ARBITRATION AND THE CONSTITUTION

PETER B. RUTLEDGE

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Athens, GA

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INTRODUCTION

Arbitration and the Constitution? At first glance, these two bodies of law appear to be strange bedfellows.

Arbitration, one would think, essentially involves private conduct. In arbitration, private parties contractually exit the system of state-controlled dispute resolution in favor of a purely private system wherein they authorize a private decision maker to resolve their rights and obligations. Proceedings typically are confidential, and the parties agree in advance to be bound by the result reached by the decision maker. Under these circumstances, state institutions such as courts play little to no role. They may become involved at the front end of the dispute, when one of the parties challenges the enforceability of the agreement. Or they may become involved in the back end of the dispute, when the losing party does not voluntarily comply with the arbitrator's award. Even in these instances when state actors do become involved, they play only a limited role. In most civilized legal systems, courts presumptively enforce the parties' arbitration agreements subject to a narrow range of exceptions. Similarly, they presumptively enforce the arbitrators' awards, subject again to a narrow range of exceptions.

By contrast, systems of constitutional law generally regulate various forms of public conduct. Consider the U.S. Constitution, for example. That document governs three main types of relationships with public institutions. First, it addresses the horizontal distribution of power among branches of government (for example, the division between the president and the Senate of the power to make and

ratify treaties). Second, it sometimes covers the vertical distribution of power across levels of government (for example, Article III's limited grant of subject-matter jurisdiction to the U.S. courts. with the implication that state courts enjoy exclusive jurisdiction over other matters not enumerated therein). Third, the Constitution speaks to the relationship between the State and the individual (for example, the Fourth Amendment's bar on unreasonable searches and seizures serves as a restraint on the interaction between law enforcement officers and private citizens). Tellingly, what the Constitution does not regulate (subject to a few minor exceptions) is the relationship between purely private actors. Thus, for example, the Constitution does not dictate how two neighbors (or businesses) resolve the disputes that arise between them.

This intellectual separation between arbitration and the Constitution was not always the case. Consider the following examples

- The French Constitution of 1793 specified that "[t]he right of the citizens finally to resolve their disputes through arbitrators of their choice cannot in any respect be decreased by law."[1] By the time of the Napoleonic Code, however, arbitration fell into disfavor.[2]
- The Articles of Confederation provided for resolution of interstate disagreements by jointly appointed "five commissioners or judges." In the event of disagreement, parties employed a complex list system to strike names of unacceptable candidates.[3] By the time the Constitution was adopted, this idea had dropped out.
- At one time, the law of certain German principalities such as Bavaria and Prussia granted citizens a right to arbitrate and enforce their agreements. That changed when the National Socialists came to power in the 1930s. The Nazis curtailed the use of arbitration. According to the Guidelines of the Reich regarding arbitration tribunals, "from a state-political point of view a further spread of arbitration would shatter confidence in state jurisdiction and the State itself." One intellectual sympathetic to the Nazi cause declared

[1] French Constitution of Year 1, 1793 (Art. 86).

[2] *See* GARY B. BORN, INTERNATIONAL ARBITRATION 18 (2010).

[3] Articles of Confederation Art. IX (1781). *See also* JACKSON H. RALSTON, INTERNATIONAL ARBITRATION FROM ATHENS TO LOCARNO 190 (1929).

> "that the national-socialist state rejects – contrary to the liberalists' view – arbitral tribunals" altogether.[4]

The relationship between arbitration law and constitutional law therefore raises many puzzles. Some are historical, such as trying to explain the rising and falling popularity of arbitration within and across societies (some historical research dates its earliest use back 2550 B.C.[5]). Others are jurisprudential, as we try to unpack how legal systems navigate the relationships between these two seemingly disparate fields. This book focuses on that latter set of puzzles.

At the advent of the twentieth century, these two regimes – arbitration and constitutional law – indeed would have been strange bedfellows. They comfortably occupied separate spheres. Constitutional law did not influence the design of arbitration systems, and arbitration cases had little influence on the development of constitutional law.

Several forces contributed to the "wall" separating the two fields. For much of the nineteenth century, the division was traceable to courts' refusal to enforce pre-dispute arbitration agreements at all, viewing them as illegal contracts that sought to divest courts of jurisdiction.[6] Even as countries began to soften their resistance to arbitration as an effective form of dispute resolution (an acceptance symbolized through treaties such as the Geneva Convention of 1927[7] and statutory enactments such as the Federal Arbitration Act of 1925[8]), the non-arbitrability doctrine helped to ensure that arbitration would occupy only a relatively narrow field, largely limited to private commercial disputes between businesspersons. Finally, although arbitration between states enjoyed a relatively rich historical tradition, arbitration between private companies (or individual investors) and those states had not.[9] Consequently, arbitration did not implicate any serious constitutional values.

