Chapter 3

INVITED PAPERS

I. Optimality Theory and Its Implications for Arbitral Practice

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When I told one of my Academy colleagues the title of my paper, *Optimality in Arbitration*, he repeated with a somewhat bemused and quizzical look on his face–*ophthalmology in arbitration*? And while that was funny (or at least intended to be), it did ring quite true in a sense. There is a controversy in arbitration that I will lay out for you, but this paper is at least in part about *seeing* the attributes of disputes and seeing the match between those attributes and dispute resolution procedures. First, the controversy. Then I will discuss optimality, not ophthalmology, and the final part of the paper will focus on what I call optimizing effects.

The Controversy

Generally stated, the controversy is whether privatizing justice through arbitration is appropriate in cases involving statutory claims. More specifically stated, the controversy is whether contracting parties with unequal bargaining power should be bound by predispute agreements to arbitrate statutory claims that might arise during their contractual relationship.

The Federal Arbitration Act (FAA),[1] passed in 1925 made predispute arbitration agreements (agreements entered into in some cases well before the dispute arose) "valid, irrevocable, and enforceable save upon such grounds as exist at law or in equity for the

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[1] 9 U.S.C. §§ 1–15 (1925).

revocation of any contract."[2] Early anti-reform sentiment made passage of this law difficult in light of a major concern that these predispute agreements permitted businesses to escape public regulation through a kind of one-sidedness in making and performing arbitration agreements.[3] It is not surprising that cases presenting the greatest tension for enforcement of arbitration agreements under the FAA involved statutory claims that one party sought to adjudicate in arbitration rather than litigation in court, the forum contemplated by the relevant statute. Permitting arbitration of these claims smacked of insulating businesses from the regulatory policies contained in the statute and undermining the public interest.[4]

In a 1953 case, *Wilko v. Swan*,[5] involving a purchaser of securities who sued the seller to recover damages under the 1933 Securities Act, the Supreme Court resolved the tension in favor of nonenforcement of the arbitration clause. The court in *Wilko* considered the characteristics of arbitration, particularly the arbitrator's ability to make awards without explanation and a complete record as well as the narrow scope of judicial review. It then announced that resolving disputes through arbitration would lessen the advantages to buyers under the 1933 Act contrary to an antiwaiver provision of that statute.

However, beginning in 1985, the Supreme Court reversed this weak commitment to commercial arbitration under the FAA and took a position strongly supportive of the arbitration of statutory claims. Starting this trend was *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*[6] It upheld a predispute agreement that forced the parties to arbitrate antitrust claims arising out of an international transaction. Next, in 1987, the *Shearson/American Express v. McMahon*[7] case enforced an agreement to arbitrate the

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[2]Section 2 of the FAA reads:

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exists at law or in equity for the revocation of any contract. 9 U.S.C. § 2.

[3]*See* McNeil, AMERICAN ARBITRATION LAW 47 (1992) (recounting early efforts at reform and resistance to those efforts, noting Julius Cohen's articulation of concerns about the weaker party, and distinguishing between post- and predispute agreements).

[4]*Id.* at 61–62.

[5]346 U.S. 427 (1953).

[6]473 U.S. 614 (1985).

[7]482 U.S. 220 (1987).

plaintiff's Securities Act and RICO claims. A second *Shearson/American Express* case, *Rodriguez de Quijas v. Shearson/American Express, Inc.*,[8] decided in 1989, raised a 1933 Securities Act claim and overruled the 1953 *Wilko* decision that had originally announced the Court's hostility to the arbitral adjudication of statutory rights. In these cases decided in the 1980s, the Court proclaimed arbitration fully capable of handling the legal and factual issues that arise under statutes without unduly compromising the substantive rights of the parties. It also expressed confidence in the ability of arbitrators to apply the law and the sufficiency of judicial review (notwithstanding its narrow scope) to ensure the arbitrator's compliance with the relevant statute.

This change of heart by the Court was put to its severest test in *Gilmer v. Interstate/Johnson Lane Corp.*,[9] decided in 1991. *Gilmer* raised an issue of employment discrimination. The Court had repeatedly ruled on the arbitration of statutory claims in the employment context in three earlier cases, *Alexander v. Gardner-Denver*,[10] *Barrentine v. Arkansas-Best Freight Systems*,[11] and *McDonald v. City of West Branch*.[12] Those cases had arisen in the context of collective bargaining agreements that contained arbitration provisions and involved a race discrimination claim under Title VII, a wage claim under the Fair Labor Standards Act (FLSA), and a section 1983 civil rights claim. In each of these cases the plaintiff had lost in arbitration under a collective bargaining agreement and wanted, essentially, a second bite at the apple by filing suit in federal court. In each case the Court had permitted this second bite at the apple (sometimes characterized as one bite at two apples), based on the distinction between statutory and contractual claims and the relatively limited role of the arbitrator. In these cases the Court thought that arbitrators enforcing contracts were different from courts enforcing statutes. Employee contractual rights were thought to be different from employee statutory rights. The arbitrator's task was to effectuate the intent of the parties—to construe the law of shop and not the law of the land. Arbitrators are chosen for their familiarity with industrial relations not public law. Arbitral procedures were informal and did not offer the eviden-

[8]490 U.S. 477 (1989).
[9]500 U.S. 20 (1991).
[10]415 U.S. 36 (1974).
[11]450 U.S. 728 (1981).
[12]466 U.S. 284 (1984).

tiary guarantees that govern civil trials. The Court concluded that the federal courts should consider these claims de novo, giving arbitration decisions appropriate weight but not preclusive effect.

In *Gilmer*, the arbitration agreement was not contained in a collective bargaining agreement. Rather, it was contained in a stock exchange application that applied to Robert Gilmer's employment, as he was required to register with the New York Stock Exchange in order to perform his job as a manager of financial services for the company, Interstate Johnson Lane. The company terminated Gilmer at age 62, and he filed a charge with the Equal Employment Opportunity Commission (EEOC) followed by a suit alleging age discrimination under the Age Discrimination in Employment Act (ADEA). Relying on the arbitration agreement and its enforceability under the FAA, the company moved to compel arbitration and the Supreme Court ultimately held that the FAA compelled Gilmer to arbitrate his ADEA claim unless Gilmer could show that Congress in the ADEA intended to preclude the arbitration of ADEA claims or that arbitration was inherently inconsistent with the statutory framework and purposes of the ADEA.

Gilmer was unable to make this showing, and the Court rejected Gilmer's generalized attacks on the adequacy of arbitration procedures as reflected in the problems of arbitral bias, the inadequacy of discovery, the absence of a written opinion, and limitations on the remedial powers of arbitrators and judicial review. The Court in *Gilmer* distinguished the collective bargaining cases, which did not involve an agreement to arbitrate statutory claims and were not decided under the FAA, but did involve a tension between collective representation and individual statutory rights.

