***Resolving The Arbitration Controversy Through Arbitral Integrity and Judicial Supervision***

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**I.**

***Introduction***

As a new member of the club, thinking about a topic for my first presentation it was illuminating to read Clinton DeWitt's work on the origin and early history of the club. The topics presented during the first and second twenty years of the life of the club showed a wide range of inquiries from gnostic philosophy to "food for fitness." And scattered among this range of topics were quite a number of legal and public policy topics. In the early days Judge Alexander Hadden and Judge Frederick Henry talked about the courts.

It was also quite evident from this review that, while members spoke on multiple topics, these often grew out of their professional fields. So what I have prepared is a talk on public policy involving an alternative to the courts in one of my professional fields. The professional field and alternative to courts is arbitration, and the public policy issue I'll spend some time introducing.

**II.**

***Settling Disputes***

The history of human interaction has generated a range of techniques for settling disputes. All of us are familiar with litigation. In the American legal system it is the ultimate mechanism for resolving disputes involving legal rights. And as certainly the lawyers in the room know legal rights are created in a number of ways including by statutes, contracts and the common law (or judge made law).

Although we associate courts with the resolution of disputes involving legal rights,

alternatives to courts do exist to resolve rights. The term that you may have heard that captures the array of non-court mechanisms for resolving rights disputes is alternative dispute resolution or ADR. The primary ADR mechanisms are negotiation, mediation and arbitration----there are other forms as well, but these are the three I want to spend a little time talking about in the context of arbitration so as to better inform your thinking about the public policy issue.

Starting with negotiation. What is negotiation? Well, we all do it, whether we realize we're doing it or not. We do it with our children, our spouses, our friends, our business associates, and our adversaries. One scholar [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." It is the most basic form of dispute resolution procedures.

Although 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 than interest and claiming value rather than creating value.

Regardless of type, negotiation barriers exist that may make negotiations difficult. 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. Another barrier might be the divergent interests of the principle and agent. One scholar uses the example of incentives against early settlement for lawyers working on billable hours. The more hours, the greater the bill, the lower the motivation to turn off the spigot by settling early.

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

Mediation is negotiation assisted by a third party who possesses no power to impose a solution. 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 to resolve the dispute. The barriers to dispute resolution through negotiation suggest that mediation may be optimal where barriers exist. An effective mediator can resolve the tension between efficiency and distributive concerns (how big will be my slice of the pie) by encouraging the parties to disclose important information, or circumvent reactive devaluation by becoming 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 is a process of decision-making based o the presentation of proofs and reasoned argument. Adjudication, unlike negotiation and mediation, is not optimal to resolve disputes that arise in the process of deal making. 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.

Courts and administrative agencies are the primary government institutions for adjudicating public legal rights. Arbitration is a form of adjudication, which is an informal

adversarial proceeding that is contractually designed by the parties. The advantages of arbitration are the following:

(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 a trial date 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.

(6) expertise of the factfinder–since the factfinder is party-selected and not court imposed, they may improve accuracy by selecting an expert . [gsr 234]

And arbitration has had a distinguished history. First, it's been around since antiquity. Paul in 1 Corinthians 6:1-8 is exhorting the early Christians to take their grievances to arbitration (a wise person among them who can decide disputes between believers) rather than lawsuits. And, more recently, arbitration has had a distinguished history in resolving labor disputes.

There were required of all agreements by the war labor board in WWII, and the parties kept them in their agreement following the end of the war. Upwards of 99% of all collective bargaining agreements have arbitration provisions. The features of labor disputes give us some insights about the circumstances that make arbitration optimal.

*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

procedure. 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. 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 interest of the employer, employees and 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.

P*rivate ordering*. Through collective bargaining th parties order their relationship by legislating wages, hours, and terms and conditions of employment. 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 eventually arbitrated may range from the simple absenteeism case to the complex merger of seniority lists of merging companies.

The informality of arbitration is conducive to the lay participation of party representatives as well as other users. It is also 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. The parties rely upon this body of law not only when they try their cases before an arbitrator. They also draft contractual provisions with an eye to likely interpretation. In such a regime arbitration adds value by supplying an expert factfinder and "contract reader' whose experience gives the parties confidence in the decisions

and the capacity of collective bargaining to order their relationship.

*Costly alternatives*. Litigation is not the only costly alternative to arbitration in labor relations.

–labor disputes off stark alternative to arbitration. Labor history has been checkered by violent confrontation between labor and management. 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. 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.

