

2-1-2009

The Future of Commercial Arbitration

Richard Chernick

William F. Rylaarsdam

Thomas J. Stipanowich

Stephen J. Ware

Follow this and additional works at: <https://digitalcommons.pepperdine.edu/drlj>



Part of the [Dispute Resolution and Arbitration Commons](#), and the [Other Law Commons](#)

Recommended Citation

Richard Chernick, William F. Rylaarsdam, Thomas J. Stipanowich, and Stephen J. Ware, *The Future of Commercial Arbitration*, 9 Pepp. Disp. Resol. L.J. Iss. 2 (2009)

Available at: <https://digitalcommons.pepperdine.edu/drlj/vol9/iss2/6>

This Speech is brought to you for free and open access by the Caruso School of Law at Pepperdine Digital Commons. It has been accepted for inclusion in Pepperdine Dispute Resolution Law Journal by an authorized editor of Pepperdine Digital Commons. For more information, please contact bailey.berry@pepperdine.edu.

The Future of Commercial Arbitration

Richard Chernick, William F. Rylaarsdam, Thomas J. Stipanowich & Stephen J. Ware*

I. INTRODUCTION

This is the Third Annual Robert Weil Lecture that has been hosted by the Los Angeles County Bar Association Dispute Resolution Services (DRS). Bob Weil was a distinguished judge of the Los Angeles Superior Court. He was a legal editor and co-author of the Weil & Brown *Civil Procedure Practice Guide*, which is the leading guide in California. At the end of his career, he was a popular and effective private judge. That is his most direct connection with DRS. He had a unique commitment to teach others and to share his knowledge, whether it was as an author of legal texts, as an instructor at the judicial college, as the Educational Director of the Gold Card, or as a member of the board of editors of *California Lawyer*. He

* This article is adapted from the program at the Third Annual Robert I. Weil Lecture, co-sponsored by the Los Angeles County Bar Association Dispute Resolution Services (DRS) and the California Judges Association (CJA). The event took place on October 22, 2008. The panel discussion was moderated by Richard Chernick, Weil Lecture Committee Chair, and Vice President and Managing Director of JAMS arbitration practice. William F. Rylaarsdam is an Associate Justice of the California Court of Appeal, District Four, and is a renowned expert on commercial arbitration. Thomas J. Stipanowich was President and CEO of the New York-based International Institute for Conflict Prevention and Resolution (CPR Institute) prior to his current role as Academic Co-Director of the Straus Institute at Pepperdine University School of Law. Stipanowich is also the co-author of a much cited leading arbitration treatise, IAN R. MACNEIL, RICHARD E. SPEIDEL & THOMAS J. STIPANOWICH, *FEDERAL ARBITRATION LAW* (Aspen 1995) and of a leading book for law schools on conflict resolution, JAY FOLBERG, ET AL., *RESOLVING DISPUTES: THEORY, PRACTICE & LAW* (Aspen 2005), as well as many articles and other publications. In 2008 he received the highest award given by the American Bar Association, the D'Alemberte/Raven Award, for contributions to the field. He was recently named William H. Webster Chair in Dispute Resolution at Pepperdine School of Law. Stephen J. Ware is a Professor of Law at the University of Kansas and has authored more than a dozen articles on arbitration law, as well as two books: *Principles of Alternative Dispute Resolution* (Thomson/West Concise Hornbook Series 2d ed. 2007) and *Arbitration Law in America: A Critical Assessment* (Cambridge University Press 2006) (with Edward Brunet, Richard Speidel & Jean Sternlight).

loved the opportunity to share his knowledge, experience, ideas and opinions, and always welcomed the presence of others, to have an audience. He would love the idea of a lecture named in his honor.

DRS and the California Judges Association present a unique partnership to carry this lecture series forward. DRS is an innovative leader in fostering dispute resolution activities in the community, in the schools, in peer mediation programs, and in the legal profession. The California Judges Association (CJA) has always been a leader in preserving and enhancing our justice system and the independence of the judiciary. We have a number of sponsors here tonight. I would refer you to your program and we thank all of you for your support of this event.

Our panel tonight is an extraordinary group of arbitration experts. Professor Tom Stipanowich is Co-Director of the Straus Institute at Pepperdine. He is a former President of the International Institute for Conflict Prevention & Resolution (CPR Institute). He is a founding fellow of the College of Commercial Arbitrators and was an academic advisor on the Revised Uniform Arbitration Act. Professor Stephen Ware, from the University of Kansas School of Law, is the author of several really exceptional alternative dispute resolution (ADR) casebooks and treatises, and he is a true scholar of arbitration. And finally, Justice William Rylaarsdam is a member of the Fourth District Court of Appeal in Orange County. He's been a judge for twenty-one years. Most importantly, he is now a co-editor of the Weil & Brown Practice Guide, and he is a frequent lecturer for the Rutter Group and others on civil procedure and arbitration topics. He is also the author of several important arbitration cases.