Gilmer, of course, represented a potential sea change in the enforcement of statutory rights. The one hitch was that in section 1 of the FAA there was an exemption making the FAA inapplicable to employment contracts of workers in interstate commerce. For 10 years there was uncertainty about whether the exemption should be narrowly or broadly construed. In 2001, the Supreme Court in *Circuit City Stores, Inc. v. Adams*[13] narrowly interpreted the exemption to apply "only to contracts of employment of transportation workers" rather than workers in interstate commerce broadly construed. Under a broad interpretation, most arbitration agree-

[13]121 S. Ct. 1302 (2001).

ments found in employment contracts would not have been enforceable under the FAA. Under the narrow interpretation adopted by the Supreme Court in *Circuit City*, virtually all arbitration agreements in individual employment contracts are enforceable under the FAA. Moreover, because of the narrow scope of review of arbitration awards, arbitration may be the only forum in which important statutory disputes are adjudicated. The ability of employers under *Gilmer* and *Circuit City* to require employees to sign arbitration agreements as a condition of employment can virtually eliminate access to judicial forums.

In the context of employment arbitration this background allows us to state the controversy more specifically. Is it socially desirable to permit employers to impose mandatory arbitration in disputes involving public rights? However, this question does not apply to only employers and employees; it applies more generally to *big guys* and *little guys* (businesses and consumers as evidenced by arbitration clauses in your credit card agreements, between hospitals and patients, and between investors and stock brokers).[14]

Gilmer has led to an outpouring of scholarly commentary.[15] The proponents of mandatory arbitration point to the advantages of arbitration:

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[14]Sternlight, *Panacea or Corporate Tool? Debunking the Supreme Court's Preference for Binding Arbitration*, 74 Wash. U.L.Q. 637 (1996).

[15]*See, e.g.*, Berger, *Can Employment Law Arbitration Work?*, 61 U. Mo.–Kan. City L. Rev. 693 (1993); Jaffe, *The Arbitration of Statutory Disputes: Procedural and Substantive Considerations*, in Arbitration 1992: Improving Arbitral and Advocacy Skills, Proceedings of the 45th Annual Meeting, National Academy of Arbitrators, ed. Gruenberg (BNA Books 1993), at 110; Sharpe, *Adjusting the Balance Between Public Rights and Private Process:* Gilmer v. Interstate/Johnson Lane Corporation, in Arbitration 1992: Improving Arbitral and Advocacy Skills, Proceedings of the 45th Annual Meeting, National Academy of Arbitrators, ed. Gruenberg (BNA Books 1993), at 161; Maltby, *Paradise Lost—How the* Gilmer *Court Lost the Opportunity for Alternative Dispute Resolution to Improve Civil Rights*, 12 N.Y.L. Sch. J. Hum. Rts. 1 (1994); Gorman, *The* Gilmer *Decision and the Private Arbitration of Public Law Disputes*, 1995 U. Ill. L. Rev. 635 (1995); Alleyne, *Statutory Discrimination Claims: Rights "Waived" and Lost in the Arbitration Forum*, 13 Hofstra Lab. L.J. 381 (1996); Finkin, *Workers' Contracts*, 17 Berkeley J. Emp. & Lab. L. 282 (1996); Grodin, *Arbitration of Employment Discrimination Claims: Doctrine and Policy in the Wake of* Gilmer, 14 Hofstra Lab. L.J. 1 (1996); Levy, Gilmer *Revisited: The Judicial Erosion of Employee Statutory Rights*, 26 N.M. L. Rev. 455 (1996); Malin, *Arbitrating Statutory Employment Claims in the Aftermath of* Gilmer, 40 St. Louis U. L.J. 77 (1996); Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 Wash. U. L.Q. 637 (1996); Van Wesel Stone, *Labor/Employment Law: Mandatory Arbitration of Individual Employment Rights; The Yellow Dog Contract of the 1990s*, 73 Denv. U. L. Rev.1017 (1996); Bickner et. al., *Developments in Employment Arbitration*, 52 Disp. Resol. J. 68 (1997); Estreicher, *Predispute Agreements to Arbitrate Statutory Employment Claims*, 72 N.Y.U. L. REV. 1344 (1997); Feller, *Putting* Gilmer *Where it Belongs: The FAA's Labor Exemption*, 2000 Hofstra Lab. & Emp L.J. 253 (2000); Malin, *Ethical Concerns in Drafting Employment Arbitration Agreements After* Circuit City *and* Green Tree, 41 Brandeis L.J. 779 (2003); Nolan, *Employment Arbitration After* Circuit City, 41 Brandeis L.J. 853 (2003).

(1) low cost—features like simplified procedures, absence of discovery, and absence of appeal reduce costs;
(2) speed—simplified procedures, absence of discovery, and absence of appeal, along with reduced delay for trial dates also add speed;
(3) procedural informality—procedure is determined by the parties and can be made simple and informal;
(4) privacy of the proceeding—parties may shield the proceeding from public scrutiny;
(5) finality of the decision—parties make the award final and binding; and
(6) expertise of the factfinder—because the factfinder is party-selected and not court imposed, the parties may improve accuracy by selecting an expert.

Many proponents regard the cost factor as the most important.[16] They argue that it affords access to the adjudication of statutory rights that would not otherwise exist in many cases.[17] Proponents also support predispute arbitration arrangements, noting the employer's incentive to avoid arbitration where claimants seek arbitration after the dispute crystallizes.[18]

The arguments of opponents focus on fairness. Can the bargaining that led to the mandatory arbitration be fair?[19] Can the procedures of mandatory arbitration be fair?[20] Is the outcome of mandatory arbitration fair?[21] Perhaps the most influential critique preceded *Gilmer* and was not limited to arbitration; rather, it took on the entire alternative dispute resolution (ADR) movement. In a 1984 Yale Law Review article entitled *Against Settlement*,[22] Professor Owen Fiss argued that settlement is inappropriate in the majority of cases for four reasons. First, the agreement may reflect

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[16] *See infra* notes 55–60 and accompanying text.
[17] *See infra* notes 61–62 and accompanying text.
[18] *But see* Maltby, *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. Rev. 105, 117 (2003) (supporting predispute arbitration agreements but decrying the mandatory component).
[19] *See, e.g.*, Van Wezel Stone, *Mandatory Arbitration of Individual Employment Rights; The Yellow Dog Contract of the 1990s*, 73 Denv. U. L. Rev.1017 (1996).
[20] *See, e.g.*, Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 Wash. U. L.Q. 637 (1996) (arguing that employers attempt to minimize payouts through the structuring of the arbitration).
[21] *See, e.g.*, Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 Colum. Hum. Rts. L. Rev. 29 (1998) (comparing arbitration and litigation outcomes).
[22] Fiss, *Against Settlement*, 93 Yale L.J. 1073 (1984).

the inequality of resources between the parties rather than the predicted outcome of a suit. Second, the nonexistence of party voice in setting the terms may result in agreements that reflect the interests of party representatives rather than constituents. Third, following the declaration of rights, courts are best suited to supervise some complex disputes that continue into the remedial phase. Fourth, there may be a need for justice rather than peace. Fiss captured the fourth point as follows:

> Adjudication uses public resources, and employs not strangers chosen by the parties but public officials chosen by a process in which the public participates. These officials, like members of the legislative and executive branches, possess a power that has been defined and conferred by public law, not private agreement. Their job is not to maximize the ends of private parties, nor simply to secure the peace, but to explicate and give force to the values embodied in authoritative texts such as the constitution and statutes: to interpret those values and to bring reality into accord with them. This duty is not discharged when the parties settle.[23]

Professor Jean Sternlight captures many of the arguments that opponents have directed specifically at mandatory arbitration as an alternative to court adjudication.[24] First, the freedom of contract that arguably justifies arbitration agreements over litigation in arms'-length transactions is absent in adhesion contracts involving weaker parties such as consumers and employees. Second, mandatory arbitration does not show that it is necessarily faster, cheaper, and better than litigation; businesses use arbitration to reduce their transaction costs and their payouts. Third, market forces will not prevent businesses from taking advantage of weaker parties. Fourth, in view of the skepticism that mandatory arbitration is better for society as a whole if not the individual, any societal gains from mandatory arbitration do not justify the costs imposed on individuals.

