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Contract and Kompetenz

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CONTRACT AND *KOMPETENZ*

BY
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I. INTRODUCTION

In October Term 2009, the Supreme Court decided a series of important cases involving arbitration.[1] Two of those most important decisions were *Rent-A-Center, Inc. v. Jackson* and *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp*. At first glance, these two cases appear to have remarkably little in common. *Rent-A-Center* concerns the power of the arbitrator to resolve challenges to his jurisdiction. *Stolt-Nielsen* concerns the tribunal's ability to order classwide arbitration where the agreement is silent on the matter. Indeed though both decisions were decided in the same term by the same majority of justices, *Rent-A-Center* (the later-issued option) does not even cite *Stolt-Nielsen*.

At another theoretical level, however, both cases implicate overlapping values. Specifically, both cases address the relationship between contract and the arbitrator's decisionmaking authority (*kompetenz*). That relationship has several facets. One facet is the parties' freedom to allocate decisionmaking authority between arbitrators and courts (what I term "procedural contractual freedom"). Another facet is the arbitrator's authority to fill gaps in the parties' arbitration agreements. *Rent-A-Center*, then, is a case about the limits on the parties' procedural contractual freedom. Do limits exist on the parties' ability to reallocate from a court to an arbitrator the power to rule on jurisdictional challenges? *Stolt-*

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[1] In addition to the ones analyzed here, others include *Granite Rock Co. v. Int'l Bhd. of Teamsters*, 130 S. Ct. 2847 (2010); *Union Pac. R.R. Co. v. Bhd. of Locomotive Eng'rs and Trainmen Gen. Comm. of Adjustment, Cent. Region*, 130 S. Ct. 584 (2009).

Nielsen is a case about incomplete exercises in procedural contractual freedom. Do limits exist on the arbitrators' discretion to render a procedural (or substantive) decision when the parties have unambiguously expressed their desire to arbitrate but have not expressly regulated a procedural matter in their arbitration agreement?

Elsewhere, Chris Drahozal and I have examined these cases in terms of what they reveal about procedural contracts (that is, agreements under which the parties regulate the procedures by which their disputes will be resolved).[2] That article considers both the empirical practice (based on a dataset of credit card agreements deposited with the Federal Reserve) and draws some tentative normative conclusions. Building on that work, this essay sketches out two normative propositions.[3] First, I defend a strong form of procedural contractual freedom. This flows from a conception of autonomy and social welfare that underlie general contract theory. Second, I defend a strong form of gapfilling authority by arbitrators with respect to matters where the arbitration agreement is silent. This gapfilling authority flows from the same conception of procedural contractual freedom: Judicial deference to arbitrators' gapfilling authority respects the parties' mutual intentions based on their threshold decision to arbitrate. Viewed through this lens, *Rent-A-Center* was rightly decided, but *Stolt-Nielsen* was not. The lens on the cases brings into relief unexplored tensions in the cases that their common majorities fails to recognize. Those underlying tensions will complicate efforts to resolve a host of important, unresolved questions in arbitration theory and practice.

This essay develops the foregoing thesis in three parts. Part II provides the essential background on *Rent-A-Center* and *Stolt-Nielsen*. It also places those decisions in the larger context of arbitration doctrine. Part III develops a normative

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[2] Christopher R. Drahozal & Peter B. Rutledge, *Contract and Procedure*, __ MARQ. L. REV. __ (forthcoming 2011).

[3] In an abundance of caution, I make clear that, though the views expressed here build on the joint work that Professor Drahozal and I have undertaken, the views expressed here are solely my own.

framework for thinking about parties' ability to regulate the procedures by which their disputes will be resolved. Part IV applies that framework to the issues at stake in *Rent-A-Center* and *Stolt-Nielsen*. It also considers the implications of this normative framework for other current controversies in arbitration theory and practice.

II. BACKGROUND

The factual backgrounds to *Rent-A-Center* and *Stolt-Nielsen* have been discussed elsewhere and, thus, do not warrant comprehensive re-examination here.[4] This section provides only the background essential to my broader argument and places both cases in a broader doctrinal and empirical context.

A. Rent-A-Center

Rent-A-Center arose from an arbitration agreement used by a company with its prospective employees. Rent-A-Center required its prospective employees to sign the five-page agreement as a condition of employment. Among other things, the agreement allocated to the arbitrator the "exclusive authority to resolve any dispute relating to the interpretation, applicability, enforceability or formation of [the arbitration agreement] including, but not limited to any claim that all or any part of the [arbitration agreement] is void or voidable."[5]

Such a clause is commonly referred to as a "delegation clause." The clause is so named because it attempts to exploit a wrinkle in the United States law

[4] *See, e.g.,* David S. Schwartz, *Claims-Suppressing Arbitration: The New Rules,* 87 IND. L.J. __ (forthcoming 2012); Karen Halverson Cross, *Letting the Arbitrator Decide Unconscionability Challenges*, 26 OHIO ST. J. ON DISP. RESOL. (forthcoming 2011); Richard A. Nagareda, *The Litigation-Arbitration Dichotomy Meets the Class Action*, 86 NOTRE DAME L. REV. (forthcoming 2011); Melissa Hart, *Business-Like: The Supreme Court's 2009-2010 Labor and Employment Decisions*, 14 EMP. RTS. & EMP. POL'Y J. 207, 216-219 (2010).