II. DISCUSSION

Richard Chernick:

We want to talk tonight about the future of commercial arbitration. The first topic to lead us off is the question about arbitration becoming more and more like litigation, so that the potential as an effective and economical process alternative to civil litigation is not being achieved. Arbitration may be a victim of its own success. Its growth in the past three decades, nurtured by Supreme Court decisions, has given businesses and lawyers the confidence to use it in the most complex and important cases. But those cases are way too complex for the arbitration paradigm of many years ago when the parties presented their dispute simply and quickly to an arbitrator that was knowledgeable in their business without much process at all, and got a final and binding decision quickly based on the presentation of relevant

[Vol. 9: 2, 2009]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

facts. Parties to disputes today want the protection of elaborately detailed arbitration agreements, pre-hearing discovery, motions for summary disposition, and in some cases, at least, the right to challenge the award for legal error. They also want highly experienced arbitrators, trial-like hearings, and reasoned awards. Many observers have criticized this form of arbitration as a wrong-headed undermining of the efficiency and economy of the arbitration paradigm. My first question for Steve Ware is whether we have killed the goose that laid the golden egg.

Stephen Ware:

I'm going to answer Rich's question, but first I just want to say how—from the perspective of somebody who studies arbitration law—coming here to California is really special. California is the center of the action when it comes to arbitration law and it has been for a long time. I've lived my professional life in Kansas—and before that Alabama and New York—and I can say that none of those places has the sort of developed industry of commercial arbitration that I've seen here. And it's really to the credit of people like Rich Chernick, and other folks at JAMS, AAA, and other organizations in Southern California. I think you all have done great work and that the lawyers in this area have been so sophisticated in using it.

Let me then jump in on Rich's point which is: has commercial arbitration in places that use it a lot (like California) become so much like litigation that we're losing what really should be a good thing that's different from litigation? I like Rich's phrase: "Kill the goose that lays the golden egg." I guess I would say to the extent this is a problem, I find it most helpful to think about the different players who could help mitigate the problem—the different players who could help improve the situation—and those would be the parties, their lawyers, arbitration organizations, and the courts. They can all play a role in mitigating this problem.

I'll start with the parties and their lawyers. What I haven't seen much from parties yet are arbitration agreements that attempt to plan ahead to avoid the problem of too much discovery, too much delay, too much of a litigation-like process. It seems to me that this sort of party control over their agreements is really a potential solution in that arbitration is a creature of contract. Parties can write their own ticket in arbitration. Parties could write agreements that limit the arbitration process in terms of how much discovery is going to happen or how long things are going to take and these limitations ought to be enforceable. The law I've seen suggests that if you've got commercial parties, sophisticated parties, courts are going to

417

enforce arbitration agreements like this. So I think that's an untapped potential.

And my suggestion to arbitration organizations—providers like JAMS and AAA and so forth—is you can offer this. You can offer expedited procedures that have less discovery, less delay, etc., and parties can opt into that form of arbitration if they want to.

So if commercial arbitration is becoming too much like litigation, my suggestion is that, to some extent, this is a problem made by parties and their lawyers, and parties and lawyers can mitigate the problem through agreement, through contract. What I hope, though, is that arbitrators will stick with these agreements and not succumb to the temptation of, “Oh, we need more discovery, we need more of this or that and delay,” and I hope that courts—judges—will also stick with these agreements, and enforce them, as I suspect they will.

Richard Chernick:

Don't you think it is far easier to enter into these kinds of agreements before there is a dispute than after there is a dispute? I think this kind of consideration should really go into the contract drafting, rather than in an agreement to arbitrate once there is a dispute.

Stephen Ware:

Exactly. That's what I meant about pre-dispute arbitration agreements; it is where I haven't seen parties and their lawyers taking advantage of the power the contract gives to pre-dispute [agreements], having a limit on discovery, having a limit on time periods, etc.

Richard Chernick:

Quite aside from those particular basic issues, and I don't know, maybe I'll have a little bit of time later to talk about it, we've seen in a fairly substantial number of cases where parties enter into arbitration agreements and either don't know what they're doing or the people who do the drafting don't know how arbitration works. Fairly recently we had a case in our court where parties had agreed to something called “Binding Mediation.” Now what's Binding Mediation? We were supposed to decide what Binding Mediation was. We've seen contracts where terms are interchanged between “referee,” which of course is a separate statutory proceeding and has very different consequences than “arbitrator,” and these words are used interchangeably. That doesn't seem to be, at least in those cases that end up

[Vol. 9: 2, 2009]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

being litigated, the care that is required in drafting these agreements. I think perhaps our academics could be of some assistance there too to provide formats, to make it clear what it is that parties are entering into.

Tom, let me ask you this: If parties enter into a flawed arbitration agreement, isn't the arbitrator the backstop—to really put some reason in the process and motivate the parties to do what they should have done in clause drafting—which is to figure out how to draft a clause, which defines a process, which is proportionate to the dispute?

