

Arbitration: Trial by Other Means or Settlement by Other Means?

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OVER A CENTURY ago, Oliver Wendell Holmes, Jr. wrote, “The prophecies of what the courts will do in fact, and nothing more pretentious, are what I mean by the law.”¹ This definition offered a refreshing realism. It directed those who sought the law to turn away from the abstract legal principles found in dusty books and toward the actual decisions of judges in courts.

Scholars in the past have criticized Holmes’s definition of the law as too cynical, as improperly conflating the requirements of the law with the limited ability of courts to enforce those requirements.² Today, however, one might take just the opposite view—that Holmes’s aphorism is quaintly idealistic, that his focus on the courts is no longer realistic enough. After all, more and more cases are subject to pre-dispute arbitration clauses. These clauses allow either party to a dispute to elect to resolve it through arbitration rather than trial. Courts have a strong tendency to enforce the clauses, and then to subject the outcome of arbitration to a very deferential review. This is true even when the legal rights at issue cannot be waived by agreement of the parties.³ As a result, courts may pronounce one legal standard, while arbitrators apply another. If Holmes were writing today, he might claim more appropriately, “The prophecies of what arbitrators will do in fact, and nothing more pretentious, are what I mean by the law.”

But is that right? Is the increasing use of arbitration transforming the law? Or is the outcome of arbitration not law at all, but rather an extension of the right of parties to resolve a dispute between them as

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1. Oliver Wendell Holmes, Jr., *The Path of the Law*, 10 HARV. L. REV. 457, 461 (1897).

2. See, e.g., DAVID LUBAN, *LAWYERS AND JUSTICE: AN ETHICAL STUDY* 20–24 (1988); Joshua P. Davis, *Taking Uncertainty Seriously: Revising Injunction Doctrine*, 34 RUTGERS L.J. 363, 405–10 (2003).

3. See, e.g., Stephen J. Ware, *Default Rules from Mandatory Rules: Privatizing Law Through Arbitration*, 83 MINN. L. REV. 703 (1999) (arguing that courts allow parties and arbitrators to create new legal standards through arbitration).

they wish? Is it no more the law than the terms of any settlement agreement?

I ask these questions because they point out a fundamental tension that runs through both the growing body of scholarship on arbitration and the fine essays in this symposium issue of the Law Review. Resolving that tension is essential to reach a satisfactory view on the various issues that arise in regard to arbitration and arbitration clauses. For that reason, it is worthwhile to explore the point a bit further. Whether the outcomes of arbitrations are in some sense law is just one among many related issues. More generally, one might ask whether arbitration is trial by other means, settlement by other means, or some combination of the two.

Opponents of pre-dispute arbitration clauses tend to view arbitration as similar to trial in a crucial sense: their view is that arbitration, like trial, should resolve disputes according to rules that promote justice. From this perspective, terms accepted by the parties should not completely control the structure of arbitration, just as they do not completely control court proceedings. The effect of agreements between parties on the shape of the dispute resolution process should be limited. This position finds support, among other places, in the pronouncements of the Supreme Court that arbitration changes only the process of adjudication, not underlying substantive rights.⁴ Along this line of reasoning, to ensure parties' substantive rights remain intact, perhaps arbitration should have to follow some of the procedures of trial.⁵

The difficulty with this view, however, is that the point of arbitration is to provide an attractive alternative to trial, not to replicate it. Arbitration may allow only limited discovery, permit consideration of evidence that would be inadmissible at trial, produce an outcome without any explanation of its rationale, or prevent any meaningful opportunity for appeal. For many people it is a virtue that arbitration usually discards many of the formalities of trial and provides a final result. These characteristics can reduce the time and money necessary to resolve a dispute. The strong federal policy behind enforcing arbi-

4. See, e.g., *Circuit City Stores v. Adams*, 532 U.S. 105, 123 (2001); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985).

5. See Richard C. Reuben, *Public Justice: Toward a State Action Theory of Alternative Dispute Resolution*, 85 CAL. L. REV. 577 (1997) (arguing that due process concerns should apply to arbitrations).

tration agreements is in part to allow parties to deviate from trial in just these ways.

One may be tempted, then, to say that arbitration is really more like settlement than trial. This is the view that proponents of pre-dispute arbitration clauses tend to adopt. In a sense, they view arbitration as settlement by other means: it allows parties to control how they will resolve their disputes.

