Why Do Businesses Use (or Not Use) Arbitration Clauses?

CHRISTOPHER R. DRAHOZAL* AND STEPHEN J. WARE**

INTRODUCTION

Arbitration and litigation provide legally binding resolution of disputes without the need for a post-dispute agreement between the parties. Indeed, for parties that do not yet, and may never, have a dispute, the only two choices for binding dispute resolution are arbitration and litigation.[1] As such, arbitration and litigation are substitutes for each other. Providers of arbitration services—individual arbitrators and administering institutions like the American Arbitration Association—compete with providers of litigation services—courts established by state governments and the federal government—as if they are selling competing products on a store shelf.[2]

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* John M. Rounds Professor of Law, University of Kansas School of Law.

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[1] STEPHEN J. WARE, ALTERNATIVE DISPUTE RESOLUTION §§ 1.5–1.7 (2d ed. 2007). A possible rare exception is that some states may enforce pre-dispute agreements for "private judging," which is somewhat different from arbitration. *See id.* at § 2.54.

[2] *E.g.*, William M. Landes & Richard A. Posner, *Adjudication as a Private Good*, 8 J. LEGAL STUD. 235, 255 (1979). The market for binding dispute resolution services, however, differs from the market for the sorts of goods that might be available at the corner grocery. First, the choice of which product to buy at a store often belongs to one individual, while the choice between arbitration and litigation belongs to the parties jointly. If the parties agree on which product (arbitration or litigation) to buy, then they get the product they jointly choose. But, if they disagree on which product to buy, then they get litigation, by default, as a result of the legal rule that a party which has not agreed to arbitrate retains the right to litigate should a dispute arise. *See id.* Second, the incentives of the respective service providers—i.e., arbitrators and judges—differ:

> Robert Cooter points out that "private judges have to attract business, so they are exposed to the same market pressures as anyone who sells a service." Because of this economic incentive, Cooter argues, "income-maximizing private judges make decisions which are Pareto efficient with respect to the litigants (pair-wise efficient)." Trial court judges have no similar incentive. Their pay is the same regardless of how they decide cases.

Christopher R. Drahozal, *Judicial Incentives and the Appeals Process*, 51 SMU L. REV.

Recent scholarship contends that arbitration is failing in its attempts to compete with litigation in attracting customers at the metaphorical binding-dispute-resolution store. According to Dammann and Hansmann, for example, "[i]n practice, arbitration does not seem to compete strongly with well-functioning public courts."[3] Likewise, William J. Woodward Jr. states that "given their choice, most businesses that negotiate contracts would prefer a judicial dispute resolution system over arbitration."[4] When arbitration does succeed in attracting customers, such as with businesses that include arbitration clauses in their consumer contracts, commentators assert that it does so illegitimately, such as by enabling businesses to evade class actions and other forms of aggregate relief.[5]

Both of these positions have found support in a pair of recent empirical studies co-authored by Professors Theodore Eisenberg and Geoffrey Miller (with one of the studies co-authored by Professor Emily Sherwin as well). The first study examined the use of arbitration clauses in a sample of material contracts (such as loan commitments and merger agreements) filed with the SEC. Eisenberg and Miller found a "surprisingly low frequency of arbitration clauses" in the contracts they studied.[6] They concluded: "[L]ittle evidence was found to support the proposition that these [sophisticated] parties routinely regard arbitration clauses as efficient or otherwise desirable contract terms."[7] Instead, they "interpret [their] findings as evidence that sophisticated actors prefer litigation to arbitration, encounter obstacles to negotiating mutually satisfactory contract terms that include arbitration clauses, or some combination of these factors."[8]

The second study (by Professors Eisenberg, Miller, and Sherwin (hereinafter Eisenberg et al.)) compared the use of arbitration clauses in

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469, 502 (1998).

[3] Jens C. Dammann & Henry B. Hansmann, *Globalizing Commercial Litigation*, 94 CORNELL L. REV. 1, 31 (2008).

[4] William J. Woodward Jr., *Saving the Hague Choice of Court Convention*, 29 U. PA. J. INT'L L. 657, 669 (2008).

[5] *See* Myriam Gilles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373, 375 (2005); Jean R. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 WM. & MARY L. REV. 1, 8–9 (2000); Jean R. Sternlight & Elizabeth J. Jensen, *Using Arbitration to Eliminate Consumer Class Actions: Efficient Business Practice or Unconscionable Abuse?*, 67 LAW & CONTEMP. PROBS. 75, 103 (2004).

[6] Theodore Eisenberg & Geoffrey Miller, *The Flight from Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in the Contracts of Publicly Held Companies*, 56 DEPAUL L. REV. 335, 335 (2007).

[7] *Id.*

[8] *Id.* at 336.

material corporate contracts of telecommunications and financial services companies to the same companies' use of arbitration clauses (and class arbitration waivers) in consumer contracts.[9] Consistent with the first study, Eisenberg et al. found little use of arbitration clauses in the material contracts. By comparison, a sizable percentage of the consumer contracts included an arbitration clause, and all of the consumer contracts with arbitration clauses also included a class arbitration waiver—a provision waiving the availability of class relief in arbitration.[10] This divergence prompted Eisenberg et al. to conclude that "consumer arbitration clauses are used as a means for avoiding aggregate dispute resolution."[11] "[A]part from the role of arbitration clauses in shoring up the validity of class action waivers," they say, "it is not clear why consumer arbitration would appeal to companies."[12]

In this paper, we revisit the Eisenberg and Miller (and Sherwin) studies. The studies provide a fascinating and valuable look into the use of arbitration clauses in the types of contracts they studied. However, as we show in detail later in this paper, the types of contracts they studied are not representative of either business or consumer contracts as a whole. Indeed, the business contracts they studied are predominantly types unlikely to include arbitration clauses, while the consumer contracts they studied are among those most likely to include arbitration clauses and class arbitration waivers. As a result, their findings should be construed narrowly, as limited to the types of contracts studied and not as applicable to either business or consumer contracts generally.

After summarizing these studies in more detail in Part I, we suggest in Part II grounds for caution in drawing inferences about the efficiency of arbitration from data on the use of arbitration clauses by sophisticated parties. Because the litigation process receives government subsidies, sophisticated parties can be expected to agree to arbitrate only when arbitration has a large cost (or other) advantage over litigation, sufficient to overcome the government subsidy to litigation. Accordingly, the fact that a contract does not include an arbitration clause does not indicate that litigation

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[9] Theodore Eisenberg, Geoffrey P. Miller & Emily Sherwin, *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J.L. REFORM 871, 881–82 (2008) [hereinafter Eisenberg et al., *Summer Soldiers*]; *see also* Theodore Eisenberg, Geoffrey P. Miller & Emily Sherwin, *Mandatory Arbitration for Customers but Not for Peers: A Study of Arbitration Clauses in Consumer and Non-Consumer Contracts*, 92 JUDICATURE 118 (2008).

[10] Eisenberg et al., *Summer Soldiers*, *supra* note 9, at 884–85.

[11] *Id.* at 893.

[12] *Id.* at 894.

is more efficient than arbitration, but only that parties prefer a subsidized dispute resolution process to an unsubsidized one.

In Part III, we examine why parties might include arbitration clauses in their contracts and, more importantly for present purposes, why they might not. Eisenberg and Miller review the arbitration literature and conclude that "the bulk of authority seems to agree that arbitration is a more efficient dispute resolution procedure than litigation. This generates the hypothesis that, in a data set of contracts freely agreed to by sophisticated parties, we will almost always observe arbitration clauses being used."[13] By contrast, we do not see the arbitration literature as so one-sided. In fact, that literature identifies several types of disputes for which parties might well prefer litigation to arbitration: high stakes ("bet-the-company") disputes, in which the parties may fear an aberrational arbitration award subject only to limited judicial review; disputes in which the parties anticipate needing emergency relief, which arbitration is ill-suited to provide; and disputes in areas with clear and well developed law and contract terms, because the industry expertise of arbitrators is of less value and the limited judicial review in arbitration more problematic.[14]

These considerations suggest that the contracts studied by Eisenberg and Miller are not "a reasonable sample of what sophisticated parties specify ex ante regarding arbitration."[15] Regulations defining what contracts must be filed along with SEC filings effectively limit the Eisenberg and Miller sample to material contracts made out of the ordinary course of business, while excluding those made by the company in the ordinary course of its business—i.e., in its day-to-day operations. In other words, the sample is limited to unusual contracts unlikely to include arbitration clauses while excluding more typical contracts that are more likely to provide for arbitration. For example, commentators have long recognized that commercial loan agreements—an important element of Eisenberg and Miller's sample—only rarely include arbitration clauses because of well developed law and contract terms applicable to such agreements. Likewise, corporate merger agreements, another type of contract studied by Eisenberg and Miller, are likely to give rise to "bet-the-company" disputes and involve requests for emergency relief, so that one would not expect merger agreements typically to include arbitration clauses. Conversely, the sample does not include those types of contracts commonly cited as likely to include arbitration clauses, such as construction contracts, contracts for the sale of

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[13] Eisenberg & Miller, *supra* note 6, at 340–41.

[14] *See infra* text accompanying notes 86–102.

[15] Eisenberg & Miller, *supra* note 6, at 349.

goods, and joint venture agreements. Thus, Eisenberg and Miller's results seem to turn to a substantial degree on the categories of contracts they studied, rather than any general preference for litigation over arbitration.

Finally, in Part IV, we explain why Eisenberg et al.'s findings regarding consumer arbitration clauses are also based on an unrepresentative sample. They only studied consumer contracts from two industries—financial services and telecommunications—both well known for using arbitration clauses and class arbitration waivers in their consumer contracts. Indeed, the available empirical evidence suggests that companies from other industries include arbitration clauses in their consumer contracts but often do not use class arbitration waivers. Such evidence contradicts the notion that the only reason for businesses to use arbitration clauses in consumer contracts is to avoid class relief. Thus, Eisenberg et al.'s data confirm and strengthen the received wisdom that some businesses' use of consumer arbitration clauses is motivated, at least in part, by a desire to reduce their exposure to class actions. However, we caution against expanding that conclusion to businesses in industries they did not study, and we believe Eisenberg et al. are too quick to dismiss non-class reasons why other businesses use consumer arbitration clauses.

I. EMPIRICAL STUDIES ON THE USE OF PRE-DISPUTE ARBITRATION CLAUSES

A number of researchers have studied the frequency with which parties include arbitration clauses in their contracts. Most of these empirical studies have focused on particular types of contracts. There have been studies of the incidence of arbitration clauses in employment contracts (both with corporate executives[16] and rank-and-file employees[17]), franchise agreements,[18]

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[16] Stewart J. Schwab & Randall S. Thomas, *An Empirical Analysis of CEO Employment Contracts: What Do Top Executives Bargain For?*, 63 WASH. & LEE L. REV. 231, 234 (2006); Randall Thomas, Erin O'Hara & Kenneth Martin, *When Do CEOs Bargain for Arbitration?: A Theoretical and Empirical Analysis* 20 (Vanderbilt Univ. Law Sch. Law & Econ., Working Paper No. 08-23, 2008), *available at* http://ssrn.com/abstract=1247843.

[17] U.S. GEN. ACCOUNTING OFFICE, EMPLOYMENT DISCRIMINATION: MOST PRIVATE-SECTOR EMPLOYERS USE ALTERNATIVE DISPUTE RESOLUTION 21 (1995); Alexander J.S. Colvin, *From Supreme Court to Shopfloor: Mandatory Arbitration and the Reconfiguration of Workplace Dispute Resolution*, 13 CORNELL J.L. & PUB. POL'Y 581, 585 (2004).

[18] Christopher R. Drahozal, *"Unfair" Arbitration Clauses*, 2001 U. ILL. L. REV. 695, 727; Christopher R. Drahozal & Keith N. Hylton, *The Economics of Litigation and Arbitration: An Application to Franchise Contracts*, 32 J. LEGAL STUD. 549, 575 (2003);

consumer contracts,[19] healthcare contracts, [20] software license agreements,[21] and international joint venture agreements.[22] Many of the studies also looked at provisions included in arbitration clauses, such as whether the clause restricts the availability of class relief in arbitration.[23]

In contrast to these single-type-of-contract studies, Professors Theodore Eisenberg, Geoffrey Miller, and Emily Sherwin studied the use of arbitration clauses in several different types of contracts. The first study, by Eisenberg and Miller, examined the use of arbitration clauses in "material" contracts filed by corporations with SEC filings. The other, by Eisenberg, Miller, and Sherwin, compared the use of arbitration clauses in material contracts with the use of arbitration clauses in consumer contracts drafted by the same companies. This Part describes each of those studies in detail and highlights the conclusions drawn by the authors from their studies.

A. *Eisenberg and Miller (2007)*

Eisenberg and Miller's first study "examined over 2800 contracts, filed with the Securities Exchange Commission (SEC) in 2002 by public firms, for the presence of contract terms requiring arbitration."[24] As Professors Eisenberg and Miller explained:

> The data consist of thirteen categories of contracts contained as exhibits to Form 8-K, "current report" filings with the SEC. A form 8-K must be filed by SEC-reporting firms to disclose certain material corporate events that have not previously been reported by the company. We searched the

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Christopher R. Drahozal & Quentin R. Wittrock, *Is There a Flight from Arbitration?*, 37 HOFSTRA L. REV. 71, 90–114 (2008).

