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## Arbitration as Contract: The Need for a Fully Developed and Comprehensive Set of Statutory Default Legal Rules

Jack Graves

Touro Law Center, [jgraves@tourolaw.edu](mailto:jgraves@tourolaw.edu)

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ARBITRATION AS CONTRACT: THE NEED FOR A  
FULLY DEVELOPED AND COMPREHENSIVE SET OF  
STATUTORY DEFAULT LEGAL RULES

JACK M. GRAVES<sup>\*</sup>

ABSTRACT

*This Article analyzes the United States Federal Arbitration Act, as a statutory framework for effective arbitration of contract disputes. While arbitration under this Act has been subject to ever increasing criticism and calls for reform on a variety of fronts—most often from the perspective of consumer or employment arbitration—this Article focuses specifically on commercial, business-to-business arbitration and critically evaluates the Act as a set of default legal rules governing arbitration as a unique contractual business relationship.*

*The Article first looks at arbitration from a contractual default rules perspective and then employs this perspective to analyze: (1) the existing federal statutory scheme; (2) the developing body of federal “common law” governing arbitration; (3) the potential impact of state legislation governing arbitration; and (4) the use of private rules to govern arbitration. Finally, the Article looks at the related doctrines of “competence-competence” and separability under U.S. law, specifically focusing on the Supreme Court’s recent decision in *Rent-A-Center, West, Inc. v. Jackson*. The Article ultimately concludes with a call for an entirely new federal statute governing both domestic and international commercial business-to-business arbitration.*

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<sup>\*</sup> Associate Professor of Law, Touro College Jacob D. Fuchsberg Law Center. J.D., University of Colorado School of Law 1994.

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## INTRODUCTION

The basic idea of arbitration is deceptively simple. Two or more persons choose to resolve their disputes privately, thereby foregoing traditional court adjudication. Upon closer examination, of course, we discover that this simple theoretical construct often raises a variety of challenging and complex issues in its practical application.<sup>1</sup> In some cases, these issues may be resolved by reference to the parties' arbitration agreement, which may include a designated arbitral institution or a set of specified rules for conducting the arbitration. In many other cases, however, the parties must look for answers within the applicable legal framework governing their arbitration agreement.

In the United States, arbitration is largely governed by the Federal Arbitration Act (FAA).<sup>2</sup> The FAA governs both domestic<sup>3</sup> and international<sup>4</sup> arbitration, though it may, under certain circumstances, give way to or be supplemented by state laws governing arbitration.<sup>5</sup> In the case of international commercial arbitration, the FAA also incorporates either the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention)<sup>6</sup> or the Inter-American Convention on International Commercial Arbitration (Panama Convention).<sup>7</sup> This broad legal framework—as a default source of the parties' rights and obligations under domestic and international agreements to arbitrate commercial, business-to-business disputes—serves as the focus of the Article.

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<sup>1</sup> For example, who decides if the parties agreed to arbitrate their dispute; how many arbitrators are required; what happens if one of the parties refuses to cooperate; how much discovery is allowed; what sort of hearing procedures are appropriate; and to what extent the arbitrator's award is subject to any sort of judicial review?

<sup>2</sup> 9 U.S.C. §§ 1-307 (2006).

<sup>3</sup> *Id.* §§ 1-16 (2006).

<sup>4</sup> *Id.* §§ 201-307 (2006).

<sup>5</sup> The requirements for choosing state arbitration law are not entirely clear. *See generally* George A. Bermann, *Ascertaining the Parties' Intentions in Arbitral Design*, 113 PENN ST. L. REV. 1013 (2009) (discussing the application of "generic" choice of law clauses, the scope of a state's arbitration laws, and the interplay between federal and state arbitration law). The extent to which the FAA preempts state law remains open to significant unresolved questions. *See* Christopher R. Drahozal, *Federal Arbitration Act Preemption*, 79 IND. L.J. 393, 407-09 (2004) [hereinafter Drahozal, *FAA Preemption*]. Each of these issues is explored more fully. *See infra* Part II.C.

<sup>6</sup> Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38 [hereinafter New York Convention].

<sup>7</sup> Inter-American Convention on International Commercial Arbitration, Jan. 30, 1975, 14 I.L.M. 336 [hereinafter Panama Convention].

As a prelude to an examination of the legal framework governing arbitration, it is worth considering briefly the nature of arbitration from a few distinctive possible viewpoints. Arbitration, like the proverbial “Elephant” examined by the “Blind Men,”<sup>8</sup> is many different things to different people—depending on one’s perspective or the lens through which it is examined.

For example, many critics focus on arbitration as a waiver of fundamental rights, often accomplished with largely unread form contracts.<sup>9</sup> One might reasonably ask whether arbitration should be highly regulated by mandatory rules, lest stronger parties take undue advantage of weaker parties. In fact, one might further ask whether ex-ante agreements between such parties should be enforced at all.<sup>10</sup>

Another lens through which one might view arbitration is that of a binding dispute resolution “procedure.” From this perspective, arbitration is simply a variation on existing court procedures available for the binding resolution of private disputes—one with private judges, perhaps fewer formalities, and less post-decisional review, but nonetheless a binding dispute resolution procedure that in many ways resembles court adjudication.

From a slightly different perspective, one might view arbitration, not by way of comparison to any sort of public adjudication, but instead, as one of many alternatives to such binding adjudication commonly described as alternative dispute resolution or ADR. From this perspective one might, for

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<sup>8</sup> See JOHN GODFREY SAXE, *The Blind Men and the Elephant*, in THE POEMS OF JOHN GODFREY SAXE 135 (J.R. Osgood ed., 1873). The parable of the blind men and the elephant has also been attributed to the Buddha. See also JOSEPH MORRISSEY & JACK GRAVES, INTERNATIONAL SALES LAW AND ARBITRATION, 299-300 (2008) (employing this analogy to introduce the law and practice of arbitration). Professor Park has used this same analogy in reference to arbitration, albeit for the purpose of drawing somewhat different distinctions. See William W. Park, *The Specificity of International Arbitration: The Case for FAA Reform*, 36 VAND. J. TRANSNAT’L 1241, 1242 n.1 (2003) [hereinafter Park, *The Specificity of International Arbitration*]; WILLIAM W. PARK, ARBITRATION OF INTERNATIONAL BUSINESS DISPUTES 222 n.1 (2006). In each case, Professor Park points out a broad variety of legal disputes that might be resolved through arbitration.

<sup>9</sup> See, e.g., Keith N. Hylton, *Agreements to Waive or to Arbitrate Legal Claims: An Economic Analysis*, 8 SUP. CT. ECON. REV. 209, 211-12 & nn.2-4 (2000).

<sup>10</sup> Several scholars have touched on this question. See generally Richard A Bales & Sue Irion, *How Congress Can Make a More Equitable Federal Arbitration Act*, 113 PENN ST. L. REV. 1081 (2009) (noting that scholars “have not shared the Supreme Court’s endorsement of compulsory arbitration”); JEAN R. STERNLIGHT, *Consumer Arbitration*, in ARBITRATION LAW IN AMERICA: A CRITICAL ASSESSMENT 127 (2006); Sarah Rudolph Cole, *Incentives and Arbitration: The Case Against Enforcement of Executory Arbitration Agreements Between Employers and Employees*, 64 UMKC L. REV. 449 (1996).

example, consider the differences between binding arbitration and voluntary mediation, conciliation, or other forms of assisted settlement.

From an international or transnational perspective, arbitration takes on additional benefits and challenges. Parties from different legal cultures, as well as private and state entities, often particularly prefer the sort of neutral forum provided by arbitration, and arbitral awards are generally easier to enforce across national borders.<sup>11</sup> However, various national laws governing arbitration may differ in ways that affect the nature of the arbitral process. Lastly, one might view arbitration as a matter of contract—examining arbitration agreements as fully independent and separable consensual agreements, even when contained within broader agreements for goods, services, or other contractual rights and obligations.

Each of these perspectives is of course instructive, and a full understanding of arbitration requires some level of understanding of all of them (just as a full understanding of the proverbial elephant requires an understanding of all of its parts). This Article will focus on arbitration as contract—not because this perspective is any more important than any other, generally, but because it provides particularly useful insights in evaluating the current state of United States law governing commercial arbitration and potential proposals for its improvement. Specifically, this Article will focus on commercial, business-to-business arbitration and examine the effectiveness of the existing American legal framework governing arbitration agreements as a unique form of contract.

While others have explored the contractual nature of commercial arbitration, such explorations typically focus on the broad autonomy granted to parties in structuring the private dispute resolution mechanism.<sup>12</sup> Somewhat less has been written about the law governing commercial arbitration as a set of contractual default rules,<sup>13</sup> and even less has been written on the need

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<sup>11</sup> William W. Park, *National Law and Commercial Justice: Safeguarding Procedural Integrity in International Arbitration*, 63 TUL. L. REV. 647, 656-57 (1989).

<sup>12</sup> See generally Edward Brunet, *Replacing Folklore Arbitration with a Contract Model of Arbitration*, 74 TUL. L. REV. 39 (1999) (noting that parties add “customized features” to arbitration agreements); Thomas Carbonneau, *The Exercise of Contract Freedom in the Making of Arbitration Agreements*, 36 VAND. J. TRANSNAT’L L. 1189 (2003) (explaining that freedom of contract is embodied in arbitration agreements); Thomas Stipanowich, *Arbitration and Choice: Taking Charge of the “New Litigation,”* 7 DEPAUL BUS. & COM. L.J. 383 (2009) (noting the need for “real choice” in arbitration agreements).

<sup>13</sup> Much of the literature instead focuses on the tension between broad party autonomy and various proposals of mandatory rules for the protection of consumers and employees in arbitration, and the literature addressing default rules has tended to work around the edges of current federal law, as reflected in the Federal Arbitration Act. See generally EDWARD BRUNET ET AL., *ARBITRATION LAW IN AMERICA: A CRITICAL ASSESSMENT* (2006) (noting

for a singular, comprehensive and systematic treatment of both domestic and international commercial arbitration.<sup>14</sup>

Originally enacted in 1925, the “venerable” FAA has been subject to increasingly frequent critiques and calls for amendment. As suggested above, many of these critiques argue for greater protection of perceived “weaker” parties, such as consumers and employees, and propose either stronger mandatory legal rules protecting such parties or the complete exclusion of these parties from the effects of ex-ante arbitration agreements.<sup>15</sup> The FAA

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the need for a reformulation of federal arbitration law).

<sup>14</sup> See, e.g., Jack J. Coe, *The Case for the UNCITRAL Model—An Introduction*, 4 INT’L ARB. NEWS 2, 2-4 (2004); Daniel M. Kolkey, *Reflections on the U.S. Statutory Framework for International Commercial Arbitrations: Its Scope, Its Shortcomings, and the Advantages of U.S. Adoption of the UNCITRAL Model Law*, 1 AM. REV. INT’L ARB. 491, 534 (1990) (calling for revision or replacement of the FAA, but limiting focus to international commercial arbitration); see also James M. Gaitis, *The Federal Arbitration Act: Risks and Incongruities Relating to the Issuance of Interim and Partial Awards in Domestic and International Arbitrations*, 16 AM. REV. INT’L ARB. 1, 3-5 (2005) (calling for replacement of the FAA, but focusing specifically on interim and partial awards).

<sup>15</sup> See, e.g., Margaret Moses, *Arbitration Law: Who’s in Charge?* 40 SETON HALL L. REV. 147, 189 (2010); Margaret Moses, *Privatized “Justice,”* 36 LOY. U. CHI. L.J. 535, 548 (2005). Under most national legal systems, pre-dispute arbitration agreements involving consumers, employees, and other highly regulated contractual relationships are invalid and unenforceable. See Margaret Moses, *Privatized “Justice,”* *supra*; Christopher R. Drahozal, *New Experiences of International Commercial Arbitration in the United States*, 54 AM. J. COMP. L. SUPP. 233, 253 (2006) [hereinafter Drahozal, *New Experiences of International Commercial Arbitration*]. There is currently legislation before both houses of Congress that would achieve a similar result under United States law—rendering pre-dispute arbitration agreements invalid and unenforceable with respect to employees, consumers, franchisees, civil rights claimants, and other parties whose transactions are statutorily regulated based on unequal bargaining power. S. 931, 111th Cong. (2009); H.R. 1020, 111th Cong. (2009). The prospects for passage of the foregoing are uncertain at this time. Congress has, however, recently passed the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010), which provides for regulatory oversight and potential restriction of arbitration of financial disputes involving consumers. See Karen Halverson Cross, *Letting the Arbitrator Decide Unconscionability Challenges*, 26 OHIO ST. J. ON DISP. RESOL. (forthcoming 2011), available at <http://ssrn.com/abstract=1552966>. In one respect, the elimination of ex ante arbitration agreements involving consumers, employees, and other protected parties—which raise a whole host of unique issues—might very well make it much easier to address the inadequacy of the FAA, as related to commercial, business-to-business arbitration. It is often observed that one of the most significant challenges in amending the FAA is the fear of opening the proverbial “Pandora’s box” of special interests, particularly those involving consumer and employment arbitration. Park, *The Specificity of International Arbitration*, *supra* note 8, at 1295; see also Drahozal, *FAA Preemption*, *supra* note 5, at 235. With these concerns removed, it may be easier to address more basic business concerns regarding the existing legal structure. See Thomas J. Stipanowich, *Arbitration: The New*

has also been subject to critiques and calls for amendment to correct a variety of other deficiencies.<sup>16</sup> The problems presented by the FAA are perceived by many to be particularly acute in the context of international transactions, leading to calls for a variety of potential solutions, including amendment,<sup>17</sup> a new “restatement” of existing common law,<sup>18</sup> and even a completely new statute specifically governing international commercial arbitration.<sup>19</sup> However, there have been very few, if any, thorough examinations of the potential value of a comprehensive new statute governing both domestic and international commercial arbitration.<sup>20</sup> This Article attempts to fill that void. The objective of this Article is to explore more fully the idea of commercial, business-to-business arbitration,<sup>21</sup> not simply as a contract subject to autonomous ordering, limited by any appropriate mandatory legal rules, but as a sufficiently unique and important genus of contract to justify a specific,

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*Litigation*, 2010 ILL. L. REV. 1, 57 (2010) (explaining that an understanding of key contextual differences between business-to-business transactions, as compared to consumer and employee transactions, is essential to lawmakers); Thomas E. Carbonneau, *Arguments in Favor of the Triumph of Arbitration*, 10 CARDOZO J. CONFLICT RESOL. 395, 417-18 (2009) (noting the “maul[ing]” of U.S. domestic arbitration by the “claws of politicalization”). However, depending on the final structure of any amendment addressing consumer or employment arbitration, important elements of business-to-business, commercial arbitration might be adversely affected. See generally Thomas E. Carbonneau, “*Arbitracide*”: *The Story of Anti-Arbitration Sentiment in the U.S. Congress*, 18 AM. REV. INT’L ARB. 233 (2007); Edna Sussman, *The Arbitration Fairness Act: Unintended Consequences Threaten U.S. Business*, 18 AM. REV. INT’L ARB. 455 (2007) (addressing similar legislation to the current legislation cited above). The comprehensive approach to new legislation ultimately suggested by this article would, however, avoid such unintended spillover from any efforts to amend the current statute.

<sup>16</sup> See Edward Brunet, *The Appropriate Role of State Law in the Federal Arbitration System: Choice and Preemption*, in *ARBITRATION LAW IN AMERICA: A CRITICAL ASSESSMENT* 63-87 (2006).

<sup>17</sup> See Park, *The Specificity of International Arbitration*, *supra* note 8, at 1242-43.

<sup>18</sup> George A. Bermann, et al., *Restating the U.S. Law of International Commercial Arbitration*, 113 PENN ST. L. REV. 1333 (2009) (outlining the purpose, scope, and drafting process of the Third Restatement on International Commercial Arbitration).

<sup>19</sup> See Coe, *supra* note 14, at 2-4.

<sup>20</sup> For two excellent examples of recent national legislation governing both domestic and international commercial arbitration, one might consider the United Kingdom’s Arbitration Act, 1996, c. 23 (Eng.), available at <http://www.legislation.gov.uk/ukpga/1996/23/contents> (demonstrating a statute with a common law heritage), or Germany’s Arbitration Act, Schiedsverfahrensrecht [Arbitration Act], Jan. 1, 1998 (Ger.), available at <http://www.dis-arb.de/materialien> (showing a statute with a civil law heritage).

<sup>21</sup> This Article will address both domestic and international commercial arbitration, but will exclude arbitration of consumer and employment agreements, each of which present various issues that differ significantly from those faced in commercial, business-to-business arbitration.

comprehensive, and systematic legal regime, complete with a fully developed set of default legal provisions.

This Article begins, in Part I, by examining the specific potential for incomplete commercial agreements to arbitrate disputes and the application of various theories of default rules to these incomplete agreements. Under the vast majority of legal regimes governing arbitration, including the FAA, a simple agreement to final and binding arbitration of commercial disputes is fully enforceable—even if the agreement says little, if anything, else about the process of dispute resolution.<sup>22</sup> Thus, an agreement to arbitrate presents a number of classic issues in providing for default rules, as well as some particularized issues based on the nature of an arbitration agreement. These issues are further analyzed in terms of the theory of nominate contracts and analogized to the manner in which American law treats agreements for the sale of goods<sup>23</sup> and partnership agreements<sup>24</sup>—albeit by reference to uniform state law rather than a federal statute.<sup>25</sup> In considering these issues, the UNCITRAL Model Law on International Commercial Arbitration (UNCITRAL Model Law)<sup>26</sup> provides a useful point of comparative reference, as a comprehensive statutory scheme providing a broad array of default rules governing arbitration.

Part II addresses potential sources of gap filling for incomplete contracts, beginning with an analysis of existing law under the FAA—a statute almost

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<sup>22</sup> An arbitration agreement “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity of the revocation of any contract.” 9 U.S.C. § 2 (2006).

<sup>23</sup> See generally U.C.C. art. 2 (superseded 2003).

<sup>24</sup> See generally UNIF. P’SHIP ACT (1997).

<sup>25</sup> This distinction is more fully discussed *infra*, Part II.

<sup>26</sup> Model Law on Int’l Commercial Arbitration of the U.N. Comm’n on Int’l Trade Law, U.N. GAOR, 40th Sess., Supp. No. 17, U.N. Doc. A/40/17, annex I, at 81-93 (June 21, 1985) [hereinafter UNCITRAL Model Law]. This model law has been adopted, in substance, by over fifty countries and six U.S. states. See *Status: 1985 UNCITRAL Model Law on Int’l Commercial Arbitration*, UNCITRAL: U.N. COMM’N ON INT’L TRADE LAW, [http://www.uncitral.org/uncitral/encitral\\_texts/arbitration/1985Model\\_arbitration\\_status.html](http://www.uncitral.org/uncitral/encitral_texts/arbitration/1985Model_arbitration_status.html) (last visited Mar.27, 2011) [hereinafter *Status: 1985 UNCITRAL Model Law*]. For a discussion of the effect of U.S. state adoptions see *infra* Part II.C.3 on the law governing international commercial arbitration. At least one country, Germany, has also adopted the UNCITRAL Model Law to govern domestic arbitration as well. Dr. Stefan Kröll, *Germany*, in III INTERNATIONAL HANDBOOK ON COMMERCIAL ARBITRATION 1, 1 (Albert Jan van den Berg ed., 2007). The UNCITRAL Model Law was amended in 2006 to modernize the writing requirement (art. 7) and add a far more comprehensive set of provisions governing interim measures. See Model Law on Int’l Commercial Arbitration of the U.N. Comm’n on Int’l Trade Law, U.N. GAOR, 61st Sess., Supp. No. 17, U.N. Doc. A/61/17, annex I at 56-60 (as revised on July 7, 2006) [hereinafter UNCITRAL Model Law—2006 Amendment].

entirely devoid of default legal rules regarding the conduct of arbitration proceedings.<sup>27</sup> In evaluating the effectiveness of the FAA as a set of default legal rules, Part II.A also looks at a variety of challenges under the existing multi-part statutory structure, while Part II.B addresses the broader question of whether gaps in agreements to arbitrate are more effectively filled by courts under a common law approach or by the legislature under a comprehensive statutory approach.

Part II.C then examines the question of whether gaps—if statutorily filled—are best addressed by state or federal law. While most state laws historically provided little more than the FAA in the way of default rules, the Revised Uniform Arbitration Act of 2000 (RUAA)<sup>28</sup> expressly attempts to fill this void with respect to domestic arbitration.<sup>29</sup> However, it is debatable whether RUAA goes far enough in providing a comprehensive statute, and its effectiveness is significantly limited by the potentially broad and, to some degree, uncertain pre-emptive effect of the FAA on various matters addressed by RUAA.<sup>30</sup> A number of United States states have attempted to fill the void left by the FAA with respect to international commercial arbitration by adopting at least substantial portions of the UNCITRAL Model Law.<sup>31</sup> However, these adoptions have not been particularly uniform,<sup>32</sup> and significant unresolved issues of preemption call into question the effectiveness of such adoptions.<sup>33</sup>

Part II.D addresses the availability of various institutional and ad hoc arbitration rules and the potential that such rules might obviate the need for any default legal rules. In comparing the relative value and effectiveness of default legal rules versus the parties' own agreement, including privately chosen rules, Part II.D addresses the specific challenges of the unique contractual version of competence-competence (the jurisdiction of an arbitral tribunal to decide its own jurisdiction) developed by the United States Supreme Court in its interpretation of the FAA.