[5] Rent-A-Center v. Jackson, 130 S. Ct. 2772, 2775 (2010).

governing the parties' ability to delegate to the arbitrator the power to rule on challenges to his jurisdiction. That idea typically is described in the literature as the principle of *kompetenz-kompetenz*.[6] Unlike several other countries, such as France and Germany, the Federal Arbitration Act does not explicitly regulate that principle.[7] Nonetheless, in *First Options v. Kaplan*, the Supreme Court sought to address this lacuna in the legislation. Under *First Options*, courts presumptively resolve challenges to the validity of the arbitration agreement while arbitrators resolve challenges to the validity of the underlying contract.[8] This presumptive allocation of authority, however, merely operates as a default rule (which, effectively, operates to fill a gap in the parties' procedural contract). Where there is "clear and unmistakable evidence" that the parties intended to allocate to the arbitrator the power to resolve challenges to the validity of the arbitration agreement, courts must defer to that determination (and consequently await an award before intervening in the matter).[9] Thus, a delegation clause such as the one at issue in *Rent-A-Center* attempts to exploit this exception to the *First Options*

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[6] *See*, *e.g.,* William W. Park, *The Arbitrability Dicta in First Options v. Kaplan: What Sort of Kompetenz-Kompetenz Has Crossed the Atlantic*, 12 ARB. INT'L 137 (1996).

[7] Other countries' approaches vary widely. Under French law, for example, the arbitrator has the sole power to resolve jurisdictional challenges, and courts become involved only after an award has been rendered. *See generally* William W. Park, *Determining Arbitral Jurisdiction: Allocating Tasks between Courts and Arbitrators*, 8 AM. REV. INT'L ARB. 133 (1997) (discussing French law). By contrast, under German law, both the arbitrator and courts can resolve jurisdictional challenges in parallel and the arbitration can be stayed while the judicial challenge is pending. *See* German Code of Civil Procedure (ZPO) para. 1032. This reflects one of the few modifications that Germany made to the UNCITRAL Model Arbitration Law, under which explicitly allows arbitration to proceed while a jurisdictional challenge is pending before a national court. *See* UNCITRAL Model Arbitration Law Art. 8.

[8] First Options of Chi., Inc. v. Kaplan*,* 514 U.S. 938 (1995). In other cases, the Court has elaborated on this general gapfilling principle. Courts resolve claims that the underlying agreement was never formed. Granite Rock Co. v. Int'l Bhd. of Teamsters, 130 S. Ct. 2847, 2856 (2010). Arbitrators resolve challenges that the underlying agreement is illegal. Buckeye Check Cashing, Inc. v. Cardegna*,* 546 U.S. 440, 449 (2006). Other cases have elaborated upon what constitutes a "gateway" issue that courts may resolve. Howsam v. Dean Witter Reynolds, Inc.*,* 537 U.S. 79, 83-86 (2002).

[9] *First Options*, 514 U.S. at 944.

default rule and to reallocate a greater share of decisionmaking authority to the arbitrator.

Such express delegation clauses are rather uncommon. As Chris Drahozal and I have documented in our empirical research of several different arbitration databases, most arbitration agreements do not use such delegation clauses.[10] Far more common is a related phenomenon in which the parties incorporate institutional rules that attempt to accomplish the same result – allocating to the arbitrator the authority to resolve challenges to her jurisdiction.[11] (I return to the implications of *Rent-A-Center* for these sorts of cases in Part III.)

The Court held that the delegation clause reallocated the authority to the arbitrator to resolve challenges to the underlying arbitration agreement. Critical to its conclusion, the Court conceptualized the parties' contract as containing two different agreements: (1) the arbitration agreement, and (2) the delegation clause. This notion expanded the separability doctrine, a principle of federal law, even though there was no extrinsic evidence that the parties in *Rent-A-Center* intended to "separate" the delegation clause from the arbitration agreement.[12] In other words, by consenting to arbitration, the parties were opting into this expanded separability rule even though they had never agreed upon it.

Through this "bifurcation" of the parties' contract (effectively a "trifurcation" in cases of single contracts containing both arbitration clauses and delegation clauses[13]), the Court could isolate the residual role played by courts with respect to the arbitration clause's enforceability. That is, courts could only resolve challenges to the validity of the delegation clause itself. Otherwise, all other disputes (both those relating to the arbitration agreement and those relating to

[10] *See* Drahozal, *supra* note 2.
[11] *Id.*
[12] *See Buckeye Check Cashing*, 546 U.S. at 445. Though oft forgotten, it is worth recalling that *Prima Paint*, the case originally articulating the separability doctrine, conceptualized it as a default rule that the parties could override by contract. *See* Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 402-403 (1967).
[13] Put another way, the Court announced a principle of double separability.

the underlying claims) would be resolved by the arbitrator. Judicial oversight of those matters would have to await an arbitral award.

