares various outcomes and timing factors involved in 125 employment discrimination cases filed in the Southern District of New York with 186 arbitrations involving employment disputes in the securities industries.

Claimants prevailed 46 percent of the time in an arbitral forum versus 34 percent in court. The outcomes involving arbitration generated higher median monetary awards for successful claimants, \$100,000 for arbitration compared with \$95,554 in court. Furthermore, arbitrations were significantly more efficient than litigation, as the median time from filing to judgment was 16 ½ months for arbitrations and 25 months for claims subject to litigation.

The study concluded that plaintiffs are better served by arbitration relative to the federal courts, in terms of speedy justice and the likelihood of positive outcomes, and that arbitration provides the benefit of faster dispute resolution and lower transactional costs than the courtroom can offer.

## **Private Justice: Employment Arbitration and Civil Rights**

**Lewis L. Maltby**

*Columbia Human Rights Law Review* – Fall, 1998

(30 Colum. Hum. Rts. L. Rev. 29)

Combining the results of several studies comparing numerous factors involved in the resolution of employment disputes brought in arbitration and in court, this article presents results that further establish that employees are successful more of the time when their case is brought in arbitral forum. Relying on a study of employment arbitrations that took place between 1993 and 1995 and federal district court cases in 1994, employees were found to be successful 63 percent of the time in arbitration, compared with only 15 percent in federal court. The article notes that the average case resolved in an arbitral forum took 8.6 months, compared to two and a half years in the courts. Lastly, a discussion of barriers to an individual plaintiff's access to justice concludes that as many as 95 percent of those who seek help from the private bar with an employment matter do not obtain counsel primarily because the costs associated with resolving an employment dispute in a court can be as begin at \$10,000, even if the case is resolved without trial.

## **Employment Arbitration: Is It Really Second Class Justice?**

**Lewis L. Maltby**

*Dispute Resolution Magazine* – Fall, 1999

6 No. 1 Disp. Resol. Mag. 23

Using data from employment arbitrations taking place between 1993 and 1995, employees were found to have won 63 percent of the time. By contrast, employees were only successful 15 percent of the time when their employment claims were taken to federal district court in 1994. Data is also presented which demonstrate that

some 60 percent of the cases brought in court are resolved by summary judgment, where employers prevail on motion 98 percent of the time. Furthermore, the entire class of employees who took their disputes to arbitration received 18 percent of their total demand, compared with only 10.4 percent in court. Maltby concludes that far more employees win in arbitration than in court and their awards are almost twice as high.

### **Out of the Frying Pan, into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements**

**Lewis L. Maltby**

(Available at <http://www.workrights.org>; last viewed on June 25, 2003)

Analyzing arbitration data for 2001 and 2002, Maltby finds that employees would have little chance of obtaining access to justice if only post-dispute voluntary agreements to arbitrate were enforceable. The research showed that post-dispute agreements are extremely rare. Only 6% of 2001 employment arbitrations and 2.6% of 2002 employment arbitrations were the result of post-dispute agreements. Maltby concludes that if the law were changed to allow only post-dispute agreements to arbitrate, the result could be that employees with smaller claims would be denied access to justice completely.

### **Costs and Value of Arbitration**

**Lisa Brener**

Juris Publishing, *Perspectives* Vol. 14, No. 4 – April, 2003

Using the rules of procedure from a major North American dispute resolution provider, this article examines the nature and scope of arbitration costs, as well as its overall value in contrast to litigation. In a 1990 survey, 100 percent of respondents found arbitration to be quicker than litigation. Furthermore, 89 percent found that

arbitration was less expensive than litigation. Also noteworthy in the survey was that only 17 percent of attorney's time was spent on discovery in an arbitral setting, compared with 45 percent in court, and over half of the respondents believed arbitral awards were more equitable than the outcomes in litigation.

**Due Process At Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association**

**Elizabeth Hill**

Ohio State University Journal on Dispute Resolution, Vol. 18, Issue 3, 777-828 (2003).

This empirical study of 200 employment arbitration awards, randomly selected from a pool of 356 awards made by arbitrators, evaluated numerous factors and refuted common criticisms of employment arbitrations. The study concluded that employment arbitration is not biased in favor of employers or highly compensated employees and that arbitration can competently resolve statutory employment discrimination claims, contrary to former criticism in this regard. Also, the study presented evidence that conclusively refutes any empirical support for the "repeat player effect," the theory that an employer who arbitrates more than once will win more frequently than other employers. If anything, the study concluded, the data suggests a bias in favor of employees, rather than a bias in favor of employers.