Thomas J. Stipanowich:

As arbitrators, we've all had experiences where we have been faced with deficiencies in the drafting process. There is much a good arbitrator can do to address such deficiencies, but there is no question that business users are in the best position to lay the groundwork for an appropriate arbitration procedure in their original agreement. As I discuss in two new articles, *Arbitration: The "New Litigation"*¹ and a companion piece, *Arbitration & Choice: Taking Charge of the "New Litigation,"*² contract planners and drafters too often end up incorporating in their agreements a "one size fits all" form of arbitration. Such general-purpose provisions may work out perfectly fine when you have lawyers that are willing to work together and collaborate with the arbitrators to ensure an efficient process. But all too often the arbitration experience becomes a long and costly nightmare akin to litigation. The problem is that with expanded discovery and more extended hearing processes—and, of late, with customized clauses providing for expanded judicial review of arbitration awards—we are making arbitration more and more like litigation.

If business users truly desire more efficient and economical processes, they need to make appropriate provisions for such processes at the time of contracting. The problem is, there are many barriers to making such choices. People don't like to talk about dispute resolution at all when they're negotiating a contract. Unless client and counsel have thought about what they want and made provisions ahead of time, they are unlikely to

1. Thomas J. Stipanowich, *Arbitration: The "New Litigation,"* 2010 U. ILL. L. REV. 1 (forthcoming Jan. 2010), available at <http://ssrn.com/abstract=1297526>.

2. Thomas J. Stipanowich, *Arbitration and Choice: Taking Charge of the "New Litigation (Symposium Keynote Presentation),"* 7 DEPAUL BUS. & COM. L.J. 3 (forthcoming 2009), available at <http://ssrn.com/abstract=1372291>.

achieve anything. Abbott Labs Program did this and developed an arbitration procedure aimed specifically at distributorship contracts. They said “we don’t need discovery in most of these cases. We know pretty much all of the issues and the facts when the dispute arises, and we want to keep our relationship going. Let’s keep arbitration short; let’s keep it simple; let’s keep it short and sweet.” So they were able in a number of cases to sell that to their business partners on more than one occasion.

Richard Chernick:

Bill, let me pick up on something that Tom just mentioned, this notion of “enhanced review.” If we’re talking about an arbitration process that’s supposed to be reasonably constrained, the idea of giving parties the right to define the review process, and to create a layer of review for legal error seems to me to be heading in the wrong direction. I think Steve’s language of “mitigating and improving” the arbitration process may have been done a disservice to that objective by our Supreme Court fairly recently when they came out with a case called *Cable Connection v. Direct TV*, which really is a surprising result—At least, I was surprised. Maybe people who are smarter than I am weren’t quite as readily surprised as I was, but all of our cases so far, including the California Supreme Court and certainly any substantial number of Court of Appeal cases, have basically drawn the line and said “we’re not going to do judicial review of arbitration decisions.” I don’t think that is a bad rule frankly. In this *Cable Connection* case, in a 5-2 or 4-3 decision depending on how you read Justice Baxter’s concurring opinion, they really totally changed that. They held that if the parties have so contracted, there can be judicial review of arbitration awards.

The federal courts have taken a totally different direction. We had a Ninth Circuit case back a few years ago, *Kyocera Corporation*, and the United States Supreme Court in *Hall Street Associates* earlier this year held that under the Federal Arbitration Act the courts do not have the power to judicially review the legal errors of the arbitrators. But that’s changed in California. Under *Cable Connection*, the California rule is that the parties may obtain judicial review of the merits if they so expressly agree. Again, here is an area that seems to me ought to be subject to some negotiation. Again, it’s the kind of negotiation you want to do before there actually is a dispute, whether or not you’re going to buy into this. Because if you do buy into this, there is very little difference in terms of the length of time it takes and the expense. All the other reasons that are supposed to justify arbitration largely disappear if at the tale end of it you’re going to first have to go to the Superior Court and then after the Superior Court decides whether or not the arbitrator is heard, you’re then going to have to go to the

[Vol. 9: 2, 2009]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

court of appeal. You know you're another year or two down the line before you have a final decision and so the objective of early and final determination seems to be frustrated.

Steve, in some of these clauses the parties have chosen to create their own appeal process because of the uncertainty that existed on the federal side and in California, up until this year, whether enhanced review was even possible. What do you think about parties creating a crafted internal arbitration appeal procedure which then results in an award which is reviewable under traditional standards?

Stephen Ware:

It seems to me like this is a good example of where the freedom of contract that arbitration law provides is both a blessing and a curse. You could go to the traditional limited judicial review of, for example, Federal Arbitration Act section 10. You could go to the other extreme of the sort of contract provision allowing full judicial review, or you could go to what Richard's describing now, a sort of a half-way, an intermediate, of a private appellate arbitral panel. On this issue, I think Richard captures the essence of it when he says: "We want a process that is proportionate to the dispute," as opposed to the one-size-fits-all that Tom referred to. If it's small cases, then rational parties, you'd think, would stick to the traditional arbitration with the very limited judicial review. On the other hand, if it is a very high-stakes, "once in a blue moon" case, I think it's good law that the California Supreme Court did in the *Cable Connection*³ case, to allow parties to invoke the more searching review of the courts. So although I'd want to counsel most parties to not do it, occasionally there's a case that deserves the proportionate big process, and I'm glad the California courts are enforcing agreements that call for that.