B. Stolt-Nielsen

Stolt-Nielsen involved an arbitration clause in a standard charter party. Like most arbitration agreements, the arbitration clause was silent as to many procedural matters. Among other things, according to a stipulation between the parties, the arbitration clause did not expressly address whether arbitration could proceed on a classwide basis. Following some early procedural wrangling, the parties agreed to let the tribunal decide whether the agreement permitted classwide arbitration. The arbitrators concluded that it did.[14]

The issue of classwide arbitration was not entirely new to the Court. Several years earlier, in *Green Tree Finance v. Bazzle*, the Court considered whether an arbitrator had the authority to order classwide arbitration in a case where the arbitration agreement was silent on the matter.[15] The case yielded a fractured opinion, but a majority of the Court in *Bazzle* appeared to recognize the possibility that arbitration could proceed on a classwide basis. In the wake of that decision, a number of arbitral institutions, including the American Arbitration Association ("AAA"), established procedures for administering classwide arbitration. By the time *Stolt-Nielsen* reached the Court, the American Arbitration Association had already administered over two hundred classwide arbitrations.[16]

Though raising an important issue, *Stolt-Nielsen* was an unusual case in several respects. For one thing, the case involved commercial parties, whereas many cases examining the relationship between arbitration and class actions

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[14] Stolt-Nielson v. AnimalFeeds Int'l Corp., No. 80-1198, slip op. at 4 (2d Cir. April 27, 2010).
[15] Green Tree Fin. Corp. v. Bazzle, 539 U.S. 444, 447 (2003).
[16] David S. Clancy & Matthew M.K. Stein, *An Uninvited Guest: Class Arbitration and the Fed. Arbitration Act's Legislative History,* 63 BUS. LAW. 55, 56 (2007).

involved disputes between companies and consumers. Furthermore, the case involved an agreement that was silent on the issue of classwide arbitration. In the wake of *Bazzle*, parties to arbitration agreements had new reason to address the matter explicitly. They sometimes did so through bans on classwide arbitration (with a severability clause in case the class waiver is found unenforceable), though the empirical record is mixed on how frequently parties utilized such clauses or otherwise addressed classwide arbitration in their agreements.[17]

The Court announced two broad holdings. First, it held that the arbitrator lacked the power to order classwide arbitration in the face of a silent agreement (thereby departing from the view of the *Bazzle* plurality).[18] Second, it held that this departure supplied a ground for vacating the arbitral award (an interim award finding that the arbitration could proceed on a classwide basis).[19] The Court relied principally on Section 10(a)(4) of the Federal Arbitration Act under which a court may vacate an award "where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made."[20] In a rather cryptic footnote, the Court also indicated that, to the extent the "manifest disregard of the law" doctrine supplied an independent ground for vacating awards, the arbitrator's conduct in this case constituted manifest disregard as well.[21]

This section has provided the essential background on the two cases and placed them in doctrinal and empirical context. The next section develops a normative theory for evaluating the decisions.

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[17] Drahozal, *supra* note 2; Christopher R. Drahozal & Quentin R. Wittrock, *Is There a Flight from Arbitration?,* 37 HOFSTRA L. REV. 71, 106-109 (2008); Theodore Eisenberg et al., *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts* 41 Univ. Mich. J. L. Reform 871 (2008).
[18] Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp*.,* 130 S. Ct. 1758 (2010).
[19] *Id.*
[20] 9 U.S.C. § 10(a)(4).
[21] *Stolt-Nielsen S.A.*, 130 S. Ct. at 1768 n.3.

III. THEORY

As noted in the introduction, both *Rent-A-Center* and *Stolt-Nielsen* supply platforms by which one can think about the relationship between arbitration and contract theory. Both cases lie at the intersection of contractual freedom and gapfilling.[22] *Rent-A-Center* concerns the limits on parties' freedom to agree on a matter, but that contractual freedom is analyzed against the backdrop of two important default rules (the *First Options* rule and the principle of separability). *Stolt-Nielsen* concerns gapfilling in cases where the parties' agreement is incomplete, but that gapfilling question occurs against the backdrop of principles of contractual freedom (namely, what authority the parties are granting to the arbitrator through their mutual commitment to arbitrate). Here, I defend a normative view that endorses a strong form of procedural contractual freedom and a strong form of arbitral authority to fill gaps in parties' procedural contracts.

A. Contractual Freedom

Contract theory can teach us something about why societies enforce contracts. One theory focuses on the relationship between autonomy and contract.[23] Contracting is simply an expression of our autonomous preferences – what we buy, how we alienate our labor and, in this context, how we resolve our disputes. By enforcing contracts, the state is validating our expressions of autonomy.

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[22] For a thoughtful article that approaches these issues from another perspective- namely whether the Supreme Court's arbitration jurisprudence faithfully applies contract principles, see Lawrence A. Cunningham, *Rhetoric versus Reality in Arbitration Jurisprudence:How the Supreme Court Flaunts (and Flunks) Contracts (and Why Contracts Teachers Need Not Teach the Cases)*, 61 Duke L. J. __ (forthcoming 2011).