In addition, Professor Lisa Bingham has identified the repeat player effect as a factor in arbitral decision making.[25] The repeat player in noncollective, mandatory arbitration is the employer—

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[23] *Id.* at 1085.

[24] Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 Wash. U. L.Q. 637 (1996).

[25] *See* Bingham, *Employment Arbitration: The Repeat Player Effect*, 1 Employee Rts. & Employment Pol'y J. 189 (1997).

not the employee. Arguably the unbiased arbitrator is susceptible to the subtle influence of this potential source of future benefits.

My suspicion is that neither the proponents nor the opponents of mandatory, predispute arbitration agreements are completely right or wrong. The current project is to explore with a sensitivity to both viewpoints the question of when arbitration might be appropriate and inappropriate.[26]

Optimality

Optimality in ADR

Optimality is defined in my favorite dictionary as "the point at which the condition, degree, or amount of something is the most favorable."[27] Because arbitration is an ADR procedure, I think it is useful to step back and take a look at it in context. In many ways this discussion supplies the theory to yesterday's mock proceedings comparing mediation, arbitration, and court adjudication.

The history of human interaction has generated a range of dispute settlement techniques.

Although lawyers have been most familiar with litigation as the preeminent dispute settlement mechanism in contemporary American society, many other procedures for dispute settlement exist in the field of ADR. Primary among these are negotiation, mediation and arbitration.[28] However, in the ADR movement that gained momentum in the 1970s, hybrid procedures have also been designed to meet the special needs of parties—med-arb, mini-trial, and summary jury trials to name a few.[29] The discussion of optimality in this paper will focus on only the primary procedures for the purpose of distinguishing arbitration as a form of adjudication.

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[26]The "mandatory" aspect of predispute arbitration agreements has been roundly deplored. *See, e.g.*, Van Wesel Stone, *Mandatory Arbitration of Individual Employment Rights; The Yellow Dog Contract of the 1990s*, 73 Denv. U. L. Rev. 1017 (1996) (characterizing mandatory arbitration as the modern yellow dog contract) and Maltby, *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. Rev. 105 (2003) (supporting predispute arbitration but saying that the mandatory aspect is wrong).

[27]The American Heritage Dictionary of the English Language, 4th ed. (2000) (defining the noun form of the word "optimum").

[28]*See* Goldberg et al., Dispute Resolution Negotiation, Mediation and Other Processes, 4th ed. (2003), 287–88.

[29]*Id.* at 271–90.

Negotiation. Richard Shell has described negotiation as "an interactive communication that may occur whenever we want something from someone else or someone else wants something from us."[30] It is the most basic form of dispute resolution procedures. Alhough disputes typically involve claims based on rights or past arrangements, negotiations are not necessarily limited to such disputes. In fact, Sander and Rubin distinguish deal-making negotiation, a forward-looking process involving a decision about whether to enter into a relationship, from settlement negotiation, a backward-looking, adversarial process that is more focused on rights rather than interest and claiming rather than creating value.[31]

Regardless of type, negotiation barriers exist that may make negotiations difficult.[32] Some of these barriers are strategic, such as the reluctance to disclose information that may make bargaining more efficient but affect the size of a party's slice of the pie.[33] Another barrier might be the divergent interests of the principle and agent. Professor Mnookin uses the example of incentives against early settlement for lawyers working on billable hours. There are also cognitive barriers such as risk aversion, and something called reactive devaluation, where a party attaches less value to a proposal made by an opponent than the same proposal from an ally or neutral. And there are many other barriers to negotiated

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[30]Shell, Bargaining For Advantage (1999), at 6 (defining negotiation as "an interactive communication that may occur whenever we want something from someone else or someone else wants something from us"), and Goldberg et al., *supra* note 28 at 19 (defining negotiation as "communication for the purpose of persuasion").

[31]*See* Sander & Rubin, *The Janus Quality of Negotiations: Dealmaking and Dispute Settlement*, 4 Neg. J. 109 (1988).

[32]Goldberg et al., *supra* note 28 at 89, suggest the following barriers:

1. Failure of adequate preparation (fact gathering and analysis as well as strategic planning).
2. Failure of effective communication.
3. Emotionalism.
4. Extrinsic factors such as linkages to other disputes or preexisting commitments.
5. Different perceptions of alternatives to agreement.
   a. Different information.
   b. Different assessments of the same information.
6. Constituency pressures.
7. Stakes not suited to compromise, such as intensely held personal values that are not likely to be conceded voluntarily, or where a party's economic survival is threatened.
8. Different attitudes toward risk.
9. Different attitudes toward the desirability of a prompt settlement.
10. No zone of agreement.

[33]*See* Goldberg et al., *supra* note 28 at 100–01, and Mnookin, *Why Negotiations Fail: An Exploration of Barriers to the Resolution of Conflict*, 8 Ohio St. J. on Dis. Resol. 235 (1993) (discussing strategic barriers).

settlements. When these exists, dispute resolution through negotiation may not be optimal.

Mediation. Mediation, of course, is negotiation assisted by a third party who, unlike an arbitrator, possesses no power to impose a solution.[34] Mediation can be an effective preserver of party relationships, where the mediator succeeds in uncovering the true sources of tension and makes acceptable proposals that help the parties constructively resolve the dispute.[35] We saw such a process at work yesterday. The barriers to dispute resolution through negotiation suggest that mediation may be optimal where barriers exist.[36] For example, an effective mediator such as yesterday's mediator in the mock proceeding, Jacque Wood, resolves the tension between efficiency and distributive concerns by encouraging the parties to disclose important information or circumvents reactive devaluation by becoming himself the source of workable proposals. Where negotiation would be an effective means of dispute settlement absent its obstacles, mediation might be an optimal technique.

Adjudication. Adjudication is a process of decision making based on the presentation of proofs and reasoned argument.[37]

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[34]*See* Goldberg et al., *supra* note 28 at 111. Noting that the mediator changes the dynamics of the negotiation, Goldberg et al., list the following ways a mediator may seek to overcome the barriers to dispute settlement through negotiation:

- Encourage exchanges of information.
- Provide new information.
- Help the parties to understand each other's views.
- Let them know that their concerns are understood.
- Promote a productive level of emotional expression.
- Deal with differences in perceptions and interests between negotiators and constituents (including lawyer and client).
- Help negotiators realistically assess alternatives to settlement.
- Encourage flexibility.
- Shift the focus from the past to the future.
- Stimulate the parties to suggest creative settlements.
- Learn (often in separate sessions with each party) about those interests the parties are reluctant to disclose to each other.
- Invent solutions that meet the fundamental interests of all parties.