In conclusion, this Article calls for a new and comprehensive federal statutory scheme governing domestic and international commercial arbitration—and fully replacing the existing Federal Arbitration Act. Such a

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<sup>27</sup> Drahozal, *New Experiences of International Commercial Arbitration*, *supra* note 15, at 236, 238.

<sup>28</sup> UNIF. ARBITRATION ACT (2000) [hereinafter RUAA].

<sup>29</sup> *Id.* at Prefatory Note.

<sup>30</sup> See Drahozal, *FAA Preemption*, *supra* note 5, at 420 tbl.1.

<sup>31</sup> See Jack J. Coe Jr., *The Serviceable Texts of International Commercial Arbitration: An Embarrassment of Riches*, 10 WILLIAMETTE J. INT'L L. & DISP. RES. 143, 148 (2002).

<sup>32</sup> Gerold Herrmann, *UNCITRAL's Work Towards a Model Law on International Commercial Arbitration*, 4 PACE L. REV. 537, 538 (1984).

<sup>33</sup> See Drahozal, *FAA Preemption*, *supra* note 5, at 407-25.

scheme could eliminate the need for state law or any “restatement” of the existing common law governing arbitration in this country and would fully complement the use of private rules of arbitration, to the extent the latter might be incorporated by the parties into their arbitration agreement.

#### I. INCOMPLETE COMMERCIAL AGREEMENTS TO ARBITRATE: THE NEED FOR DEFAULT RULES

Parties may conclude a binding agreement to arbitrate their disputes by simply saying so in writing.<sup>34</sup> They need not say anything more about the specific nature of their intent. As long as they agree to final and binding arbitration of a defined range of disputes and the dispute in question falls within the scope of this range, each of the parties is fully bound to comply.<sup>35</sup> In agreeing to arbitration, the parties will have effectively displaced a detailed and fully developed set of procedures for adjudication of their dispute by a court. In the case of a simple, bare-bones agreement to arbitrate, however, the parties will have provided nothing to replace these court procedures. While a simplified dispute resolution procedure is admittedly one of the major reasons parties choose arbitration, few would likely say they chose arbitration for the lack of any procedure at all. Thus, we have a very real potential for binding arbitration agreements that lack a significant degree of completeness.

##### A. *Reasons for Incomplete Arbitration Agreements*

All contracts are, to at least some degree, incomplete.<sup>36</sup> The reasons for this lack of completeness vary, but might generally be divided into two broad categories: (1) lack of *ex ante* awareness of all of the factual or legal issues

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<sup>34</sup> In fact, an agreement need not even necessarily be in writing under the current version of the UNCITRAL Model Law. *See* UNCITRAL Model Law—2006 Amendment, *supra* note 26, art. 7. *See also* Jack Graves, *ICA and the Writing Requirement: Following Modern Trends Towards Liberalization or Are We Stuck in 1958?*, 3 BELGRADE L. REV. 36 (2009) (discussing the liberalization of form requirements for arbitration agreements). However, the extent to which national legislatures will follow this trend towards liberalizing form requirements governing arbitration agreements is yet to be determined. *Id.* at 39.

<sup>35</sup> Of course, the parties can always mutually agree to modify or terminate their agreement, as in the case of any contract. However, an agreement on the resolution of disputes is often particularly difficult to modify at the time of its performance because parties in need of binding dispute resolution will often have a difficult time agreeing on anything.

<sup>36</sup> Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821, 821 (1992).

that might ultimately arise between the parties; and (2) lack of willingness or ability to expend the time, energy, goodwill, or financial capital to resolve the issue at the time of contract formation.<sup>37</sup> The reasons for the latter source of incompleteness are particularly acute in the context of arbitration agreements.

In some circumstances, “the very act of negotiating for a specific contract term may signal negative information to the other party.”<sup>38</sup> While the basic suggestion of resolving any disputes through arbitration might generally be viewed in a positive light,<sup>39</sup> attempts to provide further details with respect to such arbitration might very well suggest that the party suggesting these details believes an arbitrated dispute to be a likely outcome of the parties’ relationship.<sup>40</sup> Or, even worse, any detailed negotiation of an arbitration agreement might be seen as an attempt to gain a tactical advantage in the event of such an outcome.<sup>41</sup> Thus, an arbitration agreement is even more likely to be incomplete as a result of the perceived costs of completing the agreement more fully.

Many parties, as well as many of their transactional counsel, will also often lack a thorough understanding of the myriad of issues that may—and all too often do—arise during the process of resolving a dispute through arbitration.<sup>42</sup> When considering the options for binding dispute resolution, the parties essentially have two choices: (1) litigation; or (2) arbitration. While there are a host of positive, well documented reasons why parties affirm-

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<sup>37</sup> *Id.* at 822; see also Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 *YALE L.J.* 87, 94 (1989) (defining, more narrowly, the former category based on one party’s strategic behavior in consciously withholding information from its contracting partner). In the analysis that follows, this Article will treat this alternative source of incompleteness discussed by Ayres and Gertner as a subset of the broader category of cases in which the parties’ knowledge is incomplete, for whatever reason.

<sup>38</sup> Stephen J. Choi, *The Problem with Arbitration Agreements*, 36 *VAND. J. TRANSNAT’L L.* 1233, 1236 (2003).

<sup>39</sup> At a very basic level, a general suggestion at the time of contracting that the parties agree to stay out of court would often be seen as quite positive in terms of the future relationship.

<sup>40</sup> Choi, *supra* note 38, at 1236. In addition, even sophisticated parties will often enter into a contractual relationship with an overly optimistic belief in their ability to avoid disputes, thereby reducing the potential value of “completing” the dispute resolution term. *Id.*

<sup>41</sup> In fact, at least one author suggests negotiating arbitration agreements in hopes of achieving just such a tactical advantage. Stipanowich, *supra* note 12, at 388-89. However, this same author agrees that, as a practical matter, this is often quite difficult, because parties intent on making a deal are reluctant to dwell on the subject of possible conflict resolution. *Id.* at 390.

<sup>42</sup> *Id.* at 389.

actively choose arbitration,<sup>43</sup> many also choose it simply because of what it is not—in effect, choosing arbitration simply because it is *not* litigation.<sup>44</sup> As a general alternative to litigation—albeit one that many parties do not fully understand—an agreement to arbitrate will often be incomplete based on the parties’ lack of knowledge regarding many of the nuanced details of arbitration.

When we consider both the lack of knowledge with respect to many parties and their transactional counsel, as well as the significant potential costs of negotiating terms in specific contemplation of an eventual contract dispute, it is easy to see why many arbitration agreements are incomplete. This of course leads to the question of how, if at all, such agreements should be completed.

*B. Should the Law Fill Gaps in Any Manner When an Arbitration Agreement is Incomplete?*

The initial question is whether gaps in an incomplete arbitration agreement should be filled at all. The act of filling gaps in the parties’ agreement is ultimately a double-edged sword. On one hand, completing those items the parties left out due to ignorance or the high cost of completion would seemingly serve the parties’ interests in giving full effect to their intentions.<sup>45</sup> On the other hand, completing the parties’ agreement also risks the

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<sup>43</sup> See Christopher Drahozal & Stephen J. Ware, *Why Do Businesses Use (or Not Use) Arbitration Clauses?* 25 OHIO ST. J. DISP. RESOL. 433, 435-37 (2010); Hon. Curtis E. von Kann, *A Report Card on the Quality of Commercial Arbitration: Assessing and Improving Delivery of the Benefits Customers Seek*, 7 DEPAUL BUS. & COM. L.J. 499, 500-01 (2009); see also Loukas Mistelis & Crina Baltag, *Recognition and Enforcement of Arbitral Awards and Settlement in International Arbitration: Corporate Attitudes and Practices*, 18 AM. REV. INT’L ARB. 319, 320, 322 (2008) (explaining a 2008 survey of corporate attitudes towards international commercial arbitration, but also useful with respect to commercial arbitration, more generally).

<sup>44</sup> Stephen L. Hayford, *Building a More Perfect Beast: Rethinking the Commercial Arbitration Agreement*, 7 DEPAUL BUS. & COM. L.J. 437, 439 (2009) (explaining parties’ very fundamental desire for “a clear alternative to traditional litigation”).

<sup>45</sup> See RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW* 372 (3d ed. 1986) (suggesting that the law should supply the terms the parties would have adopted had they addressed the issue); Douglas Baird & Thomas Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829, 835-36 (1985) (providing the parties with the term they would have negotiated had they recognized the issue and had the time and money to address it). *But see* Ayres & Gertner, *supra* note 37, at 90-91 (suggesting that the most efficient default terms will not always be those the parties would have wanted, but may sometimes be those that at least one party does not favor).

possibility of getting it wrong. In fact, the parties may perceive that their agreement is fully complete—notwithstanding apparent gaps.

For example, the parties to an arbitration agreement may have simply provided for binding arbitration before a single arbitrator chosen by the parties. While one might suggest that this agreement leaves a rather large gap with respect to the arbitral procedure, it might also be that the parties simply intended to grant the arbitrator complete discretion with respect to procedure.<sup>46</sup> If so, then perhaps the agreement does not really include any gaps at all.

The FAA does not speak directly to this possibility.<sup>47</sup> However, the UNCITRAL Model Law provides a potential indication of the parties' likely normative views. Article 19(2) provides that an "arbitral tribunal may, subject to the provisions of [the UNCITRAL Model Law], conduct the arbitration in such manner as it considers appropriate."<sup>48</sup> One might reasonably infer that this represents a commercial norm suggesting that the parties often prefer broad grants of discretion to the arbitrators. However, this apparently broad grant of authority comes in the context of a very well developed set of default rules governing many of the most common procedures likely to arise in arbitral proceedings.<sup>49</sup> Thus, it is much more difficult to draw any inference that parties would typically grant complete discretion to arbitrators in the absence of any default rules. Moreover, any exercise of arbitrator discretion presupposes the existence of an arbitrator to exercise that discretion and, without at least some sort of default rule regarding the appointment of an arbitrator, effectuation of the parties' agreement to arbitrate is impossible.<sup>50</sup>

Once an arbitrator has been chosen, the parties may grant that arbitrator broad authority to decide their dispute on equitable principles without

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<sup>46</sup> See Alan Scott Rau, *Federal Common Law and Arbitral Power*, 8 NEV. L.J. 169, 180-81 (2007) (suggesting "unfettered arbitral discretion and control" as the "universally accepted 'meta gap-filler'").

<sup>47</sup> See *id.* Though, one might argue that the FAA speaks indirectly to the issue by largely omitting any gap fillers. Seemingly, this is Professor Rau's view in suggesting the lack of need for specific FAA gap fillers. See *id.*

<sup>48</sup> UNCITRAL Model Law—2006 Amendment, *supra* note 26, art. 19(2).

<sup>49</sup> See, e.g., *id.* art. 17.

<sup>50</sup> One of the very few default rules provided by the FAA is that, if the parties cannot agree, a court shall appoint an arbitrator. 9 U.S.C. § 5 (2006). Court appointment is not, however, the only option. Many institutional rules provide for appointment by the institution. See, e.g., AM. ARBITRATION ASS'N, COMMERCIAL ARBITRATION RULES AND MEDIATION PROCEDURES 8 r.11 (2010); UNCITRAL Arbitration Rules, G.A. Res. 31/98, art. 6, U.N. GAOR, 31st Sess., U.N. Doc. A/31/98 (Dec. 15, 1976) (providing for designation of any appointing authority by the Permanent Court of arbitration).

reference to any particular substantive law.<sup>51</sup> This sort of arbitrator authority might also suggest a broad discretionary norm. However, arbitral rules addressing the issue require the parties' express consent to grant the arbitrator such broad discretionary power over the substance of their dispute.<sup>52</sup> In the same vein, the parties are unlikely to have intended a grant of virtually unlimited procedural discretion in the absence of a clear indication of that intent. Thus, the parties' intentions are most likely served by default terms reflecting those they would have likely agreed upon in the event they had addressed the issues in question.

*C. What Sort of Default Rules Might Be Appropriate for Filling Gaps in Incomplete Arbitration Agreements?*

The classic "majoritarian" approach to default rules is to seek to determine the rule that most similarly situated parties would have wanted had they actually considered and negotiated the issue at the time of contracting.<sup>53</sup> In contrast, one of the most commonly discussed alternatives is the "penalty" default approach.<sup>54</sup> The basic idea of a penalty default is that the default rule should be designed to be a rule disfavored by a party likely to possess information useful to its contracting partner.<sup>55</sup> The party with the relevant information is, therefore, faced with the option of either accepting a rule it does not like or disclosing the information.<sup>56</sup> In the case of arbitration agreements, a "majoritarian" approach is likely to be the most appropriate.

Penalty defaults are most appropriate when the ex ante cost of contracting is relatively cheap.<sup>57</sup> However, the cost of contracting for specific details of

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<sup>51</sup> See, e.g., AM. ARBITRATION ASS'N & INT'L CTR. FOR DISPUTE RESOLUTION, INT'L DISPUTE RESOLUTION PROCEDURES 13 art.28(1) (2009).

<sup>52</sup> *Id.* at art.28(3).

<sup>53</sup> Joshua Fairfield, *The Cost of Consent: Optimal Standardization in the Law of Contract*, 58 EMORY L.J. 1401, 1441-42 (2009); Ayres & Gertner, *supra* note 37, at 93.

<sup>54</sup> Fairfield, *supra* note 53; see Ayres & Gertner, *supra* note 37, at 97. One of the classic examples of a penalty default is the rule of *Hadley v. Baxendale*, which provides that consequential damages are limited by foreseeability. 156 Eng. Rep. 145, 150 (1854). The party contracting for carriage is faced with either accepting a limit on liability for late delivery or disclosing to its contracting partner information as to the potentially large losses it might suffer with respect to late delivery. *Id.* With such information in hand, the carrier can negotiate over whether it is willing to accept such risks and at what price. *Id.*

<sup>55</sup> Ayres & Gertner, *supra* note 37, at 97.

<sup>56</sup> *Id.*

<sup>57</sup> *Id.* at 93.

an arbitration agreement is likely to be particularly high.<sup>58</sup> Moreover, it seems unlikely that, at the time of contracting, either party would be strategically withholding information regarding a potential arbitration process that the other might value in negotiating a more detailed arbitration agreement.<sup>59</sup> A majoritarian approach also seems particularly appropriate when one looks at commercial arbitration from a normative perspective.

To a large degree, most business parties to a commercial arbitration agreement share the same general expectations. In choosing arbitration of a dispute arising out of a commercial, business-to-business transaction, the parties are typically interested in the following characteristics:

- Arbitration is generally perceived as faster than litigation and, at least to the extent it is faster, cheaper than litigation;<sup>60</sup>
- Arbitration is generally perceived as more flexible and less adversarial than litigation;
- The parties may choose their decision-maker for his or her expertise, thereby leading to more accurate outcomes;
- Arbitration is private and largely confidential;<sup>61</sup> and
- The decision of the arbitrator is final, thus bringing closure to the dispute and allowing the parties to return to any remaining business relationship.<sup>62</sup>

When the transaction crosses national borders, the parties to an international commercial arbitration agreement share the same expectations listed above, but also typically choose arbitration for two additional reasons:

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<sup>58</sup> See *supra* Part I.A.

<sup>59</sup> At the time of contract conclusion, it seems unlikely that either party would be sufficiently prescient to know what information it might strategically withhold from the other or, in contrast, disclose in attempting to negotiate around a disfavored default rule.

<sup>60</sup> The cost of the arbitrator makes this aspect of arbitration more expensive than litigation. However, the speed and efficiency of arbitration are generally thought to more than compensate for this cost, thus reducing the overall cost of the process. *But see* JACKSON WILLIAMS, PUBLIC CITIZEN, THE COSTS OF ARBITRATION 61-67 (Frank Clemente et al. eds., 2002), available at <http://www.citizen.org/documents/ACF110A.PDF>.

<sup>61</sup> The parties may agree upon a confidentiality requirement within the arbitration proceedings themselves. See, e.g., JAMS, COMPREHENSIVE ARBITRATION RULES AND PROCEDURES 27 r.26(a) (2009). They may also agree upon a requirement that the parties, the arbitrators, and any institution maintain such confidentiality outside of the proceedings. See, e.g., LCIA, ARBITRATION RULES, art. 30.1 (1998). However, any such agreement is subject to required disclosures pursuant to judicial proceedings. JAMS, *supra*; LCIA, *supra*. Thus, the benefit of confidentiality is often lost when parties end up in court over issues arising out of the arbitration agreement.

<sup>62</sup> See, e.g., Drahozal & Ware, *supra* note 43, at 451-52; Kann, *supra* note 43, at 500-01.

- Arbitration provides a neutral forum, as compared to national courts; and
- Arbitration awards are generally easier to enforce in a national jurisdiction other than that in which they are issued.<sup>63</sup>

These latter two attributes related to international transactions in no way conflict with the former list of more general characteristics. Thus, there is no apparent reason why a set of default rules for domestic commercial arbitration would necessarily need to be any different from those suitable for international commercial arbitration.

We can also find significant agreement on those attributes of arbitration agreements that parties find least attractive, most of which relate to the increased costs and delay associated with two things: (1) the increasing tendency of lawyers—especially American lawyers—to turn arbitration into something that looks very much like litigation;<sup>64</sup> and (2) court proceedings in connection with an arbitration agreement.<sup>65</sup> Each of these concerns can, to some degree, be minimized with an appropriate set of default rules.<sup>66</sup>

A regime of default rules for arbitration based on a majoritarian approach would, therefore, likely include rules providing for a relatively expeditious, inexpensive, cooperative and flexible means of dispute resolution before a neutral expert decision maker; conducted in a private and confidential setting; and culminating in a final, and fully enforceable award, deciding the merits of the parties' dispute, all with as little court intervention as possible. Admittedly, there are several important variations on this general theme, and frequent variations are found in institutional arbitration rules. However, these variations in rules are in no way inconsistent with the premise that a

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<sup>63</sup> See, e.g., Drahozal & Ware, *supra* note 43, at 452; MORRISSEY & GRAVES, *supra* note 8, at 312-15.

<sup>64</sup> See, e.g., Steven Seidenberg, *International Arbitration Loses Its Grip: Are U.S. Lawyers to Blame?* 96 A.B.A. J. 50, 51 (2010); see also Hayford, *supra* note 44, at 438-39 (pointing out the stark difference between clients' interest in efficient and cost effective dispute resolution and the lawyer's interest in fighting to win every possible battle irrespective of the costs or effectiveness of doing so).

<sup>65</sup> See, e.g., Lou Whiteman, *Arbitration's Fall from Grace*, CORPORATE COUNSEL (July 13, 2006), <http://www.law.com/jsp/cc/PubArticleCC.jsp?id=1152695125655>.

<sup>66</sup> The third concern about arbitration is that of the inability to join other parties to the dispute who are not parties to the arbitration agreement. While some national laws and institutional rules have begun to address this issue in a limited manner, arbitral jurisdiction is ultimately based on consent, and, without consent, joinder is likely to remain a challenge. As such, this issue is not addressed in the context of this default rules analysis.

substantial majority of parties to an arbitration agreement are looking for the same general characteristics in resolving their dispute. For example, one might analogize a set of arbitration rules to the rules of carriage found in standard shipping terms, such as “Ex Works,” “Free on Board,” or “Cost, Insurance, and Freight.”<sup>67</sup> However, the fact that parties may choose terms of carriage that differ on important issues in no way undermines the value of the default rules found in uniform sales law, such as Uniform Commercial Code (U.C.C.) Article 2 or the United Nations Convention on the International Sale of Goods.<sup>68</sup> In a similar fashion, a set of default rules governing commercial arbitration would provide a valuable baseline in filling gaps in the parties’ agreement in the absence of any express choice—either directly or by incorporation.

It is often said that arbitration is based entirely on consent.<sup>69</sup> When business parties fail to contract around a set of established default legal rules, the parties might reasonably be said to have tacitly consented to these rules by their silence.<sup>70</sup> However, such an inference is only reasonable if (1) the parties had reason to know of the default rule and (2) the cost of contracting around the rule is not prohibitive.<sup>71</sup> The latter issue, in particular, presents a problem in the context of an arbitration agreement because, as discussed earlier, the costs of negotiating an arbitration agreement may often be unusually high.<sup>72</sup> Whether such costs are sufficiently high to preclude an inference of tacit consent, the issue is at least a problematic one in terms of inferring consent from silence. However, even where parties cannot be said to have tacitly consented via silence, the imposition of default legal rules “may still be justified on the grounds of consent when default rules are chosen to reflect the common sense or conventional understanding of most parties.”<sup>73</sup>

In contracting for arbitration, “the parties’ subjective intent is most likely to be satisfied by a default rule that interprets manifested consent to reflect the commonsense or conventional expectations that are likely part of the tacit

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<sup>67</sup>International Chamber of Commerce, *Incoterms 2010*, <http://www.iccwbo.org/incoterms/id3040/index.html> (last visited Feb. 22, 2011) [hereinafter *Incoterms 2010*].