[23] MICHAEL J. TREBILCOCK, THE LIMITS OF FREEDOM OF CONTRACT 241-244 (Harvard Univ. Press, 1997) (1993); RANDY E. BARNETT, PERSPECTIVES ON CONTRACT LAW (Aspen Law & Business 3d ed. 2005) (1995); Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 309 (1986).

An alternative theory grounds contractual freedom in notions of social welfare. Enforcing promises is a socially desirable goal, not simply for the benefits derived by the individual, but also for the net increase in social wealth.[24] Consider a variety of transactions ranging from a home purchase to the sale of goods. Each of these transactions yields an array of benefits, including the development of communities, the employment of individuals producing the goods, the downstream production of other goods using the factors of production, etc. All of these transactions, however, entail various degrees of risk – risk of sequencing (i.e., whether payment must be made before the goods are produced) and time (i.e., if payment precedes delivery, how long is the buyer out of pocket?). Robust enforceable contract rules facilitate such transactions (and the consequent rise in social wealth) by reducing the risks and uncertainties associated with them. If the buyer knows that he can be made whole in the event that the seller fails to deliver the promised goods, he will be more willing to part with his capital up front.

The choice among theoretical bases has important implications. For example, notions of contractual freedom grounded in autonomy will support enforcement of contracts even when they do not produce a net gain in social welfare. Consider, for example, contracts for prostitution or contracts to alienate one's labor at an amount below minimum wage. Even if these contracts arguably produce some benefits for the individual, they produce externalities (in the case of prostitution) or a potential decrease in social welfare (by reducing the wage at which labor will be alienated). By contrast, notions of contractual freedom grounded in social welfare will support the enforcement of contracts even when doubts may arise about the expression of an individual's will. Consider, for example, the unconscionability doctrine. Courts will impose a high standard before declaring a contract unconscionable – not because the contract represents a good

[24] MICHAEL J. TREBILCOCK, THE LIMITS OF FREEDOM OF CONTRACT 244-248 (Harvard Univ. Press 1997) (1993); Charles J. Goetz & Robert E. Scott, *Enforcing Promises: An Examination of the Basis of Contract,* 89 YALE L.J. 1261, 1265 (1980); Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law,* 113 YALE L.J. 541, 569 (2003).

deal for the individual in the inferior bargaining position (it well may not) but rather because the social costs of invalidating the contract are so great that they outweigh the impact to the individual party. For example, if a court declares a front-end fee on a credit card unconscionable, that may end up resulting in higher interest rates spread across a broader array of users.

These general theories of contractual freedom resonate in the specific context of procedural contracts. Both autonomy theory and social welfare theory can help justify a strong form of procedural contractual freedom.[25] Under the autonomy theory, procedural contractual freedom makes sense as a manifestation of a party's preference about how to resolve a dispute – whether in the form of resolution (settlement, mediation, arbitration or litigation.)[26] According to the social welfare hypothesis, procedural contract freedom supports the parties' efforts to reduce their "process costs;" that is, the parties choose the form of dispute resolution that maximizes their net welfare (the benefits of the particular form of dispute resolution less process costs).[27]

Regardless of the proper theory of contractual freedom, each theory faces a counterargument. The autonomy theory is often met with complaints that it fails to account for limitations on one of the contracting parties. These limitations may take the form of either unequal bargaining positions (that is, a party's preferences are formed but she is effectively unable to manifest them in the contract – adhesion contracts providing the most obvious example) or bounded rationality (where, a party's preferences are themselves skewed because he does not know what is in his best interest – taking out term-life insurance on a newborn child). The social

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[25] The Supreme Court's very recent decision in *AT&T Mobility LLC v. Concepcion*, No. 09-893 (Apr. 27, 2011), released just as this essay was going to press, rests on these theoretical underpinnings to support a strong form of procedural contractual freedom.

[26] Lon L. Fuller, *The Forms and Limits of Adjudication*, 92 HARV. L. REV. 353 (1978); Owen M. Fiss, *Against Settlement*, 93 YALE L.J. 1073, 1078 (1984).

[27] Keith N. Hylton, *Agreements to Waive or Arbitrate Legal Claims: An Econ. Analysis*, 8 SUP. CT. ECON. REV. 209, 213 (2000); *See* Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. DISP. RESOL. 89 (2001).

welfare theory is often met with complaints that it fails to account for distributional disparities in the perceived social benefits. For example, arbitration clauses are often defended on the ground that they reduce the costs of resolving disputes ("process costs") and those savings are passed onto the other party (the customer or the employee). While theoretically coherent, that account assumes a certain elasticity. To the extent the consumer or employee lacks a meaningful choice among goods or services in a given market, so the argument goes, the company can retain the benefits without passing them along (technically, if the benefits are not passed onto the consumers or employees, they inure to the benefit of the ultimate equity holders of the firm). I return to these objections in Part III.

