Clauses In Conflict: Can an Arbitration Provision Eviscerate a Choice-of-Law Clause?

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INTRODUCTION

Advocates of arbitration have extolled the process as providing a more tailored, expeditious, cost effective, and private alternative to litigation.1 Citing these numerous benefits, businesses and private parties increasingly utilize the mechanism to resolve their commercial disputes.2 Similarly, despite initially viewing arbitration with skepticism, courts began to embrace the process following the passage of the Federal Arbitration Act (“FAA”)3 in 1925.4 Today, most

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3 Pub. L. No. 68-401, 43 Stat. 883 (1925) (codified as amended at 9 U.S.C. §§ 1–16 (2000)). The United States Supreme Court has stated that the FAA’s “purpose was to reverse the longstanding judicial hostility to arbitration agreements that had existed at English common law and had been adopted by American courts, and to place arbitration agreements upon the same footing as other contracts.” Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 24 (1991). Section 2 of the FAA, the Act’s primary substantive provision, declares that a written agreement to arbitrate “in any maritime transaction or a contract evidencing a transaction involving [interstate] commerce . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.” 9 U.S.C. § 2. The United States Supreme Court has interpreted this provision broadly, finding that “Section 2 is a congressional declaration of a liberal federal policy favoring arbitration agreements . . . .” Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983).

4 Wood, supra note 2, at 383.
courts have recognized not only agreements to arbitrate, but also the enforceability of such agreements and the resulting arbitral awards.\(^5\)

An important feature of arbitration that receives considerably less attention is that, “[a]bsent provision to the contrary in the arbitration agreement, arbitrators are not bound by principles of substantive law . . . .”\(^6\) Although parties often draft contracts stipulating that the laws of a certain jurisdiction will guide,\(^7\) “[n]one of the courts that have evaluated the effect of a simple choice-of-law provision on arbitration have specifically held that such a provision requires arbitrators to use substantive law principles as the primary decision-making criteria.”\(^8\)

Therefore, there seems to be a structural contradiction in contracts that contain both a choice-of-law provision and an arbitration clause. This Article investigates this apparent tension, delineates its practical implications, and offers guidance on how parties and their attorneys can draft arbitration clauses that protect their interests more effectively.\(^9\)

I. THE STRUCTURAL TENSION BETWEEN AN ARBITRATION PROVISION AND A CHOICE-OF-LAW CLAUSE

Because arbitration is a creature of contract,\(^10\) parties generally can control the structure of their arbitrations.\(^11\) In drafting these

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\(^5\) Id.


\(^7\) Interview with Scott Shagin, Esq., in Newark, N.J. (Mar. 2, 2004) [hereinafter Shagin Interview].


\(^9\) Although there are important choice-of-law considerations in international arbitration, such a discussion is beyond the scope of this Article. For an analysis of arbitrators’ choice-of-law decisions in international arbitration, see Rachel Enge, Party Autonomy in International Arbitration: Where Uniformity Gives Way to Predictability, 15 TRANSN. L. 323 (2002) (arguing that arbitrators should honor parties’ choice-of-law clause when determining the governing law in an international arbitration).

\(^10\) Wood, supra note 2, at 391.

\(^11\) Levin, supra note 8, at 112. There are two basic types of arbitration agreements. NAT’L INST. FOR TRIAL ADVOCACY, supra note 1, § 2.3. First, the parties can craft a “future-dispute arbitration agreement,” which is an arbitration clause contained in a broader contract between the parties. Id. Such an arbitration clause describes the arbitration procedures the parties must follow if a contractual dispute were to arise. Id. Second, the parties can create a “present-dispute arbitration agreement,” known as a “submission agreement,” which the parties craft when the parties wish to arbitrate a dispute, but the contract does not include a pre-existing arbitration clause. Id. Typically, parties include future-dispute arbitration
agreements, however, most parties rely extensively on the model clauses of organizations that specialize in alternate dispute resolution, such as the American Arbitration Association (“AAA”).12 The AAA’s arbitration clause, which is the most commonly used, does not expressly bind an arbitrator to apply substantive law:13

Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration administered by the American Arbitration Association in accordance with its Commercial [or other] Arbitration Rules . . . and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.14

For a variety of reasons, the extent to which arbitrators are required and actually do apply principles of substantive law is unclear. First, although parties have the right to specify the substantive law that arbitrators must employ, they rarely include such language in their arbitration agreements.15

Second, even when parties have expressly delineated their preference for the application of a particular jurisdiction’s substantive laws, courts have still allowed the arbitrators to decide what law, if any, they will apply. Although arising in an international arbitration context, Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer16 is illustrative. In Vimar, the disputants’ contract included an arbitration provision and a choice-of-law clause, which mandated the application of Japanese substantive law.17 After a dispute arose and the petitioner sued in the United States District Court for the District of Massachusetts, the respondent moved to stay the judicial proceedings and compel arbitration.18 The District Court granted this motion, and the United States Court of Appeals for the First
Circuit affirmed,\textsuperscript{19} reserving judgment on the choice-of-law clause.\textsuperscript{20} The United States Supreme Court affirmed, holding that a “choice-of-law question . . . must be decided in the first instance by the arbitrator.”\textsuperscript{21}

Third, without endorsing their inclusion in any arbitration agreement, the AAA provides three sample provisions permitting parties to specify what law will govern the contract and the arbitration proceedings.\textsuperscript{22} None of the sample provisions, however, expressly directs the arbitrator to apply the laws of the selected state.\textsuperscript{23} In fact, AAA’s General Counsel, Eric Tuchmann, acknowledges that his organization’s rules do not generally require that arbitrators decide cases in accordance with any particular legal principles.\textsuperscript{24} Instead, the AAA empowers arbitrators to apply substantive law when appropriate and also to consider “the agreement of the parties and the customs, rules, standards of conduct, and unwritten codes of the particular industry.”\textsuperscript{25}

Fourth, many courts have emphasized that parties, in selecting arbitration, have endorsed a process that is focused more on the ability and knowledge of the arbitrator than on a rigid application of the law.\textsuperscript{26} Such judicial deference is the basis on which many courts

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  \item \textsuperscript{19} Id. at 532.
  \item \textsuperscript{20} Id. at 541.
  \item \textsuperscript{21} Id.; see also Crown Equip. Corp. v. Supplies & Servs., No. 98-3435, 1999 U.S. App. LEXIS 7876, at *11–12 (6th Cir. Apr. 20, 1999) (holding that the arbitrator decides what substantive law governs the dispute); Medika Int’l, Inc. v. Scanlan Int’l, Inc., 830 F. Supp. 81 (D.P.R. 1993). In Medika, the disputants included the following choice-of-law clause in their contract: “This Agreement shall be deemed to have been executed and entered into in the State of Minnesota, U.S.A. and this Agreement, and its formation, operation and performance, shall be governed, construed, performed and enforced \textit{in accordance with the substantive laws of the State of Minnesota, U.S.A.}” Id. at 87 (emphasis added). Despite this clear provision, the District Court deferred “all issues arising from the Distribution Agreement, including the choice-of-law issue, to the arbitrator.” Id.
  \item \textsuperscript{22} \textit{Practical Drafting Guide}, supra note 11, pt. V.E.
  \item \textsuperscript{23} See id.
  \item \textsuperscript{24} Telephone Interview with Eric Tuchmann, General Counsel, American Arbitration Association (Mar. 24, 2004) [hereinafter Tuchmann Interview].
  \item \textsuperscript{25} Id.
  \item \textsuperscript{26} Levin, supra note 8, at 124. For example, in \textit{School City v. East Chicago Federation of Teachers}, 422 N.E.2d 656 (Ind. Ct. App. 1981), the court noted:

  Where, as here, the agreement contains a broad arbitration clause courts have generally held that arbitrators are \textit{not} bound by the principles of substantive law. . . .