<sup>68</sup>See *infra* Part II.D for a more developed comparison of default contract terms, adopted by way of incorporation, with default legal rules, adopted by choosing a particular seat for the arbitration.

<sup>69</sup>CHRISTOPH SCHREUER, UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, COURSE ON DISPUTE SETTLEMENT IN INTERNATIONAL TRADE, INVESTMENT AND INTELLECTUAL PROPERTY 5 (2003).

<sup>70</sup>Barnett, *supra* note 36, at 826.

<sup>71</sup>*Id.* at 866.

<sup>72</sup>See *supra* notes 38-41 and accompanying text.

<sup>73</sup>Barnett, *supra* note 36, at 827.

assumptions of particular parties.”<sup>74</sup> Such commonsense expectations are those normative expectations shared by most people choosing arbitration for dispute resolution. Thus, where default rules are based on a strong, majoritarian set of commercial norms, they may be said to reflect the commonly held consent of the commercial arbitration community. To some degree, this argument might be made in support of any set of normative default rules, such as U.C.C. Article 2.<sup>75</sup> However, the normative force of expectations within the arbitration community is arguably even greater than in most such identifiable transactional communities, as those common sense expectations tend to be particularly pervasive within that community. Thus, majoritarian default rules governing arbitration agreements may be reasonably characterized as reflecting the general consent of those businesses choosing to resolve their disputes through arbitration.

The final issue regarding the nature of default rules is the extent to which such rules might be tailored to the particular circumstances of specific parties.<sup>76</sup> Perhaps one of the most significant choices in dispute resolution generally and arbitration in particular is the choice between speed and cost on the one hand and reaching the “correct” decision on the other. This apparent tension need not necessarily present any conflict at all, as many disputes can be arbitrated quickly, inexpensively, and accurately—without sacrificing any of these virtues. However, to the extent these concerns may sometimes conflict, the parties’ expectations at the time of contracting may differ depending on the nature of the transaction subject to resolution of disputes through arbitration. If so, it may be worth considering whether default rules can be tailored to address this particular potential difference in expectations.

The most significant critique of arbitration today comes from the cost and delay associated with long, protracted proceedings,<sup>77</sup> and the business community is increasingly calling for a more expeditious, cost effective process.<sup>78</sup> However, in at least some instances, business parties may value getting the

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<sup>74</sup> *Id.* at 880.

<sup>75</sup> Such “common sense” rules might be contrasted with those that would not be part of the commonsense expectations of most commercial parties. For example, the default rules regarding the division of partnership profits seem quite contrary to common sense in many circumstances. *Id.* at 884.

<sup>76</sup> Ayres & Gertner, *supra* note 37, at 91-92 (noting the distinction between tailored and untailored defaults).

<sup>77</sup> Seidenberg, *supra* note 64, at 51; *see also* Hayford, *supra* note 44, at 438-39 (noting business decision makers concerns with delay and opportunity costs).

<sup>78</sup> *See, e.g.*, Hayford, *supra* note 44, at 438-39; Peter Morton, *Can a World Exist Where Expedited Arbitration Becomes the Default Procedure?* 26 ARB. INT’L 103, 104 (2010).

“correct” result over efficiency. Thus, a set of default legal rules governing arbitration might distinguish between default rules applicable in expedited arbitration and those applicable in non-expedited arbitration.<sup>79</sup> One option would be to leave this distinction to the arbitrators to make a determination on a case-by-case basis, depending on what is “reasonable in the circumstances.”<sup>80</sup> While it is difficult to identify any singular method for distinguishing between the parties’ expectations in all circumstances, the size of the transaction will often provide a strong indication.<sup>81</sup>

In any event, this potential conflict between efficiency and accuracy is one of the differences between party expectations most likely to lead to a need for tailored defaults,<sup>82</sup> and any set of default legal rules governing arbitration should consider and address this and any other such issues. However, the need for a few select, tailored default rules in no way precludes a largely majoritarian approach to the provision of default legal rules governing incomplete agreements to arbitrate.

In thinking about a set of default legal rules governing arbitration, it is also worth considering the broader structural framework for such rules. For this purpose, Article 2 of the U.C.C.,<sup>83</sup> as well as the Uniform Partnership Act (both original and revised),<sup>84</sup> provide useful analogies.

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<sup>79</sup> For example—and only by way of example—the former might provide default rules requiring only a single arbitrator, minimal discovery, and short time frames for submission of pleadings, while the latter might provide for three arbitrators and greater opportunity for discovery. One might also suggest, in the latter case, an opportunity for some sort of substantive appellate review—an option arguably foreclosed under the FAA. *See* *Hall St. Assoc. v. Mattel, Inc.*, 552 U.S. 576, 584 (2008) (holding that the provisions for review of an arbitrator’s decision under sections 10 and 11 are exclusive).

<sup>80</sup> Ayres & Gertner, *supra* note 37, at 91-92. This approach is used in a variety of provisions within U.C.C. Article 2. *See, e.g.*, U.C.C. § 2-206 (2005) (contract offer “inviting acceptance” when in manner “reasonable in the circumstances”).

<sup>81</sup> *See, e.g.*, THE CHAMBERS OF COMMERCE AND INDUSTRY OF BASEL, BERN, GENEVA, NEUCHÂTEL, TICINO, VAUD AND ZURICH, SWISS RULES OF INTERNATIONAL ARBITRATION 21 art.42 (2006) (providing a default rule for expedited arbitration of disputes of less than one million Swiss Francs).

<sup>82</sup> The Swiss Rules actually contemplate both a discretionary tailored rule based on the “complexity of the subject matter and/or the amount in dispute.” *Id.* at 9 art.6(2) (providing for discretion as to the number of arbitrators), as well as a “bright line” tailored rule. *Id.* at 21 art.42(2) (providing for expedited procedures below a certain amount in dispute).

<sup>83</sup> U.C.C. §§ 2-305, -308, -309 (providing default terms for incomplete contracts).

<sup>84</sup> NAT’L CONFERENCE OF COMM’RS ON UNIF. STATE LAWS, UNIFORM PARTNERSHIP ACT 1 (1997) (stating in the Prefatory Note that the Act is “largely a series of default rules that govern the relations among partners in situations they have not addressed in a partnership agreement”), available at [http://www.nccusl.org/nccusl/Home\\_desktop\\_default.aspx](http://www.nccusl.org/nccusl/Home_desktop_default.aspx) (follow “Final Acts & Legislation” link; then find the act in “Select an Act Title” box).

*D. Arbitration Agreements as Nominate Contracts?*

The treatment of sales and partnership as unique and specific forms of contract goes back to Roman law, where each was treated as a form of nominate contract, complete with its own set of default provisions.<sup>85</sup> The French Civil Code also treated arbitration as a nominate contract—a distinction still maintained today in the civil codes of Louisiana and Quebec.<sup>86</sup> In the case of such nominate contracts, a code will necessarily provide for a default set of rights and obligations, which will govern the parties' agreement in the absence of any contrary intent. While the theoretical underpinnings of traditional civilian nominate contracts and common law default rules are admittedly distinct, the basic ideas are sufficiently similar to be worthy of our consideration in drawing possible analogies. This civil law approach to codification of traditional nominate contracts is, to some degree, reflected in the U.S. approach to codification of the law governing the sale of goods and partnerships—two of the oldest forms of nominate contracts.<sup>87</sup> As another traditional form of nominate contract, arbitration arguably deserves a comparable comprehensive and systematic approach to codification.

In his campaign for enactment of a uniform commercial code governing, *inter alia*, sales of goods, Professor Karl Llewellyn often pointed to the cost of uncertainty in commercial transactions governed by common law as being a result of the uncertainty linked with the outcome being determined by the highest court of the relevant jurisdiction.<sup>88</sup> Llewellyn sought to avoid that uncertainty by providing a highly structured set of default legal rules governing the parties' transactions in the absence of any contrary intent.<sup>89</sup> He employed a normative approach to drafting these rules and weaved the individual provisions together in a comprehensive and systematic mosaic within which its own fabric often provides the basis for filling any remaining gaps.<sup>90</sup> While perhaps not as storied as Llewellyn's drafting of the U.C.C., the uniform laws governing partnership agreements in this country provide additional examples of comprehensive and systemic codifications of a

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<sup>85</sup> BARRY NICHOLAS, *FRENCH LAW OF CONTRACT* 46 (1982).

<sup>86</sup> *See* LA. REV. STAT. ANN. §§ 9:4201-:4217 (2010); Civil Code of Québec, S.Q. 2005, c. 18 (Can.).

<sup>87</sup> *See supra* notes 83-84.

<sup>88</sup> Shael Herman, *The Fate and the Future of Codification in America*, 40 AM. J. LEGAL HIST. 407, 428-29 (1996).

<sup>89</sup> *Id.* at 429-31.

<sup>90</sup> *Id.* at 428-29.

specific form of contract that could otherwise be governed by the common law of contracts.<sup>91</sup>

As explained more fully below, the same sort of uncertainty Llewellyn spoke of, over fifty years ago, exists today with arbitration agreements governed by the FAA—a bare bones statute largely displaced by federal “common law.”<sup>92</sup> Instead of providing a comprehensive and systematic approach to the law governing arbitration, the FAA relies almost entirely on the common law of contracts, along with the developing federal common law governing those unanswered common law of contracts questions.<sup>93</sup> There is no good reason why arbitration contracts do not deserve the same thoughtful statutory treatment the law provides to other unique contracts, such as those for the sale of goods or partnership.<sup>94</sup>

The vast majority of other modern legal systems have done much more than the United States to develop default legal rules governing arbitration.<sup>95</sup> The UNCITRAL Model Law (adopted, at least in part, by over fifty countries and seven U.S. states)<sup>96</sup> contains a well-developed and reasonably comprehensive set of default provisions systematically addressing many of the issues that might arise under an arbitration agreement that does not incorporate a complete set of private institutional or ad hoc rules.<sup>97</sup> A number of other countries, including France and England, have their own unique default legal regimes governing arbitration—somewhat different from the Model Law, but each far more comprehensive than the FAA.<sup>98</sup>

Admittedly, not every incomplete contract should be completed by reference to default rules and not every type of contract requires a uniquely tailored statutory scheme.<sup>99</sup> However, the unique and specialized nature of an

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<sup>91</sup> See *supra* note 84 and accompanying text.

<sup>92</sup> Margaret Moses, *Statutory Misconstruction: How The Supreme Court Created a Federal Arbitration Law Never Enacted by Congress*, 34 FLA. ST. U. L. REV. 99, 99-100 (2006).

<sup>93</sup> 9 U.S.C. § 2 (2006) (stating that an arbitration agreement is valid “save upon such grounds as exist at law or in equity for the revocation of any contract”).

<sup>94</sup> One might ask at this stage if arbitration ought to be governed by uniform state law instead of federal law. In fact, a number of states have adopted either the original Uniform Arbitration Act or the Revised Uniform Arbitration Act. See *infra* notes 248 & 257 and accompanying text. However, as more fully explained in Part II.C *infra*, the use of state law to cure the current ills of the FAA is fraught with its own set of perils.

<sup>95</sup> See, e.g., UNCITRAL Model Law, *supra* note 26; NOUVEAU CODE DE PROCÉDURE CIVILE [N.C.P.C.] art. 1442-1507 (Fr.) [hereinafter Arbitration Rules of France]; Arbitration Act 1996, c. 23 (Eng.) [hereinafter English Arbitration Act].

<sup>96</sup> *Status: 1985 UNCITRAL Model Law*, *supra* note 26.

<sup>97</sup> See generally *id.*

<sup>98</sup> See Arbitration Rules of France, *supra* note 95; English Arbitration Act, *supra* note 95.

<sup>99</sup> See Lisa Bernstein, *Social Norms and Default Rules Analysis*, 3 S. CAL. INTERDISC.

arbitration agreement,<sup>100</sup> coupled with a significant body of strong and well-established commercial norms surrounding such an agreement,<sup>101</sup> would seem to demand a unique and comprehensive statute governing domestic and international commercial arbitration in this country.<sup>102</sup>

## II. FILLING THE GAPS: POTENTIAL SOURCES OF DEFAULT RULES

The FAA governs both domestic and international arbitration.<sup>103</sup> Domestic arbitration is governed by Chapter 1,<sup>104</sup> while international arbitration is governed by Chapters 2<sup>105</sup> and 3.<sup>106</sup> The original FAA (Chapter 1) provides for enforcement of domestic agreements to arbitrate and grants the parties broad autonomy in structuring such arbitration,<sup>107</sup> while providing very few default rules to guide the parties who fail to exercise that autonomy.<sup>108</sup> Therefore, when one is faced with a “gap” in the details of the parties’ agreement to arbitrate, the FAA provides little guidance in filling that gap.<sup>109</sup>

Chapter 2 of the FAA addresses foreign and other “non-domestic” agreements to arbitrate<sup>110</sup> and provides for the application of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) to such arbitration agreements and any resulting awards.<sup>111</sup> Chapter 3 of the FAA also addresses foreign and other “non-domestic” agreements to arbitrate,<sup>112</sup> but provides for the application of the Inter-American Convention on International Commercial Arbitration (the Panama

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L.J. 59, 67 (1993).

<sup>100</sup> See Imre S. Szalai, *The Federal Arbitration Act and the Jurisdiction of the Federal Courts*, 12 HARV. NEGOT. L. REV. 319, 321 (2007).

<sup>101</sup> See IAN R. MACNEIL, RICHARD E. SPEIDEL & THOMAS J. STIPANOVICH, FEDERAL ARBITRATION LAW § 7.1.2.1 (1999).

<sup>102</sup> This idea is more fully discussed *infra*, Parts II.B-D.

<sup>103</sup> See Szalai, *supra* note 100, at 325.

<sup>104</sup> 9 U.S.C. §§ 1-16 (2006).

<sup>105</sup> *Id.* §§ 201-208.

<sup>106</sup> *Id.* §§ 301-307.

<sup>107</sup> *Id.* §§ 1-16. While a few new sections have been added to the FAA, such as those on appeal, 9 U.S.C. § 16, and the legal effect of the statute has arguably changed significantly through the decisions of the United States Supreme Court. See *generally* Moses, *supra* note 92. The text of the original 1925 statute remains largely unchanged today.

<sup>108</sup> See Moses, *supra* note 92, at 111-112.

<sup>109</sup> See *generally* 9 U.S.C. §§ 1-307.

<sup>110</sup> *Id.* §§ 201-208.

<sup>111</sup> *Id.* § 201; New York Convention, *supra* note 6, § 201.

<sup>112</sup> See 9 U.S.C. §§ 301-307.

Convention)<sup>113</sup> to arbitration agreements in which the majority of the parties are citizens of signatory states to the Panama Convention.<sup>114</sup> While Chapters 2 and 3 serve their intended purposes of giving effect to these respective Conventions, their interaction with FAA Chapter 1 also raises some issues of uncertainty in their application.<sup>115</sup> In addition the Panama Convention raises a unique issue because of its adoption of a complete set of default rules of the Inter-American Arbitration Commission.<sup>116</sup>

As more fully explained below, this broad, vague attempt at “statutory dépeçage”<sup>117</sup> fails for at least two reasons. First, the overall statute is insufficiently detailed in providing default provisions.<sup>118</sup> Second, many of the details it does provide in international transactions do not mesh well with the law governing domestic transactions, and the overall structure of the statute arguably creates as many questions as it resolves.<sup>119</sup>

#### *A. The Current State of American Federal Law Governing Commercial Arbitration*

Congress enacted the FAA in 1925<sup>120</sup> for the specific purpose of overcoming “centuries of judicial hostility to arbitration agreements<sup>121</sup>” and enforcing contracts on an equal basis with other common law contracts.<sup>122</sup> Since that time, the United States Supreme Court has given broad effect to this purpose in both federal and state courts<sup>123</sup> and has consistently resisted

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<sup>113</sup> *Id.* at § 301. *See generally* Panama Convention, *supra* note 7.

<sup>114</sup> 9 U.S.C. § 305(1) (2006).

<sup>115</sup> *See* Park, *The Specificity of International Arbitration*, *supra* note 8, at 1248.

<sup>116</sup> *See* 9 U.S.C. § 306(a) (2006); Panama Convention, *supra* note 7, 1 art.3. *See generally* SICE, Rules of Procedure of the Inter-American Arbitration Commission, COMMERCIAL ARBITRATION AND OTHER ALTERNATIVE DISPUTE RESOLUTION METHODS (July 1, 1988) [hereinafter IACAC Rules], available at [http://www.sice.oas.org/dispute/comarb/iacac/rop\\_e.asp](http://www.sice.oas.org/dispute/comarb/iacac/rop_e.asp). This incorporation of a complete set of default rules is unique in American arbitration law.

<sup>117</sup> “Dépeçage” is the process whereby a single legal relationship may be governed by different laws. *See* BLACK’S LAW DICTIONARY 469-470 (8th ed. 2004). The term seems appropriate here, where the FAA attempts to apply a collection of separate and independent legal instruments to govern a single contractual relationship—the agreement to arbitrate an international commercial dispute.

<sup>118</sup> *See* Drahozal, *New Experiences of International Commercial Arbitration*, *supra* note 15, at 236.

<sup>119</sup> *See* Park, *The Specificity of International Arbitration*, *supra* note 8, at 1248.

<sup>120</sup> Szalai, *supra* note 100, at 325.

<sup>121</sup> Scherk v. Alberto-Culver Co., 417 U.S. 506, 510 (1974).

<sup>122</sup> *Id.* at 510-11.

<sup>123</sup> *See generally* Southland Corp. v. Keating, 465 U.S. 1 (1984) (holding the FAA applies in state courts, as well as federal courts). This was arguably the single most important

state efforts to limit the enforcement of arbitration agreements on any grounds other than those applying broadly to any and all contracts.<sup>124</sup> For those favoring arbitration generally as a means of binding dispute resolution, the FAA would seem to be a resounding success in achieving its original goal.<sup>125</sup> However, the parties to an arbitration agreement are likely seeking more than just enforceability of their agreement—they are also likely trying to stay out of court altogether.<sup>126</sup> In this respect, the FAA, as interpreted by the Supreme Court, and as amended by Congress to accommodate international treaties, has arguably been far less successful.<sup>127</sup>

*1. The Federal Arbitration Act: The Minimalist Approach to Domestic Arbitration Under Chapter 1*

The loadstar rule of FAA Chapter 1 is found in section 2,<sup>128</sup> which provides that an agreement “to settle by arbitration a controversy . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”<sup>129</sup> An arbitration agreement is fully binding as long as: (1) the parties agree in writing to final and binding arbitration and (2) the dispute in question falls within the scope of the arbitration agreement.<sup>130</sup> Of course, many arbitration agreements will provide

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decision the Supreme Court has ever issued with respect to the FAA, because it preempted efforts by the states to regulate arbitration—at least to the extent such efforts were contrary to the Supreme Court’s interpretation of FAA article 2. Moreover, the preemption issues left open by *Southland* and subsequent Supreme Court cases are largely responsible for the uncertainty surrounding current state laws purporting to govern certain elements of arbitration. The original *Southland* decision drew a vigorous and well reasoned dissent. *See id.* at 21-36 (O’Connor, J. and Rehnquist, C.J., dissenting). At least one justice is still fighting the battle lost in *Southland*. *See, e.g.*, *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 449 (2006) (Thomas, J., dissenting based on his view that the FAA does not apply in state court proceedings).

<sup>124</sup> *See, e.g.*, *Doctor’s Assoc., Inc., v. Casarotto*, 517 U.S. 681, 686-88 (1996).

<sup>125</sup> *See Moses, supra* note 92, at 99-100.

<sup>126</sup> *See* John M. Townsend, *Drafting Arbitration Clauses Avoiding the 7 Deadly Sins*, 58 DISP. RESOL. J. 28, 31 (2003). Even if court intervention is unnecessary to give effect to the parties’ arbitration agreement, a party may find it necessary to resort to courts regarding remedies such as specific relief, which are generally unavailable from the arbitral tribunal.

<sup>127</sup> *See, e.g.*, *Moses, supra* note 92, at 101.

<sup>128</sup> David Horton, Essay, *The Mandatory Core of Section 4 of the Federal Arbitration Act*, 96 VA. L. REV. IN BRIEF 1, 4 (2010), <http://www.virginialawreview.org/inbrief/2010/04/02/horton.pdf>.

<sup>129</sup> *See* 9 U.S.C. § 2 (2006).