B. Gapfilling

Contract theory can also teach us something about gapfiliing and incomplete contracts. Incomplete contracts typically arise from either excess contracting costs or the parties' bounded rationality. Most accounts start with the unremarkable premise that the purpose behind gapfilling is to effectuate the likely intent of the parties if they had originally sought to regulate the matter in their contract.[28] While seemingly uncontroversial, this theoretical account is not entirely bug-free. One problem is the difficulty in discerning the intent of the parties.[29] The parties may well have left a matter unregulated in their contract precisely because they did not think about it. Another peril is the risk of post-hoc rationalizations.[30] The need for gapfilling arises precisely in situations where parties have a dispute

[28] *See, e.g.,* Omri Ben-Shahar, *A Bargaining Power Theory of Default Rules,* 109 COLUM. L. REV. 396, 396 (2009); Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 93 (1989).

[29] *See, e.g*., Ben-Shahar, *supra* note 28; Richard A. Posner, *The Law and Economics of Contract Interpretation,* 83 TEXAS L. REV. 1581, 1586 (2005).

[30] George M. Cohen, *The Negligence- Opportunism Tradeoff in Contract Law,* 20 HOFSTRA L. REV. 941, 946 (1992); Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729, 731 (1992); Ian Ayres, *Menus Matter*, 73 U. CHI. L. REV. 3, 6 (2006); Ian Ayres & Robert Gertner, *Majoritarian vs. Minoritarian Defaults*, 51 STAN. L. REV. 1591, 1592 (1999).

over the meaning of their contract. Once that dispute arises, of course, the parties naturally have an incentive to rationalize their positions based on their present interests (rather than attempt to approximate their interests at the time of contracting). Finally, attempting to reconstruct the parties' intentions raises a third set of problems – namely the incentive effects.[31] Excessive judicial gapfilling may have the unfortunate effect of encouraging either contractual laziness or, worse, strategic omissions by parties.

In response to some of the perceived weaknesses in the "effectuate the parties' intent" approach, an alternative theory conceptualizes gapfilling in terms of penalty default rules. Penalty default rules operate to incentivize one party to a transaction to regulate the matter explicitly in the transaction or, otherwise, suffer the negative consequences of silence.[32] Economically, the penalty default rule is typically imposed on the cheapest cost avoider, that is, the party who can regulate the matter contractually in the most efficient manner.[33] In the context of contractual gapfilling, penalty default rules operate in a manner not unlike the *contra preferentem* doctrine – except here we are not construing ambiguous terms against the drafter; instead we are construing silence against the interest of the party who can most efficiently regulate that silence through greater contractual specificity.

The general contract theory on gapfilling has important implications for procedural contractual freedom but necessitates an important modification. In the context of a procedural contract (like an arbitration agreement), the need to fill gaps is just as present as in a substantive context, but the court's role is more

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[31] *See, e.g.,* Frederick W. Lambert, *Path Dependent Inefficiency in the Corporate Contract: The Uncertain Case with Less Certain Implications,* 23 DEL. J. CORP. L. 1077, 1129-33 (1998).

[32] Ayres & Gertner, *supra* note 28, at 95-108; Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608, 617-622 (1998); Gregory Klass, *Intent to Contract,* 95 VA. L. REV. 1437, 1461-68 (2009).

[33] Dennis Patterson, *The Pseudo-Debate over Default Rules in Contract Law,* 3 S. CAL. INTERDISC. L.J. 235, 253-58 (1993); Cohen, *supra* note 30.

constrained. Compared to ordinary gapfilling in a substantive contract, procedural contractual gapfilling concerns two layers of analysis – (1) what is the proper gapfilling term and (2) *who is the proper entity to decide the matter* (by contrast in the substantive context, it is taken as a given that courts will perform the second-listed function). By opting into arbitration and including a set of arbitral rules, the parties effect a choice as to that second question. By giving effect to that choice, courts vindicate the strong form of procedural contractual freedom. By contrast, when courts override the arbitrator's decision about how to fill a gap in the parties' procedural contract, they ironically undermine procedural contractual freedom.

IV. APPLICATION

This section builds on the theoretical account developed in the preceding subsection. It critically applies the theory to the issues at stake in *Rent-A-Center* and *Stolt-Nielsen*. When viewed through the same lens (namely, the relationship between procedural contractual freedom and procedural contractual gapfilling), the two decisions stand in some tension. This section also considers the implications of that critical account on other issues presenting the same theoretical quandaries.

A. Procedural Contractual Freedom

Viewed against the framework developed in the preceding section, *Rent-A-Center* was rightly decided. It vindicated the parties' freedom to regulate how challenges to their arbitration agreement would be resolved. From the perspective of autonomy, the decision bolstered private choice. From the perspective of social welfare, the decision provided a predictable enforcement regime to such contracts that can have the salubrious effect of reducing process costs, namely the costs of resolving challenges to the enforceability of the arbitration clause that can retard completion of the arbitration.