**Report to the Securities and Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations**

**Michael Perino, Visiting Professor Columbia Law School, Associate Professor St. John's University School of Law**

(Report contained at <http://www.nyse.com>)

This report, commissioned by the Securities and Exchange Commission (SEC),

examines and evaluates the requirements governing the disclosure of arbitrator conflicts for self-regulatory organizations (SRO) subject to SEC oversight.

In a November 2002 report on arbitral fairness in securities arbitrations involving consumers, Professor Michael Perino from St. John's University School of Law found no evidence of favoritism towards one party or another in more than 30,000 arbitrations.

The data were derived from securities arbitrations involving consumers over a 21-year period (1980-2001). During those years securities industry arbitrators decided 31,001 public customer cases and 16,294 of those cases (52.56%) resulted in awards for consumers. (Note: Federal court data from the National Center for State Courts show that in 2000, plaintiffs litigating securities and exchange issues in federal court prevailed 56.5% of the time compared to the above-mentioned 52.6% win-rate in arbitration, a difference of only a few percentage points).

Furthermore, in a study surveying the responses of NASD investor-participants regarding their perceptions of fairness of SRO arbitrations, the results showed that an overwhelming 93 percent of the respondents believed that their cases were handled fairly and without bias. Also, over 91 percent of respondents said that their arbitrators demonstrated a level of fairness that was classified as excellent or good.

### **Securities Arbitration: How Investors Fare**

#### **United States General Accounting Office**

Rep. No. GAO/GGD-92-74 – May 11, 1992

At the request of Congress, the U.S. General Accounting Office (GAO) compared the results of over 6,600 awards issued from both industry-sponsored self-regulatory organizations (SRO) and independent dispute resolution providers during a six-

month period, including the American Arbitration Association (AAA), to analyze the differences in awards between the two types of forums for resolution of securities arbitration disputes. The GAO concluded that the arbitration forum did not affect investors' chances of receiving an award. For most securities arbitrations decided at industry-sponsored forums and at AAA, an average of 60 percent of investors received an award, and the amount awarded averaged about 60 percent of the amount claimed. The GAO also determined that the results of decisions in arbitration cases at both industry-sponsored and independent forums showed no indication of a pro-industry bias in decisions.

### **Legal Dispute Study**

#### **Roper Starch Worldwide: Survey for the Institute for Advanced Dispute Resolution**

September, 1999

In 1999, the Institute for Advanced Dispute Resolution commissioned a study to ascertain the general adult population's awareness, knowledge, attitudes and experience regarding arbitration as an alternative means to lawsuits. The results of the over one thousand Americans taking part in the study showed that 59% of Americans would automatically choose arbitration over litigation, a number that jumped to 83% in favor of arbitration when informed of the relative costs. Seventy-one percent of the respondents said that lawsuits take too long and cost too much. Furthermore, almost half of the people surveyed believed it was better to have a judge decide a dispute rather than a jury.

### **Legal Dispute Study**

#### **RoperASW: Survey for the Institute for Advanced Dispute Resolution**

April, 2003

Updating a study conducted in 1999, this study revisits Americans' awareness, knowledge, attitudes and experiences regarding arbitration as an option for resolving disputes. Most notably the study found that, sixty-four percent of respondents said that they would choose arbitration over a lawsuit in disputes involving monetary relief. This figure represents an increase of five percent from the 1999 study. Also, the number of Americans that believe it is usually worthwhile to initiate a lawsuit has dropped significantly since 1999, fifty percent in 1999 compared with thirty-four percent in 2003. Furthermore, two-thirds or some sixty-seven percent of respondents feel that lawsuits take too long, while one-third or some thirty-two percent said that lawsuits cost too much.

## **SECTION 9—MEDIATION AND OTHER ADR METHODS**

### **9.1 MEDIATION PROCEDURES AND RULES**

Many judicial jurisdictions have established mediation procedures and rules applicable to their cases. These processes are jurisdiction specific. ADR providers, including the National Arbitration Forum and JAMS, provide mediation services to the judiciary. Judges can appoint a Forum or JAMS mediator or issue an order requiring the parties to mediate a case. This section contains an example of a proposed order.