[19] Linda J. Demaine & Deborah R. Hensler, *"Volunteering" to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience*, 67 LAW & CONTEMP. PROBS. 55, 63–64 (2004).

[20] Elizabeth Rolph, Erik Moller & John E. Rolph, *Arbitration Agreements in Health Care: Myths and Reality*, 60 LAW & CONTEMP. PROBS. 153, 171 (1997).

[21] Florencia Marotta-Wurgler, *"Unfair" Dispute Resolution Clauses: Much Ado About Nothing?*, *in* BOILERPLATE: THE FOUNDATION OF MARKET CONTRACTS 45, 52 (Omri Ben-Shahar ed., 2007).

[22] CHRISTOPHER R. DRAHOZAL & RICHARD W. NAIMARK, TOWARDS A SCIENCE OF INTERNATIONAL ARBITRATION: COLLECTED EMPIRICAL STUDIES 59–61 (2005).

[23] Demaine & Hensler, *supra* note 19, at 65; Drahozal, *supra* note 18, at 731–32; Drahozal & Wittrock, *supra* note 18, at 106–09; Marotta-Wurgler, *supra* note 21, at 51.

[24] Eisenberg & Miller, *supra* note 6, at 335.

> Form 8-K filings and coded information about any contract that fit into [these] categories. The resulting sample consisted of 2858 contracts.[25]

Their thirteen categories of contracts, not surprisingly given the source, were heavy on merger agreements, commercial lending contracts, and related corporate agreements. The sample also included executive employment contracts and licensing agreements, although a much smaller number of each.[26]

Eisenberg and Miller found what they characterize as a "surprisingly low frequency of arbitration clauses" in the contracts studied.[27] Overall, only 10.6% of the contracts in the sample included arbitration clauses. The percentage of international contracts with arbitration clauses (20.2%) was more than double the percentage of domestic contracts with arbitration clauses (9.6%),[28] but still well below the much higher percentage sometimes asserted in the international arbitration literature.[29]

The use of arbitration clauses varied across the types of contracts in their sample. Table 1 shows the number and percentage of contracts containing an arbitration clause, listed by type of contract.[30] Of the five most common types of contracts (securities purchase, merger, asset sale/purchase, credit

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[25] *Id.* at 348.

[26] *Id.* at 349. Although Eisenberg and Miller's Table 1 shows the number of contracts classified as "other" as 362, their Tables 2 and 4 show the number as 462. The latter figure presumably is the correct one as it makes the total sum to 2,858. *Id.* at 349, 351.

[27] *Id.* at 335.

[28] *Id.* at 351.

[29] *E.g.*, KLAUS PETER BERGER, INTERNATIONAL ECONOMIC ARBITRATION 8 & n.62 (1993) ("About ninety percent of international economic contracts contain an arbitration clause.") (citing ALBERT JAN VAN DEN BERG, ARBITRAGERECHT 134 (1988)). Gary Born addresses such estimates as follows:

> This [90%] figure lacks empirical support and is almost certainly substantially inflated: in reality, significant numbers of international commercial transactions—certainly much more than 10% of all contracts—contain either forum selection clauses or no dispute resolution provision at all. It is probably true that, in negotiated commercial (not financial) transactions, where parties devote attention to the issue of dispute resolution, and where the parties possess comparable bargaining power, arbitration clauses are more likely than not to be encountered. This remains a highly impressive endorsement of arbitration, and permits one to fairly say that international arbitration is the preferred means for contractual dispute resolution, but more ambitious statistical claims are unsustainable.

GARY B. BORN, INTERNATIONAL COMMERCIAL ARBITRATION 71 (2009).

[30] Eisenberg & Miller, *supra* note 6, at 351.

commitments, and underwriting), all included arbitration clauses less than 20% of the time.[31] Roughly 19% of merger agreements (18.98%) and asset sale/purchase agreements (19.43%) included arbitration clauses; 16.67% of securities purchases agreements included an arbitration clause, while just over 2% (2.31%) of credit commitments and well under 1% (0.28%) of underwriting agreements included arbitration clauses. By comparison, one-third or more of employment contracts (36.94%) and licensing agreements (33.33%) included arbitration clauses. But the higher percentages of arbitration clauses in these types of contracts had little effect on the overall percentage because the number of contracts in the sample was much smaller.

The conclusions Eisenberg and Miller draw from the study raise questions about the value of arbitration.[32] Based on their data, Eisenberg and Miller concluded that that "[l]ittle evidence was found to support the proposition that these [sophisticated] parties routinely regard arbitration clauses as efficient or otherwise desirable contract terms."[33] Instead, they "interpret [their] findings as evidence that sophisticated actors prefer litigation to arbitration, encounter obstacles to negotiating mutually satisfactory contract terms that include arbitration clauses, or some

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[31] For merger agreements, we wonder how Eisenberg and Miller classified provisions that use arbitration only to resolve certain valuation disputes, such as disputes over the amount of "earnouts." *See, e.g.*, Agreement and Plan of Merger By and Among Quality Systems, Inc., Nextgen Healthcare Information Systems, Inc., Ruth Merger Sub, Inc., and Practice Management Partners, Inc. ¶ 1.7(f)(iii) (Oct. 15, 2008) ("If, at the end of the second 30-day period referenced in subsection (ii) above, Parent and the Stockholder Representatives have not resolved all disagreements submitted to the Accountants for mediation with respect to whether the calculation of the Earnout Payment is in accordance with the terms of Section 1.7 of this Agreement, any such remaining disagreement, regardless of the legal theory upon which it is based, will be settled by final, binding arbitration pursuant to the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, in accordance with the applicable rules of the American Arbitration Association ("AAA") in effect at such time, which will be the sole and exclusive procedures for any such disagreement.").

If Eisenberg and Miller classified contracts including such narrow clauses as those providing for arbitration, the use of arbitration to resolve merger disputes is even less than their data suggest. Conversely, if they did not count such narrow clauses, the number of merger agreements with arbitration provisions, albeit narrow ones, is greater than they report.

[32] Although the title of Eisenberg and Miller's article is "The Flight from Arbitration," we question that title. Because their data show a snapshot at one point in time—"the contracts we study exist in a small slice of time"—rather than a change in the use of arbitration over time, they do not show a "flight" from arbitration. Eisenberg & Miller, *supra* note 6, at 367; *see* Drahozal & Wittrock, *supra* note 18, at 73 n.12.

[33] Eisenberg & Miller, *supra* note 6, at 335.

combination of these factors."[34] Whether Eisenberg and Miller intended their conclusions to reach so broadly is uncertain, but clearly others are interpreting their findings as showing a widespread rejection of arbitration by sophisticated parties.[35]

Table 1. Arbitration Clause Usage in Material Corporate Contracts—by Contract Type

Contract Type	No Arbitration Clause	Arbitration Clause	Total
Mergers	333 81.02%	78 18.98%	411
Bond indentures	154 99.35%	1 0.65%	155
Settlements	60 83.33%	12 16.67%	72
Securities purchase	406 88.26%	54 11.74%	460
Employment contracts	70 63.06%	41 36.94%	111
Licensing	32 66.67%	16 33.33%	48
Asset sale/purchase	253 80.57%	61 19.43%	314
Credit commitments	211 97.69%	5 2.31%	216
Underwriting	350 99.72%	1 0.28%	351
Pooling & servicing	173 100.00%	0 0.00%	173
Security agreements	35 94.59%	2 5.41%	37
Trust agreements	48 100.00%	0 0.00%	48
Other	429 92.86%	33 7.14%	462
Total	2554 89.36%	304 10.64%	2858

[34] *Id.* at 336.

[35] *See supra* text accompanying notes 3–4.

At the conclusion of the study, Eisenberg and Miller suggested that their findings also might be relevant for the ongoing debate over the use of arbitration clauses in consumer contracts:

> Our core arbitration clause finding contrasts with the reportedly widespread use of mandatory arbitration clauses in certain consumer contracts. Business interests defend consumer arbitration as a "less-expensive, more efficient alternative to a court dispute resolution." Some suggest that arbitration clauses in consumer contracts may be used for some other purpose, such as a mechanism to avoid dispute resolution by foreclosing class actions, or to gain an advantage in dispute resolution over parties who cannot realistically negotiate. Our study suggests the value of further inquiry into the advantages and disadvantages of using binding arbitration in standardized consumer contracts.[36]

Following their own suggestion, Eisenberg and Miller soon engaged in that "further inquiry."

B. *Eisenberg, Miller, and Sherwin (2008)*

In the second study, Eisenberg et al. examined the use of arbitration clauses in material contracts filed with the SEC and consumer form contracts drafted by the same companies. According to Eisenberg et al., "[s]tudying a firm's pattern of arbitration clause use provides information about the firm's true preferences about arbitration clauses."[37] They set out the following hypotheses:

- "[T]he companies we studied, or organizations to which they belong, have publicly endorsed the virtues of arbitration, particularly in the context of challenges to pre-dispute arbitration clauses and related class action waivers in consumer agreements. Arbitration, they maintain, 'takes less time and costs less than litigation;' it is 'fair and effective;' and it offers 'a quick, cheap, and easy dispute resolution mechanism' that is 'more efficient' than resolving disputes through litigation. Based on these assertions, we would expect that companies would consistently contract for dispute resolution through arbitration in all types of contracts and disputes."[38]

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[36] Eisenberg & Miller, *supra* note 6, at 373.

[37] Eisenberg et al., *Summer Soldiers*, *supra* note 9, at 878.

[38] *Id.*

- "[T]he stated justifications for mandatory [39] arbitration typically apply to all types of disputes; they do not distinguish between consumer and other cases, for example. Thus our second hypothesis is that contracts will consistently require arbitration regardless of the nature of the contract or the identity of the counterparty."[40]

In other words, they hypothesize that a business that uses arbitration for one type of contract or dispute should act "consistently" and use arbitration for all types of contracts and disputes.

To test their hypotheses, Eisenberg et al. examined "26 consumer agreements drafted by 21 companies and 164 negotiated [non-consumer] contracts entered into by the same companies" in 2007.[41] They did not seek a random or typical collection of consumer form contracts.[42] Instead, they focused on two industries: consumer finance and telecommunications.[43] Previous research had shown that those two industries have a much higher incidence of arbitration clauses in their consumer form contracts than other consumer industries.[44] So it was perhaps no surprise that Eisenberg et al.

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[39] As one of us has noted:

> A frequent criticism of arbitration in consumer contracts is that it is "mandatory." The criticism is rhetorically powerful because viewing arbitration as "mandatory" is contrary to the whole idea of arbitration: that it is the product of an agreement between the parties. But as Richard Speidel explained, this label is "misleading because it connotes arbitration that is compelled by law regardless of consent." Arbitration is mandatory when required by law, such as mandatory arbitration of public-employee grievances. No law requires that parties to consumer contracts arbitrate disputes.

Drahozal, *supra* note 18, at 706 (quoting Richard E. Speidel, *Consumer Arbitration of Statutory Claims: Has Pre-Dispute [Mandatory] Arbitration Outlived Its Welcome?*, 40 ARIZ. L. REV. 1069 (1998)); *accord* IAN R. MACNEIL ET AL., FEDERAL ARBITRATION LAW § 2:36 n.5 (1995); Stephen J. Ware, *Contractual Arbitration, Mandatory Arbitration, and State Constitutional Jury-Trial Rights*, 38 U.S.F. L. REV. 39, 40–44 (2003).

[40] Eisenberg et al., *Summer Solders*, *supra* note 9, at 878.

[41] *Id.* at 881.

[42] By contrast, an earlier study of the incidence of arbitration clauses in consumer contracts did try to replicate the experience of an average "Joe" in Los Angeles. Demaine & Hensler, *supra* note 19, at 58.

[43] Eisenberg et al., *Summer Soldiers*, *supra* note 9, at 881.

[44] Across all the industries Demaine and Hensler studied, 35.4% of the sampled businesses included arbitration clauses in their consumer contracts. Demaine & Hensler, *supra* note 19, at 62. They found that "[t]he prevalence of arbitration clauses is highest (69.2%) in the financial category (credit cards, banking, investment, and accounting/tax consulting)." *Id.* Eisenberg et al. acknowledge that consumer finance contracts are

found that the businesses in their non-random sample used arbitration clauses in their consumer contracts far more often than in their material corporate contracts.[45]

Tables 2 and 3 summarize their results.[46] First, Eisenberg et al. found that 76.9% (20 of 26) of the consumer contracts included arbitration clauses, but only 6.1% (9 of 147) of the material non-employment contracts included arbitration clauses. Interestingly, 92.9% (13 of 14) of the executive employment contracts entered into by the companies in the sample included arbitration clauses—a much higher percentage than even the consumer contracts in the sample.[47] Second, all of the arbitration clauses in consumer contracts (20 of 20, or 100.0%) contained a class arbitration waiver. None of the arbitration clauses in the executive employment contracts (0 of 13, or 0.0%) contained a class arbitration waiver, while only 28.6% (2 of 7) of the material corporate contracts contained a class arbitration waiver.