[35]*See* Goldberg, Green, & Sander, *Litigation, Arbitration or Mediation: A Dialogue*, ABA Journal (June 1989).

[36]*See* Mnookin, *supra* note 33 (suggesting how skillful mediators may eliminate barriers).

[37]Although interest arbitration is a counterexample, see Fuller, *The Forms and Limits of Adjudication*, 92 Harv. L. Rev. 353, 364, 366–67 (1978) (describing the "distinguishing characteristic of adjudication [as] a peculiar form of participation in the decision, that of presenting proofs and reasoned arguments for a [favorable] decision" and as "a device which gives formal and institutional expression to the influence of reasoned argument in human affairs," and noting that "[a] decision which is the product of reasoned argument must be prepared itself to meet the test of reason.").

Adjudication, unlike negotiation and mediation, is not optimal to resolve disputes that arise in the process of deal making.[38] Rather, adjudication may be optimal when the parties need a third party to impose a solution. If one or more of the parties for whatever reason insist upon a declaration of rights, a voluntary process such as negotiation or mediation will not be effective.[39]

Courts and administrative agencies are the primary government institutions for adjudicating disputes involving public legal rights. As I have already noted, arbitration is a form of adjudication—an informal adversarial proceeding—that is contractually designed by the parties. It uses decisional rules that define the factual propositions to be proved in a case, evidence constituting proofs, and decisions that are binding on the parties. Because arbitration relaxes the rules of procedure, dispenses to some extent with discovery, and limits judicial review, it reduces expenses and delay, increases speed, and advances finality. Statistics show that employment civil rights cases take 689.5 days (approximately 23 months) from the time of filing to resolution compared with 8.6 months (slightly more than one-third the time) from filing to resolution in arbitration.[40] These arbitration attributes may also lead to less competent decision making, less procedural protection, and less relief. Where adjudication would be the most appropriate form of dispute resolution, when is arbitration, rather than litigation, optimal?

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[38] *Id.* at 394–404 (describing the ineffectiveness of using adjudication to deal with what he calls polycentric problems). *See* Lipsky & Seeber, The Appropriate Resolution of Corporate Disputes, 10 (1998) (finding in a survey of the Fortune 1000 corporations that about 64 percent of the respondents had not ever used arbitration of interest disputes while over 95 percent reported some use of arbitration in rights disputes).

[39] Mediation may not succeed in overcoming all obstacles to settlement. Note the likelihood that the barriers such as extrinsic factors (e.g., "linkages to other disputes or preexisting commitments"), constituency pressures, and high stakes (e.g., "intensely held personal values that are not likely to be conceded voluntarily, or where a party's economic survival is threatened"), cited in Goldberg, Sander and Rogers, *supra*, note 28, at 89 may prevent effective mediation. *See* Lipsky & Seeber, The Appropriate Resolution of Corporate Disputes—A Report on the Growing Use of AADR by U.S. Corporations 25 (1998) (noting that a party's emotional investment in the case may prevent the party from understanding the benefits of ADR and that the belief in a big victory may prevent agreement to an ADR process).

[40] *See* Maltby, *Paradise Lost—How the* Gilmer *Court Lost the Opportunity for Alternative Dispute Resolution to Improve Civil Rights*, 12 N.Y.L. Sch. J. Hum. Rts. 54 (1994); *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. Rev. 54 (2003) at 54.

Optimality in Arbitration

The economic concept of *optimality* is, of course, more rigorous than my favorite dictionary concept. Abstracting from economic analysis it can be said that optimality is the point at which costs and benefits intersect to produce the best decision in a transaction. The principle of optimality suggests that arbitration is an optimal form of adjudication when the benefits to be derived from adjudication are greater than the cost of arbitration but less than the cost of litigation.[41] In contractual cases where the relationship between the parties is privately ordered and the benefits privately defined, the cost-benefit analysis is straightforward. In statutory cases, however, the analysis is complicated by the definition of benefits. Statutes such as Title VII, the Securities and Exchange Act, and the Truth in Lending Act benefit not only individuals who are aggrieved by the conduct of violators, but also members of the public at large who fall into protected classes. This expanded (statutory) benefit may justify greater dispute resolution costs and make litigation optimal in some cases. In such cases arbitration may not be optimal because of its incapacity to produce the statutory benefit. However, in other cases the statutory benefit may not be sufficiently great to warrant the cost of litigation.[42]

A Paradigm Case

The paradigm case for optimality in arbitration is labor arbitration, because it has been the preeminent mechanism for settling disputes involving employee rights since World War II.[43] Virtually all parties in collective bargaining agreements have chosen arbitra-

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[41]*See* Drahozal & Hylton, *The Economics of Litigation and Arbitration: An Application to Franchise Contracts*, 32 J. Legal Stud., 549, 552, 533 (2003) (pointing out the incentive to bring a claim for compensation if a plaintiff's expected damage award exceeds his dispute resolution costs and also noting that a small damage award in a litigation regime eliminates the incentive to sue and creates an opportunity for joint party gain "by committing to an arbitration regime in which expected damages awards are closer to the optimal level—damages = plaintiff's harm + dispute resolution costs).

[42]An analogy is the Drahozal and Hylton point that "[t]he key factor in determining the preference for arbitration is the difference between the deterrence benefit and total dispute resolution cost. Thus, the parties may prefer an arbitration regime in which dispute resolution costs are substantially higher if the incremental deterrence benefit is large enough." *Id.* at 554.

[43]*See* Sharpe, *Introduction, An Oral History of the National War Labor Board and Critical Issues in the Development of Modern Grievance Arbitration*, 39 Case W. Res. L. Rev. 505 (1988–89) (discussing the pivotal role of the National Labor Board of World War II in development of arbitration as the principle means of settling labor disputes).

tion over litigation as the ultimate means of settling contractual disputes.[44] The endurance of this preference is evidence of its optimality. What attributes of labor disputes make them particularly well-suited to adjudication through arbitration rather than litigation?

Multiplicity of Claims. A workplace governed by a collective bargaining agreement for a term of years gives rise to many disputes, which are resolved under the contractual grievance-arbitration procedures. The number of grievances that wend their way through earlier steps of the grievance procedure depends on the size of the employer and the parties' relationship.[45] The costs of resolving these disputes in litigation would not justify the benefit of resolving garden-variety issues such as discharges based on attendance. Regardless of the size of the employer, it serves the interests of the employer, employees, and the union to have a dispute settlement mechanism that is capable of final resolution in the least disruptive, least expensive, and least cumbersome way. Arbitration offers the advantages of party control over the process, accessibility, affordability, and efficiency upon repeated use.[46]

Private Ordering. Through collective bargaining the parties order their relationship by legislating wages, hours, and terms and conditions of employment.[47] The negotiators are often lay company and union representatives whose concerns are primarily with workplace-specific issues and only secondarily with the external legal environment. The law of the shop that emerges from negotiations is an informal legal system. The issues that are eventually arbitrated may range from the simple absenteeism case to the complex combining of seniority lists of merging companies.[48]

The informality of arbitration is conducive to the lay participation of party representatives as well as other users. It is also

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[44]American Arbitration Association 1999 Annual Report 12, *available at* http://www.adr.org/upload/LIVESITE/About/annual_reports/000525ab.pdf.

