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Writing Arbitration Clauses To Get The Arbitration You Want

"Any customer can have a car painted any colour that he wants so long as it is black." —Henry Ford.[1]

These days, counsel thinking about agreeing to arbitration clauses have a lot to think about. On the one hand, arbitration can have significant advantages over litigation: if properly designed, arbitration can be faster than litigation; as well as less expensive, more private; more flexible and more closely crafted to the needs of the dispute. On the other hand, everyone seems to have some horror stories: such as the arbitrator who did not get it and issued an obviously incorrect (but now unreviewable) decision; or the arbitration that ended up costing as much (or more) than litigation would have cost because the arbitrator did not limit the discovery and let all the evidence in. To be sure, this does not happen all the time or with every arbitrator. But it happens enough to make people question the process.

So far as the Federal Arbitration Act is concerned, the U.S. Supreme Court has not done these counsel any favors. In one breath, the court emphasizes that the act is "motivated, first and foremost, by a congressional desire to enforce agreements into which parties ha[ve] entered" to achieve their objectives.[2] But, in the next breath, the court tells the parties that the objective they really need to want to have is finality.

In *Hall Street Associates LLC v. Mattel Inc.*,[3] the Supreme Court concluded that the Federal Arbitration Act barred courts applying the act from honoring parties' agreements to have courts review an arbitration decision for legal error. The court reasoned that the Federal Arbitration Act provided for only very limited review of arbitration decisions — essentially that a disinterested arbitrator's decision could not be reviewed for being legally wrong, or factually unsupported, but merely for whether the arbitrator either improperly failed to resolve an issue or prevented parties from making arguments. According to the court, the act's provisions on this point "substantiat[e] a national policy favoring arbitration with just the limited review needed to maintain arbitration's essential virtue of resolving disputes straightaway."[4]

"Resolving disputes straightaway" is good so far as it goes: there is no point to having an arbitration if the loser can just relitigate the case somewhere else. But in our experience with participants in arbitration, this finality is a means to an end, not an end in itself.

As our courts have recognized in their own procedures, the goal is to have dispute resolution be "just, speedy and inexpensive."[5] Having a regime of federal law that says that arbitrators generally cannot be reversed for getting the decision wrong, but (absent fraud) only for failing to consider something may be speedy once you get to court, but it does not afford much comfort that arbitration decisions will be just or inexpensive. Indeed, it is difficult to imagine that what people really want, above all else, out of a dispute resolution system is a guarantee that incorrect and expensive determinations will be made final and unappealable.



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We are not here to argue that the Supreme Court misread the Federal Arbitration Act. (Nor would it do much good. The justices, after all, are the ones who wear the robes). Our point is that, correct or not, what the Supreme Court read was the Federal Arbitration Act. Participants in arbitration can generally fashion a different system — one that, for example, generally permits reversal for errors of law or factual findings that lack substantial evidence bases, but makes decisions to limit discovery or exclude evidence matters of broader discretion.

The way to fashion a different system is to use a different law. Participants can draft arbitration clauses so that their choice is governed by arbitral procedures or state law that permit them to do so, instead of the Federal Arbitration Act. As the Supreme Court also said in *Hall*, the Federal Arbitration Act “is not the only way into court for parties wanting review of arbitration awards: they may contemplate enforcement under state statutory or common law, for example, where judicial review of different scope is arguable.”^[6]

Creating an arbitration agreement that is subject to different review requires some care and you need to plan ahead. But generally you can get the arbitration you want.

What Law Do You Want?

As *Hall* suggests, the Federal Arbitration Act is not the only game in town. Every state has its own law governing arbitration. The law in this area is subject to change (in fact, prior to *Hall*, lower federal courts differed over whether the Federal Arbitration Act permitted parties to contract for more searching judicial review). Accordingly, it is important to check your state’s latest law carefully. However, there are some jurisdictions with laws that afford parties flexibility to provide for judicial review of arbitration decisions.