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especially likely to have arbitration clauses:

> The 76.9% rate of arbitration clauses in our sample of consumer contracts contrasts with the 35.4% rate reported by Demaine and Hensler, a difference that is highly statistically significant ($p<0.001$). The explanation for the difference appears to lie in the industries studied. Our study is limited to a fairly narrow range of industries.

Eisenberg et al., *Summer Soldiers*, *supra* note 9, at 890–91. Cell phone contracts likewise have been identified as highly likely to include an arbitration clause. *See* Amy J. Schmitz, *Dangers of Deference to Form Arbitration Provisions*, 8 NEV. L.J. 37, 38 (2007) (stating that, "my examination of nine of the biggest cell phone service companies' form contracts revealed that consumers who want cell phone service have no real choice but to accept onerous arbitration rules.").

[45] Eisenberg et al. assert that "[e]ven including employment contracts, less than 10% of the negotiated contracts we examined contained arbitration clauses." Eisenberg et al., *Summer Soldiers*, *supra* note 9, at 883. In fact, their data show that 22 (9 material contracts and 13 employment contracts) out of 161 (147 material contracts and 14 employment contracts), or 13.7%, include arbitration clauses. *Id.* The difference does not materially alter their results, however.

[46] *Id.* at 883–84 (tbls. 2 & 3).

[47] *Id.* Eisenberg et al. explain the widespread use of arbitration clauses in executive employment contracts (much higher, in fact, than their prior study, see Eisenberg & Miller, *supra* note 6, at 351), as follows:

> In the case of employment contracts, we conjecture that both parties perceive a need for confidentiality in the resolution of the dispute. The senior employees covered by those contracts are often in the public eye. Neither the employer nor the employee stands to gain in terms of reputation [if] the dirty linen of their dispute is aired in public.

Eisenberg et al., *Summer Soldiers*, *supra* note 9, at 887–88.

Table 2. Arbitration Clause Usage by Telecommunications and Consumer Finance Companies, by Contract Type

Contract Type	No Arbitration Clause	Arbitration Clause	Total
Consumer	6 23.1%	20 76.9%	26
Employment	1 7.1%	13 92.9%	14
Material corporate	138 93.9%	9 6.1%	147
Total	145 76.3%	42 23.7%	187

Table 3. Class Arbitration Waivers in Contracts with Arbitration Clauses, Telecommunications and Consumer Finance Companies, by Contract Type

Contract Type	No Class Arbitration Waiver	Class Arbitration Waiver	Total
Consumer	0 0.0%	20 100.0%	20
Employment	13 100.0%	0 0.0%	13
Material corporate	5 71.4%	2 28.6%	7
Total	18 45.0%	22 55.0%	40

Based on these findings, Eisenberg et al. concluded that "corporations' selective use of arbitration clauses against consumers, but not against each other, suggests that their use of mandatory arbitration clauses may be based more on strategic advantage than on a belief that corporations are better serving their customers."[48] That strategic advantage, according to Eisenberg et al., is "that companies wish to avoid aggregate dispute resolution"—i.e.,

[48] Eisenberg et al., *Summer Soldiers*, *supra* note 9, at 895.

class actions and class arbitrations.[49] Indeed, "from the perspective of corporate self-interest, concern over class actions remains the most likely explanation for the prevalence of arbitration clauses in consumer agreements."[50] The study is ambiguous about how broadly this conclusion should be applied. At some points, the authors indicate that "we believe our data support the inference that *the companies in our sample* . . . view consumer arbitration as a way to save money by avoiding aggregate dispute resolution."[51] At other points, however, they write more broadly, seeming to suggest that their conclusions are not limited to telecommunications and consumer financial companies, but instead apply generally to the use of arbitration clauses in consumer contracts.[52] Perhaps not surprisingly, the Eisenberg et al. study has received notable coverage in the popular press.[53]

II. CAN WE TELL FROM THE USE OF ARBITRATION CLAUSES WHETHER ARBITRATION IS MORE EFFICIENT THAN LITIGATION?

Starting with the premise that sophisticated parties will tend to agree to exchanges that make them both better off, Eisenberg and Miller assert that "if a form of alternative dispute resolution, such as binding arbitration, provides greater social benefits than litigation, the dynamics of the process should tend to induce the parties to include a clause submitting future disputes to arbitration."[54] In other words, sophisticated parties will generally use arbitration clauses if arbitration is a more efficient means of dispute resolution than litigation; if it is not, such parties will not include arbitration clauses in their contracts.

Based on their review of the arbitration literature, Eisenberg and Miller assert that "the bulk of authority seems to agree that arbitration is a more efficient dispute resolution procedure than litigation. This generates the hypothesis that, in a data set of contracts freely agreed to by sophisticated parties, we will almost always observe arbitration clauses being used."[55]

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[49] *Id.* at 888.

[50] *Id.* at 894.

[51] *Id.* at 894–95 (emphasis added).

[52] *E.g.*, *id.* at 894 (suggesting that "from the perspective of corporate self-interest, concern over class actions remains the most likely explanation for the prevalence of arbitration clauses in consumer agreements.").

[53] Jonathan D. Glater, *Companies Unlikely to Use Arbitration with Each Other*, N.Y. TIMES, Oct. 6, 2008, at B4; Adam Liptak, *The Worst Courts for Businesses? It's a Matter of Opinion*, N.Y. TIMES, Dec. 24, 2007, at A10.

[54] Eisenberg & Miller, *supra* note 6, at 335.

[55] *Id.* at 340–41.

When they test this hypothesis, however, Eisenberg and Miller are struck by what they call the "surprisingly low frequency of arbitration clauses" in their sample.[56] They conclude: "In the simple economic view, our results suggest that corporate representatives believe that litigation can add value over arbitration."[57]

Initially, we disagree with Eisenberg and Miller's reading of the arbitration literature. The "bulk of" that literature does not assert that all contracts should include arbitration clauses, as discussed in more detail in the next section.[58] To the contrary, it identifies several important factors that parties should consider in choosing between arbitration and litigation. Those factors go far towards explaining why the use of arbitration clauses in the principal types of contracts studied by Eisenberg and Miller is so small and why the use of arbitration clauses in other types of contracts (including ones not studied by Eisenberg and Miller) is much higher.

Parties do not choose litigation over arbitration because litigation is more efficient than arbitration. Instead, the reason is much simpler: litigation receives a sizable government subsidy; arbitration does not.[59]

The government subsidy for parties in litigation begins with the fact—recognized by Eisenberg and Miller[60]—that courts are subsidized by the taxpayer. The fees litigants pay to courts do not cover the full cost of the judge, jury, court clerk, other administrative personnel, and the courthouse itself. "By contrast, parties to arbitration must pay the arbitrator's fee, as well as the administrative costs of the arbitration organization,"[61] and any cost of the hearing room. We use the term "adjudicator costs" to describe the costs of paying for the adjudicator (arbitrator, judge, jury) and support for the adjudicator (e.g., employees of the court system or arbitration organization, and the courthouse or hearing room). In short, government subsidizes the adjudicator costs of litigation, but not the adjudicator costs of arbitration.[62]

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[56] *Id.* at 335.

[57] *Id.* at 374.

[58] *See infra* text accompanying notes 86–102.

[59] Landes & Posner, *supra* note 2, at 250 (stating, "To complicate the picture still further, it is necessary to factor out the artificial competitive advantage that the public competitor enjoys by virtue of being supported out of general tax revenues and providing its services at no charge. . . .").

[60] Eisenberg & Miller, *supra* note 6, at 339–40.

[61] Stephen J. Ware, *The Case Against Enforcing Adhesive Arbitration Agreements—with Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM. ARB. 251, 285 (2006).

[62] For a counterargument, see Jeffrey W. Stempel, *Reflections on Judicial ADR and the Multi-Door Courthouse at Twenty: Fait Accompli, Failed Overture, or Fledgling*

This direct financial subsidy alone gives litigation a competitive advantage over arbitration—one that has nothing to do with the efficiency of the dispute resolution process.[63] So, at the metaphorical binding-dispute-resolution store the shoppers see that one of the two competing products on the shelf (litigation) has a coupon good for a substantial price reduction at the cash register, while the other (arbitration) has no such coupon. Furthermore,

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Adulthood, 11 OHIO ST. J. ON DISP. RESOL. 297, 358 (1996):

> But these arguments [that government subsidizes litigation but not arbitration] ignore many factors. First, large fees are often not actually paid because the contestants have styled the matter in order to minimize the value of the claim or make it ambiguous. Although this may be a refreshing means of discouraging bombastic pleadings, it suggests that private ADR organizations are not as self-supporting as assumed. AAA, for example, also receives contributions and *de facto* or in kind support from the business community.
>
> Second, private ADR groups, whether non-profit or for-profit, receive subsidies through tax benefits. By contrast, courts do not deduct salaries and expenses from tax returns. In addition, private ADR has often received quasi-subsidies in the form of active judicial enforcement of arbitration agreements and awards with minimal scrutiny over the correctness and legality of those outcomes. This occurs even where arbitration agreements are ambiguous, consent is questionable, or decisionmakers have rendered bizarre or questionable results. In essence, courts "pay" the costs of the more elaborate but nonetheless valuable appellate system.

These arguments do not persuade us. First, even if some claimants avoid fees by ambiguous pleadings, the arbitration provider has to make up the costs somewhere. As AAA no longer receives membership dues from businesses, it means that other users have to pay more—hardly a government subsidy. Second, the tax deductibility of business expenses merely reduces, but does not eliminate, the competitive advantage of courts. While deductibility reduces the post-tax cost of providing arbitration services, it does not generally reduce them to, or near zero, so courts retain a large subsidized advantage over arbitration. Third, the so-called "quasi-subsidy" of enforcing arbitration agreements in allegedly questionable circumstances has no effect on the financial subsidy to litigation. At most, it may reduce the difficulty of overcoming the default rule that disputes are resolved in court rather than litigation—a wholly separate competitive advantage of litigation. *See infra* note 64.

[63] The usual justification for the government subsidy to litigation is the external benefit (i.e., the benefit to non-parties to the dispute) from the legal precedent created by courts. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 558 (7th ed. 2007); Landes & Posner, *supra* note 2, at 250 (stating that a subsidy "may not be an unfair (inefficient) advantage if arbitration is taking a 'free ride' on the precedent-creating activities of the public courts."). But this benefit from rule production is not the focus of Eisenberg and Miller. Instead, their focus is on the efficiency of arbitration as a means of dispute resolution. *See id.* at 237–39 (distinguishing between dispute resolution and rule production functions of adjudication).

this coupon differs from those at the typical grocery store because this coupon is funded by the shoppers' taxes.

The financial subsidy just discussed is only one of the ways in which arbitration is disadvantaged in its competition with litigation.[64] But what has been said thus far enables us to contrast our view with that of Eisenberg and Miller. Arbitration may in fact be more efficient than litigation—as the term "efficient" is ordinarily understood—even if many sophisticated parties do not choose it.[65] That is because the government subsidy for litigation may be inducing the bulk of sophisticated parties to choose the less efficient process.

As long as a government subsidy reduces the price of litigation relative to arbitration, we cannot know which process is considered more efficient by the majority of sophisticated parties. No one would assert that public education is more efficient than private education solely because most students attend public schools.[66] The sizable government subsidy to public schools alters the choice students and their parents face. The same is true for litigation. To put it another way, as long as litigation's subsidized advantage in adjudicator costs is part of parties' overall comparison between litigation and arbitration, arbitration will appear "surprisingly"[67] inefficient.

III. WHY DO CONTRACTS INCLUDE (OR NOT INCLUDE) ARBITRATION CLAUSES?

Although Eisenberg and Miller recognize that different industries are likely to use arbitration clauses at different rates,[68] their working hypothesis is that companies within an industry should be "consistent" in their use of

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[64] Another is the fact that litigation is the default rule and parties have to incur the bargaining costs of overcoming the default of litigation by agreeing to arbitration. *See* WARE, *supra* note 1, § 1.5(b).

[65] Eisenberg and Miller state that "[i]nformed parties bargaining for their mutual advantage will tend to agree to provisions that maximize the social surplus." Eisenberg & Miller, *supra* note 6, at 335. Assuming this is true, given any particular legal regime, it is possible that still greater social surplus would result from informed parties bargaining under a different legal regime (e.g., one that subsidized public and private adjudication equally). In other words, the amount by which the law currently favors public over private adjudication may not be the most efficient legal regime.

[66] Private schools enrolled about 11% of U.S. elementary and secondary school students in 2005. *See* U.S. DEPT. OF EDUC., OFF. OF INNOVATION AND IMPROVEMENT, STATISTICS ABOUT NON-PUBLIC EDUCATION IN THE UNITED STATES, *available at* http://www.ed.gov/about/offices/list/oii/nonpublic/statistics.html (last visited Nov. 30, 2008).

[67] Eisenberg & Miller, *supra* note 6, at 335.