<sup>130</sup> *See* MACNEIL ET AL., *supra* note 101, at § 7.1.2.1.

substantially more detail, either within the arbitration agreement itself, or by way of incorporation of a specific set of arbitration rules.<sup>131</sup> Freedom of contract lies at the heart of commercial arbitration, with the parties granted broad autonomy in designing their own mechanism for the resolution of disputes.<sup>132</sup> Moreover, parties are encouraged to exercise this broad autonomy by thoughtfully and carefully crafting an arbitration regime meeting their specific needs.<sup>133</sup> However, the parties do not always exercise this autonomy in any great detail,<sup>134</sup> and their agreement to arbitrate will be enforced whether or not they provide such detail.<sup>135</sup>

For example, the parties to an agreement might provide that “[a]ny disputes arising out of this Agreement will be finally resolved by binding arbitration.”<sup>136</sup> The parties would almost certainly be bound to resolve their relevant contract disputes by arbitration.<sup>137</sup> However, with such a minimalist arbitration agreement, they would have to look outside the FAA to ascertain the details of such arbitration.<sup>138</sup> In theory, the law governing the arbitration should supply the default provisions necessary to fill any gaps.<sup>139</sup> Unfortunately for the arbitrating parties, the FAA provides very little guidance in this respect.<sup>140</sup>

In comparison with most modern arbitration statutes, the FAA is a “bare-bones statute directed primarily at insuring that courts give effect to arbitration clauses and awards, and prescribes no significant procedural

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<sup>131</sup> *Id.*

<sup>132</sup> See Stipanowich, *supra* note 12, at 405.

<sup>133</sup> *Id.* at 403.

<sup>134</sup> See *id.* at 405.

<sup>135</sup> 9 U.S.C. § 2 (2006).

<sup>136</sup> Townsend, *supra* note 126, at 31. Townsend suggests that this clause represents an extreme example of poor drafting. *Id.* However, this author has seen many such clauses in actual contracts drafted by both lawyers and laypeople.

<sup>137</sup> *Id.*

<sup>138</sup> *Id.* Of course, the parties could agree, after the dispute had arisen, to conduct the arbitration in a particular manner or according to a particular set of rules. However, it is common knowledge that, once a dispute has arisen, it is often difficult to get parties in an adversarial posture to agree on anything. For purposes of the foregoing analysis, I will assume that the parties are unable to reach consensus on any of the pertinent issues.

<sup>139</sup> See MACNEIL ET AL., *supra* note 101, at § 7.1.2.1; see also ALAN REDFERN & MARTIN HUNTER, *LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION* § 3-42 (Sweet & Maxwell Ltd. eds., 4th ed. 2004) (explaining that, in international commercial arbitration, gaps are filled by reference to the governing arbitration law—typically that of the place of arbitration); Carbonneau, *supra* note 15, at 418 (pointing out that many of the procedural details of arbitration—about which the parties may disagree—can be resolved by reference to the law governing the arbitration, to the extent not addressed by the parties’ agreement).

<sup>140</sup> See Drahozal, *New Experiences of International Commercial Arbitration*, *supra* note 15, at 236.

standards.”<sup>141</sup> The FAA simply fails to answer many of the questions essential to the conduct of arbitration proceedings.<sup>142</sup> As such, if the parties fail to answer these questions in their original agreement and cannot do so after the dispute has arisen, the questions all too often end up in court, thus arguably defeating the parties’ original purpose in agreeing to arbitrate in the first place.<sup>143</sup>

Whatever one may think of the FAA, it would seem, beyond any rational argument to the contrary, that Chapter 1 does not itself fulfill any significant role in filling “gaps” by way of default rules.<sup>144</sup> Thus, our next question is whether such gaps may reasonably be filled by the courts,<sup>145</sup> by state law,<sup>146</sup> or by arbitration rules.<sup>147</sup> Each of these will be addressed in turn below. However, before leaving the FAA behind, a few final issues are worth noting.

## 2. *The Federal Arbitration Act: The Rest of Chapter 1*

While the primary focus of this Article is default legal rules, this Article will also address a few other key legal rules under FAA Chapter 1, some of which are mandatory.<sup>148</sup> While this Article ultimately suggests that the FAA be fully replaced—not amended—certain of these additional provisions are important to understanding other attempts to “fill the gaps” in the parties’ agreement, as well as some of the other challenges presented by the existing legal structure.

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<sup>141</sup> *Id.* (quoting Alan Scott Rau & Edward F. Sherman, *Tradition and Innovation in International Arbitration Procedure*, 30 TEX. INT’L L.J. 89, 90 n.3 (1995)).

<sup>142</sup> *See id.* at 238.

<sup>143</sup> One of the greatest criticisms of arbitration today is the fact that parties bargaining for arbitration end up in court attempting to enforce their agreement. *See, e.g.,* Whiteman, *supra* note 65, at 1 (explaining that “[o]ur company ended up investing more than a year’s worth of time and substantial legal fees simply to enforce in court our right not to have to go to court”). It is worth considering at this juncture that a positive agreement to arbitrate is also, to a large degree, a negative agreement to stay out of court. As such, a need to resort to court in order to conduct the agreed upon arbitration proceedings would seem anathema to a basic agreement to arbitrate. This issue is explored more fully *infra* Part II.B.

<sup>144</sup> *See generally* 9 U.S.C. §§ 1-16 (2006).

<sup>145</sup> *See infra* Part II.B.

<sup>146</sup> *See infra* Part II.C.

<sup>147</sup> *See infra* Part II.D.

<sup>148</sup> Most provisions of Chapter 1, including section 2, rely entirely on party consent and are, therefore, subject to the parties’ right to override them—provided, of course, that the parties can agree. *See* 9 U.S.C. §§ 1-16.

FAA sections 3 and 4 provide for motions in federal court to stay any pending court action or compel the parties to arbitrate a dispute subject to a valid arbitration agreement under section 2.<sup>149</sup> One might reasonably read section 4 as providing a mandatory rule that the court must determine whether the parties entered into a valid arbitration agreement and whether the dispute is within its scope.<sup>150</sup> However, the Supreme Court has apparently held otherwise, ruling that this is merely a default rule, which the parties may displace if they would prefer to grant the arbitrators jurisdiction to make these threshold decisions as to their own jurisdiction over the merits of the dispute.<sup>151</sup> This issue is more fully explored in Part II.E below.<sup>152</sup>

Assuming that the parties' agreement mandates arbitration of the dispute in question, the next potentially relevant provisions are those applicable to the proceedings themselves.<sup>153</sup> Section 5 provides a default rule for appointment of arbitrators where one of the parties refuses to cooperate in constituting the panel.<sup>154</sup> The court is to make the appointment consistent with the parties' agreement, or, in the absence of any agreement, choose a single arbitrator.<sup>155</sup> The statute does not, however, provide any guidance as to how the court might go about exercising such a choice.<sup>156</sup>

Section 7 provides for court assistance in enforcing a subpoena issued by an arbitration panel.<sup>157</sup> However, Chapter 1 contains nothing more concerning the actual conduct of the arbitration from the time the tribunal is constituted through its issuance of a final award,<sup>158</sup> which brings us to the last set of issues—those arising after an award has been issued.

Section 9 provides for confirmation of an award: the process by which a private award is transformed into an enforceable public judgment.<sup>159</sup> This section provides a time limit for confirmations, a notice requirement, and jurisdiction, but otherwise mandates that an award shall be confirmed absent

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<sup>149</sup> *Id.* §§ 3-4.

<sup>150</sup> See generally Horton, *supra* note 128 (claiming that section 4 is mandatory).

<sup>151</sup> See *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995) (explaining in dicta that “the question ‘who has the primary power to decide arbitrability’ turns upon what the parties agreed about *that* matter” (emphasis in original)); *Rent-A-Center, W., Inc. v. Jackson*, 130 S. Ct. 2772, n.1 (2010) (applying the *First Options* dicta to a “clear and unmistakable” delegation of this decisional power to the arbitrator).

<sup>152</sup> See *infra* Part II.E.

<sup>153</sup> See generally 9 U.S.C. §§ 5-16.

<sup>154</sup> *Id.* § 5.

<sup>155</sup> *Id.*

<sup>156</sup> *Id.*

<sup>157</sup> *Id.* § 7.

<sup>158</sup> See generally *id.* §§ 1-16.

<sup>159</sup> *Id.* § 9. A motion for confirmation must be made within one year.

grounds for vacation under section 10, or modification or correction under section 11.<sup>160</sup> Section 10 provides a narrow set of grounds for vacation, which might reasonably be summarized as mandating an arbitration process that comports with due process; is untainted by fraud, corruption, or bias; and is ultimately derived from the consent of the parties,<sup>161</sup> while section 11 provides for modification or correction of certain clerical mistakes or issues in which the arbitrators went beyond the consent of the parties.<sup>162</sup> Lastly, appeals of lower court decisions at any stage of the process are addressed by section 16, which generally makes decisions contrary to arbitration subject to immediate appeal,<sup>163</sup> while decisions favorable to arbitration may not be appealed until the process is complete through confirmation or vacation.<sup>164</sup>

Thus, we might reasonably summarize the key elements of FAA Chapter 1 by breaking down the governing law into three parts: (1) “front end” issues as to whether the dispute is subject to arbitration; (2) “arbitration procedure” issues involving actual arbitral process, from the constitution of the tribunal through the issuance of a final award; and (3) “back end” issues involving modification, confirmation, vacation, and/or enforcement of the award.<sup>165</sup> Along with the basic enforceability provisions found in section 2,<sup>166</sup> the only significant additional front end rule is the default rule reflected in sections 3 and 4 that courts determine whether the arbitrators have jurisdiction to hear the basic dispute.<sup>167</sup> FAA Chapter 1 has only two significant default rules on arbitration procedure—one regarding the appointment of an arbitrator and one providing arbitrators with the power to subpoena witnesses.<sup>168</sup>

Most of the back end issues involve mandatory rules, and FAA Chapter 1 provides an appropriately limited set of bases for vacation, modification, or correction.<sup>169</sup> These bases for vacation in section 10 present other challenges, which will be addressed later in this part, as well as Part II.E *infra*.<sup>170</sup>

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<sup>160</sup> *Id.*

<sup>161</sup> *Id.* § 10.

<sup>162</sup> *Id.* § 11.

<sup>163</sup> *Id.* § 16(a).

<sup>164</sup> *Id.* § 16(b).

<sup>165</sup> While one might reasonably break arbitration law down in a variety of ways, this Article will take what is, essentially, the same approach as the drafters of the Revised Uniform Arbitration Act. *See* RUAA, *supra* note 28, at Prefatory Note pp. 2-3, 5 (alluding to “front end” issues, “back end” issues, and “purely procedural dimensions of the arbitration process”).

<sup>166</sup> 9 U.S.C. § 2.

<sup>167</sup> *See* Szalai, *supra* note 100, at 326.

<sup>168</sup> *See generally* 9 U.S.C. §§ 1-16.

<sup>169</sup> *Id.* §§ 10-11. For purposes of this Article, I will omit further reference to section 16 on

Notably, each of the above default rules involves direct resort to the courts, and the rule regarding appointment of arbitrators provides no guidance for a court in fulfilling its duties. Instead of providing default provisions defining the rights and obligations of the parties and thereby filling any gaps in their agreement, FAA Chapter 1 simply sends the parties to the courts to resolve the issue—assuming it addresses the issue at all.<sup>171</sup> This approach is seemingly at odds with the most basic idea of arbitration—the resolution of the parties’ dispute without resort to the courts.

The default rule that courts determine whether the parties have agreed to arbitration says nothing about which of these threshold jurisdictional issues should be determined by a court and which should be determined by the arbitrators.<sup>172</sup> As a result, this has been an often litigated issue, in some cases reaching the Supreme Court.<sup>173</sup> Again, this issue is explored more fully in Part II.E below.<sup>174</sup>

The FAA also says nothing about its application in state courts. While the Supreme Court has, since 1984, unequivocally stated that section 2 applies in state courts,<sup>175</sup> the preemptive effects of the remainder of Chapter 1 are far less certain. The Supreme Court’s interpretation of section 2, coupled with the express language of sections 3 and 4, would seem to produce the odd result that the FAA governs actions in state court, but such actions cannot be removed to federal court absent diversity jurisdiction.<sup>176</sup> The open issues involving preemption beyond section 2 call into serious question the relevance of state arbitration statutes that purport to govern many of the same issues addressed by the FAA, as well as many issues to which the FAA does not speak. This convoluted example of federalism gone haywire is explored further in Part II.C below. At this point, it is sufficient to say that FAA

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appeals, inasmuch as I do not believe its content is necessarily affected by the issues raised below.

<sup>170</sup> *Id.* § 10.

<sup>171</sup> *Id.* §§ 10-11.

<sup>172</sup> *Id.* §§ 3-4. This is not a single, unitary decision. By way of example, here are just a few of the questions that might arise: Did the parties agree to arbitrate anything? Is the instant dispute within the scope of the parties’ agreement to arbitrate? Is the contract containing the arbitration clause itself voidable or void (the separability issue)? Is the dispute subject to arbitration at all, or is it one that must be heard by courts based on public policy? Have the parties complied with any preconditions to arbitration, such as a mediation process that might be contractually required beforehand? Are each of the putative parties to the arbitration actually parties to the agreement to arbitrate?

<sup>173</sup> *See, e.g.,* *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002).

<sup>174</sup> *Infra* Part II.E..

<sup>175</sup> *Southland v. Keating*, 465 U.S. 1, 10 (1984).

<sup>176</sup> *See* 9 U.S.C. §§ 3-4. These statutes, by their express language apply only in federal court, and FAA Chapter 1 does not provide for federal question jurisdiction.

Chapter 1 leaves some “front end” issues in a state that is unnecessarily complicated and, in some cases, unresolved.

There is little case law on FAA “arbitration procedure,” which is hardly surprising in view of the lack of FAA content addressing such issues. An exemplary case in this area involved the potential applicability of California state arbitration law, which provided for a stay of arbitration under certain circumstances, pending the outcome of related court proceedings.<sup>177</sup> The outcome of this case presented anything but a clear picture with respect to the applicability of state law in any but the most clear-cut of circumstances.<sup>178</sup>

While the FAA itself appears reasonably clear with respect to “back end” issues, the courts have, nonetheless, fashioned their own additional non-statutory grounds for vacating arbitration awards—the most notorious being “manifest disregard of the law.”<sup>179</sup> Again, the extent of FAA preemption is uncertain and inconsistently applied by the courts.

At bottom, FAA Chapter 1 does a very effective job of making arbitration agreements enforceable; however, what it gives with one hand, it takes away with the other. While arbitration agreements are generally enforced, the process of enforcing and executing those agreements all too often leads the parties right back to court to fight about issues that have nothing to do with their original contract dispute.<sup>180</sup> It is no wonder that businesses are increasingly becoming frustrated with arbitration, as they end up “in a costly, protracted court battle over an issue that, by contract, never should have ended up in court at all.”<sup>181</sup>

### *3. The Federal Arbitration Act, Chapters 2 and 3: A Schizophrenic Approach to Default Rules in International Arbitration?*

The plot thickens as we move from domestic arbitration under FAA Chapter 1 to international arbitration under Chapters 2 and 3. In theory, Chapters 2 and 3<sup>182</sup> were simply intended to implement the New York Convention<sup>183</sup> and the Panama Convention<sup>184</sup> in the context of foreign

<sup>177</sup> Volt Info. Scis., Inc. v. Stanford Univ., 489 U.S. 468 (1989).

<sup>178</sup> See *infra* note 280.

<sup>179</sup> See Park, *The Specificity of International Arbitration*, *supra* note 8, at 1249-51. *But see* Hall St. Assocs. v. Mattel, Inc., 552 U.S. 576, 584-85 (2008) (arguably eliminating the manifest disregard standard).

<sup>180</sup> See *supra* note 171 and accompanying text.

<sup>181</sup> Whiteman, *supra* note 65.

<sup>182</sup> 9 U.S.C. §§ 201, 301 (2006).

<sup>183</sup> See generally New York Convention, *supra* note 6.

arbitration agreements and awards under the FAA.<sup>185</sup> FAA Chapter 1 would still, however, apply to arbitration within the scope of either convention, unless in conflict with Chapter 2 or 3, or the relevant convention.<sup>185</sup> Inasmuch as both the New York and Panama Conventions deal primarily with enforcement of foreign arbitration agreements and awards, one might reasonably expect Chapters 2 and 3 to have little effect on arbitration conducted in the United States. We will see, however, that the provisions of these chapters have additional effects as well—at least some of which were not likely intended by the drafters.

*a. Arbitration Under the New York Convention*

Chapter 2 applies to arbitration agreements falling under the New York Convention—a convention that has been ratified by 145 countries.<sup>186</sup> The application of the New York Convention is not, however, limited to awards made in foreign states. It also applies to awards that are not considered as domestic awards in the state where their recognition and enforcement are sought.<sup>187</sup> FAA section 202 makes clear that any award that involves a foreign party or foreign property, or envisages foreign performance or enforcement is non-domestic—even if the arbitration takes place in the United States and is governed by United States law.<sup>188</sup> Thus, Chapter 2 would apply, for example, to a transaction between United States parties that simply envisaged some foreign performance or potential enforcement against foreign assets. This broad definition of non-domestic awards solves one problem, but creates another.

Section 203 provides federal question jurisdiction for all actions falling under the New York Convention, including all non-domestic awards, as defined in Section 202.<sup>189</sup> As a result, the problem with the lack of federal

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<sup>184</sup> See generally Panama Convention, *supra* note 7.

<sup>185</sup> FAA sections 201 and 301 are central to their respective chapters, inasmuch as they each provide for enforcement of the respective conventions. See MACNEILET AL., *supra* 101, at § 44.8.3.1 (1999).

<sup>185</sup> *Id.*

<sup>186</sup> *Status: 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, UNCITRAL: U.N. COMM'N ON INT'L TRADE LAW [hereinafter *Status: 1958 Convention*]

[http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/NYConvention\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html) (last visited Feb. 22, 2011).

<sup>187</sup> New York Convention, *supra* note 6, at art. I(1).

<sup>188</sup> 9 U.S.C. § 202 (2006).

<sup>189</sup> *Id.* § 203.

question jurisdiction under Chapter 1<sup>190</sup> disappears under Chapter 2. To the extent that either party wishes to avail itself of the federal courts in enforcing the provisions of Chapter 2, removal is available<sup>191</sup>—irrespective of diversity. Thus, the federal jurisdictional complexities associated with Chapter 1 are avoided. However, arbitration agreements subject to Chapter 2 remain subject as well to the provisions of Chapter 1, to the extent not in conflict with the provisions of Chapter 2 and the New York Convention.<sup>192</sup>

For example, section 206 provides for the appointment of arbitrators by a court, pursuant to the parties' agreement, but says nothing about such appointment in the absence of agreement.<sup>193</sup> Presumably, a court would simply look to section 5 of Chapter 1 for such authority<sup>194</sup> as a residual supplement fully consistent with both Chapter 2 and the New York Convention; however, this overlap between Chapters 1 and 2 gives rise to potential inconsistencies in standards for setting aside or enforcing awards.

Chapter 1 provides standards for both confirmation of an award<sup>195</sup> and setting aside of an award.<sup>196</sup> However, these standards are somewhat different than those for enforcement contained in the New York Convention and those for set-aside contained in most modern arbitration laws.<sup>197</sup> As a result, the standards for set-aside and enforcement may differ, depending on the application of section 10 (and perhaps section 11) to awards governed by the

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<sup>190</sup> See *supra* text accompanying note 176.

<sup>191</sup> 9 U.S.C. § 205. Venue is also provided for in 9 U.S.C. § 204.

<sup>192</sup> *Id.* § 208.

<sup>193</sup> *Id.* § 206; John P. Bowman, *The Panama Convention and Its Implementation Under the Federal Arbitration Act*, 11 AM. REV. INT'L ARB. 1, 90 (2000) (noting that section 206 addresses appointment only pursuant to the parties' agreement, thus necessitating resort to section 5 in the absence of any agreement).

<sup>194</sup> See 9 U.S.C. § 5 (2009).

<sup>195</sup> A private arbitration award is made enforceable through court confirmation proceedings.

<sup>196</sup> An award vacated or set aside by a court with proper jurisdiction is rendered a nullity for most purposes.

<sup>197</sup> In contrast, Article 34 of the UNCITRAL Model Law on International Commercial Arbitration provides for set aside provisions that essentially mirror the bases for non-enforcement contained in Article V of the New York Convention. MORRISSEY & GRAVES *supra* note 8, at 462. This was done intentionally in an effort to harmonize the limited bases for non-enforcement, whether applied in the context of a set aside proceeding or an enforcement proceeding. See Pieter Sander, *The History of the New York Convention*, in IMPROVING THE EFFICIENCY OF ARBITRATION AGREEMENTS AND AWARDS 11, 13 (Albert Jan Van Den Berg ed., 1999).

New York Convention.<sup>198</sup> The proper answer to this issue is anything but clear.