[4] *See* Gary B. Born, *Arbitration and the Freedom to Associate*, 38 GA. J. COMP. & INT'L L. 7, 19–20 (2009).

[5] *See* Gabriel Wilner, Domke on Commercial Arbitration §2:01 (3d ed. 2006).

[6] *See, e.g.*, Kill v. Hollister, 95 Eng. Rep. 532 (K.B. 1746); Judgment of 10 July 1843 (*L'Alliance v. Prunier*), 1843 Dalloz 561 (Cour de Cassation civ.).

[7] *See* Convention on the Execution of Foreign Arbitral Awards (1927), 92 L.N.T.S. 302 (1929–1930).

[8] 9 U.S.C. § 1 *et seq.*

[9] *See* GARY B. BORN, INTERNATIONAL ARBITRATION 2–6 (2010).

Beginning in the second half of the twentieth century, a number of forces began to put pressure on the wall that had historically separated arbitration law from constitutional law. One development was the demise of the non-arbitrability doctrine. This spawned a proliferation of arbitrations in areas of "public laws" traditionally reserved to the courts (such as securities, employment, and antitrust disputes) and triggered calls for ensuring that arbitration embody fundamental principles of due process.[10] It also raised new questions under Article III about the constitutional limits on resolution of federal questions outside federal court.

A second development was the expansion of arbitration in fields such as trade and investment law.[11] The use of arbitration in these areas, coupled with extremely limited opportunity for judicial or other review of the arbitrator's action, raised concerns about whether the U.S. government is delegating too much power to democratically unaccountable actors. These developments also raised concerns about whether private arbitral tribunals, not accountable to the U.S. president, could compel the executive branch to take some sort of action. As a result of these and other forces, constitutional principles began to seep into arbitration law.

A third development was the increasing popularity of arbitration as a mechanism for resolving disputes between companies and individuals (such as employer/employee relationships, company/consumer relationships, and broker/investor relationships).[12] Critics of arbitration attacked these inroads by arbitration and, among other things, decried the apparent lack of procedural protections for the individual in these settings. This led to attempts to import principles of "due process" into arbitration – initially through litigation attempting to impose the requirements of procedural due process onto arbitration, and later (after these efforts largely failed), the development of private "due process protocols."

[10] *See, e.g.*, Scherck v. Alberto-Culver Co., 417 U.S. 506 (1974); Mitsubishi Motors Corp. v. Soler, 473 U.S. 614 (1985).

[11] *See, e.g*, CAMPBELL MCLACHLAN ET AL., INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES (2007).

[12] *See* I GARY B. BORN, INTERNATIONAL COMMERCIAL ARBITRATION 781–85 (2009).

Each of these foregoing developments produced fissures in the wall that traditionally separated arbitration law from constitutional law. Consequently, today, arbitration and constitutional law are no longer the strange bedfellows that they once were.

This cross-fertilization of arbitration and constitutional law is an organic, ongoing process that affects how a growing share of disputes in our society are resolved. Despite its importance, however, the relationship between these two disciplines suffers from a complete lack of rigorous theoretical examination. The purpose of this book, then, is to fill that gap.

Its objective, therefore, is twofold. First, as a positive matter, the book aims to chart systematically the breakdown of the wall separating these two disciplines and the alloying of their various principles. Second, as a normative matter, the book also (at times) critiques these developments. Sometimes, those critiques concern the substance of the alloying, where the constitutional norm is undesirable. Other times, those critiques concern the process whereby that alloying occurs (where, for example, a norm is developed through a private rather than public process or through a judicial rather than a legislative one).

Put simply, my thesis is as follows: Over the past half century, constitutional norms increasingly have worked their way into arbitration law and, to a lesser extent, arbitration law has influenced the development of constitutional norms. Tellingly, this seepage between the two disciplines has not occurred with a great deal of systematic thought or deliberation. Instead, it has tended to take place through incremental developments in various fields of arbitration, often occurring in isolation of each other and with little consideration of the broader implications of the growing interconnectivity of these two disciplines.