New Jersey’s arbitration act specifically allows the parties to contract for expanded judicial review.^[7] Provided some conditions are met (including that the arbitration not be “conducted under the auspices of the American Arbitration Association”), Iowa’s arbitration act provides for vacating an award where “[s]ubstantial evidence on the record as a whole does not support the award.”^[8] New Hampshire’s arbitration act^[9] has also been interpreted to allow for expanded judicial review.^[10] In 2003, Georgia amended its arbitration statute to allow judicial review for an “arbitrator’s manifest disregard of the law.”^[11]

Other jurisdictions have interpreted their statutes to operate differently from the Federal Arbitration Act. The supreme courts of California,^[12] Texas,^[13] Alabama^[14] and Connecticut^[15] have ruled that parties are free to contract for more searching judicial review than what their respective arbitration acts would, by themselves, allow. An older intermediate appellate court case in New York has also suggested that New York would permit parties to contract for broader review, by restricting the arbitrator’s authority.^[16]

In other states, the law is undecided. This provides limited comfort: people drafting arbitration clauses usually want certainty, not the chance for additional groundbreaking litigation. But an open question may still be better than a closed door. The District of Columbia’s arbitration statute allows a court to “vacate an award made in the arbitration proceedings on other reasonable ground.”^[17] The District of Columbia’s highest court has rejected the argument that this language provides for additional grounds for judicial review,^[18] but it has not ruled on whether this language might allow the parties to agree to other reasonable grounds for appeal.

More generally, the District of Columbia is one of 18 jurisdictions that have adopted the Revised Uniform Arbitration Act (RUAA) (1990) to replace the Uniform Arbitration Act (1955): the others are Alaska, Arizona, Arkansas, Colorado, Florida, Hawaii, Michigan, Minnesota, Nevada, New Jersey, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Utah, Washington and West Virginia.^[19] Section 23 of the act specifies the circumstances under which a court “shall” vacate an award, but does not explicitly state whether these circumstances are an exclusive list of those upon which a court “may” vacate an award, if the parties otherwise agree.^[20]

The National Conference of Commissioners on Uniform State Laws, which approved the RUAA in 2000, actively debated having an explicit provision allowing parties to “opt-in” to more searching

review of awards. At the time, the commissioners declined to include such a provision because (1) they disagreed among themselves about whether judicial review was consistent with the idea of arbitration; and (2) they were uncertain whether states would permit parties to “contract” for judicial review.[21] They decided instead to leave “the issue of the legal propriety of this means for securing review of awards to the developing case law under the FAA and state arbitration statutes,” recognizing that the “parties remain free to agree to contractual provisions for judicial review of challenged awards, on whatever grounds and based on whatever standards they deem appropriate ...”[22] Presumably, parties so agreeing would then test the issue by arguing that Section 23 does not prevent enforcement of their agreement.

Today, the argument for permitting such agreements (either by legislation or judicial interpretation) seems stronger than it was in 2000. To begin with, there is now more precedent for legislatures and courts to enforce the parties’ choice to have judicial review.

Also, at least at the state level, the pendulum may be in a different place than it was in 2000. In 2000, the main challenge to using arbitration appeared to be the need to eliminate the vestiges of the “bad old days when judges were hostile to arbitration and ingenious about hamstringing it.”[23] In 1997, for example, a major survey of representatives at Fortune 1000 companies showed that they overwhelmingly viewed arbitration very favorably as a less-expensive alternative to litigation — so long as arbitration could resolve the dispute.[24]

A 2014 follow-up survey showed that this same group now views arbitration as almost as expensive as litigation, and more risky.[25] Given these concerns, the cure — of presuming that finality is the only goal — starts to look worse than the disease. If arbitration decisions essentially cannot be vacated for being wrong, but can conceivably be reversed based on refusals to consider evidence, the law seems to be incentivizing arbitrators to consider everything any party would want to offer and to be less concerned about getting the decision right. The new challenge is to have arbitrations be sufficiently final to save money, while sufficiently flexible to work for those who use them.

Indeed, the RUAA is sensitive at least to the cost concern. Under the act, parties “can decide to eliminate or limit discovery as best suits their needs,” and, if they make no decision, the act affords arbitrators broad discretion to “permit such discovery as the arbitrator decides is appropriate in the circumstances, taking into account the needs of the parties to the arbitration proceeding and other affected persons and the desirability of making the proceeding fair, expeditious, and cost effective.”[26] This diminishes the incentive to let all the evidence in, as a means of avoiding reversal.

How Do You Get a Different Law?

Now that you have located law that does or may allow you to contract for what you want, the next hurdle is getting the law to apply. This process involves some traps for the unwary.