Under Chapter 1, section 9, an award is subject to “confirmation” (i.e., can be made enforceable) unless subject to being vacated, modified, or corrected under sections 10 or 11,<sup>199</sup> thus seemingly applying the same standards to both set-aside (or vacation) and enforcement (or confirmation) under Chapter 1; however, Chapter 2, section 207, provides for “confirmation” unless an award would be subject to non-enforcement under the New York Convention<sup>200</sup> — again, a different set of standards than those contained in Chapter 1, section 10.<sup>201</sup> If courts interpreting Chapter 2 were interested in harmonizing the standards for setting aside and enforcing awards, they might reasonably read section 207 broadly and apply these same bases for non-enforcement to actions to set aside an award governed by Chapter 2. Alas, they generally do not,<sup>202</sup> so a legal action addressing the viability of an award may be governed by different standards, depending on whether it is styled as a “confirmation” action or an action to “set aside” the award. The difference may be particularly dramatic to the extent a party may seek to have an award set aside based on the “manifest disregard” standard.<sup>203</sup>

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<sup>198</sup> For a more thorough examination of the inherent issues arising from the overlap between Chapters 1 and 2, *see generally* Jarred Pinkston, *Toward a Uniform Interpretation of the Federal Arbitration Act: The Role of 9 U.S.C. § 208 in the Arbitral Statutory Scheme*, 22 EMORY INT’L L. REV. 639 (2008).

<sup>199</sup> 9 U.S.C. § 9.

<sup>200</sup> *Id.* § 207.

<sup>201</sup> Bowman, *supra* note 193, at 98, 107.

<sup>202</sup> *See, e.g.*, *Jacada (Eur.), Ltd. v. Int’l Mktg. Strategies, Inc.*, 401 F.3d 701, 712 (6th Cir. 2005).

<sup>203</sup> This standard is unique to U.S. law, albeit considerably less certain in application after the decision of the U.S. Supreme Court in *Hall Street. Associates v. Mattel, Inc.*, 552 U.S. 576, 584-85 (2008). Circuit courts have split on the question of whether the “manifest disregard” basis for setting aside an arbitral award survived the Court’s decision in this case. *See Stolt-Nielsen, S.A. v. Animal Feeds Int’l Corp.*, 548 F.3d 85, 93-94 (2nd Cir. 2008), *rev’d on other grounds*, 130 S.Ct. 1758 (2010) (holding that the doctrine has survived, but noting the contrary view of the First Circuit, and then finding that the standard was not satisfied in the instant case). In reversing the Second Circuit decision, the Supreme Court analyzed the arbitration panel’s decision under section 10(a)(4) of the FAA, instead of the manifest disregard standard. *Stolt-Nielsen*, 130 S.Ct. at 1767-68. However, the Court specifically declined to address the question of whether “manifest disregard” had survived *Hall Street*, while simultaneously noting that this standard was also satisfied in the instant case. *Id.* at 1768 fn 3. In any event, the Second Circuit continues to consider the doctrine a viable one. *See Matthew v. Papua New Guinea*, No. 10-0074, 2010 WL 3784198, at \*1-\*2 (2d Cir. Sept. 30, 2010) (explaining when use of the “manifest disregard” standard would be appropriate but ultimately finding that “that the Arbitrator did not manifestly disregard the

This inconsistency in set-aside and enforcement standards arising from the overlap between Chapters 1 and 2 is a perfect example of the problems with piecemeal amendment of the FAA and the reasons why a comprehensive new statute governing domestic and international commercial arbitration is necessary. In addition to the same inconsistencies presented by Chapter 2,<sup>204</sup> Chapter 3 also presents its own unique challenge based on its overlap with Chapter 1.

*b. Arbitration Under the Panama Convention and Its Incorporation of a Fully Developed Set of Default Rules*

Chapter 3 provides for the application of the Panama Convention to the same categories of arbitration agreements governed by Chapter 2, but differs in that it only applies when a majority of the parties to the arbitration agreement are from signatories to the Panama Convention.<sup>205</sup> The Panama Convention has been ratified by a significant number of states within the Americas (including the United States),<sup>206</sup> and will generally govern arbitration involving parties from two of these states or arbitration relating to a transaction that contemplates performance or enforcement outside of the

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law”).

In providing its reasoning for continued use of the “manifest disregard” standard, the Second Circuit held in its original *Stolt-Nielsen* decision that the doctrine was unaffected by the Court’s limitation of review to FAA section 10, because it believed the “manifest disregard” doctrine to be grounded in sections 10(a)(3) and 10(a)(4). *Stolt-Nielsen*, 548 F.3d at 94-95. Section 10(a)(3) has no direct corollary under the New York Convention, and, while Article VI(c) of the Convention bears some similarities to FAA section 10(a)(4), it would be difficult, if not impossible, to find any serious suggestion that Article VI(c) included the sort of “manifest disregard” standard applied under the FAA.

<sup>204</sup> Much of Chapter 2, including section 207, is incorporated into Chapter 3, and the Inter-American Convention provisions on non-enforcement are identical to those contained in the New York Convention. Thus, cases governed by Chapter 3 must address this same inconsistency between standards for set aside and enforcement. *See, e.g.*, *Banco de Seguros Del Estado v. Mut. Marine Offices, Inc.*, 257 F. Supp. 2d 681, 684-85 (S.D.N.Y. 2003); *Paramedics Electromedicina Comercial Ltda. v. GE Med. Sys. Info. Techs., Inc.*, No. 02 Civ. 9369, 2003 WL 23641529, at \*5, \*7 (S.D.N.Y. June 4, 2003).

<sup>205</sup> 9 U.S.C. § 305.

<sup>206</sup> Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Panama, Paraguay, Peru, United States, Uruguay, and Venezuela have all ratified the treaty. *Multilateral Treaties: Inter-American Convention on International Commercial Arbitration Signatories and Ratifications*, ORG. OF AM. STATES, DEP’T OF INT’L LAW, <http://www.oas.org/juridico/english/sigs/b-35.html> (last visited Mar. 27, 2011).

United States.<sup>207</sup> Thus, it has a potentially widespread application to arbitration agreements.<sup>208</sup>

The Panama Convention is, to some degree, less complete than the New York Convention, thus potentially requiring greater supplementation via Chapter 1—with one major exception: Article 3 of the Panama Convention provides for the application of the Rules of Procedure of the Inter-American Commercial Arbitration Commission (IACAC) in the absence of an express agreement by the parties.<sup>209</sup> “The practical effect of this provision is to supply a great deal of arbitration ‘law’ through the Commission rules unless the parties otherwise provide.”<sup>210</sup> These rules are essentially identical to the original UNCITRAL Arbitration Rules.<sup>211</sup>

Currently, it may be worthwhile at this stage to recall the difference between a national law governing arbitration and a set of rules contractually agreed upon by the parties by incorporating these rules into their agreement. The UNCITRAL Model Law on International Commercial Arbitration is a modern law governing international commercial arbitration, while the UNCITRAL Arbitration Rules represent a set of rules typically incorporated by parties seeking ad hoc arbitration,<sup>212</sup> and sometimes used as a model for institutional arbitration rules.<sup>213</sup> However, there is nothing precluding the use

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<sup>207</sup> In fact, based on the statutory language of 9 U.S.C. § 202 (incorporated into Chapter 3 by § 302), read in combination with § 305, an arbitration agreement in a contract between two U.S. businesses, which contemplated performance or potential enforcement abroad—even in a country not a signatory to the Panama Convention (e.g., in Germany, China, or Australia)—would be subject to Chapter 3 and the Panama Convention. Although an enforcement action governed by the Panama Convention makes little sense if enforcement is likely in a country not a signatory, there is no fundamental reason why an arbitration proceeding between two U.S. businesses contemplating performance in Germany could not be governed by Chapter 3 of the FAA. The author is not aware of any court or commentator who has addressed this issue, but it represents yet another anomaly arising from the piecemeal drafting of the FAA.

<sup>208</sup> For a more thorough examination than that provided herein, *see generally* Bowman, *supra* note 193 (distinguishing the Panama Convention from the New York Convention).

<sup>209</sup> Panama Convention, *supra* note 7, art. 3.

<sup>210</sup> MACNEIL, ET. AL., *supra* note 101, § 44.8.2.

<sup>211</sup> Bowman, *supra* note 193, at 29. The only meaningful difference is the designation of IACAC as the appointing authority in the event that the parties are unable to agree on an arbitrator. *See* UNCITRAL Arbitration Rules, *supra* note 50, at art. 6. Under the UNCITRAL Rules, an appointing authority is designated by the Permanent Court of Arbitration in The Hague. *Id.*

<sup>212</sup> This is arbitration under a specified set of rules, but without designating an institution for purposes of administering the arbitration. *See* MORRISSEY & GRAVES, *supra* note 8, at 35.

<sup>213</sup> *See generally*, *Arbitration Rules of the Chicago International Dispute Resolution Association*, CHICAGO INT’L DISPUTE RESOLUTION ASS’N (July 1, 2005), <http://cidra.org/arbrules> (providing a list of these rules).

of a private set of rules, such as the UNCITRAL Arbitration Rules, as the basis for a legislatively enacted set of default legal rules, as apparently enacted in the case of FAA Chapter 3. In fact, private rules and legal rules address many of the same issues<sup>214</sup>—especially those default rules characterized in Part II.A.2, above, as “arbitration procedure” issues, but also sometimes including those characterized as “front end” issues.<sup>215</sup> It is the latter group of default legal rules governing “front end” issues that present perhaps the most interesting conflict between Chapter 1 and Chapter 3.

The bulk of these “front end” issues arises when the parties are unable to agree upon the appointment of an arbitrator. As explained above in Part II.A.2, FAA Chapter 1 sends the parties to court for appointment of the arbitrator.<sup>216</sup> In contrast, the IACAC Rules provide for appointment of an arbitrator by the IACAC, thereby avoiding any need to resort to court proceedings.<sup>217</sup> Thus, the default legal rule applicable under Chapter 3—by virtue of the application of the Panama Convention and its incorporation of the IACAC Rules—fundamentally differs from the default legal rule applicable under Chapter 1 on the question of appointment of an arbitrator in the absence of party agreement.<sup>218</sup> This difference is fundamental because it reflects a basic difference between United States law and modern arbitration law with respect to court involvement in front end issues. United States law reserves “front end” issues for the courts,<sup>219</sup> while many modern national laws and private rules grant considerable authority to the arbitrators or private institutions to address many of these “front end” issues.

In particular, the vast majority of modern arbitration laws grant arbitrators the authority to determine their own jurisdiction under the doctrine

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<sup>214</sup> The rules agreed upon by the parties, by way of incorporation, of course take precedence over any default legal rules, just as any specific provisions of the arbitration agreement, itself, take precedence over the incorporated rules.

<sup>215</sup> “Back end” issues are rarely addressed in private “rules,” as these more typically involve mandatory rather than default legal rules, such as the legal standards for set-aside and enforcement. Inasmuch as the parties have no power to vary such legal rules, there is little point in adding them to a set of private rules to be incorporated by the parties.

<sup>216</sup> 9 U.S.C. § 5 (2006).

<sup>217</sup> See Bowman, *supra* note 193, at 32 (pointing out the positive practical effect of reducing the need for judicial intervention and the costly delay often associated with such proceedings).

<sup>218</sup> The author is unaware of any court attempting to address this issue under Chapter 3. However, other decisions applying Chapter 3 give considerable cause for skepticism. See *infra* note 225.

<sup>219</sup> See RUAA, *supra* note 28, pp. 9-31, 35-49 §§ 2-8, 10-14 (including reference to involvement of courts in “front-end” issues in specified sections).

of competence-competence.<sup>220</sup> However, FAA Chapter 1 does not. As explained in Part II.A.2, section 4 provides that the basic jurisdictional question of whether the parties agreed to arbitrate must be decided by the court.<sup>221</sup> While the United States Supreme Court has now seemingly clarified that the parties may contractually grant the arbitral tribunal the power to decide its own jurisdiction,<sup>222</sup> such a contractual right is not equivalent to a statutory grant of competence-competence.<sup>223</sup> Thus, the incorporation of the IACAC Rules via the recognition of the Panama Convention in Chapter 3 is quite significant, because Article 21 of these rules provides for competence-competence.<sup>224</sup>

By incorporating Article 21, FAA Chapter 3 has effectively provided for statutory competence-competence, a provision quite typical in modern arbitration law outside of the U.S., but quite unique in U.S. arbitration law. Unfortunately, this “uniqueness” has apparently led at least one court to fail miserably in its attempt to interpret and apply FAA Chapter 3 and its incorporation of the IACAC Rules.<sup>225</sup> In fairness, the problem faced by

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<sup>220</sup> See, e.g., UNCITRAL Model Law, *supra* note 26, art. 16.

<sup>221</sup> See *supra* Part II.A.2.

<sup>222</sup> *Rent-A-Center, West, Inc. v. Jackson*, 130 S. Ct. 2772 (2010); see *First Options of Chi., Inc. v. Kaplan*, 514 U.S. 938, 942-43 (1995).

<sup>223</sup> The problem is largely one of circularity. Under a contractual approach to competence-competence, any power to decide whether the parties agreed to arbitrate must come from the agreement to arbitrate itself. In contrast, a statutory grant of competence-competence is not dependent on the parties’ agreement, thus, to at least some degree, avoiding this problem of circularity. The significant problems with contractual competence-competence are more fully addressed *infra* Part II.D.

<sup>224</sup> IACAC Rules, *supra* note 116, art. 21(1) and (2).

<sup>225</sup> See *Am. Life Ins. Co. v. Parra*, 25 F. Supp. 2d 467, 475-76 (Del. 1998) (giving effect to section 4 of Chapter 1 over the incorporation of Article 21 of the IACAC Rules under Chapter 3). The court first determined, somewhat inexplicably, that case law under FAA Chapter 1 was not “in conflict” with the Panama Convention. *Id.* at 475. Thus, the provisions of Chapter 1 were not superseded by Chapter 3. It is hard to see how one could support such an assertion, and the court does not. However, its analysis is also interesting for its remarkable preference for case law over a clear and unambiguous statutory provision. The court goes on to suggest that a statute should not be read to differ from a common law result, absent a clear and unequivocal imperative required from the nature of the enactment. *Id.* at 476. Finding no express intent to change the common law (notwithstanding the express intent in Chapter 3 to give effect to the Panama Convention), the court declines to give effect to the clear and unequivocal language of Chapter 3, the Panama Convention, and the IACAC Rules. Finally, the court seemingly characterizes FAA Chapter 1, section 4, as a mandatory rule of law (citing Article 1(2) of the IACAC Rules, which states that such rules are subject to mandatory rules of law), while simultaneously citing *First Options*, which clearly suggests that section 4 is not a mandatory rule of law, but one that even parties can contract around. *Id.* at 476; see also *Bowman*, *supra* note 193, at 140-49 (providing its own critical analysis of the court’s decision).

courts attempting to interpret and apply Chapters 2 and 3 of the FAA is one of attempting to reconcile substantially different bodies of arbitration law on a number of fundamental issues. Under such circumstances, perhaps it should not be surprising that courts are often not up to the challenge.

Ultimately, the FAA provides solid footing for the enforcement of arbitration agreements to the extent the parties provide the details of such agreements. However, the FAA provides little more than bare skeletal provisions beyond its basic pro-enforcement bias. Moreover, the integration of the original act with the enabling legislation supporting the enforcement of the relevant international conventions has added further challenges and confusion to the growing common law body of United States arbitration law.<sup>226</sup>

One suggested solution to the current confusion and inconsistencies found in United States law governing international commercial arbitration is a new “restatement” of this law.<sup>227</sup> Normally, the idea of “restating” a statute would seem to be logically inconsistent with the basic nature of a statute.<sup>228</sup> In this case, however, the very idea of “restating” the United States law governing international commercial arbitration demonstrates the inadequacy of the current statutory scheme—as a statute. In effect, this obsolete, inadequate, and often inconsistent statute has largely been displaced by federal common law.<sup>229</sup> Thus, it might be useful to ask the more basic question of whether any arbitration—domestic or international—should be governed by common law.

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<sup>226</sup>George A. Bermann, *Restating the U.S. Law of International Commercial Arbitration*, 42 N.Y.U. J. INT'L L. & POL. 175, 176 (2009) (noting commercial arbitration is “an area of the law needing clarification”).

<sup>227</sup>*Id.* (arguing the publishing of the new Restatement in this area will clarify aspects of U.S. arbitration law and judicial precedents).

<sup>228</sup>The author is by no means questioning the need to do “something” to improve the current state of the law in this area or the qualifications of the extraordinary group of individuals assigned to perform the task, but simply the concept of “restating” law purportedly governed by a statute. For example, it seems unlikely that anyone would ever suggest a “restatement” of the law governing the sale of goods, because sales of goods are governed in the United States by U.C.C. Article 2, unless displaced in certain cross-border transactions by the CISG—each fully developed coherent statutes.

<sup>229</sup>It is this odd mix of statutory metamorphosis in conjunction with international conventions—now largely overtaken by federal common law—that gives rise to the need for such a restatement. Notably, restating the law governing international commercial arbitration is apparently proving to be an unexpectedly difficult task. *See* Bermann, *supra* note 226, at 175 (noting “already a number of difficult, and to some extent unexpectedly difficult, questions have arisen” in the development of a restatement).

*B. Gap Filling Under Federal Law by Courts or Legislators: Is It Time To Amend or Replace the FAA, or Should We Leave the Job to the Courts?*

Many of the gaps in the FAA have been filled by court decisions, including numerous decisions of the Supreme Court. In fact, these Supreme Court decisions have seemingly left the actual language and intent of the statute far behind.<sup>230</sup> As a result, what we have today is arguably a body of federal common law governing arbitration. Assuming one agrees with this assertion, one might next reasonably ask whether this is a good thing.

Professor Rau acknowledges that arbitration in the United States is governed today by federal common law,<sup>231</sup> but suggests this common law approach provides good reasons to leave the FAA alone rather than amend it.<sup>232</sup> Rau acknowledges some of the standard rationales one hears in opposition to amending the FAA, including the notion that any attempt to tinker in any way with the FAA will open the proverbial “Pandora’s box” of various special interests and vexing issues.<sup>233</sup> But Rau focuses primarily on his asserted belief that courts are more likely than legislators to “get it right” and provides numerous examples of what he believes to be particularly grievous examples of proposed statutory solutions to various issues arising in arbitration.<sup>234</sup>

This focus on poor drafting and flawed reasoning might miss the mark. After all, it is likely that even Professor Rau would acknowledge the plethora of badly reasoned and poorly drafted court decisions on arbitration—though perhaps suggesting that a bad court decision is easier to fix than a bad statute. Presumably, one can find excellent examples of both judicial and statutory draftsmanship if one looks in the right places, and this is arguably the aspirational standard. If so, then this might lead one to ask if there is some basis other than institutional competence for determining whether arbitration

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<sup>230</sup> See Moses, *supra* note 92, at 99.

<sup>231</sup> See Rau, *supra* note 46, at 202. In effect, Professor Rau suggests that, by definition, a common law statute can never contain a “gap” inasmuch as such gaps are filled by decisional common law. *Id.* Thus, apparently, the “bare-bones” FAA is fully fleshed out if we simply know how to view it properly. Of course, it could also be said that any civil law statute, by definition, contains no gaps, inasmuch as any apparent gaps are simply filled by looking to the general principles underlying the statutory enactment. However, that misses the issue, which is whether the actual express provisions of the FAA are sufficiently well developed to provide useful guidance as a set of default legal rules governing arbitration.

<sup>232</sup> *Id.* at 169.

<sup>233</sup> *Id.* at 170.

<sup>234</sup> *Id.* at 169-82.

ought to be governed by a comprehensive statute or a comprehensive body of common law cases.

On this point, Professor Rau explains his basic preference for the common law, as an incremental and dynamic means of developing the law,<sup>235</sup> and one could debate this question at length based on the relative advantages and disadvantages of common law versus statutory legal regimes.<sup>236</sup> However, it is important to remember that this is a very specific sort of contract—an agreement to resolve disputes by arbitration—and not by court adjudication. As such, it would seem that the parties' intent ought to inform the determination of an appropriate legal regime.

At a bare minimum, the parties to a binding arbitration agreement have expressed their intent to resolve their dispute through final and binding arbitration. Assuming that the arbitration agreement says nothing more, it can, at the very least, be inferred that these same parties intended not to go to court.<sup>237</sup> Thus, the very idea of using appellate court cases to construct a body of law to govern their relationship is antithetical to the notion of arbitration. Certainly, there will always be parties who overreach in attempting to take a dispute to arbitration when it belongs in the courts, and there will always be recalcitrant parties who attempt to avoid arbitration—notwithstanding an earlier agreement to use it for dispute settlement. Courts will also likely remain necessary for certain forms of specific relief.<sup>238</sup> However, these occasions on which the parties must resort to the courts should be the exceptions, and they certainly should not be the lifeblood of the law governing an agreement *not to go to court*.

Professor Rau correctly points out that arbitration is ultimately based on the consent of the parties.<sup>239</sup> As such, the parties' consent to arbitration must,

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<sup>235</sup> See *id.* at 199, 202-03 (showing support for the common law as a principled and accretional method for developing law).

<sup>236</sup> One might even go further with this analysis by comparing common law and civil law based legal systems.