Rarely has this seepage taken the form of express "constitutionalization" of arbitration; with very rare exception, courts have not expressly subjected arbitral regimes to the constitutional norms governing state-run organs of dispute resolution such as judiciaries or administrative agencies. In other words, the wall between arbitration and constitution remains, although significant porous cracks have formed. The resulting seepage takes various forms. In some cases, constitutional norms have affected arbitration law through the design of treaties or statutes by the

executive and legislative branches. In other cases, constitutional norms have affected arbitration law through judicial interpretation of those treaties or statutes. Finally, and perhaps most interestingly, constitutional norms have affected arbitration law through the development of private norms, whether by arbitral institutions or the parties themselves; those norms are then incorporated by the parties into their arbitration agreements and, like any other provision of contract, shape the course of the dispute.

Before we turn to the chapters that elaborate on this thesis, a few preliminary matters are in order. First, it is necessary to articulate a more formal definition of "arbitration," as that term has many meanings depending on the context. Second, it is important to describe the methodology animating the study. Third and finally, this introduction offers a road map to the remaining chapters.

DEFINING ARBITRATION

Although scholars may quibble around the edges, there is a broad consensus about the defining features of arbitration. A classic definition posits that arbitration – at least private commercial arbitration – is the private, voluntary agreement to have a dispute resolved by a private actor whose decision is presumptively binding on the parties.[13] This definition includes certain arbitrations within self-regulated organizations ("SROs") such as the National Association of Securities Dealers ("NASD") and the New York Stock Exchange ("NYSE"). It excludes, however, certain types of court-ordered arbitration for parties who have not previously consented to the procedure.

A classic example would be a sales contract between two private parties providing, in relevant part, that any disputes related to the contract shall be resolved exclusively by a single arbitrator in New York pursuant to the rules of the American Arbitration Association and subject to New York law. To be sure, arbitration clauses do not *need* to contain all of these elements. Sometimes the clause may not specify

[13] *See* BORN, *supra* note 11, at 1–7; CHRISTOPHER R. DRAHOZAL, COMMERCIAL ARBITRATION 14–27 (2d ed. 2006).

the arbitral forum or the applicable law. In other cases, the arbitral clause may not specify the applicable rules (preferring instead ad hoc arbitration), or the number of arbitrators (leaving the matter to the parties or, otherwise, an appointing authority). In all events, though, the parties have opted to have their dispute resolved extrajudicially (in contrast to a forum selection clause) and to be bound by the outcome before they know the terms of the results (in contrast to mediation).[14]

Arbitration takes other forms beyond the private commercial setting. These variations are important because they often become the medium through which one or more constitutional norms first seeps into arbitration law. The simplest variation is a private arbitration between parties of unequal bargaining power such as employment contracts or consumer contracts. That form of arbitration involves all the hallmarks of private commercial arbitration but may raise distinct public policy concerns. These concerns prompt some countries to treat these arrangements as per se non-arbitrable (at least on a pre-dispute basis), whereas others allow them. This toleration of such private arrangements is the sort of doctrine that puts pressure on the wall separating arbitral law from constitutional law and creates the conditions for seepage of due process norms into arbitration.

Investment arbitration presents another variation. Unlike private commercial arbitration, the parties in an investment arbitration often are not in direct contractual privity (instead, the right to arbitrate arises by virtue of a treaty between the investor's state and the capital-importing state);[15] moreover, awards under investment arbitration often are subject to less judicial oversight than private commercial awards. As with consumer and employment arbitration, these variations put pressure on the wall separating arbitration law from constitutional law and stimulate the seepage of constitutional norms (such as transparency protocols) into arbitration law.

Finally, there is a long tradition of State–State arbitration as well. Such arbitrations, such as those that occurred between Ethiopia and

[14] *See* GARY B. BORN, INTERNATIONAL ARBITRATION AND FORUM SELECTION AGREEMENTS: DRAFTING AND ENFORCING (3d ed. 2010).

[15] According to one report, over 2500 such treaties are presently in force. *See* UNCTAD, I. Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking.

Eritrea, enjoy a long history as a mode of resolving disputes such as boundary or compensation claims between States. Like commercial arbitration, they typically involve a consensual act (the States' willingness to consent to the arbitration), but, unlike private arbitration, the results are not ordinarily enforced through national courts. Although perhaps one of the most historically significant forms, State-to-State arbitration has not been as fertile a source for the incorporation of constitutional norms into arbitration. That historical puzzle, however, lies beyond the scope of this book.

Although this book focuses primarily on commercial arbitration, an understanding of these other forms is important. This is because those forms often become the mediums through which constitutional principles first filter into the arbitration jurisprudence. Once nested into the particular branch of arbitration such as investor/state arbitration, they can eventually spread, like water, into other crevices such as commercial arbitration.