First, you need to be explicit about what your chosen law will govern. While Hall addressed what the Federal Arbitration Act does and does not do, other Supreme Court cases have addressed when and to what extent the Federal Arbitration Act preempts states from doing something different. When it applies, federal preemption is quite broad. For example, the Supreme Court has now ruled that, where it applies, the Federal Arbitration Act not only preempts states from enforcing a public policy barring consumer agreements that waive class action rights,[27] but also preempts state courts from construing an arbitration agreement not to waive class action rights, where the construction relies on assuming the viability of the public policy.[28]

The Supreme Court has also ruled that parties, who want to avoid the Federal Arbitration Act (and its preemption), need to say so very specifically. In *Mastrobuono v. Shearson Lehman Hutton*,[29] the court ruled that a provision stating that a contract was governed “by the laws of the State of New York,” merely applied “New York’s substantive rights and obligations,” and did not mean that the parties had chosen to apply a New York law that “allocate[ed] of power between alternative tribunals” by preventing arbitration panels (as opposed to courts) from awarding punitive damages.[30]

One message from Mastrobuono is that if you want to have a state's arbitration act govern appeal rights, you should not just say "this contract shall be governed by the law of X state." Instead, say something like "this agreement will be governed by X's substantive laws and the X Arbitration Act as it may be amended and construed by its courts." Otherwise, at least where your contract involves interstate commerce, a court may well presume you wanted your arbitration to be governed by the Federal Arbitration Act.

Another message from Mastrobuono is that substantive law and procedural law can come from different sources. Particularly in international arbitration, it is very common to have different law govern the substance of the contract and the procedure by which the arbitration award is confirmed. Parties can agree that the substance of their contract is governed by one state's law, but that confirmation or vacatur of the arbitration decision will be governed by the procedures of a different state.

Second, parties may need to have a basis for choosing the law of a state that otherwise has no connection with the contract. Some states, like California, Delaware and New York, have statutes explicitly allowing parties (provided that the contract meets a monetary threshold) to have their law govern contracts regardless of whether the parties have a connection to the state.[31] Other states, like Texas, require that parties seeking to apply its law have some kind of reasonable relationship to the state.[32] Section 187 of Restatement (Second) of Conflict of Laws provides that courts will enforce parties' agreement to have specified law apply to their contract provided (1) it does not contravene a fundamental public policy of the forum state, and (2) the state chosen has a reasonable relationship to the transaction.[33]

None of this is a problem if the state whose arbitration law you choose has a reasonable relationship to the parties or the contract. (If, for example, one of the parties is incorporated or has its principal place of business, negotiated the contract from, or quite likely other more remote, but reasonable, connections with New Jersey, likely any court will honor the parties' choice to use New Jersey's arbitration act). But if there is no connection, the need for a "reasonable relationship" may depend on the law of the forum where the dispute is brought.

For example, *Pinela v. Neiman Marcus Group Inc.*[34] dealt with a choice of law provision in an employment contract between Neiman Marcus and its employees providing that all disputes would be governed by Texas law. A group of California employees filed a class action in California state court alleging various violations of the California Labor Code. The court found that the arbitration agreement and its choice of law clause was "plainly obnoxious to public policy in California" and amounted to a waiver of the plaintiff's substantive rights. Neiman Marcus cited approvingly to Restatement Section 187.[35] Similarly, Federal courts apply the choice of law rules of the state in which they sit.[36]

In theory you may be able to solve this problem through creative (though, as far as we know, untested) efforts to create a "reasonable relationship" with the state whose arbitration act you want. (E.g., flying to Newark Airport to sign the contract?). But, if you have no apparent connection with the state whose arbitration law you want, a safer solution would be to select not only the arbitration law that governs but also the forum that will decide whether to confirm or to vacate an award.

If You Can't Be With the Law You Love, Love the One You're With

Another (again, we caution, largely untested) possibility that even Hall would appear to leave open is to be creative about delimiting the arbitrator's powers. One of the grounds under which courts "shall" vacate arbitration awards under the federal and both state uniform acts is where "an arbitrator exceeded the arbitrator's powers." [37] In some circumstances, parties have been able to obtain judicial review by circumscribing what the arbitration could do in the first place. For example, a California case vacated an arbitrator's decision to overturn a tenure decision because the arbitration agreement, as relevant to the case, limited the arbitrator's power to instances where the decision was "not based on reasoned judgment," and the arbitrator had exceeded his authority by substituting his judgment for that of the university.[38]

Of course, most parties will not want to limit an arbitrator to deciding whether one party took

action “based on reasoned judgment.” But there does not appear to be any reason why parties could not specify other things they do not want their arbitrator to do. Would it be possible for parties to direct an arbitrator to follow specified law and to declare that any failure to follow that law would be presumed not just to be a mistake, but a failure to conform to the terms of the arbitration agreement? Uncertain. But some creativity may be better than no chance.