[68] *Id.* at 357.

arbitration clauses across different types of contracts.[69] On this view, if a company includes an arbitration clause in one type of contract, it should use an arbitration clause in all of its contracts. The broad form of this view is reflected in Eisenberg and Miller's statement, after a review of the arbitration literature that "the bulk of authority seems to agree that arbitration is a more efficient dispute resolution procedure than litigation. This generates the hypothesis that, in a data set of contracts freely agreed to by sophisticated parties, we will almost always observe arbitration clauses being used."[70]

This reading of the literature and resulting hypothesis conflicts with writings by both academics and practitioners on the use of arbitration clauses. No competent lawyer would advise a client to use arbitration clauses in all of its contracts, for the sake of consistency, without regard to the nature of the contract or the nature of the client.[71] For these reasons, it is no surprise that in their empirical results, Eisenberg et al. find that businesses do not "consistently" include arbitration clauses in their contracts.

Based on the arbitration literature, we propose a more nuanced set of hypotheses on when sophisticated parties will prefer litigation to arbitration in resolving disputes. We expect parties to prefer litigation over arbitration, all else equal, in the following types of cases: (1) when the governing law and contract terms are well-developed and relatively certain in application; (2) in "bet-the-company" cases with very high stakes; and (3) when emergency relief is likely to be important for resolving disputes.[72] Examples of such contracts include two categories prominent in Eisenberg & Miller's sample: commercial loan agreements (for which the governing law and contract terms are well developed) and merger agreements (which are "bet-the-company" cases in which emergency relief is likely to be critical). Meanwhile, important categories of contracts long identified as likely to include arbitration clauses either do not appear in Eisenberg and Miller's sample, or receive little attention. In short, the arbitration literature predicts that parties are likely to prefer litigation to arbitration in precisely the sorts of

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[69] Eisenberg et al., *Summer Soldiers*, *supra* note 9, at 878.

[70] Eisenberg & Miller, *supra* note 6, at 340–41.

[71] It is true that sales literature from arbitration providers, and advocacy documents by parties whose arbitration agreements are being challenged, often tout the benefits of arbitration. Indeed, these are precisely the sorts of documents on which Eisenberg, Miller, and Sherwin base their hypotheses. *Id.* at 336 nn.2 & 3; Eisenberg et al., *Summer Soldiers*, *supra* note 9, at 878 nn.27–30. To the extent Eisenberg et al.'s results suggest that these sorts of statements may be overbroad, we agree. But such sources do not constitute the "bulk of authority" addressing when parties are likely to agree to arbitrate. Eisenberg & Miller, *supra* note 6, at 340.

[72] *See infra* text accompanying notes 86–102.

contracts studied by Eisenberg and Miller. The Eisenberg and Miller sample of contracts, while entered into by sophisticated parties, is not representative of the contracts those parties enter.

A. *Why Arbitrate?*

We start with the expectation that well-informed people do not ordinarily pay thousands of dollars to get what they can get elsewhere for free. So, we ask, why any sophisticated parties choose to do that with respect to binding adjudication. Why do they choose arbitration over litigation? We believe that all the possible reasons fall into two categories: process and outcomes. In their pre-dispute shopping, sophisticated parties drafting their contract may choose arbitration because they expect that it will provide them with a better process than litigation, because they expect that it will provide them with better outcomes than litigation, or both.[73]

Those two broad categories of reasons, of course, comprise a number of more particular reasons why parties might agree to arbitrate. For domestic arbitration, those reasons include:[74]

- arbitration may be faster and cheaper than litigation, at least for some types of disputes;[75]
- arbitration may lessen the risk of punitive damages awards or aberrational jury verdicts;[76]
- arbitration may decrease exposure to class actions or other forms of aggregate litigation;[77]
- arbitration may result in more accurate outcomes because of arbitrator expertise and incentives;[78]

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[73] *See* Christopher R. Drahozal, *Contracting Out of National Law: An Empirical Look at the New Law Merchant*, 80 NOTRE DAME L. REV. 523, 531–32 (2005) (stating that "The starting point is that court litigation is the default: the parties' dispute will be resolved in arbitration only if they so agree. Arbitration may differ from litigation in two main ways. First, the process costs of arbitration may be higher or lower than the process costs of litigation. . . . Second, the outcome in arbitration may be different from the outcome in court.").

[74] Drahozal & Wittrock, *supra* note 18, at 77–78.

[75] Christopher R. Drahozal, *Arbitration Costs and Forum Accessibility: Empirical Evidence*, 41 U. MICH. J.L. REFORM 813, 840 (2008).

[76] Christopher R. Drahozal, *A Behavioral Analysis of Private Judging*, 67 LAW & CONTEMP. PROBS. 105, 131–32 (2004); Drahozal & Hylton, *supra* note 18, at 574.

[77] Eisenberg et al., *Summer Soldiers*, *supra* note 9, at 888; Sternlight, *supra* note 5, at 8–9.

- arbitration may better protect confidential information from disclosure;[79]
- arbitration may enhance the ability of parties to have their disputes resolved using trade rules;[80] and
- arbitration may enable the parties to better preserve their relationship.[81]

Many of the same reasons apply to transnational contracts. In that context, however, commentators emphasize two additional benefits: arbitration may provide a neutral forum and may be more likely to result in an award enforceable in another jurisdiction.[82]

Notably, however, commentators make clear that not every contract should include an arbitration clause, and that arbitration is not always the most appropriate means of resolving a dispute.[83] That holds true not only for domestic contracts but also for transnational contracts.[84] Existing empirical

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[78] Drahozal & Hylton, *supra* note 18, at 558–61.

[79] Amy J. Schmitz, *Untangling the Privacy Paradox in Arbitration*, 54 U. KAN. L. REV. 1211, 1222–26 (2006).

[80] Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765, 1782–87 (1996).

[81] David B. Lipsky & Ronald L. Seeber, The Appropriate Resolution of Corporate Disputes: A Report on the Growing Use of ADR by U.S. Corporations 17, 26 (2008).

[82] *See* CHRISTIAN BÜHRING-UHLE, ARBITRATION AND MEDIATION IN INTERNATIONAL BUSINESS: DESIGNING PROCEDURES FOR EFFECTIVE CONFLICT MANAGEMENT 127–56 (1996).

[83] *E.g.*, STEPHEN C. BENNETT, ARBITRATION: ESSENTIAL CONCEPTS 8 (2002) (stating, "Despite its many advantages, arbitration is not necessarily the best form of dispute resolution in every case. Parties choose not to arbitrate for any number of reasons. . . ."); BETTE J. ROTH ET AL., ALTERNATIVE DISPUTE RESOLUTION PRACTICE GUIDE § 3.21 (2008) (chapter by Robert C. Field) (stating that, "The decision to arbitrate has significant consequences and should be made only after careful consideration of many issues. The parties should consider the type of dispute subject to arbitration, the type of arbitration proposed, and the method of selection of the arbitrators. The parties should further consider the nature of the relief sought and whether appellate rights are significant."); CENTER FOR PUBLIC RESOURCES, ADR SUITABILITY SCREEN (1998) (setting out "a series of questions that permit choices between arbitration and litigation") [hereinafter ADR Suitability Screen].

[84] *E.g.*, BORN, *supra* note 29, at 71 ("Parties frequently consider the relative advantages and disadvantages of international arbitration and forum selection agreements, not infrequently opting for the latter if their negotiating power permits."); GARY B. BORN, INTERNATIONAL ARBITRATION AND FORUM SELECTION AGREEMENTS: PLANNING, DRAFTING AND ENFORCING 13–15 (2d ed. 2006).

studies of the use of arbitration clauses support that view as well.[85] The question then is whether it is possible to identify, on a systematic basis, the types of contracts that are less likely to include arbitration clauses.

B. *Why Not Arbitrate?*

1. *Arbitration's Drawbacks for "Material" Contracts*

It is an oft-cited truism (from the U.S. Supreme Court, no less) that "by agreeing to arbitrate, a party 'trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration.'"[86] As the Tenth Circuit put it,

> Arbitration provides neither the procedural protections nor the assurance of the proper application of substantive law offered by the judicial system. Those who choose to resolve a dispute by arbitration can expect no more than they have agreed. One choosing arbitration should not expect the full panoply of procedural and substantive protection offered by a court of law. In short, "by agreeing to arbitrate, a party 'trades the procedures and opportunity for review of the courtroom for the [perceived] simplicity, informality, and expedition of arbitration.'"[87]

In sum, courts recognize that, compared to litigation, arbitration tends to be a less elaborate means of adjudication than litigation.[88]

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[85] Drahozal, *supra* note 18, at 762–64; Drahozal & Hylton, *supra* note 18, at 580–81; Drahozal & Wittrock, *supra* note 18, at 78–80.

[86] Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 29–33 (1991) (quoting Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985)); *see* Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 481–82 (1989).

[87] Bowles Financial Group, Inc. v. Stifel, Nicolaus & Co., Inc., 22 F.3d 1010, 1011 (10th Cir. 1994).

[88] Of course, arbitration has changed over time, and increasingly commentators are writing of the "judicialization" of arbitration. *E.g.*, Edward Brunet & Jennifer J. Johnson, *Substantive Fairness in Securities Arbitration*, 76 U. CIN. L. REV. 459, 465 (2008) ("The cost of arbitration also increases as a result of enhanced judicialization achieved by mandating various pre-trial procedures."); Alan Scott Rau, *Contracting Out of the Arbitration Act*, 8 AM. REV. INT'L ARB. 225, 259 (1997). Professor Rau states:

> The growing use of custom-tailored arbitration clauses—whether intended to diminish the finality of awards or to increase formality in arbitral procedure—is surely but one manifestation of what is often described and decried as the "judicialization" or "legalization" of arbitration; it is in a sense the natural consequence of the capture of the ADR movement by lawyers intent on remaking all dispute resolution in the image of the courtroom.

In what sorts of contracts would one expect to find well-informed parties choosing the less elaborate sort of adjudication, the one without all the procedural "bells and whistles": in routine, lower-dollar contracts or in the most important, higher-dollar contracts? We expect the former rather than the latter, and arbitration commentators agree. Thus, several commentators recommend arbitration when there will "likely be a large volume of small dollar disputes," and litigation when there "is a non-negotiable interest which needs protection."[89] Likewise, arbitration is discouraged when "a vital corporate interest or 'bet the company' case [is] involved that requires the full panoply of procedural protection afforded by court and full appeal rights."[90]

Accordingly, we hypothesize that contracts likely to give rise to "bet-the-company" cases are less likely to include arbitration clauses.[91] Conversely, we hypothesize that routine contracts, with less at stake should a dispute arise, are more likely to include arbitration clauses.

Id. The effect of excessive judicialization is to reduce the cost advantages arbitration otherwise might have over litigation, and make it less attractive to parties. However, there is no empirical evidence that parties are systematically "fleeing" arbitration for litigation as a result. *See* Drahozal & Wittrock, *supra* note 18, at 94–97.

[89] *See, e.g.*, Jack L. Foltz, et al., *Alternative Dispute Resolution*, *in* 3 SUCCESSFUL PARTNERING BETWEEN INSIDE AND OUTSIDE COUNSEL § 57.4 (Jan. 2008):

> Dispute resolution clauses in commercial agreements are not "one size fits all." The kind of dispute that may arise in a commercial agreement should dictate the preferred dispute resolution option such as, for example, the following:
>
> • Does the client want a quick, negotiated resolution? (Negotiation/Mediation)
> • Is there a non-negotiable interest which needs protection? (Litigation)
> • Will there likely be a large volume of small dollar disputes? (Arbitration)
> • Or a small number of big dollar disputes? (Mediation)
> • Is the transaction a cross-border one? (Arbitration)

See also Richard C. Downing & Patrick R. James, *Arbitration of a Securities Dispute—An Overview for the Practitioner*, 13 U. ARK. LITTLE ROCK L. REV. 621, 646 (1991) ("As with most forums, there are good and bad points. Arbitration is preferable for small dollar disputes and is less appealing for major disputes which take days to present.").

[90] *E.g.*, ADR Suitability Screen, *supra* note 83, item 5.

[91] To be clear, our hypothesis is that, all else equal, contracts likely to give rise to "bet-the-company" cases are less likely to include arbitration clauses. But in some types of cases, countervailing considerations may prevail. For example, international arbitrations may have high stakes, but because of the value of a neutral forum, may nonetheless be more likely to be resolved in arbitration than similar domestic cases.

2. *Limited Court Review of Arbitration Awards*

Just as a trial court's decision may be erroneous, so might an arbitrator's award. But it is far more likely that a trial court's erroneous ruling will be overturned on appeal than an arbitrator's erroneous ruling will be vacated by a court.[92] The grounds for vacating an arbitration award are very limited; an arbitrator's error in ruling on the merits of the case is not a ground for vacating an arbitration award.[93]

The limited court review of arbitration awards is important in two categories of cases. First, it is an important reason why parties tend to prefer litigation in "bet-the-company" cases. As one of us and a co-author wrote,

> parties may avoid arbitration of what might be called "bet-the-company" cases—high stakes cases in which an erroneous outcome could jeopardize the continued existence of the company. At least some parties may perceive arbitration as too risky for such cases because of the limited court review of arbitration awards. In more routine cases, "knucklehead awards" or "'roll-the-dice' or 'Russian roulette' arbitration" awards would be just another cost of the dispute resolution process. But in high stakes cases, an aberrational award could have a devastating effect on the company, and may lead parties to avoid arbitration altogether for contracts that may give rise to such disputes.[94]

To put it another way, sophisticated parties may (quite rationally) prefer to pocket the process-cost savings that come from less elaborate adjudication (arbitration), despite the greater risk of uncorrectable errors, in routine cases because a particular party is as likely to benefit from an error as be harmed by it, so, over the run of cases, those errors essentially offset each other. By contrast, in big cases the risk that an uncorrectable error harms, rather than benefits, a party may be so great as to outweigh the process-cost savings.[95]

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[92] Eisenberg and Miller recognize this. Eisenberg & Miller, *supra* note 6, at 337 nn.11 & 340.