A NOTE ON METHODOLOGY

At a certain level of generality, the themes of this book are universal. As the anecdotes introduced earlier illustrate, they apply across historical eras and across cultures. The only ingredients necessary to examine them are a State organized around a system of constitutional principles and some room for private orderings of dispute resolution, which then rely upon the power of the State for their enforcement.

Consequently, there is a certain temptation to make this book a truly comparative undertaking. I have opted not to do so for a couple of reasons. For one thing, I recognize that the art of comparative constitutional jurisprudence requires a degree of linguistic expertise that simply lies beyond my ken. Merely relying on available translations of foreign law sources would paint a picture that is at best inadequate and at worst affirmatively misleading. For another thing, that undertaking would distract from my purpose – which is to focus on the act of cross-fertilization between the two disciplines rather than a comparison of how the cross-fertilization occurs (or does not) across countries. Thus, my focus is primarily on U.S. law, the system I know best.

At the same time, foreign law is not entirely irrelevant to the undertaking. One of the joys of this project has been the opportunity to explore the ideas at a theoretical level with colleagues from a variety of other countries such as Italy, Norway, Austria, Canada, and the United Kingdom, just to name a few. Those interactions have enlightened me to instances in which other legal systems have confronted similar issues, lessons that can serve both to illustrate the phenomenon and that enrich our understanding of how American courts ventilate these themes. Thus, I quite explicitly introduce such foreign examples along the way where they help to elucidate a point or deepen the reader's understanding. A broader comparative undertaking is possible and may be the subject of a future work. But now is not the time.

ROAD MAP

What remains, then, is to provide a road map to the reader about the book. The project unfolds in three parts, organized around major areas of constitutional law. The first part focuses on separation-of-powers issues. Drawing on ideas that I developed in a prior article published by the *Vanderbilt Law Review*, Chapter 1 considers the basic question raised but ultimately unresolved by the Supreme Court – namely, are there structural limits on Congress's ability to require judicial enforcement of an arbitrator's award absent de novo review of the award? This question has taken on newfound importance in light of trade and investment treaty regimes that provide for extremely circumscribed judicial review of arbitral awards (such as NAFTA and the Washington Convention). Chapter 2 then considers separation-of-powers issues raised by more specialized forms of arbitration, such as the compatibility of the arbitral appointment provisions of trade treaties with the Constitution's Appointments Clause, and the compatibility of the implementation provisions of NAFTA with the Take Care Clause, both of which were heavily litigated (but ultimately unresolved) in the *Canadian Softwood Lumber* case in the D.C. Circuit.

The second part focuses on vertical separation-of-powers principles, an important but underappreciated aspect of U.S. arbitration law. Chapter 3 will begin with the odd approach to federalism taken by the

FAA. On the one hand, the FAA tramples on state rights: Section 2 – which requires courts to enforce arbitration agreements "save upon such laws as exist at law or in equity for the revocation of any contract" – preempts inconsistent state law that discriminates against arbitration. Moreover, the Supreme Court has made clear that Section 2 applies in state court. Yet in other respects, the FAA provides states an outlet to regulate arbitration agreements. Unlike most cases of preemption, states can reassert the legislative prerogative. Because general state contract law, rather than federal law, ordinarily supplies the standard under Section 2 of the FAA for determining the enforceability of Section 2, states can employ – and have employed – contract law doctrines (such as unconscionability and public policy) in an effort to reassert control over arbitral agreements. This sets the United States apart from most nonfederalized countries, which employ a single national standard on the issue. Moreover, because state contract law (rather than statutory enactments) provides the relevant metric under Section 2, the effect of this jurisprudence has been to allocate power to state courts – as opposed to state legislatures – to police the enforceability of arbitration clauses. Chapter 4 considers the complexity presented by choice-of-law clauses. Under a line of Supreme Court jurisprudence that has been highly criticized but technically remains good law, parties can subject their arbitration clauses to state law, thereby incorporating features of that state's arbitration law, which differ from the federal practice. The availability of these choice-of-law devices has the potential to create a type of "market" for arbitration law.

The third part focuses on the relationship between arbitration and individual liberties. The explosion in arbitrations between companies and individuals (whether consumers or employees) has drawn attention to this topic. Suddenly, one can no longer assume that arbitration agreements represent contracts between parties of equal bargaining positions. Instead, they now might reflect contracts of adhesion, or arrangements where one party to the contract had not given his or her informed consent to the agreement. Chapter 5 begins by testing whether arbitration should properly be considered "state action," invoking the old *Shelley v. Kramer* line of cases under which judicial enforcement of a private agreement can satisfy the Fourteenth Amendment's state-action requirement. It then addresses how the ultimate