Here, the objection may be raised, as it is raised against strong form normative views of contractual freedom generally, that one of the parties (in *Rent-A-Center* the employee) is neither engaging in an autonomous choice nor deriving any benefit from the net increase in social welfare generated by enforcement of the delegation clause.[34] Both forms of this argument, however, suffer from major difficulties. The autonomy-based criticism undermines the autonomy of the employee more severely than enforcement of the agreement. It rests on the premise that the employee does not know what is good for himself (or herself), so the objective manifestation of his (or her) intentions cannot be trusted. But where does that leave us? Even accepting the validity of the premise, it presupposes that there is some other, more reliable manifestation of the employee's preferences than his or her own agreement. Yet how those preferences are to be identified, who shall vindicate them and how one overcomes the *post hoc* rationalization problems are all difficulties that defenders of the autonomy-based criticism cannot overcome.

A deeper flaw with the autonomy-based criticism is that it has no logical stopping point. Even assuming that the consent to the delegation clause was not within the employee's preference set, there is a clearer case that the employee was assenting to arbitration at the time he signed the agreement. Indeed, *Rent-A-Center* presents an especially strong case for that proposition because, as already noted, the arbitration agreement was a separate document from the employment application and required an independent signature manifesting the applicant's assent. Yet if we cannot trust that the assent to the delegation clause represented an autonomous choice, is there any more reason to trust the assent to the arbitration clause? The short answer is "no," for the same basic reason – the autonomy-based critique to *Rent-A-Center* lacks any independently derived alternative for measuring the expressed preferences of the employee.

[34] Schwartz, *supra* note 4.

Of course, the employee (or more generally the party in the inferior bargaining position) is not entirely without protection. The precise purpose of the *First Options* default rule is to compel at least one party (here Rent-A-Center) to make an explicit choice to reallocate decisionmaking authority to the arbitrator. In this respect, the *First Options* default rule operates as a sort of judicially imposed gapfilling provision allocating *kompetenz* to the court absent an express manifestation of procedural contractual freedom by the parties.

B. Procedural Contractual Gapfilling

Viewed against the background developed in Part II, *Stolt-Nielsen* was wrongly decided. By deferring to the tribunal's decision to allow arbitration to proceed on a classwide basis, the Court in *Stolt-Nielsen* would have been reaffirming the principles of autonomy and social welfare that underpinned the strong normative defense of procedural contractual freedom sustaining *Rent-A-Center*. Instead, by revisiting that decision, the Court undermined the very values that it sought to promote in *Rent-A-Center*.

Here, it will naturally be objected that the procedural decision by the arbitrators – namely to allow the arbitration to proceed on a classwide basis – was an exceptional one. Even accepting that the arbitrators have some procedural discretion, so one would object, surely that discretion is not limitless, and when it concerns as core a matter as the identity of the parties to the arbitration, the tribunal exceeds its power and, thus, is subject to correction. That was the essence of Justice Alito's argument in the last part of the Court's opinion.[35]

There is a tempting seductiveness to this argument, but it ultimately is unpersuasive. Centrally, it bears emphasis that the parties to the class arbitration were all in some sort of contractual privity including an arbitration agreement. There was no suggestion in *Stolt-Nielsen* that any of the purported users of the

[35] Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., 130 S. Ct. 1758, 1776 (2010).

charter party had entered into an agreement lacking an arbitration clause. In other words, no one was being forced to arbitrate against his or her will. Rather, the tribunal was simply making the reasonable procedural decision to consolidate proceedings into a single, manageable one rather than a sprawling, multi-proceeding one – not unlike the sort of discretionary procedural decision that a federal court or the panel on multidistrict litigation undertakes.

The arbitration clause presents one complicating factor on the particular facts of this case. That is, unlike many arbitration clauses, the arbitration clause in this case neither specified the applicable rules (effectively making the case an *ad hoc* arbitration) nor expressly accorded to the tribunal the power to resolve procedural gaps in the parties' agreement. Nonetheless, the nature of the submission agreement in this case overcomes that problem. As every member of the Court recognized, the parties expressly submitted the class arbitration question to the arbitrators, effectively aligning it with the more common practice of vesting the arbitrators with the power to resolve procedural issues unaddressed by the parties' agreement (at least as to the class arbitration question).

Apart from the crabbed view the *Stolt-Nielsen* court takes of the arbitrator's discretion (and more broadly) the parties' procedural contractual freedom, the decision suffers from a deeper flaw. For its conception of gapfilling authority rests on a power of judicial review that sits uneasily with the Federal Arbitration Act. Recall the grounds for the Court's decision to vacate the award. Putting aside the confusing and unfortunate dicta on manifest disregard of the law, the Court ultimately rested its decision in Section 10(a)(4) of the Federal Arbitration Act. Here it is important to state that ground in full: the court may order vacatur of the award "where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made."[36] Read closely, Section 10(a)(4) actually sets

[36] 9 U.S.C. § 10(a)(4).

forth two grounds – (a) exceeding the powers and (b) imperfectly executing the powers. Moreover, the section contains the unusual phrase "that a mutual, final, and definite award upon the subject matter submitted was not made." It is far from clear whether this phrase modifies only the second ground or, instead, both grounds. The Court's decision presumes the first interpretation of the section but nowhere justifies it. Nor does it attempt to articulate the difference between "exceeding powers" and "so imperfectly executing" them. The Court has instructed elsewhere that statutory terms must be construed in a manner so as to give each term an independent meaning.[37] Applying that canon here, the two terms must be designed to describe different sorts of errors.