  . . .

The reason for this traditional approach is the view that a part of
have declined to vacate an arbitrator’s award as being in “manifest
disregard of the law.”

Fifth, the FAA, the Uniform Arbitration Act, and state statutes
do not describe the role that substantive law should play in
arbitration.

Finally, parties often will not know whether or to what extent the
arbitrators applied substantive law, because the arbitrators generally
issue awards without an opinion. Thus, it is fair to say that
arbitrators are usually not bound to follow any substantive law when
rendering their awards.

Parties often specify the jurisdiction whose law will govern in a
contractual choice-of-law clause. Such a provision is either a
separate clause contained in the broader contract or a component of

what the parties have bargained for is dispute resolution based upon
the sense of equity or fairness of an impartial umpire who is familiar
with their problems and who should not be constrained by legal
technicalities. . . .

Id. at 662 (footnotes omitted).

27 See Levin, supra note 8, at 134–49. Professor Murray S. Levin, an arbitrator with
over fifteen years of experience, notes that courts have overwhelmingly held that an
arbitrator’s error of law does not subject the decision to appellate review. Id. at 125–
26. Rather, courts have applied the more relaxed “manifest disregard of the law”
standard, which has virtually precluded reversals of arbitrators’ decisions. Id. at 149.
Furthermore, because arbitrators usually do not support their decisions with written
opinions and arbitral records are typically sparse, awards are “virtually immune” from
judicial criticism. Telephone Interview with Murray S. Levin, Arbitrator and
Associate Professor of Law, University of Kansas (Mar. 12, 2004) [hereinafters Levin
Interview].


29 Levin, supra note 8, at 107–11. Professor Levin does note several exceptions,
however. For example, the New Jersey Alternate Procedure for Dispute Resolution
Act requires that all arbitrators analyze cases according to substantive law. Id. at 111
(citing N.J. STAT. ANN. § 2A:23A-1 to -30 (West 1987 & Supp. 1995)). This provision is
narrow, however, because it only applies to arbitrants who have agreed to arbitrate
pursuant to the Act. Id. (citing N.J. STAT. ANN. § 2A:23A-12(a), -12(c), -13(c)(5), -
13(c)(4) (West 1987)). If the Act does not apply, the New Jersey Arbitration Act,
which does not include any substantive law provision, guides. Id. at 111–12 (citing
N.J. STAT. ANN. § 2A:24 (West 1987)).

30 Lon L. Fuller, The Forms and Limits of Adjudication, 92 HARV. L. REV. 353, 387
(1978) (“Under the procedures of the American Arbitration Association awards in
commercial cases are rendered usually without opinion . . . “); Wood, supra note 2,
at 398 (“The absence of any requirement . . . for arbitrators to offer an explanation
of their decision has become a source of increasing attention.”); Levin Interview,
supra note 27.

31 Levin, supra note 8, at 106.

32 Shagin Interview, supra note 7.
the arbitration clause. In either scenario, the parties have manifested an intention to be bound by specific substantive law. If arbitrators have the discretion to decide awards based on the equities of the case and are not compelled to follow any substantive law, it follows that an arbitrator can essentially eviscerate a contract’s choice-of-law provision.

Courts have reviewed choice-of-law provisions in the context of arbitration. The reported cases, however, generally do not concern the applicability of substantive law. Rather, the jurisprudence deals with whether a state or federal arbitration act determines the procedural law, whether attorneys’ fees or punitive damages are available, and whether state or federal law dictates the validity and scope of the arbitration provision.

In one of the rare exceptions, Mastrobuono v. Shearson Lehman Hutton, Inc., the United States Supreme Court did examine the role of substantive law in arbitration when the Court attempted to reconcile a contract with an apparent contradiction. In Mastrobuono, petitioners opened a securities trading account with securities broker Shearson Lehman by executing a standard-form contract, which contained both an arbitration provision and a choice-of-law provision. Four years after opening the account, the petitioners alleged that Shearson Lehman mishandled their account and sued in federal court for damages.