[93] *See* 9 U.S.C. § 10 (2006); Burchell v. Marsh, 58 U.S. 344, 349 (1854) ("If the award is within the submission, and contains the honest decision of the arbitrators, after a full and fair hearing of the parties, a court of equity will not set it aside, either in law or fact."). Indeed, whether under the Federal Arbitration Act an award can be set aside even for "manifest disregard of the law" is subject to serious question. *See The Viability of Manifest Disregard Challenges After Hall Street*, INTERNATIONAL DISPUTE RESOLUTION (Skadden, Arps, Slate, Meagher & Flom, New York, N.Y.), Nov. 2008, at 14 ("Whether or not manifest disregard challenges remain viable continues to be a hotly debated issue.").

[94] Drahozal & Wittrock, *supra* note 18, at 79–80.

[95] Evidence that sophisticated parties (or their lawyers) think this way is found in the

Second, because of limited court review of awards, parties may also prefer litigation in cases in which the governing law is clear, the contract provisions are well developed, and the underlying facts are unlikely to be disputed. In such cases, some have said, "[a]rbitration . . . may appear as an unnecessary invitation to a 'split the difference' award, reminiscent of King Solomon's famous threat to cut the baby in two."[96] Although the (little available) empirical evidence does not support the oft-expressed fear that arbitrators frequently render compromise awards,[97] the lack of court review of awards makes any arbitrator error more difficult to correct. Moreover, in such cases, the expertise of the arbitrator (who may be more likely than a judge to have particularized knowledge of the industry or type of contract[98]) is of much less value than it otherwise would be. If parties expect disputes that arise under their contract typically to be of such a type, they may well prefer litigation over arbitration.

Thus, in addition to "bet–the–company" cases, we hypothesize that parties will be less likely to include arbitration clauses in contracts they expect to give rise to disputes in which the governing law is clear and arbitrator expertise is of less value.

3. *Availability of Interim Relief*

Finally, courts also are better suited than arbitrators to grant emergency relief, such as a temporary restraining order (TRO).[99] In important high-dollar cases, sophisticated parties are sometimes able to secure temporary relief in court almost immediately, even at night from a judge at home in his

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fact that sophisticated parties have for at least a decade tried to mitigate the problem of uncorrectable errors in high-dollar cases by using arbitration clauses that require courts to review arbitration awards much the way appellate courts review trial courts. *E.g.*, Carroll E. Neesmann, *Contracting for Judicial Review*, DISP. RESOL. MAG., Fall 1998, at 18, 18. However, the risk of a "knucklehead award" in a "bet-the-company" case was recently exacerbated by the Supreme Court's decision in Hall Street Assocs., L.L.C. v. Mattel, Inc., 552 U.S. 576 (2008), which refused to enforce an expanded review provision under the Federal Arbitration Act. *Id.* at 1405–08.

[96] William W. Park, *Arbitration in Banking and Finance*, 17 ANN. REV. BANKING L. 213, 216 (1998); *see also* Dammann & Hansmann, *supra* note 3, at 34.

[97] *See* Stephanie E. Keer & Richard W. Naimark, *Arbitrators Do Not "Split the Baby": Empirical Evidence from International Business Arbitrations*, 18 J. INT'L ARB. 573, 573 (2001), *reprinted in* DRAHOZAL & NAIMARK, *supra* note 22, at 311.

[98] *See supra* text accompanying note 78.

[99] Eisenberg and Miller also recognize this. Eisenberg & Miller, *supra* note 6, at 340.

or her pajamas.[100] By contrast, arbitration cannot offer such relief until an arbitrator has been appointed.[101] As appointment of an arbitrator generally requires the post-dispute consent of both parties, the party against whom a TRO, for instance, is sought likely can delay appointment of the arbitrator until it does whatever the other party sought to restrain. By the time there is an arbitrator with jurisdiction to issue an emergency order, the benefit of the order will have been lost.[102] Accordingly, we hypothesize that parties will be less likely to include arbitration clauses in their contracts when they expect emergency relief to be important in the event a dispute arises.

C. *Application to Types of Contracts Prominent in Eisenberg & Miller's Sample*

Eisenberg and Miller draw their sample of contracts from "material" contracts attached to corporate filings with the SEC.[103] The types of contracts common in the sample include securities purchase agreements, corporate merger and asset sale/purchase agreements,[104] credit commitments, bond indentures, and underwriting agreements, as well as contracts commonly

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[100] *E.g.*, *Aviation: Political Compromise*, TIME, July 24, 1950, *available at* http://www.time.com/time/printout/0,8816,812856,00.html (describing, "Armed with his sworn affidavit, Landis sped to suburban Chevy Chase, where at 1:30 a.m. he rapped on the door of Federal District Court Judge Henry A. Schweinhaut. In pajamas and nightrobe, the judge sleepily listened to Landis' arguments, then signed a temporary restraining order.").

[101] *See* BENNETT, *supra* note 83, at 8 (explaining, "Parties choose not to arbitrate for any number of reasons, including . . . [d]ifficulty in acquiring preliminary relief"); Drahozal & Wittrock, *supra* note 18, at 78–79 (noting that "[a]rbitration providers . . . have responded to this difficulty by establishing readily available panels to rule on emergency requests, but that option appears to be used only rarely").

[102] Furthermore, even if there is a standing arbitrator who can quickly issue interim relief, how would the party seeking such relief get the arbitrator's order enforced? That party would still need to get a judge's order confirming the arbitrator's order before that party would have a piece of paper that actually tells the sheriff or others to execute the order. The extra step in arbitration (getting an order and then getting it confirmed before it will be enforced) may be trivial in most cases, but could be huge in time-is-of-the essence emergencies.

[103] Eisenberg & Miller, *supra* note 6, at 348.

[104] A merger agreement and an asset sale/purchase agreement both "involve corporate restructurings," and so we treat them together. Securities purchase agreements also are commonly part of corporate restructuring or financing transactions as well. Theodore Eisenberg & Geoffrey P. Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies' Contracts*, 30 CARDOZO L. REV. 1475, 1489 (2009).

used in asset-backed securities arrangements.[105] Such contracts make up over three-quarters (2,165 of 2,858, or 75.8%) of the sample. Indeed, the only other types of contracts in the sample are executive employment contracts (111 of 2,858, or 3.9%), licensing agreements (48 of 2,858, or 1.7%), and settlement agreements (72 of 2,858, or 2.5%), along with an undefined category of "other" contracts (462 of 2,858, or 16.2%).[106] Miller and Eisenberg assert that "[b]ecause the[ir studied] contracts are material events in the lives of publicly traded corporations, the contracts are a reasonable sample of what sophisticated parties specify ex ante regarding arbitration."[107]

We disagree. We believe that it is precisely because these contracts are so important—"material events in the lives of publicly traded corporations"—that they are an *unrepresentative* sample of the contracts between sophisticated parties and are less likely to contain arbitration clauses than are other such contracts.

Because Eisenberg and Miller rely on contracts filed as exhibits to SEC filings, their sample in effect is defined by SEC regulations governing what sorts of contracts must be filed. Those regulations specify that the following types of contracts must be filed as exhibits to reports or registration statements:[108] underwriting agreements,[109] merger agreements,[110] "[a]ll instruments defining the rights of holders of the equity or debt securities being registered" (such as bond indentures),[111] voting trust agreements,[112] and other "material contracts."[113] As defined by the SEC, a "material contract" is a contract "not made in the ordinary course of business which is material to the registrant."[114] With only a handful of exceptions,[115] SEC

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[105] Eisenberg & Miller, *supra* note 6, at 348.

[106] *See* Table 1, *supra* text accompanying note 30.

[107] Eisenberg & Miller, *supra* note 6, at 349.

[108] In addition to the contracts listed in the text, numerous other documents (not contracts) are listed as required exhibits as well. *See* 17 C.F.R. § 229.601(b) (2009).

[109] *Id.* § 229.601(b)(1) (stating, "Each underwriting contract or agreement with a principal underwriter pursuant to which the securities being registered are to be distributed").

[110] *Id.* § 229.601(b)(2) (stating, "Any material plan of acquisition, disposition, reorganization, readjustment, succession, liquidation or arrangement").

[111] *Id.* § 229.601(b)(4).

[112] *Id.* § 229.601(b)(9).

[113] *Id.* § 229.601(b)(10).

[114] *Id.* § 229.601(b)(10)(i). In addition, the regulations require the filing of various management compensation plans. *Id.* § 229.601(b)(10)(iii). As

> [e]xamples of material contracts," the SEC lists the following: "Asset Purchase Agreements; Bridge Loan Agreements; Cash Bonus Plans; Director Fee

regulations provide that "[i]f the contract is such as ordinarily accompanies the kind of business conducted by the registrant and its subsidiaries, it will be deemed to have been made in the ordinary course of business and need not be filed."[116]

In other words, the sample on which Eisenberg and Miller rely includes several specified types of contracts (which certainly would be material and entered into out of the ordinary course of business), as well as a catch-all of "material contracts" expressly defined as contracts made out of the ordinary course and "material" to the business.[117] At the same time, the sample excludes contracts made in the ordinary course of business, including virtually all contracts "such as ordinarily accompan[y] the kind of business conducted" by the company.[118]

> Agreements; Director Indemnification Plans; Employment Agreements; Executive Compensation Plans and Incentive Plans; Financial Services Agreements; Joint Venture Agreements; Lease Agreements; Letters of Intent; License Agreements; Pension Plans; Profit Sharing Plans; Purchase Agreements; Stock Option Agreements; Stock Purchase Agreements; Termination Agreements.

U.S. Securities and Exchange Commission, Researching Public Companies Through EDGAR: A Guide for Investors III.D.8, http://www.sec.gov/investor/pubs/edgarguide.htm (last visited Dec. 2, 2008).

[115] The exceptions (i.e., those contracts that "ordinarily accompany the kind of business conducted by the registrant" that must be filed) are the following:

> (A) Any contract to which directors, officers, promoters, voting trustees, security holders named in the registration statement or report, or underwriters are parties other than contracts involving only the purchase or sale of current assets having a determinable market price, at such market price;
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> (B) Any contract upon which the registrant's business is substantially dependent, as in the case of continuing contracts to sell the major part of registrant's products or services, or to purchase the major part of registrant's requirements of goods, services or raw materials or any franchise or license or other agreement to use a patent, formula, trade secret, process or trade name upon which registrant's business depends to a material extent;
>
> (C) Any contract calling for the acquisition or sale of any property, plant or equipment for a consideration exceeding 15 percent of such fixed assets of the registrant on a consolidated basis; or
>
> (D) Any material lease under which a part of the property described in the registration statement or report is held by the registrant.

17 C.F.R. § 229.601(b)(10)(ii).

[116] *Id.*

[117] *Id.* at § 229.601(b).

[118] *Id.* at § 229.601(b)(10).

These regulatory requirements—again, which define the Eisenberg and Miller sample—are important for two reasons. First, they make clear that many if not most contracts a business makes, i.e., those in the ordinary course of its business, need not be filed with the SEC and hence will not be in Eisenberg and Miller's sample. That is a big gap: although the study claims to be based on "a reasonable sample of what sophisticated parties specify ex ante regarding arbitration,"[119] the sample in fact is much more limited, as will be discussed further in the next section.[120] Second, those contracts that are included in the sample are not likely to be representative of all the contracts entered into by the business. To the contrary, as material contracts entered into out of the ordinary course of business, they are precisely the sorts of contracts for which less elaborate adjudication is likely to be ill-suited. In short, the sample relied on by Eisenberg and Miller not only is unrepresentative, it is also biased in favor of contracts unlikely to include arbitration clauses.

Indeed, consistent with the hypotheses we identified in the previous section, several types of contracts in the sample can be readily identified as unlikely to include an arbitration clause.[121] First, loan commitments (together with associated contracts) are prominent in their sample. But as Eisenberg and Miller acknowledge,[122] commentators have long noted that such credit agreements are unlikely to include arbitration clauses. As William W. Park has stated, "[i]n contrast to the commercial and insurance communities, bankers have traditionally preferred judges over arbitrators."[123] The reasons

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[119] Eisenberg & Miller, *supra* note 6, at 349.

[120] *See infra* text accompanying notes 131–45.

[121] As Eisenberg and Miller say of their data, "the type of contract involved is the strongest indicator of whether or not the contract contains an arbitration clause." Eisenberg & Miller, *supra* note 6, at 350. We focus on those types of contracts—credit commitments and merger agreements—most clearly addressed in the literature. Our supposition is that similar arguments apply to other types of contracts in the sample, and our discussions with corporate lawyers have suggested that is the case.