–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.

*Deterrence benefit*. Since the accessibility of arbitration increases the likelihood that contractual rights will be enforced, this threat is credible enough to deter violations.

—deterrence would be diminished, if enforcement were less credible as with litigation.

## **III**.

## ***The Controversy***

So, you might be saying, this sounds like good news. Where's the controversy?

Collective bargaining cases involve contractual arrangements where the rules are made up by the parties; they are ordering their own relationship. In a very real way they declare what the law is—the private law that applies to them.

But what happens when the contract subjects not only the parties' private law to arbitration but public law as well—laws like Title VII (which prohibits race, sex, religious, disability, and age discrimination in the workplace), or the anti-trust law (which protects competition in the marketplace), or the securities laws (which protects stockholders), or the Truth in Lending Act (which protects borrower). Should disputes arising under these laws be subjected to arbitration?

Notice that the only reason that this question comes up is because the parties have entered into an agreement that disputes arising under these laws will be arbitrated. But also notice that these agreements may be contracts of adhesion–meaning that the weaker party—the employee, the consumer, the patient—must accept the contract on a take-it-or-leave it basis. It is for this reason that this kind of arbitration is often referred to as mandatory arbitration.

Also, notice that the court's role is quite limited, where a case is submitted to arbitration. In labor arbitration, even where the arbitrator is wrong on the merits, the courts may not properly step in and correct the decision. The arbitrator is the parties' chosen decision-maker, and they must live with the decision unless the arbitrator engages in some kind of misconduct (being wrong is not misconduct) or exceeds her authority under the contract by e.g. awarding a remedy that the contract prohibits.

Finally, notice that when these agreements to arbitrate are entered into and upheld by the courts, it means that the parties have waived (or forfeited) their rights to go to court despite the fact that statutes contemplate that courts will decide cases arising under the statutes. It's important to point out the difference between contractual cases, where the parties create the rules and statutory cases where congress creates the rules. Even in collective bargaining cases where

arbitration's credentials are impeccable, the supreme court has held that cases involving Title VII issues decided in arbitration can still go to court. The arbitration decision (called an award) does not preclude a judicial action.

The Supreme Court in a case [***Gardner-Denver***] said that arbitrating a case involving contractual rules is one thing; arbitrating a case involving statutory rules is quite another matter. Arbitrators were competent to apply the law of the shop (private law) and not the law of the land (public law). And the court in *Gardner-Denver* thought that arbitration as a process was inferior to judicial factfinding because: (1) the record is not as complete, (2) the usual rules of evidence and procedure do not apply, (3) arbitrators are not required to give reasons for an award, (4) the informality of arbitration that allows it to be an efficient, inexpensive, and expeditious means for dispute resolution makes it less appropriate to resolve Title VII issues. While the law was developing this way in the collective bargaining context, the law governing arbitration was also developing on a different track outside of collective bargaining, often involving parties with unequal bargaining power unlike unions and employers.

Generally stated, the controversy is ***whether privatizing justice in cases involving statutory claims is appropriate.*** More specifically stated, the controversy is whether contracting parties with unequal bargaining power should be bound by pre-dispute agreements to arbitrate statutory claims that might arise during their contractual relationship. A federal arbitration law, the Federal Arbitration Act (FAA), passed in 1925 made pre-dispute arbitration agreements (agreement entered into in some cases well before the dispute arose) valid and enforceable. Early anti-reform sentiment made passage of this law difficult, a major concern being that these pre-dispute agreements permitted businesses to escape public regulation through a kind of one-

sidedness in making and performing arbitration agreements.

Its 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. And in a 1953 case, *Wilko v. Swan*, 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 non-enforcement 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 anti-waiver 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. In these cases decided in the 1980's 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*, 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 including *Gardner-Denver* that arose in the context of collective bargaining agreements that contained arbitration provisions. 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. 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* represented a potential sea change in the enforcement of statutory rights.

Because of the narrow scope of review of arbitration awards, arbitration may be the only forum in which important statutory disputes are adjudicated. Why is that? Because *Gilmer* and *Circuit City* give employers the ability to require employees to sign arbitration agreement as a condition of employment. So, is it socially desirable to permit employers to impose mandatory arbitration in disputes involving public rights. ( And this does not only apply to employers and employees, it applies to big guys and little guys in general including business and consumers—read your credit card agreement; it has an arbitration provision—hospital and patients)

Proponents point to the advantages of cost, speed, procedural informality, privacy, special expertise and finality that I've already noted. Many proponents regard the cost factor as the most important. They argue that it affords access to the adjudication of statutory rights that would not otherwise exist in many case. Proponents also support pre-dispute arbitration arrangements noting the employer's incentive to avoid arbitration where the claimants seek it after the dispute crystallizes.