There have been some experiments, I think, to have an appellate process as part of the arbitration proceeding. I'm under the impression that it generally has not been very successful, and I wonder why?

Richard Chernick:

You know, it's available at JAMS. Occasionally I've seen clauses that have it, but it is very rarely invoked. Parties want it there for the protection

3. *Cable Connection, Inc. v. DirectTV, Inc.*, 190 P.3d 586 (2009).

so that if something bad happens, they've got some place to go. Lawyers, particularly litigation lawyers who are used to being in court, hate the idea of arbitration being a one-shot deal where if a mistake is made there's no real remedy. But if you've got the provision in your contract which says, "if this goes badly I have the right to appeal internally within the arbitration process to three other arbitrators," that's the protection that gives them comfort. Nine times out of ten they're reasonably satisfied with the award either in the sense that they won, they didn't lose as badly as they thought they might have, or the decision was not that extreme that they would have any reasonable expectation of overturning it in an appeal process. Having that protection, I think, creates a value even if it isn't used very often.

Stephen Ware:

Well, if that is true, then perhaps parties won't take advantage of the opportunity that has been offered under the *Cable Connection* case because those same considerations would probably enter into it there.

Richard Chernick:

Perhaps. Let me move on to a different topic. One of the things that I admire about lawyers is their creativity. Lawyers who are given the pen and asked to craft an arbitration agreement sometimes—particularly if they think they know something about arbitration—like to try to get creative in mixing processes together that somehow creates specialized advantages for a particular case, or that give them some special opportunity. Bill mentioned a moment ago that some of those cases turn out badly. But let me ask Tom the question: What are the practicalities of the mixed-process arbitration, and where do you see the advantages and the risks?

Thomas J. Stipanowich:

I'm someone who is drawn to this field because of the possibility of exercising choice and being creative—of, as Frank Sander once said, "fitting the forum to the fuss." When it comes to having a single neutral play multiple roles as mediator and arbitrator, American lawyers tend to throw up their hands in horror. We recently did an interactive video program at the Straus Institute, *Along the Borderline*, which is intended to provoke discussion about mixed processes where you have a neutral wearing more than one hat. When we have used the video with audiences of U.S. lawyers or law students, they tend to be overwhelmingly concerned about one or another of the perceived dangers of mixing processes, at least in the abstract.

First of all, there are fears that a mediator who is also empowered to adjudicate the case as arbitrator may be in a position to coerce the parties into a bargain, undermining party autonomy. Also, one hears concerns about whether parties can really be candid with a mediator who they know will judge the case; the fear is that the game will simply be about manipulating the would-be judge.

On the arbitration side, there are concerns that people raise about the arbitrator making a ruling on the basis of derived from *ex parte* communications during the mediation process. Finally, there is the problem of perceptions—a party may think they received a guarantee of some kind from the neutral in mediation that was not borne out when the same person arbitrated the case.

Despite all these concerns, it is clear that many neutrals are confronted by invitations to serve in multiple roles from time to time, and some accept the challenge. One of the best-known examples of the “multiple-hat” approach was the effort over an extended period to address relational issues between IBM and Fujitsu by Bob Mnookin and another neutral. They played arbitral roles but also mediated, successfully facilitating an ongoing conversation between the parties.

In a related vein, we are seeing a strong trend in the direction of stepped dispute resolution approaches or “filtering systems” for conflict, and this is occurring both nationally and internationally. Although it is most evident in American employment programs, we’re seeing it more and more in different kinds of commercial processes. We also have, from time to time, ill-fated experiments that find their way into the published decisions. When they develop a “one-off” clause such as a provision for nonbinding arbitration or some hybrid, they need to think carefully about how a court may interpret their creative language. In *The Arbitration Penumbra*,⁴ I observe that for a variety of reasons such provisions often produce unpredictable results.

Richard Chernick:

Bill, I want to tell the audience that one of the reasons that you’re on this panel is because, by luck of the draw, you and your division seem to

4. Thomas J. Stipanowich, “*The Arbitration Penumbra: Arbitration Law in the Changing Landscape of Dispute Resolution*,” 8 NEVADA L. REV. 101 (2007) (UNLV Symposium on the Future of the Federal Arbitration Act).

have drawn many of these oddball cases. It is a fact that many of these mixed process cases that went bad ended up in the Fourth District, in Bill's division. So I need you to comment on what your perception is on this process of what I would call "well-intentioned lawyer creativity."