Regardless of the proper scope of *Stolt-Nielsen* regarding the arbitrator's gapfilling authority, the decision has potentially far-reaching implications for its views about judicial review of arbitral awards. The Court's formal reliance on Section 10(a)(4) breathes new life into a provision of the FAA that, until the Court's decision, had largely been a dead letter in federal arbitration practice.[38] Its alternative holding, resting on the manifest disregard doctrine, resurrected an ongoing debate[39] over whether the "manifest disregard" doctrine represents an independent ground for vacating an award (as the Court had suggested in dicta in two prior decisions[40]) or, instead, merely represents a short-hand reference to the Section 10 grounds generally (as the Court had recently suggested in dicta in another, more recent decision).[41]

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[37] Williams v. Taylor*,* 529 U.S. 362, 364 (2000) (stating that it is a cardinal rule of statutory construction to give effect to every clause and word of a statute).

[38] Peter B. Rutledge et al., *United States, in* PRACTITIONER'S HANDBOOK ON INTERNATIONAL COMMERCIAL ARBITRATION (Frank-Bernd Weigand ed., Oxford Univ. Press 2d ed. 2009).

[39] Richard A. Bales & MyLinda Kay Sims, *Much Ado About Nothing: The Future of Manifest Disregard After Hall Street*, 62 S.C. L. REV. (forthcoming 2011); Griffin Toronjo Pivateau, *Reconsidering Arbitration: Evaluating the Future of the Manifest Disregard Standard*, 21 SOUTHERN L.J. (forthcoming 2011).

[40] Wilko v. Swan*,* 346 U.S. 427, 436-437 (1953); First Options of Chi., Inc. v. Kaplan, 514 U.S. 938 (1995).

[41] Hall Street Assocs., L.L.C. v. Mattel, Inc.*,* 552 U.S. 576, 584-586 (2008). For exemplary circuit court decisions grappling with whether the manifest disregard doctrine remains an

Here, it is worth considering the relative consequences of the conceptions of judicial review articulated in *Rent-A-Center* and *Stolt-Nielsen*. *Rent-A-Center* involves an effort by one party to seek judicial intervention before arbitral proceedings have taken place; *Stolt-Nielsen* involves an effort by one party to seek judicial intervention after arbitral proceedings have taken place[42] (following an unsuccessful attempt to invoke judicial assistance at the agreement stage). Between the two sorts of attempts to invoke judicial assistance, the intervention undertaken in *Stolt-Nielsen* works a greater cost in terms of party welfare. It effectively forces the parties to endure all the sunk costs of the initial arbitration and then, following vacatur of the award, start over (albeit on an individualized basis). By contrast, from a social welfare perspective, judicial intervention in *Rent-A-Center* at least had the advantage of minimizing the parties' sunk costs by determining the delegation question before the arbitration had meaningfully proceeded.

In sum, *Rent-A-Center* and *Stolt-Nielsen* thus sit uncomfortably alongside each other. *Rent-A-Center* rested on a strong notion of freedom of contract, but that notion depended critically on a gapfilling rule (double separability) to which neither party agreed. By contrast, *Stolt-Nielsen* took a narrow view of arbitral gapfilling and, thereby, also took a crabbed view of the parties' freedom to allocate procedural decisionmaking to the arbitrator. The next subsection examines the implications of that tension.

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independent vacatur ground following *Hall Street*, *see e.g.*, Citigroup Global Mkts, Inc. v. Bacon, 562 F.3d 349, 352-54 (5th Cir. 2009); Comedy Club, Inc. v. Improv West Assoc., 553 F.3d 1277, 1289-91 (9th Cir. 2009); Lagstein v. Certain Underwriters at Lloyd's, London, 607 F.3d 634, 641 (9th Cir. 2010).

[42] Technically, the intervention occurs at an interim or preliminary stage. As noted above, the tribunal in *Stolt-Nielsen* issued an interim award on jurisdiction which enabled the parties to bring a vacatur action. While tribunals sometimes render awards of this sort, nothing compelled them to do so. In some cases, tribunals may pretermit interim jurisdictional awards until they have heard decisions on the merits. *See* Peter B. Rutledge, *Decisional Sequencing* 62 ALA. L. REV. 1 (2010).

C. Implications

The preceding subsection illustrated the wisdom of the result in *Rent-A-Center*, the error of *Stolt-Nielsen* and the underlying tension between the two decisions. This subsection considers the implications of that uneasy tension for other issues percolating in the lower courts and in academic literature.