Another alternative is to have an appeal as part of the arbitration itself. The American Arbitration Association (AAA) and the International Institute for Conflict Prevention and Resolution (CPR), have responded to Hall by adopting rules for appellate arbitration.[39] In principle, it would also be possible to establish a method of appeal in an ad hoc arbitration (one that does not use an administering organization like AAA or CPR) — by agreeing to a two-stage appellate procedure, with one arbitrator (or panel), for example, reviewing the initial decision for legal error or lack of substantial evidence much like a court might review an adjudication by a government agency. That is not a court, but the parties can specify qualifications for the arbitrators (e.g., former appellate judges), or even agree in advance on a list of acceptable candidates.

Delaware’s recently enacted Rapid Arbitration Act[40] uses a hybrid approach. This act is a business-to-business arbitration statute that cannot be used in consumer arbitrations.[41] If businesses using its terms do not contract for an appellate arbitration, actions to enforce or to vacate arbitration awards go the Delaware Supreme Court. Under this route, the Hall review standard appears to govern because the act specifies that the Delaware Supreme Court vacates, modifies, or corrects the final award in conformity with the Federal Arbitration Act.[42] However, the act also gives the parties the power to contract for appellate review of a final award by one or more arbitrators who may be appointed by Delaware Court of Chancery. And, in that case, appellate review proceeds as provided in the agreement.[43]

Arbitration as an Exercise in Problem Solving

Today, Fords come in many colors. Perhaps one reason is that, ultimately, people who wanted colorful cars did not have to buy Fords. Good lawyering is an exercise in care and creativity. And for arbitration, it may take some of both to make the system work for you. But you can get the arbitration you want.

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[1] Henry Ford and Samuel Crowther, *My Life and Work* at 72 (1922).

[2] *Dean Witter Reynolds Inc. v. Byrd*, 470 U. S. 213, 220 (1985). See also *DIRECTV Inc. v. Imburgia*, 136 S. Ct. 463, 473 (2015).

[3] 552 U.S. 576 (2008).

[4] *Id.* at 588.

[5] Fed. R. Civ. P. 1.

[6] Hall, n.4 above, 552 U.S. at 590.

[7] N.J. Stat. Ann. § 2A:23B-4 (2016).

[8] Iowa Code § 679A.12(1)(f) (2009) (Also specifying that the “court shall not vacate an award

on this ground if a party urging the vacation has not caused the arbitration proceedings to be reported, if the parties have agreed that a vacation shall not be made on this ground, or if the arbitration has been conducted under the auspices of the American arbitration association”).

[9] N.H. Rev. Stat. Ann. § 542:8 (Granting courts the power to correct or modify an award for plain mistake.)

[10] See *Finn v. Ballentine Partners LLC*, 2016 N.H. LEXIS 60, at *10 (N.H. June 14, 2016) (“We have construed this statute to grant a court the authority to vacate an award for plain mistake if it ‘determine[s] that an arbitrator misapplied the law to the facts’”) (citation omitted).

[11] Ga. Code Ann. § 9-9-13(b)(5) (2015).

[12] *Cable Connection Inc. v. DIRECTV Inc.*, 44 Cal. 4th 1334, 1355 (2008). See also *Mave Enterprises Inc. v. Travelers Indemnity Co.*, 219 Cal. App. 4th 1408, 1432 (2013) (suggesting the defendant could have contracted for judicial review of the arbitration award for errors of law if it included the appropriate language in the parties stipulations). See also *Dotson v. Amgen Inc.*, 181 Cal. App. 4th 975, 987 (2010) (upholding arbitration agreement providing for the same standard review as that applied by an appellate court reviewing a decision of a trial court sitting without a jury.)

[13] See *Nafta Traders Inc. v. Quinn*, 339 S.W.3d 84, 101 (Tex. 2011) (“We hold that the FAA does not preempt enforcement of an agreement for expanded judicial review of an arbitration award enforceable under the TAA.”)

[14] See *Raymond James Fin. Servs. v. Honea*, 55 So. 3d 1161, 1169 (Ala. 2010) (Alabama law allows a court to conduct a de novo review of an award so long as the agreement provides for such a review.)

[15] *Garrity v. McCaskey*, 612 A.2d 742, 745 (Conn. 1992) (the arbitration agreement is limited if it “contains express language restricting the breadth of issues, reserving explicit rights, or conditioning the award on court review”). See also *Maluszewski v. Allstate Ins. Co.*, 640 A.2d 129, 132 (Conn. App.) (“[i]f the parties engaged in voluntary, but restricted, arbitration, the trial court’s standard of review would be broader depending on the specific restriction,” and if the restriction is that the arbitrator’s award must conform to the law, the court would be bound to enforce the restriction), app. denied, 642 A.2d 1214 (Conn. 1994).