William Rylaarsdam:

To just follow up on what Tom was saying: maybe it's because we tend to think too much in boxes, but when you present a contract clause to us, we have to know what the heck you mean by it. One of the worst cases I had was a case that's over ten years old now, *Old Republic v. St. Paul*, which just happened to be my case. The clause just conflated rules pertaining to an agreement for the appointment of a temporary judge, for an arbitration, a contractual arbitration and a judicial arbitration, and for references to a special master. It was all mixed up together and then, to add insult to injury, they provided that if any party was dissatisfied they could go directly to the court of appeal to have a decision on whether this process was correct or not. Incidentally, as an aside, I think that Justice Baxter in the *Cable Connection* case points out some of the problems that may arise, under the rule announced in that case, when the parties think that they can confer jurisdiction where no jurisdiction exists. He also points out the problem of judicial review, where in the arbitration process you often have a series of interim decisions. Are you going to get judicial review each step of the way, which you wouldn't normally have in trials? I doubt very much the court's going to permit that. We refused to consider that case, and I think we rightly did so.

We had another case, which had a little different twist, that was not too many years ago. It was an interesting situation where again the parties conflated a reference with an arbitration. Of course a reference as CCP section 638 has very different consequences in terms of judicial review than an arbitration, at least until the *Cable* case. There, the arbitrator undertook to decide. It was a reference under CCP section 638 by three arbitrators under the rules of the American Arbitration Association. The arbitrators undertook to interpret that clause and said that it was an arbitration. We affirmed and said that it was within the power of the arbitrators to decide those issues. I hope that arbitrators will take the initiative and not send these problems to us. I don't know how much time you want to take here. I have about a dozen different cases all with various variations on this kind of conflating of ADR proceedings.

[Vol. 9: 2, 2009]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

Richard Chernick:

I can't resist the temptation to ask the only non-California person here to comment on whether this is a California thing, or whether Steve, you run into these kinds of situations in the other forty-nine states.

Stephen Ware:

I like the way you phrased the question, Rich, because as Tom was talking about how American lawyers typically react, he described me with accuracy. I am that stereotypical guy who is very concerned that mediation is a different animal from arbitration. If the mediator is going to be the arbitrator, what from mediation is going to come back to haunt me if we do not reach a settlement? I suppose if everybody knows up front that that's the kind of mediation we're doing, then I'm all for these parties to be able to opt into that approach, but I certainly do have the hesitation that Tom talked about. I think you're right Rich, that there's some unfamiliarity with it, that those of us in the rest of the country are unfamiliar with it, and so I, like most lawyers, we're risk averse about things we're not familiar with.

William Rylaarsdam:

I had some analogous experiences when I was on the trial court and we used to do settlement conferences. At the outset, I used to conduct settlement conferences in my own cases, which were cases I was going to try if the cases didn't settle. I finally stopped doing that because the parties weren't really comfortable with it, and I wasn't comfortable with it. Perhaps there are people who have the capability of doing this, but I certainly did not. I just wondered, if I were a litigant, I think I'd be very reluctant to enter in a process where we start with mediation and then, if we can't resolve the matter, this same mediator is now all of a sudden going to be the decider.

Thomas J. Stipanowich:

If you go on our website, you'll see a streaming video of a conversation that we had with a number of neutrals, sponsored by the Beijing Arbitration Commission. You'll hear a group of California arbitrators and mediators talking with their counterparts in China. The Beijing Arbitration Commission just created for the first time a free-standing commercial mediation program intended to address Sino-Western business disputes.

Heretofore, what did they have? Well, in China the expectation is that conciliation or mediation will be done by a judge if you're in court or by an arbitrator if you're in arbitration. Historically, that has been the way things are done. We know that there's a cultural component to this. Despite the sensitivities that our Anglo-American colleagues have regarding mixed roles, you go to places like China, or to some extent Switzerland or Germany, and there are different perceptions about this. Now it's going to be interesting as we move forward with these kinds of cross-border dispute resolution processes. First of all, to see if stand-alone mediation can make it in China, but also what the continuing dialogue is about mixed roles.

Richard Chernick:

Is the success of commercial arbitration creating a two-tiered system of justice? Think of public versus private schools, or public versus private medical care. Does our reliance on arbitration for important commercial cases prevent the orderly and full development of case law defining legal norms? There was a recent article in *Judicature Magazine*, by Peter Murray, a professor at Harvard Law School, who has summarized all of the arguments that have been floating around for a long time about this topic. But I think when it was first raised many years ago in sort of the infancy of ADR, it was much less resonant than it is today when there are very large arbitration providers, very large mediation services, and large numbers of cases going through mediation, either never getting to the court system or getting side tracked from the court system. There are probably as many cases being tried in arbitration as in our court system, maybe more. It's something that as arbitration has become more popular, and the cases that arbitrators have been asked to decide become more important, it becomes a much more pressing issue. Steve, what do you think about this?