The typical provisions involved in a mediation process administered by an ADR provider include a set of mediation procedures that govern the rights and obligations of the parties, information to be provided to a mediator, conflicts of interests and ethical guidelines for the mediator, mediation procedures, mediation fees, and related issues. An example of procedures, rules, and fees follow and appear at [www.arb-forum.com](http://www.arb-forum.com), [www.adr.org](http://www.adr.org), and [www.jams.com](http://www.jams.com).

#### **9.1.1 Mediation**

Mediation involves disputing parties voluntarily resolving their differences with the assistance of a mediator who facilitates the reaching of an agreement. Participants in a mediation include the parties, their attorneys or representatives, and the mediator. A mediator is a neutral, impartial person who serves various roles. A mediator can clarify what the parties want and why, focus on their needs and interests, remain a source of trust and confidence for the parties, diffuse hostilities and reduce the adverse impact of emotions and feelings, and suggest alternative and creative ways

to reach an accord.

Mediation is a voluntary, non-binding, confidential process. Mediation differs from arbitration in that no person issues a decision that is involuntarily binding upon the parties. Mediation ranges from a couple of hours to a number of days, depending upon the complexity of the issues and the position of the parties. The costs of mediation include the mediator's fees and an administrative fee.

### **9.1.2 Mediation Agreements**

#### **Pre-Dispute Agreement**

Parties may agree to a pre-dispute mediation clause in a contract. Alternative examples of these agreements follow.

The parties agree to mediate any controversy or claim arising out of or relating to this contract, or the breach of this contract. The parties further agree to attend and participate in a mediation to resolve any dispute.

or

Any controversy or claim arising out of or relating to this agreement, the relationship resulting in or from this agreement or any breach of duties shall first attempt to be resolved by mediation in accordance with the mediation procedures of National Arbitration Forum at [www.arbitration-forum.com](http://www.arbitration-forum.com).

A mediation clause may include references to specific needs of the parties and any special procedures to which the parties agree. The parties can agree to the type of disputes to be submitted to mediation, as well as the procedures to be used. The clause should include the identity of the mediation service provider.

## **Post-Dispute Agreement**

If the parties do not include a mediation clause in an agreement before a dispute, the parties may voluntarily agree to mediate after the dispute arises. An example of a post-dispute mediation clause follows.

*The undersigned parties agree to use mediation services provided by \_\_\_\_\_ to resolve their dispute regarding (explain controversy). All parties recognize that mediation is a voluntary settlement process and that the mediator is not a judge and has no authority to force a settlement on the parties. \_\_\_\_\_ will administer the mediation in accordance with its mediation procedures. The parties agree that \_\_\_\_\_ will be the mediator and recognize that this mediator is an independent contractor and not an employee or agent of \_\_\_\_\_. Costs for the mediation services include an administrative fee of \$\_ and an hourly fee of \$\_ for each hour of mediation. The parties agree to share the costs evenly, unless as part of the settlement they agree to a different allocation. Fees in excess of the amount deposited by the parties shall be promptly paid in equal proportions or in such other proportions as the parties agree. The parties recognize that neither \_\_\_\_\_ nor the mediator provides legal advice or counseling. The parties may be represented by an attorney or another representative during the mediation. The parties understand that mediation sessions are settlement negotiations and that discussions during settlement negotiations are inadmissible in any litigation or arbitration of their dispute, as provided by applicable law. The parties recognize that the mediation session is private and confidential. The parties will not subpoena or otherwise require the mediator to testify or produce records or notes in any future proceedings.*

Parties involved in a dispute need not necessarily agree to a written agreement. The parties or their attorneys may orally consent to mediation, select a mediation service, and proceed to mediation without having to sign any agreement. The participation

by the parties suffices to initiate and continue the mediation process.

### **9.1.3 Court-Mandated Mediation**

A growing number of jurisdictions order parties in litigation to attend mediation at some stage of the trial process. Parties who are ordered by a court to mediate may approach the process with varied perspectives. Some enthusiastically embrace the process, while others come to the meeting kicking and screaming. Some have faith in this system and accept the court-imposed process, while others are not interested in being diverted from the litigation process.