The arguments of opponents focus on fairness. Can the bargaining that led the

mandatory arbitration be fair? Can the procedures of mandatory arbitration be fair? Is the outcome of mandatory arbitration fair? Perhaps the most influential critique preceded *Gilmer* and was not limited to arbitration; rather, it took on the entire adr movement. In a 1984 Yale Law Review article entitled, *against settlement*, Professor Owen Fiss argued that settlement is inappropriate in the majority of cases for four reasons. First, the agreement may reflect the inequality of resources between the parties rather than the predicted outcome of a suit. Second, the non-existence 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.

> 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.

## IV.

### *Optimality in Arbitration*

I believe that neither the opponents nor the proponents are complete right or wrong. Using labor arbitration as the paradigm case, I believe that arbitration is optimal in certain kinds of cases: 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 alternative 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/or the parties' relationship is privately ordered.

And when I speak of cost here I'm considering the cost of litigation as well as costs in time and harm to relationships. 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. It is likely that arbitration will be optimal under this test even in cases involving 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 non-judicial 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. I don't have time to give you all of his findings but I will note 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 received,

(3) employees won a higher percentage of claims that they filed than the claims that es filed in arbitration and fare slightly better remedially,

(4) employees seem satisfied with the outcomes in arbitration as evidenced by the studies that

have been done on ee satisfaction and rates of appeals of awards, and ee attitudes about e adr systems.

(5) average civil case takes 2 ½ years versus 8.6 months for arbitration,

(6) much less access to courts because of the staggering costs of litigation compared to arbitration.

And there are cases where arbitration is not optimal. Cases that have broad policy implications e.g. *Brown V. Board of Education*, the 1954 case that struck down segregation of schools under the separate but equal doctrine. Cases involving new legal issues that the court should resolve so that they provide guidance as precedent. 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. This argument would seem to hold for cases involving joint or consolidated claims, permitted by federal procedural rules but not by arbitration. Arbitration would not be optimal where an arbitrator could not award an appropriate remedy.

*Optimizing effects*

> Lewis Maltby makes the following statement at the end of his Columbia piece:
>
> > at 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 hold the potential for bringing justice to many to whom it is currently denied**.**

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 positive features. I will note them quickly.

*The Due Process Protocol and ethical obligation*. The major procedural concern 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 task forces have promulgated due process protocols that set forth procedural requisites for conducting employment, consumer and health care arbitrations. These protocols typically address (1) neutrality of the neutral, (2) selection of the arbitrator, (3) right to counsel, (4) reasonable discovery, (5) identical remedies, and (6) written opinions.

Because of considerations of public policy, statutory arbitration cases carry a special drafting obligation. Lawyers must draft fair procedures for the conduct of arbitration.

*Arbitral Integrity and Judicial Review.* I think that arbitrator conduct and reasoning must be at the highest level of professionalism with well-reasoned and written awards. I think we must broaden the standard of review in a way that preserves arbitral autonomy while expanding the

courts' supervisory role. Where arbitrators have selected the wrong statute and reached the wrong decision, the court should reverse. Where the correct law has been selected and the wrong decision reached, the arbitrator should not be automatically reversed. Rather, the court should make sure that the arbitrator reasoned from the evidentiary materials in the record. If the arbitrator is wrong and provides no reasoned written opinion, the presumption is that she did not reason from the materials in front of her. The decision should be reversed. The requirement of a written reasoned opinion is critical to this standard of review. I believe that this kind of monitoring will help courts to meet their public responsibility and arbitrators to get it right.

## V.

## *Conclusion*

My conclusion is yes. Mandatory arbitration in statutory disputes can be a good thing. It can be the answer to the variety of problems created by litigation in vindicating statutory rights. It can be the antidote to a kind of institutional failure. Without arbitration far fewer rights would be enforced than with arbitration. And with greater enforcement employers and other big guys have a greater incentive to accord statutory protections. In this way the legislative purpose will be achieved. The professional integrity of arbitrators and the greater supervision of the courts is critical to the achievement of the legislative purpose.