Stephen Ware:

I think Rich asked two questions, and I want to take the second one first; the second question being what I'll call "precedent." Is the growth of commercial arbitration denying the legal system, to use Rich's nice phrase, "case-law-defining legal norms," that is, developing common law precedent?

Rich asked us before the event tonight to be provocative, and I have tenure at my university so I think I can safely be provocative. Maybe what I'm about to say will be somewhat provocative. To ask the question: "is the legal system losing the value of developing common law precedent?" is to raise the fundamental question of "whose dispute is it?" Is it the parties'

dispute, or is it, to some extent, society's dispute? I very much start with the premise that it's the parties' dispute, so that they ought to be able to resolve it however they want even if that deprives society of a precedent.

Here comes the controversial part now, if that wasn't controversial already. The controversial part is that I so much see it as the parties' dispute that I wonder why we have a government court system at all. I wonder why my tax dollars go to pay to resolve somebody else's dispute, particularly when it's a business-to-business dispute between sophisticated parties with significant assets. Why are my tax dollars subsidizing their dispute resolution? That's where I start.

Now, I see arguments for a public legal system. I see arguments that there should be precedent. But those arguments seem to me, at most, to get us to: "yes there ought to be a tax-funded court system." I don't think they take us all the way to, "we ought to force people to use that public system when they're willing to use a private system at their own expense."

And I think this gets to the other question Rich raises about a two-tiered system of justice. Do we have a first-class system (private arbitration) for business parties that can pay and a second-class system (public court) for others? Frankly, I like the idea that if I'm the victim of a tort or the victim of a crime, then my case will get to trial sooner because the docket is not clogged up with commercial cases that could have gone to arbitration. Focusing the public court's resources where they're really needed, instead of diverting them to cases that could be handled privately, appeals to me. So I think the two-tiered system would be a good thing, but I don't see it happening. I don't think the problem we're talking about here—lack of commercial cases going to court—is happening. I teach commercial law, and I see tons of commercial cases in court. So, I don't think we have any lack of precedent and don't see it as a big problem.

Stephen Ware:

The first thing I want to address is the judicial review of arbitrators' decisions, which the federal courts, including the Ninth Circuit here, have dealt with for several years. There's a great concurring opinion by Judge Kozinski in the Ninth Circuit *LaPine*⁵ case where I think he answers your concern. He draws a distinction between you, as a trial court judge,

5. *LaPine Tech. Corp. v. Kyocera Corp.*, 130 F.3d 884, 891 (9th Cir. 1997) (Kozinski, J., concurring).

reviewing an arbitrator's decision under a contract with standards judges are familiar with (from reviewing administrative agencies, etc.,) and trying to review under unfamiliar standards, such as Judge Kozinski's ridiculous example about the judge being asked to look at the entrails of a dead fowl. In other words, the freedom of parties to contract shouldn't tell a judge to do something that judges ought not to do. So, I don't think you'll have that problem in California. I think you'll have standard provisions on courts reviewing arbitrator's decisions.

I don't think judges should be uncomfortable with arbitration agreements that require the court to review, *de novo*, whether the arbitrator made an error of law. These agreements simply require judges to do what they do whenever a breach of a professional services contract is alleged: determine whether the professional performed or breached the contract. Here, the arbitrator is providing the service and the contract requires the arbitrator to ascertain and apply the law so the court has to determine whether the arbitrator performed or breached that duty. Conceptually, it is similar to a court determining whether any professional, such as an engineer or an accountant, provided her services in a way that performed or breached the contract.

Now, let's move to the other topic you raise, regarding the right to a jury. It is crucial to distinguish between the role of criminal and civil juries, where criminal juries ought to exist; and civil juries ought to exist too, for parties who want them.

The civil context is where the question arises, "can parties opt out of a jury trial with a pre-dispute agreement?" In most of the country, the answer is yes. California is unusual in not enforcing pre-dispute jury waiver clauses;⁶ but certainly, post-dispute parties can choose to arbitrate or do something else rather than the jury trial, and the question again is do you want to force parties who don't want a jury to have one?

William Rylaarsdam:

I think your use of "force"—you use it now and you used it in your earlier statement—I really don't see where it has a place in this discussion. There has been a lot written, and I think we all know, about this concern that there might be a limitation on the development of the common law because these matters are now outside the court system. But I haven't heard anyone

6. Brian S. Thomley, Comment, *Nothing is Sacred: Why Georgia and California Cannot Bar Contractual Jury Waivers in Federal Court*, 12 CHAP. L. REV. 127 (2008); Stephen J. Ware, *Arbitration Clauses, Jury-Waiver Clauses, and Other Contractual Waivers of Constitutional Rights*, 67 LAW & CONTEMP. PROBS. 167 (2004).

[Vol. 9: 2, 2009]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

suggest that parties should be forced to go into the public courts. There's been concern, but nobody's really said what to do about it. If there have been suggestions, I don't think any of them suggested, "well, let's just outlaw arbitration," or "let's prohibit people from going through arbitration."