[45]*See, e.g.*, Bales, Compulsory Arbitration: The Grand Experiment in Employment 102–13 (1999) (given statistics on number of disputes in company of 25,000 employees).

[46]*See, e.g.*, United Nations Conference on Trade and Development—Dispute Settlement, World Intellectual Property Organization. 4.2 Domain Name Dispute Resolution. See *www.unctad.orgUNCTAD/EDM/Misc.232/Add.35* (describing an example of the online arbitration system established by the World Intellectual Property Organization to resolve a high volume of domain name disputes (4,000 decisions from December 1999 through April 2003) efficiently and affordably).

[47]*See* Feller, *A General Theory of the Collective Bargaining Agreement*, 61 Cal. L. Rev. 663 (1973).

[48]*See, e.g.*, St. Antoine, The Common Law of the Workplace—the Views of Arbitrators (2d ed. in preparation).

adaptable enough to accommodate seasoned counsel in complex cases.

Expertise. Contractual labor relations is a specialized area of the law with a well-settled body of jurisprudence memorialized in arbitration reporters.[49] The parties rely upon this body of law not only when they try their cases before an arbitrator, but they also draft contractual provisions with an eye to likely interpretation. In such a regime, arbitration adds value by supplying an expert fact finder and "contract reader" whose experience gives the parties confidence in the decisions and the capacity of collective bargaining to order their relationship.[50]

Costly Alternatives. Litigation is not the only costly alternative to arbitration in labor relations. Labor disputes offer stark alternatives to arbitration. Labor history has been checkered by violent confrontation between labor and management.[51] Even when no blood is involved, the grievance strike can be much more costly to the parties than a more peaceful form of dispute resolution.[52] Moreover, as noted earlier, the peaceful method of litigation will typically involve greater costs than arbitration.

Continuing Relationship. Labor disputes involving rights under a collective bargaining agreement occur during the term (usually three years) of the agreement. They involve issues regarding the "meaning, application, and interpretation" of the agreement.[53] The parties to such an agreement have an interest in preserving the relationship during the term of the agreement. The characteristics of arbitration contribute to continuation of the relationship, while litigation tends to sever it.[54]

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[49]At the time of the presentation of this paper, the BNA Labor Arbitration Reports was up to volume 118.

[50]*See* Hylton, *Agreements to Waive or to Arbitrate Legal Claims: An Economic Analysis*, 8 Sup. Ct. Econ. Rev. 209, 229 (2000) (explaining increased deterrence as a function of reduction of the likelihood of error in arbitration). *See* St. Antoine, *Judicial Review of Labor Arbitration Awards: A Second Look at* Enterprise Wheel *and Its Progeny*, 75 Mich. L. Rev. 1137 (1977) (coining the "contract reader" term to describe the arbitral function).

[51]*See, e.g.*, Reuther, The Brothers Reuther, 143–70 (1976).

[52]*See, e.g.*, Sharpe, *A Study of Coal Arbitration Under the National Bituminous Coal Wage Agreement Between 1975 and 1990*, 93 W. Va. L. Rev. 497, 499–500 (1990) (describing the unique circumstances of wildcat strikes in the coal mining industry).

[53]*See, e.g.*, *United Steelworkers of Am. v. American Mfg. Co.*, 363 U.S. 564 (1960).

[54]*See* Williamson, The Economic Institutions of Capitalism, 71 (1985) (pointing out that "whereas continuity (at least completion of the contract) is presumed under arbitration machinery, that presumption is much weaker when litigation is employed.").

Deterrence Benefit. Professors Drahozal and Hylton, two economists/law professors, have made a point that "parties will structure their contracts so that future disputes are resolved within the forum that provides the optimal level of deterrence against undesirable conduct."[55] They define deterrence as "the sum of harms avoided net of avoidance costs."[56] The harms avoided are "losses due to the breach of explicit or implicit contract terms."[57] Avoidance costs include administering either implicit or explicit governance provisions.[58] They hypothesized that "contracting parties will choose the dispute resolution forum that maximizes the deterrence or governance benefits with their contract net of dispute resolution costs."[59] Following an empirical analysis of a sample of 75 franchise agreements to identify the determinants of arbitration provisions, they concluded that "the results suggest[ed] that deterrence issues matter more than dispute costs."[60] The labor arbitration experience seems to support this finding, as the parties, especially the union, are concerned that the likely enforcement of contractual rights be credible enough to deter their violation.

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[55]Drahozal & Hylton, *The Economics of Litigation and Arbitration: An Application to Franchise Contracts*, 32 J. Legal Stud. 549, 580 (2003).

[56]*Id.*

[57]*Id.* at 550. *See* Hylton, *Agreements to Waive or to Arbitrate Legal Claims: An Economic Analysis*, 8 Sup. Ct. Econ. Rev. 232, 229 (2000) (observing that the parties in a labor arbitration agreement "may be driven entirely by cost reduction, or by both cost reduction and deterrence").

[58]*Supra* note 55 at 550-551.

[59]*Id.* at 580.

[60]*Id.* at 550–51, 581. The authors started with the proposition that an optimal damage award equals losses to the plaintiff plus plaintiff's dispute resolution costs. This is also the point at which the defendant's incentive to forbear is socially optimal. Plaintiffs will bring claims "if [the] expected damage award exceeds . . . dispute resolution costs," and plaintiffs' ability to bring claims is pivotal to the forbearance of defendants (who would not forbear if plaintiffs could not bring claims). One of the implications of this formulation is that damages failing to cover plaintiffs' losses and dispute resolution costs would cause defendants not to forbear "in some instances in which forbearance is socially useful," while damages exceeding plaintiffs' losses and costs would cause defendants to forebear in some cases "in which forbearance is not socially desirable." *Id.* at 552–53. The authors did a multiple regression analysis to isolate the impact of independent variables on the inclusion of an arbitration clause in the franchise agreement as a dependent variable. These included high externality (low incidence of repeat business), startup costs, number of company owned outlets, permission to operate the franchise from home or part-time, restrictions on punitive damages, time limits for filing a claim, location restriction on filing a claim, home office state litigiousness, and existence of franchise protection statutes. The authors found their prediction that deterrence factors "have a greater impact than litigation cost factors" to be supported by the following variables. Parties were more likely to opt for arbitration where they expressed a concern about punitive damages (generating overdeterrence costs). When the parties have made efforts to control litigation through location and time limits, they are less likely to agree to arbitration. But parties were more likely to choose arbitration if they have chosen dispute resolution in a litigious home state. As the number of units owned by the franchiser increases, arbitration becomes less likely

The Drazahol/Hylton findings do not transfer perfectly to statutory arbitration cases, because (unlike franchise agreements) true arms'-length negotiation is missing in agreements between stronger and weaker parties. However, in some agreements, such as employment, employees have an interest in deterring statutory violations that is similar to the franchiser's interest in deterring franchisee shirking and free-riding.[61]

A Theory.