But parties do not have an unlimited ability to settle claims, at least not those that have yet to arise. There are various substantive legal rights that are not susceptible to waiver in advance. These include certain rights under federal employment laws,⁶ consumer protection laws, and landlord-tenant laws,⁷ to name but a few examples. The courts appear to have concluded that these rights are subject to pre-dispute arbitration clauses.⁸ But if certain substantive rights that cannot be waived can be the subject of mandatory arbitration, then perhaps there should be restrictions on when arbitration agreements should be enforced or on the form that arbitration may assume. Such restrictions would ensure that plaintiffs do not waive rights indirectly that they cannot waive directly.⁹

Attention to these competing models helps to situate each of the contributions to this law review symposium. Consider, for example, the enlightening exchange between Professors Jean Sternlight and Stephen Ware. The issue they address is the relationship between pre-dispute arbitration clauses and the right to trial by jury. Of particular interest is their discussion of how this issue plays out in state court. Professor Sternlight notes that many states will enforce a waiver of the right to trial by jury only if it is knowing, voluntary, and intelligent. This standard, she explains, is higher than courts have generally ap-

6. See David Schwartz, *Understanding Remedy-Stripping Arbitration Clauses: Validity, Arbitrability, and Res Judicata*, 38 U.S.F. L. REV. 49, 63 (2003) (citing *Alexander v. Gardner-Denver Co.*, 415 U.S. 35, 51 (1974)).

7. See, e.g., Stephen J. Ware, *Consumer Arbitration as Exceptional Consumer Law (with a Contractualist Reply to Carrington & Haagen)*, 29 McGEORGE L. REV. 195, 207-10 (1998) (noting mandatory rules in court, including strict products liability, the warranty of habitability, usury laws, and certain restrictions on insurance and employment contracts).

8. See, e.g., *EEOC v. Luce*, No. 00-57222, 2003 U.S. App. LEXIS 20007, at *29-33 (9th Cir. Sept. 30, 2003); *Desiderio v. Nat'l Ass'n of Sec. Dealers*, 191 F.3d 198, 206 (2d Cir. 1999).

9. It is perhaps no coincidence that Keith Hylton's defense of enforcement of pre-dispute arbitration clauses is, in essence, an argument in favor of allowing parties to waive rights, which could include those that are currently inalienable. See Keith N. Hylton, *Agreements to Waive or to Arbitrate Legal Claims: An Economic Analysis*, 8 SUP. CT. ECON. REV. 209 (2000).

plied to enforcement of pre-dispute arbitration clauses. Relying on state contract law, courts will, for example, enforce such clauses in adhesion contracts against parties who were unaware of their existence.

Professor Sternlight contends that a heightened standard for consent should apply to enforcement of pre-dispute arbitration clauses in regard to claims that entail the right to a jury trial. She makes the argument that the jury plays a special and important role at trial, that it is significant not only for disputants but also for the working of our political system, that arbitration deprives parties of a jury and, as a result, that pre-dispute arbitration clauses should be subject to the same scrutiny as any similar waiver of the right to trial by jury.

Professor Ware's essay does not address directly which standard should govern whether to enforce a pre-dispute arbitration agreement, although he has argued elsewhere that ordinary contract law should apply.¹⁰ However, he does question whether pre-dispute arbitration clauses should be called "mandatory," as Professor Sternlight labels them. After all, as he points out, it is the refusal to enforce pre-dispute arbitration clauses that would result in a mandatory rule, for it defies the contractual agreement of the parties. In contrast, the decision to enter into a contract, even a contract of adhesion, is voluntary. Further, he states that he is generally (although not always?) against mandatory rules. Taken together, these two points support the position that in state court, just as Professor Ware has argued regarding federal court, the ordinary contract standard should apply to enforcement of pre-dispute arbitration clauses.

The choice between these positions may depend on whether we view arbitration as similar to trial or settlement. Professor Sternlight's argument is strongest if we think of arbitration as largely akin to trial. If that analogy governs, then waiver of the right to trial by jury through arbitration should be afforded the same protection as waiver of that right at trial. In both cases, the need for procedural fairness may require special protection. In contrast, Professor Ware's view is attractive if we accept the premise that arbitration is like settlement and that paramount above fair procedures is the need to honor the

10. See Stephen J. Ware, *Arbitration Clauses, Jury-Waiver Clauses and Other Contractual Waivers of Constitutional Rights*, 67 *LAW & CONTEMP. PROBS.* (forthcoming Winter/Spring 2004).

decisions of the parties. Proceeding from this premise, the position that the ordinary contract standard should apply seems unassailable.¹¹

A similar contrast applies to the analyses of Professors Sternlight and Ware of the extent to which the Federal Arbitration Act ("FAA")¹² preempts state law regarding waiver of the right to trial by jury. In other words, if we assume Professor Sternlight is right that a heightened consent standard applies to pre-dispute arbitration clauses for claims that entail a right to trial by jury, does the FAA preempt this aspect of state law?