<sup>237</sup> A positive choice of final and binding arbitration is also a negative rejection of court adjudication. Cf. Julian Lew, *Does National Court Involvement Undermine the International Arbitration Process?* 24 AM. U. INT'L L. REV. 489, 491 (2009) (saying that while parties to an international transaction may have additional reasons to avoid national courts, the parties' implied rejection of court adjudication by choosing private arbitration is equally clear in a domestic transaction).

<sup>238</sup> Stephen P. Bedell & Louis K. Ebling, *Equitable Relief in Arbitration: A Survey of American Caselaw*, 20 LOY. U. CHI. L.J. 39, 40, 79 (1988) (noting the impossibility for arbitration to grant rescission and reformation or to provide relief not explicitly contracted for in the arbitration agreement).

<sup>239</sup> Rau, *supra* note 46, at 204.

at some point, be subject to judicial determination if disputed.<sup>240</sup> However, this determination need not be required as a threshold matter (or even necessarily permitted as a full judicial determination) prior to the constitution of the tribunal and completion of the full arbitral process—including a jurisdictional determination by the arbitrators.<sup>241</sup> Moreover, courts should be a last resort, because when the parties go to court, many of the specific benefits they sought in choosing arbitration in the first place are lost.

The parties' preference for confidentiality is typically lost with the first court proceeding, as their private dispute suddenly becomes public.<sup>242</sup> The parties' preference for an expert decision maker is lost to the extent their arbitration agreement may be subject not only to a court review, but to a jury determination.<sup>243</sup> Perhaps most significantly, the parties' desire for a prompt, efficient resolution of their dispute on the merits is completely lost in a painfully long process of court determinations—potentially including an appellate process to the highest level—before any decision maker ever has a chance to hear the merits of the underlying dispute.<sup>244</sup> Whatever one's preference for the common law, it flies in the face of basic common sense to

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<sup>240</sup> *Id.* at 204-05. In fact, it is under the FAA that this obvious point has been called into serious question. In *First Options*, the Supreme Court seemingly provided that the parties could vest the arbitrators with the power to determine their own jurisdiction—just as they can vest the arbitrators with the power to decide the merits of their dispute. *See First Options of Chi., Inc. v. Kaplan*, 514 U.S. 938, 943 (1995) (suggesting that an arbitrator's decision on jurisdiction, if mandated by the parties' agreement, should be treated essentially the same on review as a decision on the merits). However, such questions on the merits are not subject to appellate review, so one might reasonably ask whether, under this Court-developed doctrine of contractual competence-competence, a court would ever have the power to review the basic question of whether the parties agreed to arbitration. The Court's recent decision in *Rent-A-Center, West, Inc. v. Jackson*, 130 S. Ct. 2772 (2010), seems only to confirm and add to these concerns and is discussed more fully *infra* Part II.E.

<sup>241</sup> Under many arbitration regimes, the arbitrators not only have the authority to determine their own jurisdiction, but, in many instances, a court is precluded from conducting any more than a *prima facie* inquiry prior to the arbitrators' determination. *See* John J. Barcelo, *Who Decides the Arbitrators' Jurisdiction? Separability and Competence-Competence in Transnational Perspective*, 36 VAND. J. TRANSNAT'L L. 1115, 1124-30 (2003). Any subsequent review may be informed by the arbitrators' analysis (even though it is not binding in any way on a reviewing court), and the issue may never arise, depending on the outcome of the arbitration proceedings on the merits (the party bringing a claim in arbitration would, of course, have no basis to contest the arbitrators' jurisdiction over the claim).

<sup>242</sup> Arbitration proceedings are private, and parties are often bound to strict confidentiality requirements. In contrast, court proceedings are a matter of public record.

<sup>243</sup> *See* 9 U.S.C. § 4 (2006). Whatever one's views as to juries, the parties' intent to refer disputes to an expert decision maker would seem contrary.

<sup>244</sup> This is the most significant complaint expressed by business users of arbitration today. *See supra* Part I.

require parties to sacrifice the most fundamental benefits of their bargains in order to learn the content of those bargains. Yet, this is exactly what transpires when parties must go to court—and to appellate courts—in order to learn the default rules governing final and binding arbitration.

In the case of an agreement to final and binding arbitration, the parties' expectations are best served by a complete and comprehensive statutory scheme—not a piecemeal series of attempts to patch together an aging statute—but a complete and comprehensive statute, drafted to reflect normative commercial arbitration practices and the expectations of the business community. If, however, one agrees with this proposition, this does not end the inquiry, as legislation might be provided at either a state or federal level.<sup>245</sup> The potential for providing default legal rules governing arbitration under state law is explored next.

### C. *What About State Law?*

Arbitration may also—at least potentially—be governed by state law, and virtually every state has enacted a statute of some sort governing arbitration.<sup>246</sup> The following states have general arbitration statutes that follow the Uniform Arbitration Act of 1956 (UAA): Arkansas; Delaware; Idaho; Illinois; Indiana; Iowa; Kansas; Kentucky; Maine; Maryland; Massachusetts; Missouri; Montana; Nebraska; South Carolina; South Dakota; Tennessee; Virginia; and Wyoming.<sup>247</sup> This Act addresses most of the same issues addressed by the FAA, but also adds provisions addressing a few

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<sup>245</sup> For example, U.C.C. Article 2, discussed *supra* at Part I.C, is a model statute enacted at the state level.

<sup>246</sup> In fact, the Uniform Arbitration Act dates back to 1955, and, by the year 2000, forty-nine states had arbitration acts. RUAA, *supra* note 28, at Prefatory Note (2000).

<sup>247</sup> ARK. CODE ANN. §§ 16-7-201 to 16-7-224 (2007); DEL CODE ANN. tit. 10, §§ 5701-5725 (2007); IDAHO CODE ANN. §§ 7-901 to 7-922 (2007); 710 ILL. COMP. STAT. 5/1-5/23 (2007); IND. CODE §§ 34-57-2-1 to 34-57-2-22 (2007); IOWA CODE ANN. §§ 679A.1-679A.19 (West 2007); KAN. STAT. ANN §§ 5-401 to 5-422 (2007); KY. REV. STAT. ANN. §§ 417.045-417.240 (LexisNexis 2007); ME. REV. STAT. ANN. tit. 14, §§ 5927-5949 (2007); MD. CODE ANN., CTS. & JUD. PROC. §§ 3-201 to 3-234 (LexisNexis 2010); MASS. GEN. LAWS ANN. ch. 251, §§ 1-19 (LexisNexis 2007); MO. ANN. STAT. §§ 435.350-435.470 (West 2007); MONT. CODE ANN. §§ 27-5-111 to 27-5-324 (2007); NEB. REV. STAT. ANN. §§ 25-2601 to 25-2622 (LexisNexis 2007); S.C. CODE ANN. §§ 15-48-10 to 15-48-240 (2007); S.D. CODIFIED LAWS §§ 21-25A-1 to 21-25A-38 (2007); TENN. CODE ANN. §§ 29-5-301 to 29-5-320 (2007); VA. CODE ANN. §§ 8.01-577 to 8.01-581.16 (2007); WYO. STAT. ANN. §§ 1-36-101 to 1-36-119 (2007).

procedural issues ignored by the FAA, as well as an additional specific ground for vacating an award where there was no agreement to arbitrate.<sup>248</sup>

The following states have not explicitly adopted the UAA, but their arbitration statutes include provisions very similar to the UAA: Connecticut; Florida; New Hampshire; Ohio; Pennsylvania; Texas; and Vermont.<sup>249</sup> The Mississippi Code looks particularly similar to the UAA; however, it does seem to add more provisions than the UAA.<sup>250</sup> For example, it adds a Notice to Parties provision and the Code goes more into detail on the role of arbitrators.<sup>251</sup> Michigan has adopted many of the same provisions as the UAA, but has taken a rather unique approach in getting there. The actual statute includes a general provision on enforceability, a provision for court appointment of an arbitrator, and provisions on court jurisdiction and venue, but little else of obvious consequence.<sup>252</sup> However, section 5021 directs the reader to the rules of the Michigan Supreme Court,<sup>253</sup> which include a number of provisions on procedure, as well as confirmation, vacation, or modification—much like those of the UAA.<sup>254</sup> Of course, by including such provisions in the court rules, the legislature has delegated the power to amend these rules to the Michigan Supreme Court.<sup>255</sup>

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<sup>248</sup> See generally UNIFORM ARBITRATION ACT §§ 1-25 (1956). More specifically, section 12(a)(5) provides for vacation of an award where the arbitrators themselves (and not the court) determined the parties had agreed to arbitrate and did so over an objection by the party seeking vacation, and the reviewing court determines that the parties did not agree to arbitrate the dispute. *Id.* at § 12(a)(5). This provision would seem to avoid the challenges presented by the Supreme Court's dicta in *First Options*, suggesting a more deferential standard of review under such circumstances. See *First Options of Chi., Inc. v. Kaplan*, 514 U.S. 938, 943 (1995) (suggesting that an arbitrator's decision on jurisdiction, if mandated by the parties' agreement, should be treated essentially the same on review as a decision on the merits). However, one might ask if this "solution" to the *First Options* problem somehow makes the statute less "pro-arbitration," in which case it would likely be preempted by the FAA.

<sup>249</sup> CONN. GEN. STAT. ANN. §§ 52-408 to 52-424 (West 2007); FLA. STAT. ANN. §§ 682.01-682.22 (West 2007); N.H. REV. STAT. ANN. §§ 542:1-542:11 (2007); OHIO REV. CODE ANN. §§ 2711.01-2711.16 (LexisNexis 2007); 73 PA. CONS. STAT. ANN. §§ 7301-7320 (West 2007); TEX. CIV. PRAC. & REM. CODE ANN. §§ 171.001-171.098 (West 2007); VT. STAT. ANN. tit. 12, §§ 5641-5681 (2007).

<sup>250</sup> MISS. CODE ANN. §§ 11-15-1 to 11-15-37 (2007).

<sup>251</sup> *Id.* §§ 11-15-5, 11-15-7.

<sup>252</sup> MICH. COMP. LAWS ANN. §§ 600.5001-600.5035 (West 2007).

<sup>253</sup> See *Id.* § 600.5021 (stating that "[t]he arbitration shall be conducted in accordance with the rules of the supreme court").

<sup>254</sup> See MICH. CT. R. 3.602. Rule 3.602 further cross-references the reader to the standard rule of civil procedure for subpoenas. See *id.* at (F)(1).

<sup>255</sup> See MICH. CT. R. 1.201. One could reasonably ask if this might be a more transparent and predictable approach than that of the United States Supreme Court in periodically

The following states have general arbitration statutes that follow the Revised Uniform Arbitration Act (RUAA): Alaska; Arizona; Colorado; Hawaii; Minnesota; Nevada; New Jersey; New Mexico; North Carolina; North Dakota; Oklahoma; Oregon; Utah; and Washington.<sup>256</sup> Even though the following states have not explicitly adopted the Revised Uniform Arbitration Act, their statutory provisions are extremely similar to those of the RUAA: California; Georgia; and Rhode Island.<sup>257</sup> Wisconsin has adopted an extremely detailed arbitration statute and, more specifically, an explicit set of default provisions.<sup>258</sup>

The Louisiana statute largely mirrors the FAA, while adding a few provisions similar to those found in the UAA.<sup>259</sup> Perhaps of more interest in relation to the issues explored by this Article in Part I.D, the Louisiana statute is extraordinarily unique in its placement. While found within Revised Statutes, it has been placed in a section specifically addressing “Code Ancillaries,” and within that section, among various forms of nominate contracts. In effect, Louisiana law treats arbitration as a civil code based nominate contract.<sup>260</sup>

The remaining states have arbitration statutes that are arguably even more minimalist in nature than the FAA. The Alabama Code focuses primarily on the arbitrators and a few procedural matters but does not even clearly state that *ex ante* arbitration clauses are enforceable.<sup>261</sup> West Virginia’s statute

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defining or redefining the contours of the FAA.

<sup>256</sup> RUAA, *supra* note 28; ALASKA STAT. §§ 09.43.300-09.43.595 (2007); COLO. REV. STAT. §§ 13-22-201 to 13-22-223 (2007); HAW. REV. STAT. §§ 658A-1 to 658A-29 (West 2007); NEV. REV. STAT. ANN. §§ 38.206-38.248 (LexisNexis 2007); N.J. STAT. ANN. §§ 2A:23B-1 to 2A:23B-32 (West 2007); N.M. STAT. ANN. § 44-7A-1 to 44-7A-32 (West 2007); N.C. GEN. STAT. §§ 1-569.1 to 1-569.31 (2007); N.D. CENT. CODE §§ 32-29.3-01 to 32.29.3-29 (2007); OKLA. STAT. tit. 12, §§ 1851-1881 (2007); OR. REV. STAT. ANN. §§ 36.600-36.740 (West 2007); UTAH CODE ANN. §§ 78B-11-101 to 78B-11-131 (LexisNexis 2007); WASH. REV. CODE ANN. §§ 7.04.101-7.04.220 (West 2007). Arizona and Minnesota enacted these statutes in 2010. *See* H.R. 2430, 49th Leg., 2d Reg. Sess. (Ariz. 2010), *available at* <http://www.azleg.gov/legtext/49leg/2r/bills/hb2430h.pdf>; H.R. 1692, 86th Leg., Reg. Sess. (Minn. 2010), *available at* <https://www.revisor.mn.gov/data/revisor/law/2010/0/2010-264.pdf>. The District of Columbia has also adopted RUAA. *See* D.C. CODE §§ 16-4401 to 16-4432 (2001).

<sup>257</sup> CAL. CIV. PROC. CODE §§ 1280-1294.2 (West 2007); GA. CODE ANN. §§ 9-9-1 to 9-9-18 (2007); R.I. GEN. LAWS §§ 10-3-1 to 10-3-21 (2007).

<sup>258</sup> WIS. STAT. ANN. §§ 788.01-788.18 (West 2007).

<sup>259</sup> LA. REV. STAT. ANN. §§ 9:4201-9:4217 (2007).

<sup>260</sup> As noted *supra* at note 86, the Québec Civil Code treats arbitration in a similar manner.

<sup>261</sup> ALA. CODE §§ 6-6-1 to 6-6-16 (2007).

addresses even fewer issues than Alabama's and clearly applies only to ex post submissions of controversies.<sup>262</sup> The New York statute addresses basic questions of enforceability, motions to compel or stay proceedings, a few procedural matters, and grounds for vacation of an award.<sup>263</sup> However, the statute is remarkably minimalist for a state where the most well-known American arbitration institution makes its home,<sup>264</sup> and many complex commercial cases are undoubtedly arbitrated.

Notwithstanding the current menagerie of state laws described above, one might reasonably suggest that—whatever the deficiencies in the FAA—the gaps in federal law could be filled by uniform state law instead of federal law. In fact, this was one of the primary objectives behind the relatively recent revision and promulgation of the RUAA.<sup>265</sup>

*1. The RUAA as an Attempt To Fill Gaps in the Federal Arbitration Act and Provide Default Legal Rules Under State Law*

The prefatory note to the RUAA points out that, while effective in ensuring the enforceability of arbitration agreements, earlier state law had failed to address many issues arising in modern arbitration agreements<sup>266</sup>—much as the FAA has ensured enforceability of arbitration agreements but failed to address many of the issues arising in modern arbitration agreements. The RUAA was expressly intended to provide a “default mechanism if the parties do not have a specific agreement on a particular issue.”<sup>267</sup> While the drafters realized that “front end” and “back end” issues might well be preempted by the FAA, the RUAA was intended primarily to address default legal rules governing “arbitration procedure,” which are virtually non-existent within the FAA.<sup>268</sup>

Ten years after its completion, the RUAA has only been adopted by fourteen states and the District of Columbia.<sup>269</sup> It is, thus, questionable

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<sup>262</sup> W. VA. CODE ANN. §§ 55-10-1 to 55-10-8 (West 2007). Arguably, one might reasonably suggest that this is not an arbitration statute at all, inasmuch as it does not even hint at addressing ex ante arbitration agreements.

<sup>263</sup> N.Y. C.P.L.R. 7501-7514 (MCKINNEY 2007).

<sup>264</sup> *AAA Offices: Headquarters and Departments*, AM. ARBITRATION ASSOC'N, <http://www.adr.org/sp.asp?id=29067> (“1633 Broadway, 10th Floor, New York, New York 10019”) (last visited Mar. 27, 2011).

<sup>265</sup> RUAA, *supra* note 28, at Prefatory Note.

<sup>266</sup> *Id.*

<sup>267</sup> *Id.*

<sup>268</sup> *Id.*; see *supra* Part II.A.2 for a definitional explanation of “front end” issues, “back end” issues, and “arbitration procedure.”

<sup>269</sup> *A Few Facts About the Uniform Arbitration Act (2000)*, NAT'L CONFERENCE OF

whether it is realistic to assume that the RUAA could serve to provide any “uniform” default legal rules governing even “arbitration procedure” any time in the near future. The reasons for this somewhat lackluster performance may be manifold, but the following two possibilities come to mind.

First, the actual provisions of the RUAA have been the subject of significant criticism. Professor Rau frequently points to the drafting of the RUAA in his efforts to suggest that legislators (even private legislators) are less competent than courts to provide legal rules governing arbitration, and in doing so points out particular specific problems with the statute.<sup>270</sup> The RUAA also attempts to address the broad array of existing arbitration agreements, including consumer and employee arbitration but fails to remedy many of the failures of the FAA in this respect.<sup>271</sup> More importantly for the focus of this Article on business-to-business arbitration, one of the advisors to the drafting committee levels a more general criticism, suggesting that the default procedural rules within the RUAA are more consistent with lawyers’ views of traditional litigation than with business attitudes regarding the virtues of arbitration.<sup>272</sup> To be sure, the RUAA also has its proponents and believers.<sup>273</sup> However, it has failed to achieve the sort of broad acceptance normally associated with a “uniform” state law.

Second, the extent of FAA preemption is anything but certain. While the drafters of the RUAA assumed that the FAA did not preempt state procedural rules, as long as such rules were pro-arbitration, the extent of FAA preemption remains to a large degree unresolved. The FAA unquestionably has broad preemptive force in displacing state laws governing arbitration.<sup>274</sup> While some continue to urge a significant role for state law, such as the RUAA,<sup>275</sup> and a more limited view of preemption, the issue remains subject

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COMM’RS ON UNIF. STATE LAWS, , available at <http://www.nccusl.org/Update/ActSearchResults.aspx> (last visited on Mar. 27, 2011).

<sup>270</sup> See Rau, *supra* note 46, at 170-79.

<sup>271</sup> See Sarah Rudolph Cole, *The Revised Uniform Arbitration Act: Is It the Wrong Cure?* 4 DISP. RESOL. MAG. 10, 12 (2002).

<sup>272</sup> See Hayford, *supra* note 44, at 437-39. Professor Hayford is specifically singled out as one of the major contributors, as a member of the RUAA drafting committee. RUAA, *supra* note 28, at Prefatory Note.

<sup>273</sup> Roger Alford, *Report to Law Revision Commission Regarding Recommendations for Changes to California Arbitration Law*, 4 PEPP. DISP. RESOL. L.J. 1 (2003).

<sup>274</sup> See Rau, *supra* note 46, at 192.

<sup>275</sup> See generally Stephen L. Hayford & Alan R. Palmiter, *Arbitration Federalism: A State Role in Commercial Arbitration*, 54 FLA. L. REV. 175 (2002); Jill I. Gross, *Over-Preemption of State Vacatur Law: State Courts and the FAA*, 3 J. AM. ARB. 1 (2004) (suggesting a role for state law, even on “back end” issues).

to significant questions.<sup>276</sup> In the face of such uncertainty, the only effective way to provide for default legal rules is through new federal law.<sup>277</sup>

## 2. *Additional Challenges in Looking to State Law for Default Legal Rules*

In addition to the challenges addressed above, there may be an even more fundamental reason why state law cannot reasonably serve as the foundation for a system of default legal rules governing arbitration. It is worth recalling that default rules are most needed when the parties have drafted a relatively minimalist agreement. Such a minimalist agreement may arise from the parties' ignorance regarding many of the more nuanced issues that may arise in arbitration and may often be a product of the parties' desire to avoid focusing on dispute resolution when negotiating a business transaction.<sup>278</sup> Under such circumstances, it seems unlikely that a party would include a clause expressly choosing the arbitration law of a particular state.

A general choice-of-law provision will not typically determine the law governing the parties' arbitration agreement.<sup>279</sup> Thus, the parties must, in some manner, provide a specific choice of law with respect to their arbitration agreement if such agreement is to be governed by state law rather than the FAA.<sup>280</sup> However, it seems unlikely that a typical business party

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<sup>276</sup> See Drahozal, *FAA Preemption*, *supra* note 5, at 411-15 (raising doubts about the application of state law default rules in the face of broad FAA preemption).

<sup>277</sup> See Timothy J. Heinsz, *The 2000 Revision to the Uniform Act: A Harbinger?* 3 PEPP. DISP. RESOL. L.J. 435, 435-36 (2003) (suggesting that, because of the preemptive effect of the FAA, new federal law is the only way to address fully its many inadequacies).

<sup>278</sup> See *supra* Part I.A.