The parties may have no choice in these jurisdictions except to attend the session, unless a court order can be obtained canceling the mediation. Obtaining such an order may be difficult, if not impossible, because the court administrator or judge has already decided the parties ought to mediate, and they are unlikely to change their mind. However, there are some legitimate situations when mediation may be a waste of time, and a motion to cancel or postpone a session ought to be pursued. Reasons to support such a motion parallel the reasons why some situations ought not to be mediated.

## 9.2 MEDIATION PROPOSED ORDER

The following order is an example of an order issued by a judge requiring parties to mediate a case:

### CASE CAPTION

Mediation

Order

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This Court concludes that mediation will provide the parties with an opportunity to fairly resolve their dispute and will meet this Court's obligation to afford the parties civil justice.

**THIS COURT ORDERS** that the parties in this case shall participate in mediation in an effort to settle their dispute reasonably and fairly and that the following:

**1. Appointment of Mediator:** This Court appoints the Forum to be the mediation administrator in this case (www.arb-forum.com or 800.474.2371). The Forum shall within 10 days of the receipt of this Order appoint a mediator and provide the parties with the resume of the mediator.

**[1. Alternative]** This Court appoints \_\_\_\_\_ to be the mediator in this case unless the parties, within ten (10) days of the date of this Order, mutually agree to another mediator.

**2. Fees and Expenses:** The mediator shall receive an hourly fee of \$\_\_\_\_\_ plus reasonable expenses, and shall limit preparation time to no

more than then (3) hours.

- 3. Sharing Costs:** The parties shall split equally the fees and expenses of this mediation, unless they agree on a different share as part of a mediated settlement.
- 4. Mediation Sessions:** The mediator shall promptly schedule a mediation, no later than sixty (60) days from the date of this order, and shall continue the mediation until a settlement is reached or an impasse is declared by the mediator.
- 5. Attendance and Authority:** Parties or persons with authority to enter into a full and complete compromise and settlement of the case on behalf of the parties shall attend settlement and mediation discussions, including the lawyer who will try the case. Authority means at the minimum the authority to settle the case at the full and complete demand by the opposing party. The mediator has the power to order any person the mediator concludes ought to attend the mediation, unless this Court has no jurisdiction over this person.
- 6. Submissions:** The mediator may require parties to timely submit confidential settlement documents and information. Parties may voluntarily submit these or other materials to a mediator.
- 7. ExParte Communications:** The mediator may conduct private conferences with a party relating to the mediation.
- 8. Settlement Conferences:** The settlement and mediation meetings and discussions constitute settlement conferences under the applicable rules

of evidence. Nothing said or disclosed during the settlement conferences nor any document produced during the settlement conferences that is not otherwise discoverable shall be admissible as evidence or for impeachment or other purposes in any judicial, arbitration, or administrative action.

**9. Settlement Agreement:** Each settlement is to be confirmed in a written settlement agreement signed by a party or party representative with authority to sign and by a lawyer representing each party. A party representative who signs is presumed to have full authority to bind the party. The terms of the settlement agreement is an issue for settlement negotiations.

**10. Enforcement of Settlement Agreements:** A party may enforce a written settlement agreement by bringing a motion before this Court.

**11. Mediator Orders:** If the mediator concludes that any party or counsel refuses or fails to comply with the provisions of this Order or refuses or fails to participate in good faith in the mediation, the mediator shall have the power to issue a written or oral order directing compliance. If a party or person objects to such an order by the mediator, that party or person shall file a written objection including reasons with this Court within three (3) days of the receipt of the written or oral order.

**12. Mediator Immunity:** No party, person, or entity shall call or subpoena the mediator or any member of the mediator's staff to testify or produce any notes or documents related to any settlement conference or mediation in any civil action or proceedings of any kind whatsoever. If called or subpoenaed, the mediator and other protected participants may refuse to

testify or produce notes or documents. Any party, person, or entity that attempts to compel such testimony or production will be liable for and shall indemnify the mediator and other protected participants against any liabilities, costs, and expenses, including reasonable attorney fees, which may be incurred in resisting such compulsion.

**13. Payment of Mediation Costs:** The party or parties responsible to pay the mediator shall do so no later than thirty (30) days after receipt of the expenses and fees.