Professor Sternlight's view, to oversimplify a bit, is that state laws are preempted only if they single out arbitration agreements for invalidation. The special protections afforded the right to trial by jury apply generally to certain claims, not just to waiver through an agreement to arbitrate. As a result, she concludes, they are not preempted.

Professor Ware harbors some doubts about this conclusion. The precise language of the FAA requires state (and federal) courts to enforce arbitration agreements "save upon such grounds as exist at law or in equity for the revocation of any contract."¹³ As Professor Ware notes, the right to trial by jury does not affect any contract, as specified in the FAA, but only the agreement to arbitrate certain claims.¹⁴ A strong argument can be made, he reasons, that the FAA therefore preempts state laws that require a heightened standard for consent to arbitration.

This dispute over preemption can be resolved in several ways. One may, for example, parse the language of the FAA itself or of Supreme Court precedent interpreting the statute. But the ultimate issue, I believe, is how we should view the mandate of the FAA. Does it force states to treat arbitration as a particularly strong form of settlement, so that parties may opt for arbitration even if by doing so they

11. Alternatively, Ware's position can be defended by acknowledging that pre-dispute arbitration clauses should receive the same review as other waivers to the right to trial by jury and by arguing nevertheless that ordinary contract law should apply. Professor Ware takes this approach in *Arbitration Clauses, Jury-Waiver Clauses, and Other Contractual Waivers of Constitutional Rights*, 67 LAW & CONTEMP. PROBS. (forthcoming Winter/Spring 2004), where he assumes for the sake of argument that the ordinary standard for waiver of the right to trial by jury would apply to pre-dispute arbitration clauses. He contends that ordinary contract law should apply in general.

12. United States Arbitration Act of 1925, Pub. L. No. 68-401, 43 Stat. 883 (1925) (codified as amended at 9 U.S.C. §§ 1-307 (2003)).

13. 9 U.S.C. § 2 (2000).

14. Stephen J. Ware, *Contractual Arbitration, Mandatory Arbitration, and State Constitutional Jury-Trial Rights*, 38 U.S.F. L. REV. 39, 45 (2003).

compromise rights that they could not waive in advance of a dispute? Or does the FAA allow states to incorporate into arbitration some of the rights that apply to trial? And if the states can create safeguards that apply not only to trial, but also to arbitration, where should we draw the line? Could the states require, for example, use of arbitrators employed by the state, just as judges are employed by the state? A satisfying resolution of this issue requires a coherent model of arbitration, one that explains the ways in which arbitration resembles trial and the ways in which it resembles settlement.

The same tension lurks behind Professor David Schwartz's discussion of remedy-stripping provisions in arbitration clauses. As he notes, defendants have begun to argue that the strong federal policy in favor of arbitration applies to all provisions in arbitration clauses, including those that limit the remedies available to plaintiffs. The FAA, defendants seem to reason, provides a general empowerment to parties to make all sorts of choices, including, in effect, to waive rights that could not be waived otherwise. This argument is often phrased as a demand that courts enforce arbitration clauses "as written."¹⁵

Professor Schwartz notes that courts have rejected defendants' efforts to strip plaintiffs of remedies through arbitration provisions in contracts of adhesion. He argues that provisions in arbitration clauses that indirectly achieve remedy-stripping also should not be honored, including those that reduce the statute of limitations or prohibit participation in class actions. These clauses do not expressly deprive plaintiffs of remedies, but they may have that effect. He then offers a careful analysis of how the unenforceable provisions should be treated, including the implications for purposes of *res judicata* when some, but not all, of the claims available to a plaintiff are resolved through arbitration. The general theme to his argument is that defendants overreach when they seek to use the policy in favor of arbitration to strip plaintiffs of their remedies, and that the courts should therefore interpret arbitration agreements and apply *res judicata* in a way that least rewards the defendants who draft these clauses.