<sup>279</sup> The arbitration agreement is separable (or severable) from and fully independent of the parties' broader transaction. As such, a general choice-of-law provision is typically deemed to govern only that broader transaction and not the arbitration agreement. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995); *Bermann*, *supra* note 5, at 1018. *But see* *Volt Info. Scis., Inc. v. Stanford Univ.*, 489 U.S. 468 (1989) (inexplicably applying California law based on a general choice of law provision in the parties' contract, and never expressly overruled by subsequent precedent more in line with the general rule). Notwithstanding the anomalous result in *Volt*, few, if any, would suggest that a court should apply state law to an arbitration agreement based solely on a general choice-of-law provision in the parties' contract.

<sup>280</sup> In the absence of any express choice, an arbitration agreement is almost universally governed by the law of the place of arbitration—the *lex arbitri*. *Bermann*, *supra* note 5, at 1018-19. Thus, one might reasonably ask if the choice of a particular state as the place of arbitration also amounts to a choice of that state's arbitration law. See Jack Garvey & Totten Heffelfinger, *Towards Federalizing U.S. International Commercial Arbitration Law*, 25 INT'L LAW 209, 216 (1991) (raising the same uncertain question almost twenty years ago). However, as a matter of practice, courts give virtually no analysis to the issue and simply apply the FAA. *Id.* at 1018-22. Presumably, the broad preemptive effect of the FAA gives

would be aware of such a need. Moreover, an express choice of law governing an arbitration agreement would seemingly suggest to one's contracting partner that disputes arising out of the contemplated transaction may be likely. Finally, the very notion of choosing law to govern arbitration, a largely private dispute resolution procedure, may be counter-intuitive to the typical business person—no matter how important that choice may later prove to be. As such, it seems that state arbitration law—even if otherwise perfectly suitable—would rarely, if ever, apply to govern the parties' arbitration agreement when they most need default legal rules.

Moreover, the decision of the United States Supreme Court, in *Volt*,<sup>281</sup> highlights the uncertainty in choosing state law. Whether a question of the effect of a choice-of-law provision or the effect of FAA preemption,<sup>282</sup> the parties' attempt to invoke state law will often lead them back to federal court for an answer to these questions. Thus, their intent to arbitrate their disputes and stay away from the courthouse is once again undermined.

### 3. State Laws Governing International Arbitration

Thirteen states have adopted specific laws governing international commercial arbitration, and eight of these states have, to varying degrees, based these statutes on the UNCITRAL Model Law.<sup>283</sup> These state law formulations governing international commercial arbitration also suffer many of the same challenges discussed above, including federal preemption and the

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rise to a presumption that the FAA governs, as the *lex arbitri*, rather than any otherwise applicable state law. *See* Drahozal, *FAA Preemption*, *supra* note 5, at 411-15 (expressing doubt regarding the implied intent reflected in the choice of a place of arbitration as sufficient to amount to a choice of state default rules). At the very least, the current state of jurisprudence on choice of law governing arbitration gives rise to considerable uncertainty.

<sup>281</sup> 489 U.S. 468 (1989); *see also* discussion of case cited *supra* note 279.

<sup>282</sup> *See supra* Part II.C.1.

<sup>283</sup> RUA, *supra* note 28, at Prefatory Note (indicating that twelve states have enacted specialized provisions regarding international commercial arbitration, of which seven have based these enactments largely upon the UNCITRAL Model Law; however, Florida's 2010 enactment in the following list adds one more state to this list). The UNCITRAL Model Law serves, to a large degree, as the basis for the statutes adopted by California, Connecticut, Florida, Illinois, Louisiana, North Carolina, Oregon, and Texas. CAL. CIV. PROC. CODE §§ 1287.12-1297.337 (Deering 2010); CONN. GEN. STAT. §§ 50a-100 to 50a-139 (2010); FLA. STAT. ANN. §§ 684.0001-684.0048 (LexisNexis 2010); 710 ILL. COMP. STAT. ANN. 30/1-5 to 30/25-30 (LexisNexis 2010); LA. REV. STAT. §§ 9:4241-9:4276 (2010); N.C. GEN. STAT. §§ 1-567.31 to 1-567.67 (2010); OR. REV. STAT. §§ 36.450-36.558 (2010); TEX. CIV. PRAC. & REM. CODE ANN. §§ 172.001-172.175 (West 2010).

necessity of some sort of specific choice of state arbitration law by the parties—as well as all of the uncertainties present therein. However, the adoptions of the Model Law raise some additional issues worth mentioning briefly.

Unlike the RUAA, the UNCITRAL Model Law is a complete modern law governing all aspects of arbitration, from commencement through final award, including actions for set aside or enforcement.<sup>284</sup> As such, its complete adoption<sup>285</sup> raises far more potential conflicts with the FAA than the RUAA. In addition to the provisions on “arbitration procedure,”<sup>286</sup> the Model Law provisions on “back end” and “front end” issues differ significantly from the FAA.

The UNCITRAL Model Law, like the New York Convention, includes different bases for set aside or non-enforcement than those contained in FAA section 10.<sup>287</sup> Inasmuch as section 10 has been deemed to be a mandatory legal rule rather than default provisions,<sup>288</sup> the likelihood of preemption seems far greater.<sup>289</sup> At the front end of the arbitral process, the Model Law provides for statutory competence-competence, in direct contrast to FAA

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<sup>284</sup> RUAA, *supra* note 28, at Prefatory Note.

<sup>285</sup> Not all of the eight states utilizing the Model Law as the basis for their own legislation adopted all of its provisions. However, Connecticut, Florida, Louisiana and Oregon substantially adopted the Model Law in its entirety. CONN. GEN. STAT. ANN. §§ 50a-100 to 50a-139; FLA. STAT. ANN. §§ 684.0001-684.0048; LA. REV. STAT. ANN. §§ 9:4241-9:4276; OR. REV. STAT. ANN. §§ 36.450-36.558, and all eight of these states have adopted the Model Law provisions on competence-competence (the jurisdiction of the tribunal to rule on its own jurisdiction). CAL. CIV. PROC. CODE §1287.161; CONN. GEN. STAT. ANN. § 50a-116; FLA. STAT. ANN. § 684.0001-684.0017; 710 ILL. COMP. STAT. ANN. 30/15-5; LA. REV. STAT. § 9:4256; N.C. GEN. STAT. § 1-567.46; OR. REV. STAT. ANN. § 36.484; TEX. CIV. PRAC. & REM. CODE ANN. § 172.001-172.082.

<sup>286</sup> While different than those contained in RUAA, the Model Law procedural provisions raise the same sort of preemption issues as RUAA.

<sup>287</sup> While different from section 10 of the FAA, the Model Law and New York Convention contain essentially identical provisions for both. Model Law Article 36 is identical to New York Convention Article V on enforcement issues, and Model Law Article 34 differs only in terms of the applicable law on the final two bases for set aside. The latter two bases address subject matter arbitrability (not to be confused with the broad misuse of the term by the U.S. Supreme Court) and public policy, each applying the law of the place of enforcement in actions to enforce and the place of arbitration in actions to set aside an award.

<sup>288</sup> See *Hall Street Assocs. v. Mattel*, 552 U.S. 576 (2008) (precluding the parties from agreeing to expanded judicial review by holding that such review was statutorily limited to those grounds listed in section 10).

<sup>289</sup> In fact, one might reasonably infer that the California, Illinois, and Texas legislatures consciously omitted Articles 34 and 36 of the UNCITRAL Model Law addressing set aside and enforcement based on their likely preemption by the FAA. North Carolina’s approach is more curious, inasmuch as it appears to add its own grounds for set aside, different from either the FAA or Model Law. See N.C. GEN. STAT. § 1-567.46.

section 4.<sup>290</sup> Under section 4, a court must first decide any issue as to whether the parties agreed to arbitration, whereas Model Law Article 16 grants the arbitrators the power to make this determination.<sup>291</sup> It is now clear that section 4 is far less of a mandatory rule of law than section 10, as section 4 may yield to a “clear and unmistakable” contrary choice by the parties to delegate jurisdictional decisions to the arbitrators.<sup>292</sup> However, section 4 of the FAA is much less likely to defer to state law, as the issue is unequivocally one governed by “substantive federal arbitration law.”<sup>293</sup>

Lastly, it is worth recalling the discussion in Part II.A.3.b regarding Chapter 3 of the FAA and its incorporation of the IACAC Rules, which are themselves based on the UNCITRAL Arbitration Rules. While the UNCITRAL Arbitration Rules are, in many ways, quite similar to the UNCITRAL Model Law, they are not in fact the same. Thus, an arbitration agreement governed by Chapter 3 under the FAA, but perhaps subject to a state adoption of the Model Law based on the parties’ express choice, would likely present some particularly challenging preemption questions, along with the previously discussed issues relating to conflicts between FAA Chapter 1 and Chapter 3.<sup>294</sup>

Thus, any state law attempting to remedy the deficiencies in the FAA regarding international commercial arbitration is even more likely to raise preemption issues and questions giving rise to uncertainty in the arbitral process, thus presenting an even greater likelihood of judicial involvement. The role of the FAA in United States arbitration is far too central to simply work around it. For effective legal reform, the menagerie of the FAA and its considerable body of federal common law must be replaced by a single, new, comprehensive statute. However, one final question remains. Are default legal rules truly needed, or can private rules adopted by the parties serve the same purpose?

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<sup>290</sup> See UNCITRAL Model Law, *supra* note 26, at art. 16.

<sup>291</sup> *Id.*

<sup>292</sup> See *First Options of Chi., Inc. v. Kaplan*, 514 U.S. 938, 943-44 (1995) (explaining that the parties may ask the arbitrators to decide this issue just like any other issue they might assign to the arbitrators).

<sup>293</sup> *Rent-A-Center, West, Inc. v. Jackson*, 130 S. Ct. 2772, 2781 n.4 (2010). This issue is more fully discussed in Part II.E below.

<sup>294</sup> See *supra* Part II.A.3.b.

*D. Can Institutional and Other Private Rules Serve as a Substitute for Default Legal Rules?*

One might reasonably question whether there is any need for a set of default legal rules to govern arbitration agreements in view of the broad and easy availability of institutional and ad hoc rules<sup>295</sup> from which parties may choose.<sup>296</sup> However, the parties may fail to choose any rules. As indicated earlier, the only requirement for an effective arbitration agreement is a written agreement to final and binding resolution of a defined set of disputes.<sup>297</sup> Admittedly, the concern expressed earlier about sending negative signals to one's contracting partner by negotiating over dispute resolution<sup>298</sup> may not be as acute with respect to selecting a set of rules. There is obviously a substantial difference between including fifteen pages of detailed arbitration procedures and agreeing to arbitrate under a well-known set of institutional rules, which happen themselves to be fifteen pages long. However, there may remain other reasons why parties fail to include a set of rules in their arbitration agreement.

The parties may be attempting to save money by omitting any institutional reference. In fact, this is exactly why parties sometimes choose ad hoc over institutional arbitration.<sup>299</sup> However, parties and their attorneys may or may not be aware of the existence of ad hoc rules, detached from the use of a particular arbitral institution. Thus, a party seeking to avoid dispute resolution in court, but hesitant to commit to the costs of institutional arbitration and unaware of the existence of ad hoc rules, might very well propose arbitration without designating any rules at all. Again, it is important to remember that not all contracts that include arbitration clauses are drafted by lawyers. Thus, it is quite likely there will always be a significant minority<sup>300</sup> of arbitration agreements that do not include any designation of rules.

Moreover, there is nothing inconsistent with parallel sets of (1) default legal rules and (2) private rules for autonomous incorporation into parties'

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<sup>295</sup> Ad hoc rules, such as the UNCITRAL Arbitration Rules, are typically used in the absence of institutional administration of the arbitration proceedings.

<sup>296</sup> See, e.g., Rau, *supra* note 46, at 180 (suggesting, in the context of international commercial arbitration, that the vast majority of parties to arbitration agreements designate either a set of institutional or ad hoc rules).

<sup>297</sup> See *supra* Part I.A.

<sup>298</sup> See *supra* Part I.A.

<sup>299</sup> MORRISSEY & GRAVES, *supra* note 8, at 330.

<sup>300</sup> For purposes of this Article, the author is willing to concede this is likely a minority, though an empirical analysis might be interesting—assuming one could actually sample small business agreements, as well as large.

contracts. By way of comparative example, parties to a sale of goods can easily designate INCOTERMS 2000<sup>301</sup> (or some other set of trade terms) to govern various issues involving shipping and passage of risk (much like parties to an arbitration agreement can designate a set of institutional rules). However, UCC Article 2 also provides a set of default provisions addressing these same issues in the event the parties do not—precisely in order to avoid later disputes over omitted terms.

Lastly, there are certain terms that simply do not work effectively based on autonomous choice, whether based on the parties' own terms or their incorporation of a set of arbitration rules, because of inherent flaws involving circularity. The most classic example of this problem involves the doctrine of competence-competence, or the power of an arbitral tribunal to determine its own jurisdiction.

#### *E. The Problem with Contractual Competence-Competence*

FAA section 4 provides that a court must decide any question of whether the parties agreed to arbitration of the dispute in question.<sup>302</sup> In contrast, most modern arbitration laws grant the arbitral tribunal the power to make this determination itself, deciding its own jurisdiction—though solely as an initial matter, and fully subject to later (or concurrent)<sup>303</sup> court review within a limited statutory framework.<sup>304</sup> However, one might reasonably ask whether,

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<sup>301</sup> See *Incoterms 2010*, *supra* note 67.

<sup>302</sup> 9 U.S.C. § 4 (2006).

<sup>303</sup> See, e.g., UNCITRAL Model Law, *supra* note 26, at art. 8 (providing for the possibility of concurrent jurisdictional determinations by the arbitral tribunal and a proper court).

<sup>304</sup> See, e.g., *id.* at art. 16 (granting the arbitrators the authority to determine their own jurisdiction); *id.* at art. 34, 36 (providing for court review in an action to set aside or enforce any award—but only on certain enumerated grounds, one of which is that the parties did not agree to arbitration of the dispute in question). While the doctrine of competence-competence operates differently in different legal systems as to “timing” (as to determinations by courts or arbitrators), the doctrine has gained near universal acceptance in international practice, in no small measure due to the influence of the UNCITRAL Model Law. Barcelo, *supra* note 241, at 1116-17. While this doctrine allows arbitrators to determine their own jurisdiction (either concurrently or prior to a court determination), a court will always have the final word on the issue—typically on a *de novo* basis. *Id.* at 1123. Even French law, which is perhaps the most extreme in granting arbitrators the “first” decision regarding jurisdiction. *Id.* at 1124-27; Richard W. Hulbert, *Institutional Rules and Arbitral Jurisdiction: When Party Intent is Not “Clear and Unmistakable,”* 17 AM. REV. INT’L ARB. 545, 565-66 (2009) (providing for subsequent judicial review on the question of whether the parties formed a valid arbitration agreement).

under the FAA, the parties to an arbitration agreement could not accomplish a similar result, in effect contractually granting the arbitrators the power to decide their own jurisdiction. The United States Supreme Court appeared to answer, in *First Options of Chicago, Inc. v. Kaplan*,<sup>305</sup> that parties could do exactly that.<sup>306</sup> The parties could ask the arbitrators to decide the jurisdictional question<sup>307</sup> in the same manner they could ask the arbitrators to decide any other question, such as the merits of their dispute.<sup>308</sup> While seemingly a straightforward exercise of party autonomy to refer a dispute to arbitration, this decision raised a host of questions.<sup>309</sup> If the basis of the arbitral tribunal's power to decide its own jurisdiction is no different than its power to decide the merits of the parties' dispute, as the Court suggested,<sup>310</sup> then the tribunal's decision on jurisdiction is subject to review only under the standards of FAA section 10, which does not include any reference to the lack of an agreement to arbitrate.<sup>311</sup> As such, the arbitral tribunal would not only have the power to decide its own jurisdiction, but would have the exclusive, and largely non-reviewable, power to do so.<sup>312</sup> At the very least,

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<sup>305</sup> 514 U.S. 938 (1995).

<sup>306</sup> See *id.* at 943. This answer was by no means self-evident, as section 4 might also reasonably be read as providing for "mandatory" determination by a competent court on the question of whether the parties have validly agreed to arbitrate their dispute. See generally Horton, *supra* note 128.

<sup>307</sup> The Supreme Court refers to this issue as one of "arbitrability." See *First Options of Chi., Inc. v. Kaplan*, 514 U.S. at 942. However, this Article will use the terms "jurisdiction" or "competence," in recognition of their more universal use in arbitration practice, globally. Whereas the Supreme Court deems a dispute not "arbitrable" if the parties did not agree to arbitration, the more universal practice is to say that an arbitration tribunal lacks "jurisdiction" or is not "competent" to decide a dispute if the parties have not so agreed. The problem with using this "arbitrability" term with respect to the question of whether the parties agreed to arbitration is that it also has many other meanings that are quite different and more precise, and its use regarding the agreement to arbitrate can lead to unnecessary confusion. See MORRISSEY & GRAVES, *supra* note 8, at 409-10.

<sup>308</sup> *First Options*, 514 U.S. at 942.

<sup>309</sup> See, e.g., William W. Park, *The Arbitrability Dicta in First Options v. Kaplan: What Sort of Kompetenz-Kompetenz Has Crossed the Atlantic?* 12 *ARB. INT'L* 137 (1996); Alan Scott Rau, *The Arbitrability Question Itself*, 10 *AM. REV. INT'L ARB.* 287 (1999).

<sup>310</sup> See *First Options*, 514 U.S. at 943.

<sup>311</sup> 9 U.S.C. § 10 (2006). The only possible provision a court might invoke in attempting to review a tribunal's jurisdictional decision is section 10(4)—however, any use of this section for such a purpose is potentially problematic on a much larger scale, as more fully explained below. See, e.g., Hulbert, *supra* note 304, at 546-47 (pointing out the potential that the *First Options* dicta might be read as providing not only for the power of the arbitrator to decide the jurisdictional question, but also making such decision immune from judicial review).

<sup>312</sup> It was not at all clear that the Court intended such a result, but the Court's language certainly suggested this possibility.

the Court had seemingly provided for contractually agreed upon competence-competence,<sup>313</sup> so long as the parties' intent was "clear and unmistakable."<sup>314</sup> The Court's opinion in *First Options* undoubtedly led to a number of new drafting ideas with respect to arbitration agreements, two of which are particularly relevant for our analysis here.

First, a number of United States arbitral institutions have included provisions within their domestic rules giving the arbitral tribunal the power to determine its own jurisdiction.<sup>315</sup> Of course, one might seriously question whether an arbitration agreement including a set of rules, within which the arbitral tribunal was granted the power to decide its own jurisdiction, could possibly amount to "clear and unmistakable" intent to consign this issue to the arbitrators.<sup>316</sup> However, a substantial majority of federal courts dealing with the issue have had little difficulty finding such consent in exactly this manner.<sup>317</sup> In effect, a contractual version of competence-competence is arguably becoming the norm within the United States, notwithstanding its omission in the FAA. However, it is worth noting the obvious at this stage. The arbitrators' authority to decide their own jurisdiction is based solely on whether the parties agreed to arbitration in the first instance. Thus, any grant of such authority is arguably fundamentally flawed, as a matter of contractual consent, based on its inherent circularity. Perhaps even more importantly, the arbitrators' decision may be virtually unreviewable under FAA section 10,

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<sup>313</sup> If granted by the parties, the arbitral tribunal would have the power to determine its own jurisdiction—i.e., it would possess the *competence* to determine its own *competence*.

<sup>314</sup> *First Options*, 514 U.S. at 944.

<sup>315</sup> See, e.g., AM. ARBITRATION ASS'N, COMMERCIAL ARBITRATION RULES AND MEDIATION PROCEDURES 7-8 r.7 (2010) (providing for determination by the arbitral tribunal of "the existence or validity of a contract of which an arbitration clause forms a part"); JAMS, *supra* note 61, at 14 r.11(c) (providing for determination by the arbitral tribunal of "[j]urisdictional and arbitrability disputes, including disputes over the formation, existence, validity, interpretation or scope of the agreement under which Arbitration is sought"). The AAA Rule providing for competence-competence was first added to its domestic rules in 1999, just four years after the *First Options* decision. See Hulbert, *supra* note 304, at 563.

<sup>316</sup> If agreeing to a term incorporated in a large body of rules amounts to "clear and unmistakable" consent, one might reasonably ask what sort of consent does not satisfy this purportedly heightened standard for proving consent.