**14. Court Sanctions:** The failure or refusal to comply with any part of this Order shall subject the offending party, lawyer, person, or entity to appropriate sanctions including the assessment of costs, dismissal, or other relief the Court may deem appropriate.

### **9.3 OTHER ADR METHODS**

Arbitration and mediation are the most common ways parties resolve their disputes in addition to litigation and administrative law proceedings. A combination of these proceedings is the med-arb method. A party's first attempt to negotiate a settlement with the assistance of a mediator, and then, if that fails, proceed to arbitration before the same neutral or another arbitrator.

There are other dispute resolution methods used by judges, lawyers, and parties. ADR providers, such as the National Arbitration Forum, AAA, and JAMS, provide these methods.

#### **Med-Arb**

Med-Arb proceedings combine both mediation and arbitration. Parties attempt to mediate the dispute first and, if mediation fails, then arbitrate the dispute. The neutral that mediates the dispute with the parties may also be the arbitrator, or different individuals can split the roles. The mediation process may not resolve the entire dispute, but may resolve some of the issues, with arbitration resolving the remaining issues.

#### **Litigation**

Parties may sue and litigate their dispute. A plaintiff can serve a summons and complaint on a defendant who can reply with an answer. Litigation proceeds with the parties conducting discovery and bringing motions. The case culminates in a trial with a decision reached by a judge or jury. The losing party may appeal the verdict by the jury or the decision by the judge to appellate courts.

Lawsuits may be brought in a federal or state court, which has jurisdiction over the defendant. Federal courts resolve disputes involving federal statutes and the federal constitution, disputes between citizens of different states, and special cases such as patent disputes and bankruptcy. State courts are known as courts of general jurisdiction, and hear most disputes, such as accident, personal injury, products liability, commercial, family, and probate cases, as well as other civil actions.

Most parties with a dispute cannot afford to litigate. They may be unable to find a lawyer willing to represent them, or they may be unable to afford a lawyer. Many litigators will not take disputes under \$50,000. Other litigators will require a party to pay upfront expenses and fees of \$5,000 and more.

### **Summary Jury Trial**

A summary jury trial takes place in a courtroom before a mock jury selected by the judge from the regular jury list. This procedure involves lawyers presenting an abbreviated version of their case before a mock jury, chosen at random from a jury pool. The attorneys present their arguments and some evidence through witnesses or documents to the jury, which deliberates and returns a recommended verdict. This advisory verdict provides the parties with a basis to predict what a jury would do after a complete trial. The lawyers may question the jurors about their verdict and learn why the jurors reached the decision they did. This procedure works for all types of trials and can be used with great effect for complex litigation that would involve considerable court time if not settled.

### **Administrative Hearing**

Administrative hearings typically resolve disputes involving statutory remedies. A party files a petition with an administrative tribunal, and an administrative judge holds a hearing and decides the case. Administrative proceedings are similar to court

trials. The availability of discovery and the use of motions may be limited. Controversies resolved through federal and state administrative hearings include workers' compensation claims, unemployment compensation claims, social security claims, welfare claims, tax claims, and other statutory and rule-based claims.

### **Mini-Trial**

A mini-trial is a private, consensual proceeding where each party makes a short presentation before a panel consisting of representatives selected by the parties. Usually, lawyers present evidence and summary testimony in documentary form, and present their best arguments to the representatives. The panel of representatives typically includes one or more representatives selected by each party and a neutral third person mutually agreed to by the representatives or appointed by a dispute resolution organization. The representatives confer after the mini-trial and reach a non-binding decision that provides a basis for the parties to reach a settlement.

### **Private Judging**

Parties may submit their dispute to a private judge who makes a decision after a trial. The parties may voluntarily refer their case to a judge or a court may have the parties present their case to a private judge. Some states have enacted statutes that allow the decision by the private judge to be enforced as if it were a judgment. The individual who acts as a private judge is usually a former or retired judge. Parties may prefer a private judge instead of a public judge because the private judge may have experience in resolving the type of dispute the parties have. Parties may also prefer private judging if they would rather have their dispute resolved by a trial instead of another method.