[122] *Id.* at 368.

[123] Park, *supra* note 96, at 215; *see also* Mark Kantor, *OTC Derivatives and Arbitration: Should Counterparties Embrace the Alternative*, 117 BANKING L.J. 408, 411 (2000) ("U.S. commercial banks have almost uniformly preferred court submission clauses to arbitration clauses in their credit agreements."); Walter Mattli, *Private Justice in a Global Economy: From Litigation to Arbitration*, 55 INT'L ORG. 919, 943 (2001) (explaining that it is "easy to see why bankers shun arbitration clauses, and, instead, insert in almost all international loan agreements jurisdiction clauses, selecting either New York courts or the London High Court as forums"); William W. Park, *When the Borrower and the Banker Are at Odds: The Interaction of Judge and Arbitrator in Trans-Border Finance*, 65 TUL. L. REV. 1323, 1323 (1991) ("Arbitration has been relatively rare,

are fully consistent with our hypotheses. Application of the terms of loan contracts and the governing legal principles in the event of default is likely to be clear. Keith Hylton explains that "[m]ost loan contracts are relatively clear, and courts have a great deal of experience with them. An arbitration regime would risk diluting this predictability, which in turn could reduce deterrence benefits."[124] (Similar considerations likely apply to bond indentures as well.) In addition, courts have available special, expedited foreclosure procedures in the event of default that are unavailable in arbitration.[125]

Another possible explanation is that bankers are comparing arbitration to judges, rather than to juries, because their agreements generally contain enforceable jury-waiver clauses.[126] Relatedly, bankers are also often comparing arbitration to judges with whom they are comfortable, such as those sitting in state or federal court in New York County (Manhattan) or in London.[127] And Eisenberg and Miller's data confirm that the incidence of

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even ill-favored, in financial dispute resolution.").

[124] Keith N. Hylton, *Agreements to Waive or to Arbitrate Legal Claims: An Economic Analysis*, 8 SUP. CT. ECON. REV. 209, 231 (2000); *see also* Mattli, *supra* note 123, at 943 ("Unlike in construction, engineering, and intellectual property cases, which tend to go to arbitration, the question in international loan cases is generally quite simple: has the debt fallen due and been left unpaid, and, if so, how much is it? In most cases, establishing this fact is simple. . . . [L]egal uncertainties or intricacies are also rare in loan cases. Legal matters under loan agreements are well covered by case precedents and statutes; thus, the courts in New York and the United Kingdom possess, in most cases, the requisite information to deal expeditiously with default cases."); Park, *supra* note 96, at 215–16 ("A debtor's default usually results from simple inability or unwillingness to pay, rather than any honest divergence in the interpretation of complex or ambiguous contract terms.").

[125] Park, *supra* note 96, at 216; Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. DISP. RESOL. 89, 98 ("A court order is a preliminary step to repossession of collateral by a sheriff or to a judicial foreclosure sale of collateral. Arbitration of lenders' claims relating to collateral would be an additional step the lender would have to take before going to court to get the necessary order.").

[126] *See infra* note 127.

[127] *See* Kantor, *supra* note 123, at 411:

> [L]enders have actively avoided forums in which there was any risk that a sympathetic story might move the decision-maker toward leniency not found in the terms of the financing contract. The distaste for arbitration has reflected apprehension by banks that arbitral tribunals might make decisions based on notions of equity, rather than strictly enforcing negotiated contractual terms. A preference for "home court" decision-making in financial centers such as New York is also apparent. Many such jurisdictions have developed summary procedures for resolving court disputes about promissory notes and other debt instruments and New

arbitration clauses is lower when the alternative is a court reputed to be predictable and business-oriented.[128] For all these reasons, it is no surprise that only a tiny percentage of credit commitments (and bond indentures) include arbitration clauses.

Second, merger agreements and similar contracts (such as asset purchase/sale agreements) make up another important segment of Eisenberg and Miller's sample. But merger agreements likely will result in high stakes "bet the company" cases. Moreover, as Eisenberg and Miller themselves recognize in other work, "disputes in merger contracts often will be resolved through equitable relief (for example, a motion for preliminary injunction)."[129] For both of these reasons, merger agreements also are less likely to include arbitration clauses.

One final note: the SEC has opposed the use of arbitration to resolve disputes between public corporations and shareholders, using its acceleration power to force the abandonment of a proposed arbitration clause between the issuer and buyer of securities.[130] Thus, many of the "material events in the

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> York and London in particular have developed reputations as experienced, impartial forums for financial disputes. Uncharitably, one observer has further identified the "herd mentality" of bankers as another important explanation of the preference for courts over arbitration.

New York courts were the early leaders in the enforcement of jury-waiver clauses from 1925–1960, see Stephen J. Ware, *Arbitration Clauses, Jury-Waiver Clauses and Other Contractual Waivers of Constitutional Rights*, 67 LAW & CONTEMP. PROBS. 167 (2004), and New York continues to generate many of the reported cases that readily enforce such clauses. *Id.* at 204 n.223.

[128] Eisenberg & Miller, *supra* note 6, at 358–59, 372 (as evidenced by contracts in their sample governed by New York or Delaware law having a lower incidence of arbitration than contracts governed by California law). As Eisenberg and Miller say,

> bond indentures, credit commitments, underwriting contracts, pooling and service agreements, security agreements, and trust agreements all have high choice of law concentrations. For example, nearly all bond indentures and underwriting contracts designate New York law as the governing law. Trust agreements most frequently select Delaware law as the choice of law. The others most frequently select New York law.

Id. at 355.

[129] Theodore Eisenberg & Geoffrey Miller, *Ex Ante Choices of Law and Forum*, 59 VAND. L. REV. 1975, 1982 (2006).

[130] The arbitration clause was in the corporate charter of a corporation seeking to go public. *See* Paul H. Dawes, *Building Defenses to Federal Securities Law Claims*, *in* SECURITIES LITIGATION 1993: CURRENT STRATEGIES AND DEVELOPMENTS, at 265 (PLI Litig. and Admin. Practice, Course Handbook Series No. 479, 1993); Thomas L. Riesenberg, *Arbitration and Corporate Governance: A Reply to Carl Schneider*, INSIGHTS: THE CORP. AND SEC. LAW ADVISOR, August 1990, at 2; Carl W. Schneider,

lives of publicly traded corporations" studied by Eisenberg and Miller involve financial transactions that are likely within the jurisdiction of a powerful federal agency that opposes the use of arbitration clauses in at least some corporate governance documents. Although it is difficult to evaluate the effect of the SEC's opposition to arbitration on the contracts studied by Eisenberg and Miller, it may constitute another reason why those contracts are less likely to contain arbitration clauses than are other contracts.

D. *Types of Contracts Not Appearing in Eisenberg and Miller's Sample*

Not only do Eisenberg and Miller focus on types of contracts that are unlikely to include arbitration clauses, they either do not consider, or pay little heed to, the types of contracts that the arbitration literature commonly identifies as likely to include arbitration clauses. As a result, their study likely significantly understates the use of arbitration clauses in contracts between sophisticated parties.

First, going back to Soia Mentschikoff's pioneering research,[131] the commercial arbitration literature has focused on sales of goods as the leading place to find arbitration clauses between businesses.[132] This focus on goods continues in Lisa Bernstein's widely-cited studies of trade association arbitration.[133] Bernstein documents the prevalence of arbitration in contracts for the sale of goods in industries as diverse as cotton, diamonds, grain, and textiles.[134] Moreover, sale-of-goods disputes rank highly in the caseloads of

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Arbitration in Corporate Governance Documents: An Idea the SEC Refuses to Accelerate, INSIGHTS: THE CORP. AND SEC. LAW ADVISOR, May 1990, at 21; Hal Scott, *Let Shareholders Decide How to Resolve Disputes*, FINANCIAL TIMES, July 26, 2007, at 11.

[131] Soia Mentschikoff, *Commercial Arbitration*, 61 COLUM. L. REV. 846 (1961).

[132] Indeed, Mentschikoff distinguishes among raw goods, soft goods, and hard goods, but does not even mention non-goods transactions such as those in services, credit, or land. *Id.* at 851–52.

[133] *See, e.g.*, Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765 (1996) (grain); Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992) (diamonds); Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724 (2001) (cotton); *see also* Lisa Bernstein, *Private Commercial Law*, in 3 PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 108, 108 (Peter Newman ed., 1998) ("Private commercial law exists in over fifty industries including diamonds, grain, feed, independent films, printing, binding, peanuts, rice, cotton, burlap, rubber, hay and tea.").

[134] Lisa Bernstein, *The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study*, 66 U. CHI. L. REV. 710, 730–31 n.84 (1999) (explaining

international arbitration institutions.[135] Yet none of these goods contracts is, as far we can tell, in Eisenberg and Miller's data set.

Second, construction contracts also are a major source of arbitration agreements between businesses. Until 2007, arbitration was the default mode of dispute resolution specified in standard form contracts promulgated by the American Institute of Architects (AIA).[136] In 2007, the AIA changed its standard form contract to require the parties to check a box specifying arbitration; otherwise the dispute will be resolved in court.[137] The explanation given for the change was that "arbitration is often removed from

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that the Worth Street Textile Market Rules "are incorporated into most textile contracts, which also provide for arbitration under the Rules of the General Arbitration Council of the Textile and Allied Trades, which are today administered by the American Arbitration Association."); Thomas W. Lyons, *Specs & the Single Arbitration Clause*, 56 DISP. RESOL. J. 58, 63 (2001) ("A number of judicial decisions acknowledge that in certain industries, especially textiles, arbitration is the trade custom (regardless of the size of the companies involved)."); *see also* Leadertex v. Morganton Dyeing and Finishing Corp., No. 93 Civ. 3755, 1994 U.S. Dist. LEXIS 11512, at *8 (S.D.N.Y. Aug. 17, 1994) ("[A]s a merchant in the textile industry, Leadertex cannot be surprised by the inclusion of an arbitration clause. Indeed, the 'widespread use of arbitration clauses in the textile industry puts a contracting party . . . on notice that its agreement probably contains such a clause.'") (quoting Genesco, Inc. v. T. Kakiuchi & Co., 815 F.2d 840, 846 (2d Cir. 1987)).

[135] *2007 Statistical Report*, ICC INT'L CT. ARB. BULL., Spring 2008, at 5, 12 (listing "sales agreements" (23.9% of all contracts) as the "most common" type of contract giving rise to an ICC arbitration in 2007); Arbitration Institute of the Stockholm Chamber of Commerce, Statistics 2008, http://www.sccinstitute.com/filearchive/2/25118/SCC_Statistical_Report_2008_.pdf (last visited Nov. 10, 2009) (listing sale of goods (23.9% of cases) as most common "subject matter of dispute" in 2008). Note that the only type of contract in the Eisenberg and Miller sample listed as commonly giving rise to ICC arbitrations in 2007 was shareholding agreements, which gave rise to 8.3% of ICC arbitrations. *2007 Statistical Report, supra.*

[136] Most construction in the United States occurs pursuant to form contracts promulgated by the American Institute of Architects, and prior to 2007 these form contracts contained arbitration clauses. *See* Justin Sweet, *The American Institute of Architects: Dominant Actor in the Construction Documents Market*, 1991 WIS. L. REV. 317, 317; Dean B. Thomson, *Arbitration Theory and Practice: A Survey of AAA Construction Arbitrators*, 23 HOFSTRA L. REV. 137, 154–55 (1994); *see also* EDWARD BRUNET & CHARLES B. CRAVER, ALTERNATIVE DISPUTE RESOLUTION: THE ADVOCATE'S PERSPECTIVE 324, 325 (2d ed. 2001) ("Commercial arbitration can be a dominant mode of dispute resolution in certain industries. Certainly this is the case in the construction industry where most major construction contracts have arbitration clauses.").

[137] American Institute of Architects, Standard Form of Agreement Between Owner and Contractor where the Basis of Payment is a Stipulated Sum § 6.2 (Form A101-2007), *quoted in* Paul M. Lurie, Major Changes in the 2007 AIA Documents 3 AM. INST. ARCHITECTS, *available at* http://aia.org/groups/aia/documents/pdf/aiab078762.pdf.

the AIA agreements."[138] Nonetheless, the number of construction arbitrations remains high,[139] although it is no doubt too early to observe the effect of the form contract change. Construction disputes also rank highly in the caseloads of international arbitration institutions.[140] Eisenberg and Miller's sample, even though collected prior to the 2007 AIA contract change, apparently contains no construction contracts.

Third, prior research has identified joint venture agreements as a type of contract likely to include arbitration clauses.[141] Although parties submit joint venture agreements as attachments to SEC filings, Eisenberg and Miller did not report results on the use of arbitration clauses in joint venture agreements for the time period they studied.[142] We examined a sample of joint venture agreements submitted with SEC filings in 2008.[143] As shown in Table 4, over 60% (32 of 52, or 61.5%) of the joint venture agreements contained arbitration clauses, including 71% (22 of 31) of international joint ventures

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[138] Lurie, *supra* note 137, at 2.