Professor Schwartz's essay is thoughtful and enlightening. Still, it leaves room for yet another step in the analysis. I submit that the competing views on remedy-stripping provisions differ on much the same grounds as do Professors Sternlight and Ware. In general, whether

15. See Schwartz, *supra* note 6 at 78 (citing *Green Tree Fin. Corp. v. Bazzle*, 123 S. Ct. 2402 (2003); *West Virginia ex rel. Dunlap v. Berger*, 567 S.E.2d 265, 279–80 (W. Va. 2002), *cert. denied*, 537 U.S. 1087 (2002); *Discover Bank v. Superior Court*, 129 Cal. Rptr. 2d 393, 408 (Ct. App. 2003)).

such provisions should be enforced “as written” or whether they should be subject to the restrictions that would apply in court depends on whether arbitration is trial by other means or an especially powerful form of settlement by other means.

The same choice is relevant to the details of Professor Schwartz’s analysis. Consider, for example, his argument that courts should not enforce provisions of arbitration clauses that shorten statutes of limitation or that prohibit class actions because, in practice, they deprive many plaintiffs of a remedy. His logic is persuasive on its own terms. The problem, however, is that arbitration by its nature has this effect. Limited discovery and the absence of any meaningful appeal, for example, mean that some plaintiffs will lose claims in arbitration that they would win in court. The difficult issue, then, is to come up with a principled way to distinguish those variations from trial that are permissible in arbitration and those that are not. In sum, to what extent should the dispute resolution process be within the control of the parties? This is the question that Professor Schwartz’s analysis suggests.

The same tension is found in Professor Ruth Glick’s engaging discussion of the development of the ethics rules for arbitrators in California, including the new stringent requirements regarding potential conflicts-of-interest and disclosure. Among the concerns that give rise to these rules is that repeat players may have an advantage in arbitration. In particular, arbitrators may have incentive to please the large corporations that draft arbitration clauses in contracts of adhesion and that therefore have control over the selection of providers of dispute resolution services.

Professor Glick questions whether California’s ethical rules go too far and whether arbitrators are being placed under excessive scrutiny. The real problem, she suggests, is that courts are too willing to enforce pre-dispute arbitration clauses.

As she recognizes, however, federal preemption limits the ability of states to refuse to enforce arbitration agreements. And if defendants can require arbitration, even of rights that plaintiffs cannot waive, then perhaps arbitration should include many of the procedural protections of court. Judges do not profit financially by attracting business. Their insulation from these sorts of concerns contributes to their impartiality. If plaintiffs have little meaningful ability to avoid arbitration in many contexts, and little control over the selection among provider organizations, then the rules governing the ethics for arbitrators might best be designed to make them similar to judges. The more arbitration looks like trial—a default option that a party has little

power to reject—the stronger the justification for imposing the same safeguards that govern the judiciary. These safeguards include strict disclosure requirements and protections against conflict of interest.

Finally, attention to the competing models also reveals the exceptional nature of Lewis Maltby's article. His approach is unusual in part because it is empirical. He discusses the evidence in assessing the relative results of trial and arbitration in employment cases. At least as important is that he, unlike most proponents of arbitration clauses, embraces the analogy of arbitration to trial. It is not enough for him that parties "choose" arbitration. His view is that arbitration poses a problem if it produces a lesser form of justice than trial. But he questions that it does.

After careful analysis of his own and other empirical work, Maltby arrives at important and provocative conclusions. First, the rates of success of plaintiffs in arbitration and in those cases that reach trial are comparable, at least for employment disputes resolved by reputable providers of arbitration services, like the American Arbitration Services. Second, in these disputes, taking into account the possibility of summary judgment, plaintiffs tend to succeed at a significantly higher rate in arbitration than at trial. Third, in comparable employment cases, the median award is about the same for trial and arbitration, although trial tends to produce higher mean awards and larger awards in exceptional cases than does arbitration. Fourth, employees are able to secure counsel to pursue some cases in arbitration that attorneys would not be willing to take if the alternative to settlement were trial. Together these points make a strong case for reconsidering the position that arbitration provides employees second class justice.

Indeed, the case for this view may be even stronger than the one that Maltby methodically lays out. For example, it is striking that arbitration allows employees to pursue smaller claims than does trial, and yet the median result of arbitration is about the same as the median result at trial. This suggests that for the typical employment claim, the result in arbitration may actually be better than the result at trial.

However, Maltby's work, like most good empirical analysis, suggests as many questions as it answers. What if, for example, he is right that arbitration produces more consistent results than trial, but does not yield the largest outcomes that sometimes occur at trial? Arbitration, then, may sacrifice the largest recoveries to provide redress to a broader group of people. We need a standard for justice in dispute resolution to determine whether we think this is good, bad, or indifferent.