Stephen Ware:

Well, then maybe we're all in agreement. There are jury trials for those who don't opt out of them. But we're going to allow parties to opt out of them.

Thomas J. Stipanowich:

Well, let me just say it's a short step from this discussion to another one that has had a significant impact on commercial arbitration and perceptions and regulation of commercial arbitration, and that is the use of binding arbitration clauses in individual employment and consumer contracts. I think this is the area where the concerns that you describe are at their most fervent. Steve has written a good deal about this, and there has been an ongoing academic debate about it. One of the things that I've been looking at recently is interesting kinds of spillover effects of these concerns into the commercial area, where you have arms-length business disputes. Here in California, we have the California Ethics Standards which ostensibly were established to address concerns about adhesion scenarios, but apply to commercial arbitrations as well. Rich and I have had an ongoing conversation about some of the costs, as well as the benefits, of this law. I participated in the revision of the Uniform Arbitration Act. It's a pretty long enactment. If you look at a lot of the due process elements in that Act, they are there because of concerns about adhesion contracts. They really don't need to be in the arbitration framework, a bare-bones arbitration framework, for business arbitration. There's just no need. Why have a provision that establishes the right to counsel in arbitration? It's just something you don't talk about in the business context. Of course they'll have lawyers if need be, and in other kinds of business arbitration they won't.

If you look at first-year contracts case books—I taught contracts last year—how is arbitration introduced today to contracts students? It is the poster child for the principle of "unconscionability." Often the contracts case book does not have any accompanying discussions saying: "you know,

sometimes arbitration actually makes sense. Sometimes it's a good thing. It has benefits of one kind or another." I had a colleague at Pepperdine who wrote an article on why arbitrators should not have quasi-judicial immunity. The force of her argument really stems from concerns about adhesion contracts and the need for policing of various kinds.

There is now legislation pending in Congress to modify the Federal Arbitration Act. Once again, the aim is to address concerns about adhesion contracts. Once again there are impacts on the broader realm of business arbitration.

Stephen Ware:

Even there [broker-investor disputes], which is the best case for lack of precedent, most of those claims are common law fraud claims or breach of fiduciary duty claims, and there are lots of other transactions besides securities brokers that generate those sorts of disputes. So, if our concern is not protecting the weaker party from adhesion contracts, but rather the societal interest in law developing on fraud or fiduciary duty claims then we've got that concern satisfied even if none of the cases come from the securities context.

William Rylaarsdam:

Most of the policy considerations that we've talked about tonight until just these last few minutes really dealt with commercial type arbitration. I think the policy concerns for commercial arbitration and the policy concerns for consumer and employee type arbitration are very different. I think that's one of the things where, in the courts and in the rules and in the statutes, there is really no distinction drawn between them. Perhaps we should approach these as two distinct sets of problems. I think we need to be much more concerned about the arbitration clause that suddenly shows up in the statement from your credit card company or even the one that your doctor wants you to sign before he or she will take care of you. As compared to two companies that have a dispute and enter into arbitration, I think they're totally different considerations. The equities are totally different and when we start talking about these consumer and employee type arbitrations, I think it's a fiction that most people enter freely into those contracts. I think perhaps we should not talk about them as if they are the same. I think we should analyze them as very different animals.

[Vol. 9: 2, 2009]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

Thomas J. Stipanowich:

I don't want anyone to interpret my remarks as suggesting that I'm saying we should, quite the contrary. In fact, I'm writing on that right now. It is part of these new pieces I've done. I think we do need to be much more categorical in our discussions of these different realms of arbitration. I don't know if Steve would agree with that, but I do view these as very different. My whole point was that because of the concerns in the other area, we do have, to some extent, regulation and responses that are having an impact on the business-to-business area.

William Rylaarsdam:

We probably shouldn't. But I think if you look at the California cases dealing with arbitration, the courts have never really said this in so many words. I think reading between the lines, they are looking at them differently. I think properly so. I think the courts are much more concerned about procedural fairness and substantive fairness in those kinds of consumer contracts. You will find courts refusing to enforce arbitration agreements in that area, where at least off-hand I can't really think of a case involving commercial entities entering into an arbitration contract where the courts have said, "no, this is not a fair contract. We're not going to enforce it."

Richard Chernick:

Well, once you assume or find that the two parties who have negotiated an arbitration clause or agreement are dealing at arms-length, and that it's not a contract of adhesion, there's no way you can establish procedural unconscionability. In fact, commercial parties engage in negotiations and deal with provisions which would be substantively unconscionable in agreements all the time. For example, waiving punitive damages is a common provision in commercial arbitration agreements, and businesses find that waiver to be valuable because it reduces the stakes of the typical commercial dispute so that both sides are able to have an adjudication in a setting that doesn't have that effect of potential award of punitive damages.

William Rylaarsdam:

At the same time, it tends to waive punitive damages in consumer contracts that have generally not been accepted.

Richard Chernick:

At this point, does anyone in the audience care to weigh in on any of these weighty topics?