The paradigm case suggests that reduced costs make arbitration the optimal form of dispute resolution where: (1) arbitration is capable of fully resolving the dispute and alternatives to arbitration are impractical, (2) specific expertise is important, (3) numerous claims are likely, (4) there is a special concern about deterrence, (5) the parties have a continuing relationship, and (6) the parties' relationship is privately ordered.[62]

Professor Hylton made the following observations about the relationship between cost considerations and the groundswell in arbitration usage:

> Cost considerations probably have been the major force behind the growth of these [statutory arbitration] agreements, since it is unlikely that arbitrators have an advantage over judges in applying statutory law. Costs in this case include more than simply litigation costs. In addition to reducing claim-resolution expenses, arbitration often moves faster and enables the parties to preserve a working relationship, which is notoriously difficult in the context of full-blown litigation. There are also substantial deterrence benefits in the union setting under the

(presumably because the shirking and free–riding problems are diminished by the increased monitoring and role-modeling ability of the franchiser). As the start up costs increase (increasing the franchiser's bargaining power) the incidence of arbitration agreements decreases. Part-time operation is positively associated with arbitration because of the increased need for monitoring. As the network expands, arbitration agreements are more likely in high externality (low repeat business) industries and less likely in low externality (high repeat business) industries. *Id.* at 574–77.

[61] *See* Drahozal & Hylton, *The Economics of Litigation and Arbitration: An Application to Franchise Contracts*, 32 J. Legal Stud. 549, 556 (2003).

[62] *See* Final Report of the Dunlop Commission on the Future of Worker-Management Relations, *available at* http://www.ilr.cornell.edu/library/e_archive/gov_reports/defaujlt.html (1994), *and* A Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising out of the Employment Relationship, *available at* http://www.naarb.org/protocol.huml (treating labor arbitration as a paradigm).

> arbitration regime, even with respect to statutory claims. Although arbitrators are unlikely to have an advantage over judges in interpreting statutory law, the arbitral forum may be more accessible to claimants, and have an advantage in producing evidence.[63]

Deterrence may be higher under arbitration than litigation, because of the greater accessibility of arbitration leading to a greater number of enforcement actions. The combination of greater deterrence and reduced costs may make adjudication through arbitration optimal. Furthermore, it is likely that arbitration will be optimal under this test even in cases involving statutory rights—those cases, for example, where arbitration is likely to improve the deterrence benefit over litigation because of the increased likelihood of enforcement.

Lewis L. Maltby, Director of the National Task Force on Civil Liberties in the Workplace of the ACLU and member of a blue ribbon panel established to recommend procedures for the nonjudicial resolution of employment disputes, reviewed a broad range of studies and wrote an interesting article in the *Columbia Human Rights Law Review* about the mandatory arbitration of statutory disputes in employment.[64] Some of his observations are the following:

(1) employees win more often in arbitration than they win in court and more often than the EEOC prevails in court,
(2) remedially, even though the size of the awards to successful litigants is higher, employees fare better in arbitration than in court judging from the total amount actually received,
(3) even with the repeat player effect the outcomes suggest that arbitration is fair—employees won a higher percentage of claims that they filed than employers won of their claims filed in arbitration, and employees fare slightly better remedially,
(4) employees seem satisfied with the outcomes in arbitration as evidenced by the studies that have been done on employee satisfaction and rates of appeals of awards, and employee attitudes about employer ADR systems,
(5) as noted earlier, the average civil rights case takes 23 months versus 8.6 months for arbitration, and

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[63] *See* Hylton, *Agreements to Waive or to Arbitrate Legal Claims: An Economic Analysis*, 8 Sup. Ct. Econ. Rev. 233–34 (2000). Hylton also acknowledges the following comparative costs of litigation: "disruption of relationships and polarization associated with the publicity and formality of litigation" and greater difficulty in generating evidence. *Id.* at 234–35.

[64] Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 Colum. Hum. Rts. L. Rev. 45–6. (1998).

(6) employees have much less access to courts than to arbitration, because of the staggering costs of litigation compared to arbitration.[65]

Non-Optimal Cases

This theory (or test) immediately also suggests cases where arbitration is not optimal, such as cases that have broad policy implications. An example is *Brown v. Board of Education*,[66] whose 50th anniversary we are celebrating this year, and cases involving new legal issues. For example, Professor Kenneth Abraham has written an essay arguing that mandatory arbitration should not be used in insurance coverage disputes involving new issues, because the "lawlessness" of mandatory arbitration affects not only the parties to the dispute but the legal system as a whole.[67] He claims that mandatory, binding arbitration in insurance cases presents two features of lawlessness: (1) the lack of precedential value of arbitration decisions combined with their confidentiality deprives the insured of knowledge of the insurer's position regarding the meaning of policy provisions; and (2) an insurer can continue to assert a position in arbitration, even though it has been rejected in earlier arbitrations. This lack of information makes mandatory, binding arbitration a risky proposition for insurance policy holders.[68]

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[65] *See also* Maltby, *Employment Arbitration and Workplace Justice*, 38 U.S.F. L. Rev. 105, 117 (2003) (updating and refining the arguments in the *Columbia* article to assert that "more than twice as many employees can afford to take their cases to arbitration as can afford to litigate those same cases, . . . employees who arbitrate their claims are 50% more likely to win than those who go to court, . . . the size of the award successful employees receive in arbitration is comparable to the judgments most prevailing employees receive in court, . . . [and] the only negative for employees who arbitrate the employment disputes may be that extremely large awards are less common in arbitration.").

[66] 347 U.S. 483 (1954).

[67] *The Lawlessness of Arbitration*, 9 Conn. Ins. L.J. 355 (2002/2003).

[68] In explaining the effect of mandatory, binding arbitration on legal development, Abraham contrasted the effect of a decision of the highest court:

> To see the way in which binding arbitration may adversely affect legal development, consider once again our earlier hypothetical case that can either be arbitrated or litigated. In this case, once the state supreme court's decision on the expected or intended issue was rendered, under the doctrine of collateral estoppel the insurer was precluded from taking the same position in future cases because the issue had been fully litigated and definitively decided against it. Similarly, under the doctrine of stare decisis, the decision was binding precedent that would preclude other insurers from relitigating the issue. Because of both doctrines, and regardless of the identity of the insurer, a trial court would be without authority to hold that, on the same essential facts, a policyholder expected or intended bodily injury or property damage as a matter of law. *Id.* at 366.

Class actions are often not permitted under arbitration agreements. If arbitration agreements are interpreted to preclude court class actions under federal statutes, many small claimants (including those whose claims are less than arbitration costs) would be prevented from pressing their individual claims. In *Szetela v. Discover Bank*,[69] the court demonstrated an understanding of the link between class actions and deterrence in finding substantively unconscionable and unenforceable an arbitration clause prohibiting class actions on the following reasoning:

> It is the *manner* of arbitration, specifically, prohibiting class or representative actions, we take exception to here. The clause is not only harsh and unfair to Discover customers who might be owed a relatively small sum of money, but it also serves as a disincentive for Discover to avoid the type of conduct that might lead to class action litigation in the first place. By imposing this clause on its customers, Discover has essentially granted itself a license to push the boundaries of good business practices to their furthest limits, fully aware that relatively few, if any, customers will seek legal remedies, and that any remedies obtained will only pertain to that single customer without collateral estoppel effect. The potential for millions of customers to be overcharged small amounts without an effective method of redress cannot be ignored. Therefore, the provision violates fundamental notions of fairness.[70]

Even where class action arbitrations are permitted as in *Szetela*, they may prove unworkable because of logistical and due process concerns such as excessive judicial involvement in class certification, notice and protection regarding class members, as well as approval of settlements.[71]

The court's deterrence argument in *Szetela* would seem to hold for cases involving joint or consolidated claims, permitted by federal procedural rules but not by arbitration.[72] Similarly, arbitration would not be optimal where an arbitrator could not award an appropriate remedy. For example, in *Broughton v. Cigna Healthplans*,[73] the California Supreme Court refused to order arbitration of a California Consumer Legal Remedies Act claim for

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[69]118 Cal. Rptr. 2d 862 (Cal. App. 4th Dist. 2002).