Another interesting problem relates to the effect of trial and arbitration on settlement, the most common form of dispute resolution. The threat of large damages may induce some defendants to offer larger settlements when the alternative is trial rather than arbitration, at least for those defendants who are averse to risk. On the other hand, employees who are averse to risk may be more aggressive in settlement negotiations in anticipation of arbitration than in anticipation of trial, if they feel that arbitration offers them a higher likelihood of prevailing. How these competing considerations play out in practice is crucial.

In addition, there are some less savory possibilities that may be consistent with Maltby's analysis. In particular, Maltby seems to assume that the cases on average are about as strong in trial and arbitration.¹⁶ This assumption is necessary, for example, to use the relative success rates in arbitration and trial as a measure of the relative justice they produce. However, it is possible, if speculative, that arbitration does favor employers and that employers who enter pre-dispute arbitration clauses have a tendency to violate employees' rights. In other words, the choice to enter pre-dispute arbitration agreements and the effect of those agreements may be related to the lawfulness or lawlessness of employer behavior. Employers who draft pre-dispute arbitration clauses may be bad actors, arbitration may limit their liability, and the success rate in arbitration may reflect that their employees have stronger claims than many employees who seek relief through trial. Moreover, pre-dispute arbitration agreements may be part of their overall effort to eliminate certain kinds of claims, including by prohibiting class actions, which may provide the only means for legal redress for the very smallest of claims. Admittedly, these are just possibilities.¹⁷ But some confirmation is necessary that the claims that go to arbitra-

16. For a critique of this assumption, see Stephen J. Ware, *The Effects of Gilmer: Empirical and Other Approaches to the Study of Employment Arbitration*, 16 OHIO ST. L.J. ON DISP. RESOL. 735, 755-758 (2001).

17. Note, however, that Keith Hylton's argument, and the theory of law and economics, suggest that employers might choose to enter pre-dispute arbitration clauses or other agreements that limit employees' rights as an alternative to incurring the expense of complying with the law. See generally Keith N. Hylton, *Agreements to Waive or to Arbitrate Legal Claims: An Economic Analysis*, 8 SUP. CT. ECON. REV. 209 (2000). From an economic perspective, these agreements may be efficient. Employees may be compensated in other ways for ceding substantive rights, even those rights that courts have held are inalienable. As noted in the text, Maltby does not rely on (and rejects) this justification of pre-dispute arbitration clauses. See Lewis L. Maltby, *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. REV. 105 (2003).

tion and the claims that go to trial are comparable before we accept Maltby's flattering assessment of arbitration.¹⁸

Maltby's analysis is significant on its own terms. It also has broader implications. In particular, it reveals that a complete assessment of arbitration requires not only identifying the ways in which it should be treated similarly to trial and the ways in which it should be treated similarly to settlement. We also need greater clarity as to what justice at trial and in settlement entails.¹⁹ That is the only way to determine our view of arbitration if, for example, we become convinced that arbitration improves the odds that a plaintiff will win but decreases her largest possible recovery, or if it enhances the prospects of some plaintiffs and harms the prospects of others in settlement negotiations.

None of this is to say that the essays in this symposium issue of the Law Review fail to provide valuable insights and important conclusions. The opposite is true. They have made real contributions to understanding arbitration and pre-dispute arbitration clauses. My point is that the whole of this symposium issue is greater than the sum of its parts. Together the essays point out the need for—and help us to work toward—a coherent theory of how arbitration is similar to trial, how it is similar to settlement, and what justice requires in each setting. To reach closure on the issues in this timely symposium issue, I believe we need to have that theory in place.

18. It is notable that all of these questions and concerns may apply to another area of dispute resolution that Maltby has not studied: consumer claims. This, too, is a topic on which empirical work would be invaluable.

19. I have made some efforts along these lines. See, e.g., Joshua P. Davis, *Toward a Jurisprudence of Trial and Settlement: Allocating Attorney's Fees by Amending Federal Rule of Civil Procedure 68*, 48 ALA. L. REV. 65 (1996); Joshua P. Davis, *Taking Uncertainty Seriously: Revising Injunction Doctrine*, 34 RUTGERS L.J. 363, 428–60 (2003); Joshua P. Davis, *Expected Value Arbitration*, 57 OKLA. L. REV. (forthcoming Spring 2004).