<sup>317</sup> See, e.g., *Contec Corp. v. Remote Solution Co.*, 398 F.3d 205, 208-09 (2d Cir. 2005); *Terminix Int'l Co. v. Palmar Ranch Ltd. P'ship*, 432 F.3d 1327, 1332-33 (11th Cir. 2005) (finding "clear and unmistakable" evidence based on the parties' agreement to arbitration under the AAA Rules, including Rule 7); Mark Berger, *Arbitration and Arbitrability: Toward an Expectation Model*, 56 BAYLOR L. REV. 753, 790 (2004); Joseph L. Franco, Comment, *Casually Finding the Clear and Unmistakable: A Re-Evaluation of First Options in Light of Recent Lower Court Decisions*, 10 LEWIS & CLARK L. REV. 443, 467-70 (2007).

unless perhaps the parties also contracted for heightened judicial review. This is where the second new idea came into play. In order to alleviate any concerns a court might have that an arbitrator's decision might be unreviewable, parties inserted contractual provisions for subsequent judicial review.<sup>318</sup>

In *Rent-A-Center, West, Inc. v. Jackson*,<sup>319</sup> the problems with contractual competence-competence were squarely presented. The Rent-A-Center contract executed by its employee, Jackson, included a provision in the arbitration agreement itself, clearly and unmistakably assigning to the arbitral tribunal the authority to decide any and all questions related to its jurisdiction, including the question of whether the parties had concluded a binding arbitration agreement—and assigning this decisional authority on an “exclusive” initial basis, though still subject to later judicial review.<sup>320</sup> Not surprisingly, Rent-A-Center relied on *First Options* in arguing that this provision was fully enforceable and the initial jurisdictional question was solely and exclusively for the arbitrators to decide.<sup>321</sup> In effect, Rent-A-Center took the Court at its word in *First Options* and drafted an arbitration agreement seeking to take full advantage of the Court's dicta.

Jackson asserted an unconscionability defense to the purported arbitration agreement<sup>322</sup> and, more importantly for the issue before the Court, wanted this issue decided by a court under FAA section 4, and not by an arbitrator.<sup>323</sup> Jackson pointed out the obvious flaws in *First Options* applied to these

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<sup>318</sup> At least this was the thinking before the Supreme Court decided *Hall Street Associates v. Mattel, Inc.*, 552 U.S. 576 (2008).

<sup>319</sup> 130 S. Ct. 2772 (2010).

<sup>320</sup> See Brief for the Petitioner at 4-5 *Rent-A-Center v. Jackson*, 130 S. Ct. 2772 (2010) (No. 09-497), 2010 U.S. S. Ct. Briefs LEXIS 315; Joint Appendix at 29-30 exhibit 1 *Rent-A-Center v. Jackson*, 130 S. Ct. 2772 (2010) (No. 09-497), 2010 U.S. S. Ct. Briefs LEXIS 153. Under the parties' agreement, this “exclusivity” was purely temporal. The arbitral tribunal would have the exclusive opportunity to decide the issue—as an initial matter. However, this decision was later to be subject to plenary court review under the parties' agreement. *Id.* As more fully explained below, the effect of the Court's decision in *Hall Street* likely renders this provision for plenary review ineffective.

<sup>321</sup> Brief for the Petitioner at 11-14 *Rent-A-Center v. Jackson*, 130 S. Ct. 2772 (2010) (No. 09-497), 2010 U.S. S. Ct. Briefs LEXIS 315.

<sup>322</sup> Brief for Respondent at 3-4 *Rent-A-Center v. Jackson*, 130 S. Ct. 2772 (2010) (No. 09-497), 2010 U.S. S. Ct. Briefs LEXIS 260. Jackson asserted that the arbitration agreement, specifically, is unconscionable—not the container contract—thereby attempting to avoid the doctrine of separability. *Id.* at 7-8. While an unconscionability defense directed at the arbitration agreement itself is far more likely to arise in the context of consumer or employee arbitration, other invalidity defenses, such as duress, mutual mistake, or fraud, could certainly arise in a commercial context.

<sup>323</sup> *Id.* at 10-11.

circumstances. The arbitrators' authority to determine jurisdiction could not logically rely on the very agreement that Jackson was contesting as unconscionable.<sup>324</sup> This would amount to a classic example of circularity.<sup>325</sup> Moreover, surely such circular reasoning could not serve as the basis for granting the arbitrators the "exclusive" authority to make this determination.

As presented, this case seemed to require the Court to either: (1) follow the *First Options* dicta to its logical conclusion, enforcing the parties' contractual delegation of competence-competence to the arbitrators or (2) explain that the court did not really mean precisely what it said in *First Options*. Interestingly, Jackson suggested a way the Court might limit the dicta in *First Options*, arguing that the Court merely stated that the parties could grant the arbitral tribunal the authority to determine the "scope" of their arbitration agreement, provided the parties actually had an enforceable arbitration agreement in the first instance.<sup>326</sup> However, Jackson argued, the latter issue was necessarily one for the courts—no matter what the parties' agreement said.<sup>327</sup> In a 5-4 decision, the Court took the first course and did so, in large part, by relying on the doctrine of separability.<sup>328</sup> The case nicely illustrates the fundamental problem of circularity associated with contractual competence-competence.

Separability and competence-competence represent distinct, but related, doctrines.<sup>329</sup> Competence-competence provides the arbitrators with the power to decide threshold jurisdictional issues, while separability ensures the viability of the tribunal's decision on the substantive dispute assigned to it—assuming it determines that it has jurisdiction to decide the substantive dispute in question.

For all of its continuing controversy,<sup>330</sup> the Supreme Court's original decision to embrace separability in *Prima Paint Corp. v. Flood & Conklin*

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<sup>324</sup> *Id.* at 10.

<sup>325</sup> In effect, one cannot lift oneself off the floor by pulling on one's own bootstraps—no matter how hard one pulls. *Rent-A-Center v. Jackson*, 130 S. Ct. 2772, 2779, 2781 (2010); Brief for Respondent at 24, 40 *Rent-A-Center v. Jackson*, 130 S. Ct. 2772 (2010) (No. 09-497), 2010 U.S. S. Ct. Briefs LEXIS 260.

<sup>326</sup> Brief for Respondent at 39-40 *Rent-A-Center v. Jackson*, 130 S. Ct. 2772 (2010) (No. 09-497), 2010 U.S. S. Ct. Briefs LEXIS 260.

<sup>327</sup> *Id.* at 23-31.

<sup>328</sup> See generally *Rent-A-Center v. Jackson*, 130 S. Ct. 2772, 2788 (2010) (finding that "whether the arbitration agreement is unconscionable is *itself severable* from the merits of the underlying dispute, which involves a claim of employment discrimination") (emphasis in original).

<sup>329</sup> Barcelo, *supra* note 241, at 1116.

<sup>330</sup> See *Rent-A-Center*, 130 S. Ct. at 2785 (Stevens, J., dissenting) (continuing, over forty

*Manufacturing*<sup>331</sup> was arguably an unremarkable, and entirely necessary, extension by implication of section 2 of the FAA.<sup>332</sup> Section 2 makes enforceable an agreement to resolve a contractual dispute by arbitration, and parties subject to contractual claims will often raise traditional contract validity defenses such as duress, mistake, fraud, or unconscionability. The defenses are often raised as a matter of course, and they are also frequently intertwined with the merits of the dispute referred to arbitration. Thus, if the arbitral tribunal could not effectively decide these questions, the entire arbitral process would almost certainly be subject to lengthy delays, and the agreement to arbitrate would often be rendered ineffective.<sup>333</sup>

Two simple examples illustrate the importance of the doctrine of separability to an effective arbitration regime. In each case, *A* brings an action against *B* for breach of a contract that includes an arbitration agreement. *B* raises a defense of mutual mistake, asserting that the contract is therefore voidable.<sup>334</sup> Under the doctrine of separability, the arbitral tribunal is empowered to decide this defense, without any effect on the arbitration clause contained within the potentially voidable main contract. Without separability, in example one, a court might decide this defense. However, this would essentially resolve this particular case, and the parties would be deprived of their contractual agreement to arbitrate the dispute. Still without separability, in example two, an arbitrator might go ahead and try to decide the parties' dispute. However, the arbitrator could only issue an enforceable, preclusive decision in one direction—that of denying *B*'s defense. If the arbitrator decided in favor of the defense, he or she would also necessarily have to acknowledge the lack of any remaining jurisdiction to do anything but send the parties away without resolving their dispute. Separability, of course, resolves this very important practical problem—albeit with an admitted bit of theoretical “sleight of hand”—by allowing the arbitrator to decide the parties' dispute, including any invalidity defense involving the main contract and to do so in favor of either party in an enforceable, preclusive award.<sup>335</sup>

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years later, to describe the Court's decision in *Prima Paint* as ““fantastic”” and “likely erroneous”); see also Richard C. Reuben, First Options, *Consent to Arbitration, and the Demise of Separability: Restoring Access to Justice for Contracts with Arbitration Provisions*, 56 SMU L. REV. 819, 841-48 (2003) (providing a substantial critique of the separability doctrine).

<sup>331</sup> 388 U.S. 395 (1967).

<sup>332</sup> 9 U.S.C. § 2 (2006).

<sup>333</sup> See MORRISSEY & GRAVES, *supra* note 8, at 368-71.

<sup>334</sup> For the sake of clarity and simplicity, this is the only issue in this set of hypotheticals.

<sup>335</sup> See MORRISSEY & GRAVES, *supra* note 8, at 368-71.

In *Rent-A-Center*, the parties' arguments largely centered over the interpretation of the *First Options* dicta: was "delegation" largely limited to scope (or, perhaps, other similar issues) or did "delegation" include the question of whether the parties had agreed to arbitrate anything at all? The dissent suggests that the majority announced a rule not advocated by either party,<sup>336</sup> and at least one commentator seems to agree.<sup>337</sup> However, the majority's decision in *Rent-A-Center* is arguably nothing more than an inevitable result of a literal reading of *First Options* taken to its logical conclusion, including the necessary application of the doctrine of separability.

In *First Options*, the Court stated that the parties could delegate questions regarding jurisdiction (or, in the Court's vernacular, "arbitrability") to the arbitrator, including the questions of whether the parties had agreed to arbitration at all or whether the dispute in question fell within the scope of that agreement.<sup>338</sup> In doing so, the Court explained that the parties' agreement to delegate these jurisdictional decisions to the arbitrator was the equivalent of an agreement to delegate decisions regarding their dispute on the merits, and was subject to the same standard of review as a decision on the merits—that contained in section 10 of the FAA.<sup>339</sup>

Taken at face value, the dicta from *First Options* said, quite clearly, that the parties could delegate jurisdictional decisions to the arbitrator, whose decision on the issue would be equally final to that of a decision on the merits—as long as this delegation is "clear and unmistakable."<sup>340</sup> Thus, unless the Court was prepared to ignore or, in some way, "refine" its earlier *First Options* dicta, its decision in *Rent-A-Center* was virtually a foregone conclusion; the question of whether Jackson's agreement to arbitrate might be unconscionable and, therefore, invalid had been "clearly and unmistakably" delegated to the arbitrator.

What apparently surprised some,<sup>341</sup> including the dissenters,<sup>342</sup> was the majority's application of the doctrine of separability under these circumstances. However, if the parties' delegation of the question of jurisdiction

<sup>336</sup> See *Rent-A-Center v. Jackson*, 130 S. Ct. at 2782 (Stevens, J., dissenting).

<sup>337</sup> See Cross, *supra* note 15.

<sup>338</sup> *First Options of Chi., Inc. v. Kaplan*, 514 U.S. 938, 942-45 (1995); see also Barcelo, *supra* note 241, at 1133 (explaining the rebuttable presumption against the former and contrasting it with the presumption in favor of the arbitrator's power to determine the latter).

<sup>339</sup> *First Options*, 514 U.S. at 943 (1995).

<sup>340</sup> *Id.* at 944.

<sup>341</sup> See, e.g., Cross, *supra* note 15.

<sup>342</sup> See *Rent-A-Center v. Jackson*, 130 S. Ct. 2772, 2781-82 (Stevens, J., dissenting).

to the arbitrator is no different from their “delegation” of their dispute on the merits, then the majority’s approach seems quite logical. The “delegation provision” is separable from the arbitration agreement in exactly the same manner that the arbitration agreement is separable from the main contract, of which it often forms a part.<sup>343</sup> Moreover, this application of the doctrine of separability is fully consistent with its purpose, as explained above. Absent the doctrine of separability, the arbitrator would be empowered only to make a positive decision on jurisdiction pursuant to the “delegation” clause, because a negative decision would deprive the arbitral tribunal of its jurisdiction on the “delegation” question, thereby negating the preclusive effect of any decision.

The problem with the Court’s decision in *Rent-A-Center* does not lie in its application of separability in that case. Instead, the problem arises from the *First Options* dicta and the entire notion of contractual competence-competence, which the majority in *Rent-A-Center* simply applied as written.

As mentioned earlier, the arbitration agreement at issue in *Rent-A-Center* included a provision for expanded judicial review of any decision of the arbitrators.<sup>344</sup> However, this provision is almost certainly ineffective today based on the Court’s decision in *Hall Street*, strictly limiting judicial review to the very narrow grounds provided in FAA section 10.<sup>345</sup> Thus, if *Rent-A-Center* and *Hall Street* are read together, as written, they clarify that the arbitrator’s decision on jurisdiction will be final, subject only to review under section 10, which does not include any review of whether the parties concluded a valid arbitration agreement.<sup>346</sup> The arbitrator’s decision is, essentially, unreviewable—at any stage—under the Court’s interpretation of contractual competence-competence.<sup>347</sup>

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<sup>343</sup> *Id.* at 2777-79.

<sup>344</sup> *Id.* at 2781.

<sup>345</sup> See *Hall Street Assocs. v. Mattel, Inc.*, 552 U.S. 576 (2008).

<sup>346</sup> Of course, there would be no reason to provide for such review if section 4 provided for mandatory jurisdictional decisions by a court in the first instance. See *Horton*, *supra* note 128, at 4-6 (explaining the inherent inconsistency in the Court’s treatment of section 10 as mandatory and exclusive, while treating section 4 as a default rule subject to the parties’ contrary agreement).

<sup>347</sup> Admittedly, it is possible that “manifest disregard” has, in some form, survived *Hall Street*. See Nicholas R. Weiskopf & Matthew S. Mulqueen, *Hall Street, Judicial Review of Arbitral Awards, and Federal Preemption*, 29 REV. LITIG. 361, 367-71 (2010) (providing, perhaps, some basis for review of a particularly egregious jurisdictional decision). It is also possible that a court might resort to section 10(4), providing for review and setting aside of an award in which the arbitrators “exceeded their powers, or so imperfectly executed them . . . .” However, the use of this provision, like the “manifest disregard” standard is fraught with the potential to undermine the finality of awards on the merits of an arbitral dispute, because the Court has said that “delegation” of the jurisdictional question is governed by

Taken at face value, this result seems bizarre, though such a perspective is admittedly affected by one's own subjective lens. However, the result is objectively and quite clearly inconsistent with the standards for enforcement of international arbitration awards under the New York Convention. The Convention provides for recognition of arbitration agreements, unless a court finds "said agreement is null and void,"<sup>348</sup> and provides for enforcement of foreign arbitral awards, subject to an exception where a court finds the parties' "[arbitration] agreement is not valid."<sup>349</sup> As explained in Part II.A.3.a, the New York Convention applies to a variety of non-domestic agreements and awards and is also the legal instrument through which awards rendered in the U.S. are typically enforced abroad.<sup>350</sup> This inconsistency between FAA section 10 and the New York Convention creates a very real possibility that an award that is not subject to "vacation" under section 10 might nonetheless be unenforceable under the New York Convention. Such inconsistencies can easily be avoided by simply ensuring the statutory grounds for vacation of an award mirror those for non-enforcement, and also reflect those for judicial recognition of an arbitration agreement<sup>351</sup>—an approach taken in the vast majority of modern arbitration statutes, but largely ignored in the implementation of the New York and Panama conventions under the FAA.

The purpose of an arbitration agreement is to avoid court proceedings in resolving any dispute arising from the parties' commercial relationship. An arbitrator's decision on such issues is necessarily protected from subsequent scrutiny in order to give effect to the parties' bargain for an efficient and final resolution of their dispute—without going to court. However, these same principles are misplaced when the issue is whether the parties ever agreed in the first instance to arbitrate anything. In this latter case, a court must—at some point—have an opportunity to determine whether the parties in fact gave up their right to judicial process. The statutory doctrine of competence-competence provides for efficiency in allowing an arbitrator to make this determination, while also ensuring the availability of meaningful judicial review at some point in the process. The same cannot be accomplished

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exactly the same legal principles as an agreement to arbitrate the merits of the parties' contract dispute.

<sup>348</sup> New York Convention, *supra* note 6, at art. II(3).

<sup>349</sup> *Id.*, art. V(1)(a). These same issues would arise with enforcement of an award under the Panama Convention.

<sup>350</sup> See *supra* Part II.A.3.a.

<sup>351</sup> See *supra* note 198.

through the Supreme Court's efforts to create a contractual form of competence-competence—at least not as currently articulated.<sup>352</sup>

Any attempt to address competence-competence through arbitral rules is subject to the same deficiencies as an express agreement by the parties. Even if sufficient to constitute “clear and unmistakable” consent, the effect of such consent amounts to a final and absolute delegation of the issue, without meaningful judicial review. Nor can state law effectively provide for competence-competence, inasmuch as the issue is unequivocally one governed by “substantive federal arbitration law.”<sup>353</sup>

The doctrine of competence-competence is central to modern commercial arbitration and is arguably an absolute necessity for any modern statute. It cannot be effectively invoked by contract. Instead, an effective competence-competence regime must be a part of the statutory background,<sup>354</sup> invoked not by the terms of the parties' disputed arbitration agreement, but by the very existence of such a dispute brought to the attention of the arbitral tribunal. It must also be subject to meaningful judicial review, whatever the timing of such review. Many important arbitral doctrines can be invoked by either private rules or by the law governing the arbitration. However, competence-competence must come from the underlying legal regime. Neither party autonomy, nor private rules, nor state arbitration law can reasonably serve as a substitute.

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<sup>352</sup> To the author's knowledge, there is only a single historical example of such a purely contractual doctrine of competence-competence, which was also arguably absolute and unreviewable. This was the old view of “Kompetenz-Kompetenz” that developed for a period under German law, but has since been abandoned in favor of the more modern statutory approach. Gerold Zeiler & Katarina Hruskovicova, *The Principle of Kompetenz Kompetenz According to the UNCITRAL Model Law on International Commercial Arbitration*, in *The UNCITRAL Model Law on International Commercial Arbitration: 25 Years* 109, 109 (Assoc. for Int'l Arb., eds., 2010).

<sup>353</sup> *Rent-A-Center v. Jackson*, 130 S.Ct. 2772, 2781 n.4 (2010).

<sup>354</sup> See Barcelo, *supra* note 241, at 1136 (suggesting statutory reform of U.S. law as the most reasonable method for developing a robust and effective competence-competence doctrine in this country). While Professor Barcelo also notes that even statutory competence-competence involves a degree of “bootstrapping” or circularity, *id.* at 1132, this particular exercise in circularity is at least fully subject to later judicial review.

## CONCLUSION

The time has come to jettison the aged and arcane U.S. Federal Arbitration Act. It has fully served its original purpose of making arbitration agreements enforceable<sup>355</sup> and now serves only as a giant “black hole” into which the courts pour more and more decisions and into which parties to arbitration agreements—agreements expressly intended to avoid courts—pour more and more of their money. The only fully functional way to provide an effective set of default rules for arbitration agreements is to do so with a new, comprehensive, modern arbitration statute, and the most efficient way to do this is with a single statute governing all commercial arbitration—whether domestic or international—that fully comports with modern global standards.<sup>356</sup> This is not to suggest that Congress should simply adopt, in total, any particular model or national law, but simply that the time has come to draft a modern statute to govern arbitration in the United States, and we can learn much from those who have already considered and adopted such statutes.

In commenting on a series of conference presentations, Professor Carbonneau recently observed that the presentations on international commercial arbitration were generally less controversial and more cogent than those on domestic arbitration, which had focused on disparate party arbitration—the most controversial aspect of U.S. arbitration law.<sup>357</sup> He further noted that “arbitration in the transborder context has thus far escaped being mauled by the claws of politicalization [and] is vital to global commerce ....”<sup>358</sup> If we can somehow separate commercial, business-to-business arbitration—both domestic and international—from the political morass of disparate party arbitration,<sup>359</sup> then we should be able to find

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<sup>355</sup> In fact, some might even say it has served this purpose too well.

<sup>356</sup> For two examples of such a statute, one could look to the German Arbitration Act of 1998 (an almost complete adoption of the provisions of the UNCITRAL Model Law), or the English Arbitration Act of 1996 (a unique comprehensive statute). *See* sources cited *supra* note 20.

<sup>357</sup> Carbonneau, *supra* note 15, at 417-18.

<sup>358</sup> *Id.*

<sup>359</sup> *See* Stipanowich, *supra* note 15, at 57 (pointing out the significant contextual differences involved in legislation governing business-to-business arbitration, as compared to consumer and employee arbitration). The U.S. should follow the basic European approach and separately regulate consumer and individual employment arbitration, limiting each to *ex post* agreements to arbitrate. However, the purposes of this Article could be served by any means of separating the law governing commercial, business-to-business arbitration from that governing consumer and individual employee arbitration.

common ground in developing and adopting a modern federal arbitration statute to govern this dispute resolution mechanism so vital to U.S. commerce—both at home and abroad.