[139] American Arbitration Association, AAA's Commercial Caseload Up 46% in 2007 (June 16, 2008), http://www.adr.org/sp.asp?id=34719 ("Construction: Case filings rose from 4,085 in 2006 to 4,199 in 2007, a 3 percent growth."); American Arbitration Association, AAA's Commercial Caseload Marked Breakthrough in 2006 (July 11, 2007), http://www.adr.org/sp.asp?id=32590 ("Construction case filings increased more than 7 percent overall—from 3,065 cases in 2005 to 3,288 cases in 2006. Within the category, two segments had especially strong growth—residential construction cases and large, complex construction cases. General commercial construction cases, although not up for 2006, held the 2005 line.").

[140] *2007 Statistical Report*, *supra* note 135, at 12 (listing construction contracts (13.3% of all contracts) as second most common type of contract giving rise to an ICC arbitration in 2007); Hong Kong International Arbitration Centre, Statistics, http://www.hkiac.org/show_content.php?article_id=9 (last visited Dec. 1, 2008) (listing construction disputes as most common type of contract giving rise to HKIAC arbitration).

[141] DRAHOZAL & NAIMARK, *supra* note 22, at 59 (finding that 88.2% (15 of 17) of a sample of international joint venture agreements included arbitration clauses).

[142] It is possible that Eisenberg and Miller included joint venture agreements as "other" contracts in their reported results. *See* Eisenberg & Miller, *supra* note 6, at 351 (reprinted *supra* Table 1). But the number of "other" contracts in their sample that included arbitration clauses seems rather small given the rate at which the joint venture agreements in our sample included arbitration clauses.

[143] We collected the contracts from the LEXIS database of "material contracts" submitted as exhibits to SEC filings (EXBT10), using the search ("joint venture" w/3 agree!) limited to filings between January 1, 2008, and December 31, 2008. We reviewed the search results to find actual joint venture agreements, excluding contracts that merely referred to joint venture agreements. We also excluded amendments to or consolidations of previously existing joint venture agreements, as well as options to form joint venture agreements. We make no claim that our sample is a representative sample of all joint ventures.

and almost 48% (10 of 21) of domestic joint ventures. While the rate at which arbitration clauses were included in the international joint venture agreements studied was less than the rate found in a prior study with a much smaller (and older) sample of contracts,[144] it is still much higher than the rate reported by Eisenberg and Miller for any category of international contract. Likewise, the rate at which arbitration clauses were included in domestic joint venture agreements in the sample was greater than for any category of domestic contracts Eisenberg and Miller studied as well.[145]

Table 4. Use of Arbitration Clauses in Joint Venture Agreements, 2008 SEC Filings

Type	No Arbitration Clause	Arbitration Clause	Total
Domestic	11 52.4%	10 47.6%	21
International	9 29.0%	22 71.0%	31
Total	20 38.5%	32 61.5%	52

In sum, Eisenberg and Miller's sample includes various types of contracts unlikely to include arbitration clauses and excludes types of contracts (e.g., sale of goods, construction, and joint ventures) more commonly associated with arbitration agreements between businesses.

[144] DRAHOZAL & NAIMARK, *supra* note 22, at 59 (seventeen joint venture agreements from 1993 to 1996).

[145] Eisenberg & Miller, *supra* note 6, at 353. This is by no means an exhaustive list of contracts in which arbitration clauses are used. For example, another type of contract commonly identified as including arbitration clauses is reinsurance treaties (contracts between insurance companies and reinsurers), which also do not appear in Eisenberg and Miller's sample. *See, e.g.*, Robert W. DiUbaldo, *Evolving Issues in Reinsurance Disputes: The Power of Arbitrators*, 35 FORDHAM URB. L.J. 83, 83 (2008) ("reinsurance contracts . . . often contain arbitration clauses requiring that any and all disputes arising under the contract be resolved by arbitration"); Mark Charles Kareken et al., *Challenging the Qualifications of the Reinsurance Arbitrator*, FICC Q., Winter 2000, at 141 ("it is the rare reinsurance treaty or facultative certificate that does not contain an arbitration clause."). Franchise agreements also seem to contain arbitration clauses at a higher rate than the contracts studied by Eisenberg and Miller. *See* Drahozal & Wittrock, *supra* note 18, at 95 (43.7%).

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Obtaining data on the use of arbitration clauses in contracts is difficult. Hence, Eisenberg and Miller's study is valuable for the empirical insights it provides into types of contracts for which no empirical data previously has been available. But there are strong reasons to believe that their sample is not representative of business-to-business contracts as a whole. Their study is a useful reminder that arbitration clauses are not widely used in material contracts, what one might call "extraordinary" contracts between businesses. But their study simply does not speak to the frequency with which arbitration clauses are used in ordinary contracts between businesses.

IV. Is Avoiding Class Actions the Only Reason Businesses Use Arbitration Clauses in Consumer Contracts?

With respect to consumer arbitration clauses, Eisenberg et al. suggest a Manichean dichotomy in which businesses use such clauses either for the virtues of "fairness and efficiency"[146] or "against" consumers in a "draconian attack[] on aggregate consumer dispute resolution,"[147] that is, class actions. One reading of their article is that the data from their study compels the conclusion that the one and only reason businesses use consumer arbitration clauses is to immunize themselves from class actions. They write:

> The absence of arbitration provisions in the great majority of negotiated business contracts suggests that companies value, even prefer, litigation as the means for resolving disputes with peers. The systematic eschewing of arbitration clauses in business-to-business contracts also casts doubt on the corporations' asserted beliefs in the superior fairness and efficiency of arbitration clauses.
>
> . . . .
>
> [C]orporations' selective use of arbitration clauses against consumers, but not against each other, suggests that their use of mandatory arbitration clauses may be based more on strategic advantage than on a belief that corporations are better serving their customers.[148]

The "strategic advantage" businesses gain over consumers by using arbitration clauses is, according to Eisenberg et al., the decreased threat from class actions. They espouse the following theory:

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[146] Eisenberg et al., *Summer Soldiers*, *supra* note 9, at 876.

[147] *Id.* at 896.

[148] *Id.* at 876, 895.

> Companies prefer individual over aggregate dispute resolution because aggregate treatment creates overwhelming settlement pressure and because few consumers will seek redress on an individual basis due to lack of information or the small amounts in dispute. Companies could attempt to address this problem by imposing waivers of class action litigation in their consumer contracts. But such waivers would be politically controversial and also would face a risk of being declared unconscionable by courts. The mandatory arbitration clause is a preferable alternative. Such clauses, if effective, may have the same result as class action waivers: they prevent class actions and remit consumers to individual actions which, in light of the stakes, are usually not worthwhile to pursue. But mandatory arbitration clauses are easier to sell and enforce than class action waivers.[149]

In short, Eisenberg et al. might be read as claiming that their data show that businesses rarely use arbitration clauses with each other, so their frequent use of arbitration "against" consumers must be motivated by a desire to immunize themselves from class actions, rather than by their "asserted beliefs in the superior fairness and efficiency of arbitration."[150]

Alternatively, Eisenberg et al. might be read more narrowly. In developing their hypothesis about the use of arbitration clauses, Eisenberg et al. rely on litigation filings by credit card companies and cell phone companies, and their sample consists of consumer financial and telecommunications companies—essentially the same businesses.[151] At some points in the article, they specifically limit their conclusions to the businesses in their sample.[152] On this narrower reading, Eisenberg et al.'s conclusions are limited to the use of arbitration clauses in credit card and cell phone contracts, and do not necessarily have any application to the use of consumer arbitration clauses by other businesses.

In our view, their findings contain an element of truth—that some businesses include arbitration clauses in some consumer contracts to reduce

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[149] *Id.* at 888.

[150] *E.g.*, *id.* at 894 (stating "from the perspective of corporate self-interest, concern over class actions remains the most likely explanation for the prevalence of arbitration clauses in consumer agreements" and "apart from the role of arbitration clauses in shoring up the validity of class action waivers, it is not clear why consumer arbitration would appeal to companies.").

[151] *Id.* at 878 & nn.27–30; *id.* at 881.

[152] *E.g.*, *id.* at 894–95 (claiming that, "we believe our data support the inference that *the companies in our sample* . . . view consumer arbitration as a way to save money by avoiding aggregate dispute resolution") (emphasis added). As noted above, however, they seem to extend their conclusions to all businesses, not just those in the sample. *See supra*, text accompanying notes 48–53.

their exposure to class actions. But their sample of contracts—both material and consumer—is not representative of both classes of contracts as a whole, and any conclusions from their study should be limited to the particular industries—financial services and telecommunications—involved.

A. *Consumer Arbitration Clauses: Motivations or Consequences?*

Surely businesses include arbitration clauses in their consumer form contracts because they are pursuing their own interests. We have studied consumer arbitration law for over a dozen years each and have yet to see a claim that businesses put arbitration clauses in their consumer contracts because such clauses are in the interests of the consumers *but not* of the businesses. In contrast, we have seen many claims—some by one of us—that businesses put arbitration clauses in their consumer form contracts because such clauses are in the interests of the businesses. As one of us wrote two years ago:

> Few doubt that enforcement of adhesive arbitration agreements benefits the businesses that use such agreements. This consensus is unsurprising; if businesses using these agreements did not benefit from them, why would they continue to use them? The consensus view is that businesses using adhesive arbitration agreements do so because those businesses generally find that those agreements lower their dispute resolution costs.[153]

So we do not think there is any doubt that businesses using arbitration clauses in their consumer form contracts do so because they are pursuing their own interests. The important question is whether they are also (even if indirectly and unintentionally) advancing the interests of their customers.[154]

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[153] Ware, *supra* note 61, at 254–55 n.4

[154] One of us has reviewed the empirical studies of arbitration arising out of "adhesive" form contracts and, while noting the limits of such studies, summarized the "empirical/anecdotal picture" as follows:

> [A]dhesive arbitration agreements give consumers and employees (1) better prices or wages and (2) extra leverage in small-yet-meritorious cases, but (3) reduced leverage in cases that could lead to a big-dollar jury award. For the vast majority of consumers and employees, the benefits of 1 and 2 outweigh the costs of 3 because it is the rare consumer or employee who actually has a claim that could lead to a big-dollar jury award.

Ware, *supra* note 61, at 261. We do not know that Eisenberg et al. disagree with any of this. They carefully disclaim any opinion on the "social utility" of the use of arbitration clauses in consumer contracts. Eisenberg et al., *Summer Soldiers*, *supra* note 9, at 895. While other scholars have argued against the enforcement

As we have known since Adam Smith, "[i]t is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest."[155] We twenty-first century consumers can expect no more benevolence from our credit-card issuers and cellular-service providers than consumers in Smith's day could expect from their butchers and bakers. The important question—the question that divides scholars studying consumer arbitration—is not the corporation's motivation for putting the arbitration clause in the cell-phone or credit-card form contract but whether that clause benefits or harms the customers who assent to that contract.[156]

More importantly, we believe that Eisenberg et al. set up a false choice when they suggest that "corporations' selective use of arbitration clauses against consumers" is either "based . . . on [the corporations'] strategic advantage" or on "better serving their customers."[157] If those are the only two choices, who will believe that corporations are doing something "against" consumers in order to "better serv[e]" those consumers? Eisenberg et al. have framed their choice in a way that implies that consumers must be harmed by arbitration clauses if those clauses are put in form contracts by businesses motivated by their own self-interest. In fact, however, as Eisenberg et al. acknowledge elsewhere,[158] consumers may benefit from these arbitration clauses even though they are put in form contracts by businesses motivated by their own self-interest. So we object to Eisenberg et al.'s emphasis on the motivations behind, rather than the consequences of, consumer arbitration clauses.

B. *Eisenberg et al.'s Conclusions Are Broader than Their Data*

That said, we will now engage Eisenberg et al. on their chosen ground—why businesses include arbitration clauses in their consumer contracts. Here, again, they reach conclusions beyond those that their data will support.

First, as Part III explained, Eisenberg et al.'s data do not show that businesses rarely use arbitration clauses with each other.[159] Their data shows that businesses rarely—if eleven percent is rare—use arbitration clauses *in*

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of consumer arbitration clauses in order to preserve the power of the consumer class action, Eisenberg et al. do not take this normative step. *Id.*

[155] ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 18 (Edwin Cannan ed., Univ. of Chi. Press 1976) (1776).

[156] *See supra* note 154.

[157] Eisenberg et al., *Summer Soldiers*, *supra* note 9, at 895.

[158] *Id.*

[159] *See supra* text accompanying notes 103–30.

certain types of material contracts with each other. As we discussed above, several plausible reasons explain why sophisticated parties would be less likely to use arbitration clauses in those contracts with each other than in their routine, low-dollar contracts with each other.[160] These same reasons similarly explain why a single sophisticated party would be less likely to use arbitration clauses in its material contracts than in its consumer contracts, which are, by definition, routine, low-dollar contracts.

Eisenberg et al. acknowledge this possibility, but reject it for two reasons: (1) "it is not obvious why the tradeoff should favor arbitration for small-scale disputes and litigation for large-scale ones (small claims court may be just as inexpensive as arbitration, for example)"; and (2) "the hypothesis has a somewhat fictional quality because few consumers will in fact exercise their rights under arbitration clauses."[161] By contrast, we find it quite plausible that sophisticated parties would assess the tradeoff in that way and we provide our reasoning in Part III of this article.[162] Moreover, the available empirical evidence—of which Professor Eisenberg is the co-author of the leading study[163]—suggests that consumer and employment arbitration is more accessible than litigation for small dollar claims.[164] Indeed, many consumers in fact exercise their rights under arbitration clauses with businesses, also belying this assertion.[165]

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[160] *See supra* text accompanying notes 86–102.