53 Levin, supra note 8, at 119.
54 Id. at 122–23. For cases concerning choice-of-law clauses and the proper procedural law, see Volt Information Sciences, Inc. v. Board of Trustees of the Leland Stanford Junior University, 489 U.S. 468 (1989) (applying procedural rules of California instead of Federal Arbitration Act because underlying contract stipulated such in its choice-of-law provision), and Security Insurance Co. of Hartford v. TIG Insurance Co., 360 F.3d 322 (2d Cir. 2004) (holding that choice-of-law clause providing that parties’ agreement would be governed by California law mandated use of California’s procedural rules of arbitration). For a case that addresses the availability of attorneys’ fees, see Pinnacle Group, Inc. v. Shrader, 412 S.E.2d 117 (N.C. Ct. App. 1992) (permitting arbitrator to award attorneys’ fees to movant because contract specified that arbitration agreement was governed by New York law, which unlike North Carolina law permitted such awards). For a case involving whether federal or state law determines the validity and scope of an arbitration provision, see Flight Systems v. Paul A. Lawrence Co., 715 F. Supp. 1125 (D.D.C. 1989) (applying Virginia Arbitration Act instead of Federal Arbitration Act to contract involving interstate commerce because parties contracted and agreed to arbitrate under Virginia law).
56 Id. at 54.
57 Id.
arbitration provision, filed a successful motion to compel arbitration pursuant to the rules of the National Association of Securities Dealers ("NASD").  A panel of three arbitrators ultimately awarded the petitioners compensatory damages and $400,000 in punitive damages.  

Citing the contract’s choice-of-law provision, which mandated the employment of New York law, Shearson Lehman filed a motion in District Court to vacate the punitive damages award on the grounds that New York law permitted only judicial tribunals, not arbitrators, to award such damages.  The District Court and the United States Court of Appeals for the Seventh Circuit held that the panel of arbitrators lacked the power to award punitive damages.  The Supreme Court granted certiorari to resolve the split among the circuits as to whether a choice-of-law provision can preclude an arbitrator’s award of punitive damages that would otherwise be permissible.

Although the facts seemed to indicate a contradiction in the contract resulting from the tension between the choice-of-law provision and the arbitration clause, the Supreme Court held otherwise:

We think the best way to harmonize the choice-of-law provision with the arbitration provision is to read “the laws of the State of New York” to encompass substantive principles that New York courts would apply, but not to include special rules limiting the authority of arbitrators. Thus, the choice-of-law provision covers the rights and duties of the parties, while the arbitration clause covers arbitration; neither sentence intrudes upon the other.

This pronouncement in Mastrobuono has been interpreted in different ways. For example, professor and arbitrator Murray Levin

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38 Id.
39 Id.
40 Id. at 54–55.
41 Mastrobuono, 514 U.S. at 55.
42 Id. The Court acknowledged that the arbitration provision did not expressly permit the award of punitive damages. Id. at 60. The Court did note, however, that the NASD’s Code of Arbitration Procedure did allow arbitrators to award “damages and other relief” and that an NASD arbitration manual instructed arbitrators that they “can consider punitive damages as a remedy.” Id. at 61. Considering these two pieces of information together with the common law rule that ambiguous contract language is construed against the party that drafted it, the Court concluded that the arbitration provision permitted an arbitral award of punitive damages. See id. at 62.
43 Id. at 63–64.
believes that the decision may “signal a new judicial reluctance to allow businesses to take advantage of consumers and other weaker parties by having them agree to arbitration and unwittingly relinquish certain rights.” Conversely, in his dissent, Justice Thomas averred that the decision was “limited and narrow,” applicable “only to this specific contract and to no other.” Despite these various interpretations, it is clear that Mastrobuono did not articulate a judicial standard as to whether and to what extent an arbitrator must follow substantive law. Accordingly, we must ascertain whether there are other motivations that might persuade an arbitrator to apply substantive law.