Collectively, the two decisions create significant uncertainty over how courts should resolve issues of contract and *kompetenz* where the underlying issue involves the interpretation of arbitral rules incorporated by reference.[43] In both the delegation context and the procedural gapfilling context, those rules play a central role.

Begin with the *Rent-A-Center* situation. Most leading institutional rules in the United States, including both the commercial rules of the American Arbitration Association and the arbitration rules of JAMS, contain provisions that attempt to accomplish a result similar to those sought in delegation clauses. Rule 7(a) of the AAA Commercial Arbitration Rules is exemplary:

> The arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope or validity of the arbitration agreement.[44]

Such rules raise the question of whether they, like delegation clauses, supply the "clear and unmistakable evidence" of the parties' intent to override the default rule in *First Options*. This issue is at least debatable. On the one hand, the reasoning in *Stolt-Nielsen* would suggest that, unlike delegation clauses, these sorts of provisions do not explicitly appear in the parties' agreement but instead merely are

[43] In this respect, both cases were poor candidates for review by the Court because neither contract expressly incorporated institutional rules, a common norm in procedural contracts. *See* Drahozal, *supra* note 2.

[44] American Arbitration Association, Commercial Arbitration Rules and Mediation Procedures, R-7 (June 1, 2009), *available at* http://www.adr.org/sp.asp?id=22440#R7.

incorporated by reference. On the other hand, the reasoning in *Rent-A-Center* would suggest that such provisions aim to accomplish precisely the same result as delegation clauses; moreover, as a matter of contract law generally and arbitration law specifically, parties are routinely bound by contractual terms that they incorporate by reference. The overwhelming view among the federal courts is that such provisions, incorporated by reference, supply the "clear and unmistakable evidence" required by *First Options*.[45] Yet the tensions between *Rent-A-Center* and *Stolt-Nielsen* throw this area of law into doubt.

Now consider the *Stolt-Nielsen* situation. Most rules contain general provisions affording the arbitrator maximum discretion to fill gaps in procedural matters where the arbitration agreement is silent. For example, consider Article 16(1) of the International Center for Dispute Resolution ("ICDR")Rules:

> Subject to these Rules, the tribunal may conduct the arbitration in whatever manner it considers appropriate, provided that the parties are treated with equality and that each party has the right to be heard and is given a fair opportunity to present its case.

Other rules are to similar effect.[46]

Such rules again raise the question of what exactly the parties have delegated to the arbitrator. Under the reasoning of *Rent-A-Center*, the delegation could be considered a broad one, according them to resolve the discretion over any

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[45] *E.g.*, Contec Corp. v. Remote Solution Co., Ltd., 398 F.3d 205, 208 (2d Cir. 2005); Terminix Int'l Co., L.P. v. Palmer Ranch L.P., 432 F.3d 1327, 1332 (11th Cir. 2005); FSC Sec. Corp. v. Freel, 14 F.3d 1310, 1312-13 (8th Cir. 1994); Apollo Computer, Inc. v. Berg, 886 F.2d 469, 473 (1st Cir. 1989).

[46] Jonathan L. Frank & Julie Bedard, *Electronic Discovery in Int'l Arbitration: Where Neither the IBA Rules nor U.S. Litig. Principles are Enough*, 62 DISP. RESOL. J. 62, 69 (2007) (stating that both article 15(1) of the UNCITRAL rules and LCIA Article 14 providing the arbitrator the "widest discretion" are similar to ICDR rule 16(1)).

procedural matters not expressly addressed by the parties' contract. Under the reasoning of *Stolt-Nielsen*, by contrast, courts must police the application of such clauses to ensure that the arbitrator does not "exceed" her power.

Of course, the impact of *Stolt-Nielsen* for such cases depends on whether lower courts lay stress on the majority's language about how the choice to arbitrate implicates a decision about the identity of parties with whom one will arbitrate. If that is correct, though, *Stolt-Nielsen* still sits uncomfortably alongside the jurisprudence involving arbitration against non-signatories (a topic that the Court had only recently addressed before it decided *Stolt-Nielson)*.[47] Indeed, if *Stolt-Nielsen* is correct, then it is hard to see how arbitrations involving nonsignatories to the arbitration agreement (whether involving nonsignatory claimants or defendants) can remain good law. Unlike the class arbitration at issue in *Stolt-Nielsen*, the parties there are not even in contractual privity, and at least one party is being forced to arbitrate against another party with whom it has not entered into an arbitration agreement.

V. CONCLUSION

Rent-A-Center and *Stolt-Nielsen* represent important contributions by the Court to the evolving jurisprudence of arbitration. When viewed through the lens of contract theory, however, the two decisions sit uncomfortably alongside each other. One decision reflects a strong form of contractual freedom and envisions a limited role for judicial intervention. The other takes an unduly crabbed view of the arbitrators' gapfilling authority despite the parties' mutual intention to arbitrate. Until the Court unravels the knots created by these two opinions, the tensions in their underlying reasoning threaten to inject an unfortunate uncertainty into arbitration jurisprudence.

[47] *See* Arthur Anderson LLP v. Carlisle, 129 S.Ct. 1896 (2009).