[161] Eisenberg et al., *Summer Soldiers*, *supra* note 9, at 890.

[162] *See supra* text accompanying notes 73–102.

[163] Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58-JAN. DISP. RESOL. J. 44, 53 (Nov. 2003–Jan. 2004) (stating, "The results of our study are consistent with the hypothesis that litigated non-discrimination cases are commenced mostly by higher-pay employees. Lower-pay employees seem to be unable to attract the legal representation necessary for meaningful access to court. . . . In the majority of court actions the cases likely were brought by highly paid employees, while in the arbitrations, high-pay employees represented only a minority of the claimants.").

[164] Drahozal, *supra* note 75, at 840 (stating "The [available] empirical evidence suggests that arbitration may be a more accessible forum than court for lower income employees and consumers with small claims. Consumers and employees bring claims in arbitration that would not be economical to bring in litigation.").

[165] *See* W. Mark C. Weidemaier, *The Arbitration Clause in Context: How Contract Terms Do (and Do Not) Define the Process*, 40 CREIGHTON L. REV. 655, 674 (2007) (reporting that 98.7% of JAMS consumer caseload involved cases with consumer as claimant). Perhaps Eisenberg et al. are assuming that the consumer arbitration clauses preclude classwide relief and that the bulk of consumers who "exercise their rights" do so as part of class actions. If so, then we understand their assertion that "few consumers will in fact exercise their rights under arbitration clauses" as an assertion that class actions are central to consumer law and individual consumer claims are an afterthought at most.

Second, as Eisenberg et al. themselves acknowledge, their "study is limited to a fairly narrow range of industries"—essentially consumer financial services and telecommunications companies.[166] They further acknowledge that those industries, unlike "low-arbitration-rate industries," consist of businesses that "face a substantial threat" from aggregate litigation, involving as they do "firms with millions of similarly situated customers affected by central company policy."[167] But what about other businesses that use consumer arbitration, whether from a low-arbitration rate industry or a high-arbitration-rate industry? Do those businesses include class arbitration waivers in their arbitration clauses? If not, it undercuts Eisenberg et al.'s conclusion that "from the perspective of corporate self-interest, concern over class actions remains the most likely explanation for the prevalence of arbitration clauses in consumer agreements."[168]

A report recently released by the Consumer Arbitration Task Force of the Searle Civil Justice Institute[169] addresses precisely that question. The data show that many consumer arbitrations administered by the American Arbitration Association arise out of contracts that do not preclude class relief in arbitration. Figure 1, which shows the use of class arbitration waivers in arbitration clauses giving rise to AAA consumer arbitration cases, reported by type of business, is reprinted from that report.[170] The two types of businesses with the highest usage of class arbitration waivers—both with 100% of the cases in the sample arising out of clauses including class arbitration waivers—were credit card issuers (26 of 26) and cell phone companies (5 of 5), the same types of contracts studied by Eisenberg et al. By comparison, the use of class arbitration waivers was mixed in car sales contracts (34 of 64, or 53.1%) and contracts with home builders (11 of 17, or

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While this may be the view of most lawyers who litigate consumer cases, we care about access to justice for consumers' individual claims and believe that to be a relevant criterion in assessing arbitration and litigation as means of resolving consumer disputes.

[166] Eisenberg et al., *Summer Soldiers*, *supra* note 9, at 891. Although they describe their sample as including "six major industry groups," those industries groups are in fact quite closely related. They consist of "telecommunications services," "'triple play' cable services," "securities services," "commercial banks," "retail credit cards," and "a financial credit company." *Id.* at 881.

[167] *Id.* at 892.

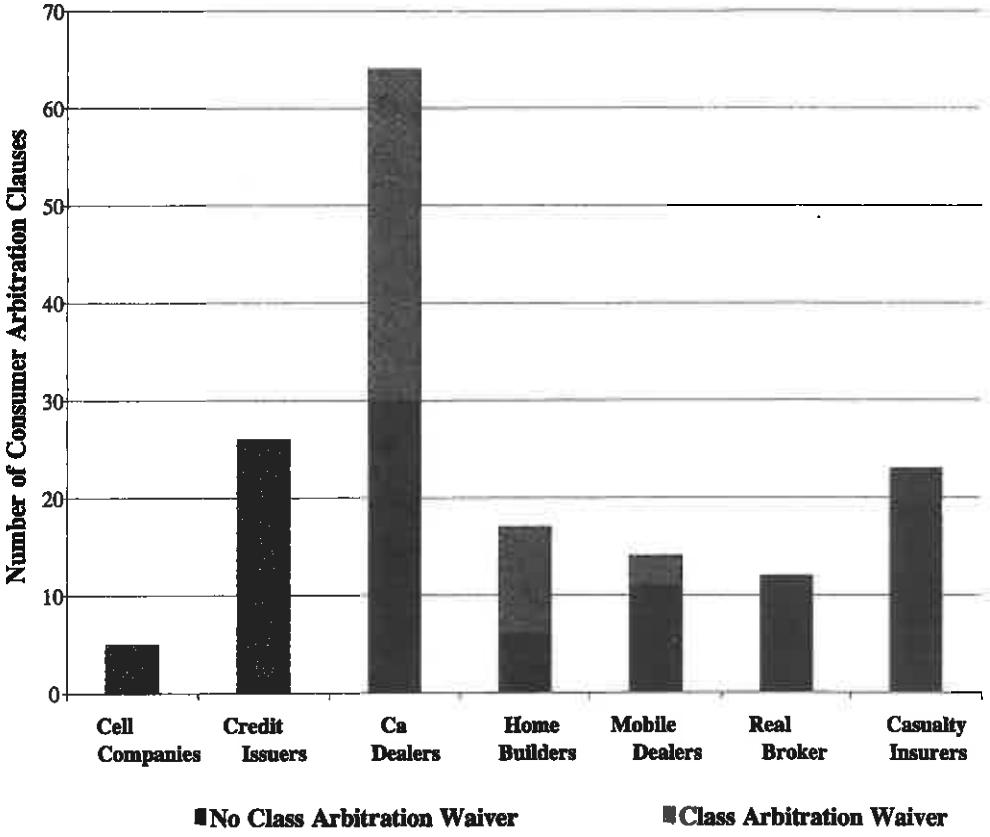
[168] Eisenberg et al., *Summer Soldiers*, *supra* note 9, at 894; *see also id.* (stating "apart from the role of arbitration clauses in shoring up the validity of class action waivers, it is not clear why consumer arbitration would appeal to companies.").

[169] Professor Drahozal is the Chair of the Task Force.

[170] *Consumer Arbitration Task Force, Consumer Arbitration Before the American Arbitration Association*, 104, MAR-2009 SEARLE CIV. JUST. INST. 104.

64.7%).[171] And the use of class arbitration waivers was nonexistent in real estate brokerage agreements and in the contract of the single casualty insurer in the sample.[172] Indeed, the substantial majority of cases (190 of 299, or 64.5%) in the sample did not arise out of an arbitration clause with a class arbitration waiver.[173] While the results are limited to AAA consumer arbitrations, they nonetheless identify a significant set of consumer arbitration clauses that do not include class arbitration waivers.

Figure 1:
Use of Class Arbitration Waivers by Type of Contract
(Cases = 161)



At bottom, then, what can we say about Eisenberg et al.'s empirical results? Perhaps their conclusions can be read narrowly. Their data do suggest that the industries they studied use arbitration clauses at least in part

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[171] *Id.* at 103.

[172] *Id.*

[173] *Id.*

to reduce their exposure to class actions.[174] That some businesses include arbitration clauses to reduce their exposure to class relief is not news, however. Numerous attorneys have recognized in print (and presumably many more have counseled clients in private) that arbitration can act as a "class action shield," reducing the exposure of businesses to potential class liability.[175] Yet that is all their study shows. The broader interpretation—that "concern over class actions remains the most likely explanation for the prevalence of arbitration clauses in consumer agreements"[176]—is not supported by a comparison of the types of business contracts least likely to include arbitration clauses (material contracts) to the types of consumer contracts most likely to include class arbitration waivers in their arbitration clauses. Such an unrepresentative sample does not support generalizations beyond the data studied.

V. CONCLUSION

Empirical data on the use of arbitration clauses, such as that presented by Eisenberg and Miller (and Sherwin), provide an invaluable perspective on the types of contracts in the sample studied. But as with all empirical studies, a central question is the extent to which we can generalize from that sample.

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[174] Even as to the businesses in their sample, their conclusion—that those businesses use arbitration clauses only to avoid class relief—likely is too broad. At least some of the businesses in the Eisenberg et al. sample use arbitration for collection of bad debts. This use of arbitration has been criticized as abusive in its own right, although the central criticism—that businesses have a high win-rate in those arbitrations—is meaningless without a comparison to how consumers fair in debt collection cases in court (which appears to be about the same). *The Arbitration Trap: How Credit Card Companies Ensnare Consumers* (Pub. Citizen's Congress Watch, Washington, D.C.), Sept. 2007, *available at* http://www.citizen.org/documents/ArbitrationTrap.pdf. *See* Peter B. Rutledge, *Arbitration: A Good Deal for Consumers*, APR. 2008 U.S. CHAMBER INST. FOR LEGAL REFORM 11 n.21; Ware, *supra* note 61, at 97–98 & n.54. Perhaps the businesses use arbitration to collect debts, even though it is a less efficient system, because they have to in order to preclude class relief. But in other contexts, arbitration clauses often carve-out debt collection actions from arbitration, which would permit the business both to reduce the risk of class actions while at the same time pursuing collection actions in court. Drahozal & Wittrock, *supra* note 18, at 114. Thus, the fact that the arbitration clauses do not include such a carve-out is suggestive that debt collection arbitration, at least for some businesses, may be a cost-effective use of arbitration.

[175] *E.g.*, Edward Wood Dunham, *The Arbitration Clause as Class Action Shield*, 16 FRANCHISE L.J. 141, 141 (1997); Alan S. Kaplinsky & Mark J. Levin, *Excuse Me, But Who's the Predator? Banks Can Use Arbitration Clauses as a Defense*, 7 MAY/JUN. BUS. L. TODAY 24, 24 (1998).

[176] Eisenberg et al., *Summer Soldiers*, *supra* note 9, at 894.

Eisenberg and Miller characterize their studied contracts as "a reasonable sample of what sophisticated parties specify ex ante regarding arbitration."[177] Accordingly, they conclude that "sophisticated actors prefer litigation to arbitration, encounter obstacles to negotiating mutually satisfactory contract terms that include arbitration clauses, or some combination of these factors."[178] Others have drawn even broader conclusions, asserting based on the Eisenberg and Miller study that "[i]n practice, arbitration does not seem to compete strongly with well-functioning public courts,"[179] and that, "given their choice, most businesses that negotiate contracts would prefer a judicial dispute resolution system over arbitration."[180] One reading of their study comparing the use of arbitration clauses in material contracts and consumer contracts from the same companies, as stated by Eisenberg et al. themselves, is that "from the perspective of corporate self-interest, concern over class actions remains the most likely explanation for the prevalence of arbitration clauses in consumer agreements."[181] None of these conclusions are adequately supported by the data.

First, a sample of "material" contracts, drawn from SEC filings, is not a representative sample of contracts entered into by sophisticated parties. Indeed, the regulations setting out SEC filing requirements limit the Eisenberg and Miller sample to material contracts made out of the ordinary course of a company's business, while excluding those made by the business in its day-to-day operations. Moreover, some of the principal contract types in the sample (commercial loan agreements and merger contracts) are exactly the types of contracts one would expect not to include arbitration clauses. Conversely, their sample apparently does not include several types of contracts commonly identified as likely to include arbitration clauses, such as construction contracts, contracts for the sale of goods, and joint venture agreements. In other words, the sample is limited to unusual contracts unlikely to include arbitration clauses while excluding more typical contracts that may be likely to provide for arbitration. Thus, Eisenberg and Miller's results depend on the types of contracts they studied, and provide no evidence of a general preference for litigation over arbitration.

Second, Eisenberg et al.'s possible conclusion that businesses use arbitration clauses in their consumer contracts primarily to avoid class relief likewise is undermined by their sample, which is limited to only two

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[177] Eisenberg & Miller, *supra* note 6, at 349.

[178] *Id.* at 336.

[179] Dammann & Hansmann, *supra* note 3, at 31.

[180] Woodward, *supra* note 4, at 669.

[181] Eisenberg et al., *Summer Soldiers*, *supra* note 9, at 894.

industries—financial services and telecommunications—both previously known for including arbitration clauses and class arbitration waivers in their consumer contracts. In contrast, the available empirical evidence identifies a number of other industries in which businesses include arbitration clauses in their consumer contracts but do not use class arbitration waivers. Eisenberg et al.'s study thus confirms the prior wisdom but does not support broad generalizations about businesses' motivations for using consumer arbitration clauses.