David Horowitz:

I'm curious about the use of references in commercial contracts. It just appears to be anecdotally that it is being used more and more often, so that you end up with a reference and then the right to review.

Richard Chernick:

Exactly. A 638 reference gives you what amounts to an arbitration-like process but with the right to appeal back into the court system. That's something that no one has had any problem with in California since 1978.

David Horowitz:

My question is whether you are seeing this being used more often.

Richard Chernick:

I see it occasionally. I think that the vast majority of commercial disputes at JAMS are commercial arbitrations. Any reactions, Tom?

Thomas J. Stipanowich:

I think one thing you have to keep in mind is that the California procedure is relatively unique in the country. I'm not aware of another state that has anything like that, but I think that implementing framework makes a big difference here.

William Rylaarsdam:

Another way to get full judicial review is to have a lawyer or a judge appointed as a private judge. This can be done.

[Vol. 9: 2, 2009]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

Thomas J. Stipanowich:

Earlier we were talking about the private appellate processes. JAMS has such a process. Some years ago, the CPR Institute also created an appellate process and what's interesting about it is that all of the appellate arbitrators are former federal judges.

Jay McCauley:

If we step back a little bit on the topic of the difference between arbitration and mediation in the commercial context, one observation is that we can justify both without stepping beyond normal principles of contract law. The normal principle of contract law is that there is freedom of contract as the baseline. I accept in certain circumstances there is a reason for the court to curtail that freedom. We talked about the adhesion contract as one of those circumstances. If you just want to put a word on what the policy is behind that, it's paternalism. We need to protect people who are not big boys and girls.

In both the *Cable Connection* case and the *Mattel* case, we're talking about the boys and girls, the commercial entities, where they plainly decided at the time they entered into the contract that the kind of arbitration they wanted would be one in which they did the tradeoff and determined that they wanted the accuracy, predictability, certainty, and safety net that comes normally to people who go into litigation. They did so, presumably, fully knowing that in doing so they would be giving up all those benefits of finality, expeditious resolution, efficiency, and all of those wonderful things. I hear some of the panelists here and, for that matter, the majority of the ADR community bemoaning what the Court did in the *Cable Connection* case. But I believe that all the Court did there was apply ordinary contract principles to the arbitration contract they faced. The Court took note of the fact that the contract had been negotiated by sophisticated parties. Once that is recognized, there is nothing that contract law permits the Court to do other than honor the contract as written. There was no need to protect them from the consequences of their own express desires.

William Rylaarsdam:

What if that contract, as Justice Baxter points out, said "and we will appeal immediately to the California Supreme Court." Should that also be honored?

433

Jay McCauley:

No. That is a factual circumstance the court in *Cable Connection* was not dealing with. But the reason they should say no to parties who seek appeal immediately to the Supreme Court goes back to the basic application of ordinary contract principles. If you and I have a contract dispute, and it's a matter of specific performance, we cannot simply, because we have a contract dispute, start at anything other than the trial level. The real question is: why do we make arbitration an exception to the rule of contract when we have a specific performance issue? We have two parties who agree that they want to limit the power of their arbitrator to impose a binding decision on them. Now, the question is a classic contract question: what is the condition that is necessary to actually get enforceability? There is not creation of jurisdiction that does not already exist. There is no imposition of anything unusual on the court. To suggest that this contract should not be enforced is to discriminate against arbitration agreements for no reason that can be justified on general contract principles. It is to single arbitration agreements out for special, disfavored, treatment. And that is exactly what Congress said courts cannot do when it passed the Federal Arbitration Act in 1925.

William Rylaarsdam:

Professor Ware would say, "why should the taxpayer pay for this? You've decided to resolve this outside the public system."

Stephen Ware:

Oh, no. What I would say is what the questioner, Jay McCauley, said. There's no question that these disputing parties had the right to use the publicly funded system for their entire dispute. So, if we're just looking at public resources, this arbitration (with judicial review of errors of law) is probably going to save the public compared to the full-blown litigation alternative.

Richard Chernick:

The Federal Arbitration Act does say that, according to the Supreme Court, there are only certain ways in which a federal court will review, confirm, correct, or vacate an arbitration award and that is the strict statutory standards contained in the Federal Arbitration Act sections 10 and 11. That's the difference between *Hall Street* and *Cable Connection*, in which the California Supreme Court found didn't have that limitation.

[Vol. 9: 2, 2009]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

One of the great things about arbitration, and the thing that I think all of us appreciate, is that it is a creature of contract and the parties do have the right within certain limitations to create the process that they want. That's what makes it so interesting for those of us who work in the field, either as lawyers, as arbitrators, or as observers of the arbitration practice.

III. CONCLUSION

This has been a terrific discussion, and I want to thank all of the panelists for their contribution to this lecture in memory of Bob Weil. I also want to thank Dorothy Weil, who is in attendance tonight, for supporting us. Thank you all. Good job and good night.