[16] *NAB Constr.Corp. v. Metro. Trans. Auth.*, 579 N.Y.S.2d 375 (1992) (approving application of a contractual provision permitting judicial review of an arbitration award “limited to the question of whether or not the [designated decision maker under an alternative dispute resolution procedure] is arbitrary, capricious or so grossly erroneous to evidence bad faith”).

[17] D.C. Code § 16-4423(b) (2016).

[18] *A1 Team USA Holdings, LLC v. Bingham McCutchen LLP*, 998 A.2d 320, 326 (D.C. 2010) (“We see nothing in the legislative history to support A1’s argument that under the revised Arbitration Act, this court ‘can now vacate an arbitral award on any ‘reasonable’ basis’”).

[19] Laura A. Kaster, “The Revised Uniform Arbitration Act at 15: The New Jersey Story,” *Dispute Resolution Magazine* (Winter 2016).

[20] Rev. Unif. Arb. Act, available at http://www.uniformlaws.org/shared/docs/arbitration/arbitration_final_00.pdf §23, Comment B.

[21] *Id.* Comment B5.

[22] Rev. Unif. Arb. Act § 23, Comment B5.

[23] *Glass, Molders, Pottery, Plastics & Allied Works Int’l U. v. Excelsior Foundry Co.*, 56 F.3d 844, 846 (7th Cir. 1995) (citation omitted).

[24] See Ryan Lamare, "The Evolution of ADR Systems at Large US Corporations," *Dispute Resolution Magazine* (Spring 2014).

[25] *Id.*

[26] Rev. Unif. Arb. Act §17(c).

[27] *AT&T Mobility v. Concepcion*, 563 U.S. 333, 352 (2011).

[28] *Imburgia*, n.3 above, 136 S. Ct at 471.

[29] 514 U.S. 52 (1995).

[30] *Id.* at 60.

[31] Del. C. Ann. tit. 6 § 2708; Cal. Civ. Code § 1646.5; N.Y. Gen. Oblig. Law § 5-1401.

[32] Tex. Bus. & Com. Code § 271.007; Tex. Bus. & Com. Code § 271.004(b)(1)(E) (defining a transaction bearing a reasonable relation to a particular jurisdiction as one where "a substantial part of the negotiations relating to the transaction occurred in or from that jurisdiction and an agreement relating to the transaction was signed in that jurisdiction by a party to the transaction...")

[33] Restatement (Second) of Conflict of Laws § 187 (1989) (The law of the chosen state will not be enforced where "(1) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties choice; and (2) application of the law of the chosen state would be contrary to a fundamental public policy of a state which has a materially greater interest than the chosen state in the determination of a particular issue and which, under the rule of §188, would be the state of the applicable law in the absence of an effective choice of law by the parties.")

[34] 238 Cal. App. 4th 227 (2015), review denied, 2015 Cal. LEXIS 6186 (Sept. 16, 2015).

[35] *Id.* at 257 (California had a materially greater interest in "ensuring that its statutory protections for California-based workers are not selectively disabled by out-of-state companies wishing to do business in [California]").

[36] *AWH Inv. P'Ship v. Citigroup*, 806 F.3d 695, 699 (2d. Cir. 2015); *First Intercontinental Bank v. Ahn*, 798 F.3d 1149, 1153 (9th Cir. 2015).

[37] Rev. Unif. Arb. Act §23(a)(4). See also Section 10(a)(4) of the Federal Arbitration Act, 9 U.S.C. §10(a)(4); Unif. Arb. Act §12(a)(3).

[38] *Cal. Faculty Ass'n v. Superior Ct.*, 63 Cal. App. 4th 935 (1998). See also *Chin v. Advanced Fresh Concepts Franchise Corp.*, 194 Cal. App. 4th 704, 711-712 (2011) (finding that a provision stating any award shall be based on established law and shall not be made on broad principles of justice and equity is "an accepted way of limiting the arbitrator's broad powers and allowing judicial review on the merits of an arbitration award"); *Garrity*, n.16, above, 612 A.2d at 745 (noting the parties' ability to restrict the arbitrator's powers).

[39] See American Arbitration Association "Optional Appellate Arbitration Rules" which can easily be included in any arbitration agreement and provide for additional grounds for review, available at <http://go.adr.org/AppellateRules>; CPR Arbitration and Appeal Procedure and Commentary, available at <http://www.cpradr.org/Portals/0/CPRArbitrationAppealProcedure2015.pdf>

[40] Del. C. Ann. tit. 10 §§ 5801-5812.

[41] *Id.* § 5803(a)(3).

[42] Id. § 5809(a).

[43] Id. § 5809(d)(2).

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