II. THE PRACTICAL IMPLICATIONS OF SUCH STRUCTURAL TENSION

Professor Levin believes that, “although in theory, arbitrators are not bound to follow substantive law, in practice, they feel a strong sense of obligation to follow it.” He also acknowledges, however, that the “fundamental goal of arbitration is to ensure a fair and equitable result, not a strict adherence to the law.” Thus, the nature of the system permits an arbitrator ample discretion to discount an express choice-of-law provision if the equities demand it.

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44 Levin, supra note 8, at 122. Professor Levin’s assertion might be lent credence by the majority’s conclusion:
As a practical matter, it seems unlikely that petitioners were actually aware of New York’s bifurcated approach to punitive damages, or that they had any idea that by signing a standard-form agreement to arbitrate disputes they might be giving up an important substantive right. In the face of such doubt, we are unwilling to impute this intent. Mastrobuono, 514 U.S. at 63.
45 Mastrobuono, 514 U.S. at 71–72 (Thomas, J., dissenting).
46 The ambiguity concerning the role substantive law plays in arbitration is still prevalent among parties, lawyers, and even arbitrators. As Professor Levin claims, “It seems that most parties and lawyers incorrectly assume that arbitrators are bound to follow substantive law.” Levin Interview, supra note 27.
47 Id. Tuchmann also believes that although arbitrators are not required to apply the substantive law specified in the contract, they “diligently do so” in the large majority of cases. Tuchmann Interview, supra note 24. Tuchmann’s and Professor Levin’s opinion has been substantiated by empirical research. See, e.g., Soia Mentschikoff, Commercial Arbitration, 61 COLUM. L. REV. 846, 861 (1961) (finding that eighty percent of arbitrators believed they should decide their cases “within the context of the principles of the substantive rules of law”).
48 Levin Interview, supra note 27. Legal scholarship corroborates this belief. See, e.g., Mentschikoff, supra note 47, at 861 (finding that approximately ninety percent of arbitrators believed they were empowered to ignore substantive law whenever they determined a more “just” ruling was obtainable).
49 Levin Interview, supra note 27. Furthermore, there is no requirement that the
Professor Levin, attorney Scott Shagin, and Tuchmann all believe that there is a significance to the tension between a choice-of-law provision and an arbitration clause. First, there are often major differences in the law among jurisdictions, so parties have a vested interest in persuading arbitrators to apply a certain substantive law. Second, because arbitrators have decided numerous cases almost exclusively on the legal merits, the choice-of-law analysis can be dispositive. Third, parties usually have specific reasons for including a choice-of-law clause in the broader contract, so an arbitrator’s decision to disregard the clause impairs the expectations of the parties. Finally, many of the underlying agreements are contracts of adhesion, so it is questionable whether the parties had equal bargaining power or volition to consent to the arbitration provision. Since the party in the weaker position might have unwittingly

panel of arbitrators contain any lawyers. Tuchmann Interview, supra note 24. Thus, unless the parties specify in their arbitration agreement or agree before the arbitration to include at least one lawyer on the panel, the likelihood of the arbitrators complying with a choice-of-law clause is low. Id. If the panel does not contain any lawyers, it is doubtful that the panel will apply any substantive law in resolving the dispute. Shagin Interview, supra note 7.

Professor Levin has not had such experiences as an arbitrator, however. Levin Interview, supra note 27; Shagin Interview, supra note 7; Tuchmann Interview, supra note 24.