### **Fact Finding**

Fact finding is an informal process in which a neutral third party selected by the parties or a court reviews the case and submits a report that identifies those facts

which are in dispute and those which are undisputed. A fact finder obtains information from the parties, as well as from other relevant sources, and recommends resolutions to the dispute, but does not make any decision. The use of the fact finder assists the parties in reaching agreement on the issues to be resolved. This process is useful in resolving public sector collective bargaining problems and complex scientific, technical, business, or economic issues where the presentation or proof on such issues is extremely difficult, expensive, and time-consuming.

### **Moderated Settlement Conference**

A moderated settlement conference is a forum for case evaluation and structured settlement negotiations between the parties and their attorneys. The trial attorneys present their cases before a panel of impartial third parties, usually lawyers, who evaluate the case and render an advisory, non-binding opinion for use by the parties in settlement negotiations. This format is similar to a summary jury trial and mini-trial used in litigated cases.

### **Regulatory Negotiation**

Regulatory negotiations seek to create agreements on potentially divisive government rules and regulations before they are issued. Parties affected by the prospective regulations review the proposed rules and suggest revisions, additions, and changes. A mediator may assist the parties and government officials in seeking agreement on key provisions of government regulations.

### **Customized Dispute Resolution Methods**

Dispute resolution organizations have developed customized dispute resolution programs for parties involved in specific disputes. The advantage of these programs is that a system can be created and implemented to meet the precise needs of the parties.

## **SECTION 10—INTERNATIONAL ARBITRATION**

International arbitration awards will become more common as practitioners have more clients who are parties to international transactions and relationships. From the court's perspective, the primary issue involving international arbitrations is the enforcement of the international arbitral award.

Arbitrations that constitute international arbitrations involve another level of enforceability over and above domestic arbitrations. International arbitration awards are enforceable under the auspices of an international treaty known as the New York Convention. See Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 21 U.S.T. 2517, 330 U.N.T.S. 38 (June 10, 1958). Over 130 countries – including the United States – have accepted the treaty. See 9 U.S.C. Section 207. The United States courts have a liberal policy favoring the recognition and enforcement of foreign arbitral awards. *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974).

The effect of this widespread acceptance is that an international arbitration award is enforceable all over the world. It is far easier to enforce an arbitration award worldwide than it is to attempt to enforce a civil judgment. There is no comparable worldwide treaty – no full faith and credit international law concept - requiring countries to enforce judicial judgments from other countries. Comity and other substantial reasons are available in some limited situations to support the recognition of foreign judgments; however courts are commonly reluctant to enforce foreign.

For an international arbitration award to be enforceable, there must be a recognizable arbitration agreement. The New York Convention defines an arbitration agreement broadly as an agreement in writing and signed by the parties under which the parties submit to arbitration their differences. See New York Convention, Article 1. The writing and signing requirement includes a signed arbitration agreement or an arbitration clause in a signed document.

There are two primary situations that define an international arbitration. The first is the most obvious: if two disputing parties are from different countries their arbitration is international, even if occurs within the United States. *Bergesen v. Joseph Muller Corp.*, 710 F.2d 928 (2<sup>nd</sup> Cir. 1983). The other occurs when a dispute between two domestic parties involves international issues. Both of these situations create an international arbitration.

In addition, most countries, including the United States, require an arbitration governed by the New York Convention to be a commercial dispute. That is, the nature of the controversy must involve a commercial transaction or relationship or one of the parties must be a commercial entity or individual. The other restriction the United States has imposed on international arbitrations is mutuality. The award must have been entered in a country that is a signatory of the New York Convention. See 9 U.S.C. Sections 201-208.

An arbitral transaction or relationship that meets these standards is an international arbitration, and the New York Convention, governs its enforceability. The Federal Arbitration Act, 9 U.S.C. Section 201. et seq., has implemented the New

York Convention. A party seeking to enforce an international award need only provide a judicial court in a country that has jurisdiction over the respondent/defendant with proof of the written arbitration agreement and a certified copy of the arbitration award. These documents support the issuance of a civil judgment confirming the award. *See* J. Voltz and R. Haydock, *Foreign Arbitral Awards: Enforcing the Award Against the Recalcitrant Loser*, 21 *Wm. Mitchell. L. Rev.*867 (1996). Similarly, adverse parties may seek to stay arbitration or seek to vacate or modify it under applicable provisions of the same New York Convention.

Overall, this confirmation process for international arbitral awards resembles the confirmation process for domestic awards and may be less susceptible to challenges for modification and vacation.