[70]*Id.* at 868.

[71]*See* Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 Wm. & Mary L. Rev. 1, 38–53 (2000) (noting the purported virtues and failings of class wide arbitration)

[72]*See* Stipanowich, *Arbitration and the Multiparty Dispute: The Search for Workable Solutions*, 72 Iowa L. Rev. 473 (1987).

[73]90 Cal. Rptr. 2d 334 (Cal. 1999).

injunctive relief, because it deemed an order of such relief through arbitration to be inappropriate under the applicable statute.[74]

Optimizing Effects

Lewis Maltby makes the following statement at the end of his Columbia piece:

> [A]t its best, however, arbitration holds the potential to make workplace justice truly available to rank-and-file employees for the first time in our history. Our civil justice system has failed at making workplace justice affordable. By reducing the costs, private arbitration holds the potential for bringing justice to many to whom it is currently denied.[75]

Maltby's optimism about the potential for arbitration "at its best" captures a big segment of the scholarly commentary and other activism on mandatory arbitration. These activities are dedicated to what I call *optimizing effects*—suggested reforms that eliminate the flaws of arbitration while preserving its positive features.

The Due Process Protocol

The major procedural concern in arbitration is that the stronger party drafting the mandatory arbitration agreement may craft procedures in arbitration that deny the weaker party (employee, consumer, patient) an opportunity to fairly prosecute a statutory claim. Recognizing this potential for abuse, employment, consumer, and health care task forces have promulgated due process protocols that set forth procedural requisites for conducting employment, consumer, and health care arbitrations.[76]

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[74]In *Broughton*, the California statute provided for damages as well as injunctive relief against deceptive business practices. The court ruled the damages claim arbitrable based on the private benefit to the plaintiff. By contrast, the court pointed to the public benefit derived from an injunction and the "institutional shortcomings of private arbitration in the field of such public injunctions," making the following observation about the monitoring role of courts:

> The continuing jurisdiction of the superior court over public injunctions, and its ongoing capacity to reassess the balance between the public interest and private rights as changing circumstances dictate, are important to ensuring the efficacy of such injunctions. *Id.* at 345.

[75]Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 Colum. Hum. Rts. L. Rev. 62 (1998).

[76]The protocols typically provide for (1) neutrality of the neutral, (2) selection of the arbitrator, (3) right to counsel, (4) right to reasonable discovery, (5) identical remedies, and (6) a written opinion. *See, e.g.*, *A Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of the Employment Relationship*, 50 Disp. Resol. J. 37 (Oct.–Dec.

Professor Margaret Harding, writing comprehensively and thoughtfully on this topic, applauds these efforts as important to the actual and perceived fairness of mandatory arbitration of disputes.[77] However, Harding is also critical of protocols as self-regulatory instruments lacking the force of law. She argues that the effectiveness of protocols depends on the quality of the standards, the voluntary commitments of arbitrators to the standards, the ability to monitor adherence, and an enforcement mechanism.[78] Harding advocates improvement of the standards and the creation of oversight entities that would monitor and enforce compliance.[79]

Other Optimizing Effects

Ethical Contract Drafting. Like Lewis Maltby, Professor Martin H. Malin recognizes the potential of mandatory arbitration. He has said:

> [W]e stand at a crossroads where employment arbitration can develop into an efficient system for resolving workplace disputes with significant benefits for employers and employees, or it can develop into a vehicle for employer avoidance of statutory duties and thwarting of legitimate employee claims.[80]

Malin has argued that considerations of public policy in statutory arbitration cases give lawyers a special professional obligation to draft fair procedures for the conduct of arbitration for their

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1995) *available at* http://www.naarb.org/protocol.html, and *Health Care Due Process Protocol: A Due Process Protocol for Mediation and Arbitration of Health Care Disputes*, Program Book (Comm'n on Health Care Dispute Resolution, ABA Section on Disp. Resol., Washington, D.C.) (April 30, 1999).

[77] *See* Harding, *The Limits of the Due Process Protocols*, 19 Ohio St. J. Disp. Res. 369, 401, 416–17 (2004). For example in describing the employment protocol, Harding observes:

> The *Employment Protocol* has had a far-reaching impact. Not only has it provided employees with a more balanced process when required to arbitrate a controversy with an employer, it has also acted as the blueprint of the development of the due process protocols for consumers and those involved in health care disputes. In addition, the *Employment Protocol* has been used to provide guidance to federal and state agencies, creating arbitration programs and to the courts when attempting to determine the enforceability of a particular arbitration clause. Federal lawmakers have also looked to it for guidance in various attempts to amend the FAA. *Id.* at 401.

[78] *Id.* at 417.

[79] *Id.* at 452–55, 441–45.

[80] Malin, *Ethical Concerns in Drafting Employment Arbitration Agreements After* Circuit City *and* Green Tree, 41 Brandeis L.J. 779, 782 (2003).

clients.[81] He reasons that the lawyer drafting an arbitration agreement is doing more than drafting a form contract—the lawyer is creating a system for vindication of public rights, which imposes on the lawyer as an officer of the court an independent professional obligation to ensure a fairly drafted procedure.[82]

Conduct of Hearing. In their survey of more than 600 Fortune 1000 companies, David Lipsky and Ronald Seeber found that 49 percent of the respondents regarded the absence of rules governing the admissibility of evidence, examination of witnesses, and discovery as an important reason for not using arbitration.[83] The surveyors noted that even though these elements are often viewed as arbitration's advantages, "many respondents view them as barriers to its use."[84]

The concern of respondents may have less to do with the relaxation of rules of evidence in arbitration than arbitrators' perceived lack of facility with the rules. To the extent that perception matches reality, arbitrators should commit to a mastery of the Federal Rules of Evidence (FRE).[85] Several reasons support this argument, as articulated by Professor Laird Kirkpatrick:

> First, parties can stipulate in the arbitration clause or submission that the hearing be conducted pursuant to formal rules of evidence. Second, evidentiary principles are applied to assess the weight of the evidence. Third, the procedures followed in arbitration proceedings are generally consistent with the procedural aspects of the Federal Rules of Evidence. Finally, the relevancy doctrine is enforced in arbitration hearings and additional exclusionary principles are also sometimes applied.[86]

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[81] *Id.* at 781.

[82] *Id.* at 814–15.

[83] *See* Lipsky & Seeber, *The Appropriate Resolution of Corporate Disputes—A Report on the Growing Use of ADR by U.S. Corporations* 26.

[84] *Id.* at 26.

[85] The FRE is the preeminent evidentiary code in the United States. It is used throughout the federal judicial and administrative systems. It is also the model for state evidentiary codes, many of which essentially track the FRE while others largely incorporate its provisions with minor variations.

[86] *See* Kirkpatrick, *Scholarly and Institutional Challenges to the Law of Evidence From Bentham to the ADR Movement*, 25 Loy. L.A. L. Rev. 837, 844–45 (1992). Kirkpatrick also notes the current application of the FRE in arbitral practice, e.g., 402 (basic relevancy), 403 (exclusion of relevant evidence because of policy considerations such as prejudice and cumulativeness), 404 (character evidence), 408 (offers of compromise or evidence of compromise negotiations), 601 (opinion evidence), evidentiary or constitutional privilege such as the Fifth Amendment privilege against self-incrimination. *See generally* Mueller & Kirkpatrick, Evidence, 3d ed. (2003).

Professor Kirkpatrick notes the critical role that the evidentiary rules play in evaluating evidence, even where the proceeding does not apply exclusionary evidentiary rules.[87] His central argument is that evidentiary principles survive in arbitration to ensure "a rational fact-finding process." Although hearsay may be admitted into evidence, for example, concerns about reliability underlying the hearsay rule will affect its weight. Similarly, even evidence not supported by the proper foundation of personal knowledge might be admitted in arbitration rather than excluded under Rule 602; it may well be given little or no weight because of reliability concerns reflected in the rationale of Rule 602.[88] Hence, the argument concludes: "arbitrators and other participants in the ADR process should be familiar with rules of exclusion because their underlying rationale helps guide the evaluation of evidence."[89]

The public policies at stake in statutory cases make a well-developed appreciation of evidentiary principles even more important for the arbitrator. The optimizing effect of added precision in evaluating evidence moves arbitration closer to its potential to effectively decide such cases. It is also likely to minimize the parties' resistance to using arbitration.

Written Reasoned Awards. The writing of a reasoned decision is an optimizing effect for two related reasons. First, the writing itself produces greater deliberation and care in the crafting of the decision.[90] The resulting enhancement of accuracy and thoroughness in the decision enhances the arbitration work product. Sec-

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[87] *Id.*

[88] A similar example would be expert testimony of questionable reliability under Rule 702 (because of doubts about the witness' qualifications, for example), admitted but discounted to reflect the uncertainty about its reliability.

[89] *Supra* note 85 at 848.

[90] *See* Abrams, *The Nature of the Arbitral Process: Substantive Decision-Making in Labor Arbitration*, 14 U.C. Davis L. Rev. 551, 585 n.88 (1981) (saying that "[t]he very activity of expressing the basis for decision channels an adjudicator's mind along rational lines" and noting the following quote attributed to Felix Frankfurter: "we all feel much more responsible if we have to sit down and write out why we think what we think"); Wald, *The Problem with the Courts: Black-Robed Bureaucracy, or Collegiality Under Challenge?*, 42 Md. L. Rev. 766, 782 (1983) (describing her conviction that every appellate decision "requires some statement of reasons," because "[t]he discipline of writing even a few sentences or paragraphs explaining the basis for the judgment insures a level of thought and scrutiny by the court that a bare signal of affirmance, dismissal, or reversal does not"); Kaczmarek, *Public Law Deserves Public Justice: Why Public Law Arbitrators Should Be Required To Issue Written, Publishable Opinions*, 4 Employee Rts. & Emp. Pol'y J. 285, 317–18 (2000) (noting the motivational effect of having to justify an award in an opinion); and Sharpe, *Integrity Review of Statutory Arbitration Awards*, 54 Hastings L.J. 311, 354–58 (2003) (discussing the importance of written opinions).

ond, the writing facilitates the reviewing court's scrutiny of the award and adds to the arbitrator's incentive to perform at the highest level.[91] Where the effective enforcement of public policy is at stake as in cases involving statutory rights, a written reasoned award is essential.

Judicial Review. The written reasoned award and judicial review of the award may be thought of as complementary effects producing the same value of accuracy. As already noted, the prospect of judicial review adds to the accuracy and hence the optimality of the award. The challenge is to deploy a standard of review that produces sufficient scrutiny to create the desired effect, while avoiding an unwarranted diminution of finality—an important attribute of arbitration. Elsewhere, I have suggested a *substantive integrity* standard that gives adequate assurance of accuracy as well as due recognition to the arbitrator's craft and professionalism; it also preserves an oversight role for the reviewing court that reinforces the optimizing effects of monitoring without unduly undermining finality.[92]

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[91] *See* Baumeister et al., Losing Control—How and Why People Fail at Self-Regulation 92 (1994) (defining accountability as "any pressure on the person to defend his or her decision or to personally accept bad consequences for making a wrong choice" and elaborating "when people expect to have to justify their judgments, or even if they merely think that their decision will be made public, they try harder to be thorough . . . [t]hus, various forms of accountability make people pay more attention, process information more thoroughly, and hence reach more informed decisions and resist bias.").

[92] The *substantive integrity* standard operates as follows:

An arbitrator's failure to apply the applicable law through legal reasoning would warrant a finding that an erroneous decision should be vacated as lacking substantive integrity.

(1) Under the proposed standard the court looks independently at the record to first determine whether the arbitrator's decision is correct; a correct decision ends the inquiry.

(2) If the decision is incorrect, the court closely examines the arbitrator's law-finding for correctness.

(3) Wrong choices of law or ignoring the law results in the setting aside of an erroneous decision.

(4) If the law is correctly selected, the court evaluates the arbitrator's fact-finding and law applying only to determine whether the arbitrator's conclusions have been reasoned from the materials in the record.

(5) Reasoned conclusions are entitled to deference, even though the court would have reached a different result.

(6) The court may draw a negative inference regarding the rationality of an erroneous award in the absence of a reasoned written opinion.

Sharpe, *Integrity Review of Statutory Arbitration Awards*, 54 Hastings L.J. 311 (2003).

Conclusion

My conclusion is affirmative. Mandatory arbitration in statutory disputes can be a good thing.[93] It can answer the variety of problems created by litigation in vindicating statutory rights. It can be the antidote to a kind of institutional failure inhering in litigation. Without arbitration, far fewer rights might be enforced than with arbitration. And with greater enforcement employers and other big guys have a greater incentive to accord statutory protections leading to greater fulfillment of the legislative purpose. Attainment of the legislative purpose, however, will depend on the extent to which optimizing effects advance arbitration toward the actualization of its potential.

What are the implications of optimality theory for arbitrators? In statutory cases, arbitrators must contribute to the optimizing of arbitration by strictly adhering to the due process protocol,[94] giving greater attention to procedure (especially evidentiary procedure) in the conduct of hearings, and writing well-reasoned awards that are subjected to limited judicial supervision. Because these aspirations are well within the purview of highly acceptable arbitrators, the prospects are bright for the effective use of high-level arbitration as a vehicle for protecting the public policies embodied in legislation.

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[93]It can be argued, as Maltby, Stone, and others do, that predispute arbitration agreements should not be mandatory—that employers, hospitals, financial companies, and other powerful contractors should not make the signing of such agreements a condition of the contractual relationships. In light of *Gilmer* and *Circuit City*, this paper takes mandatory arbitration agreements as a given, constituting the point of departure for its analysis.

[94]Such strict adherence will provide an additional incentive for the ethical drafting of arbitration agreements.