Mastrobuono illustrates such a scenario. In that case, the petitioners were able to recover $400,000 in punitive damages because they successfully argued that the contract permitted such an award. Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 54 (1995); see also supra notes 35–43 and accompanying text. Professor Levin also notes the disparity between Missouri and Kansas law regarding punitive damages and attorneys’ fees. Levin Interview, supra note 27. These differences are significant because many securities arbitration disputes in the Kansas City metropolitan area cross these geographic boundaries. Id.

Levin Interview, supra note 24. Professor Levin has not had such experiences as an arbitrator, however. Levin Interview, supra note 27. He states that in his fifteen years as an arbitrator, attorneys have rarely advanced a strict, technical analysis of choice-of-law provisions. Id. He attributes this fact to three primary reasons. First, he notes that most arbitrations are driven primarily by the facts and not by the law. Id. Because the importance of the facts generally overwhelms the legal issues, most parties present their case with a greater emphasis on the facts. Id. Second, Levin observes that when there have been legal issues, the differences in the law have not been substantial enough for attorneys to assume an intractable position regarding a choice-of-law clause. Id. Finally, he states that informed parties consent to arbitration for efficiency reasons and do not expect a formulaic application of the law. Id.

Professor Levin cautions, however, that many of these underlying agreements are contracts of adhesion, so it is questionable whether the parties had equal bargaining power or volition to consent to the arbitration provision. Levin Interview, supra note 27.

Levin Interview, supra note 27; see also supra note 44 and accompanying text.
sacrificed a substantive right by accepting the arbitration provision, arbitrators could be reluctant to apply the choice-of-law clause in a mechanical fashion.\textsuperscript{55}

As noted, although arbitrators afford substantive law a certain degree of deference when rendering their decisions, they feel empowered to deviate from the law in the interests of justice.\textsuperscript{56} According to Professor Levin, an arbitrator’s decision whether or not to follow a choice-of-law provision is based on two broad considerations.\textsuperscript{57} First, the facts and equities of the dispute generally will dictate how arbitrators approach a case.\textsuperscript{58} If arbitrators can apply the substantive law enumerated in the contract and achieve a fair result, they will follow the choice-of-law provision.\textsuperscript{59} If, however, equity and fundamental principles of fairness cannot be reconciled with the selected substantive law, arbitrators will reexamine the choice-of-law provision in the interests of justice.\textsuperscript{60}

Second, arbitrators will consider the context within which the parties negotiated their underlying contract.\textsuperscript{61} More specifically, arbitrators will examine the intentions of the parties, their relative bargaining power in the negotiations, whether or not there was true volition to sign the choice-of-law clause, and the availability of meaningful choices for the weaker party.\textsuperscript{62} For example, Professor Levin contends that his willingness to apply a choice-of-law provision would be different in an arbitration involving a contract of adhesion between Microsoft and an individual consumer than it would be in a case concerning a meaningfully negotiated contract between Microsoft and IBM.\textsuperscript{63}

Although strict adherence to the contract’s choice-of-law provision would have been disadvantageous for the consumers in \textit{Mastrobuono}, there are cases where aggrieved consumers would be

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  \item \textsuperscript{55} Levin Interview, \textit{supra} note 27. As noted, this was the scenario in \textit{Mastrobuono}, when a rigid application of the choice-of-law provision would have precluded the aggrieved consumers from recovering punitive damages. \textit{See supra} notes 35–43 and accompanying text.
  \item \textsuperscript{57} \textit{See supra} notes 47–49 and accompanying text.
  \item \textsuperscript{56} Levin Interview, \textit{supra} note 27.
  \item \textsuperscript{58} \textit{Id.}
  \item \textsuperscript{59} \textit{Id.}
  \item \textsuperscript{60} \textit{Id.}
  \item \textsuperscript{61} \textit{Id.}
  \item \textsuperscript{62} \textit{Id.}
  \item \textsuperscript{63} Levin Interview, \textit{supra} note 27.
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better served if the arbitrator followed the enumerated substantive law. For example, Scott Shagin recounts an arbitration that concerned a construction contract for a house addition. The contract contained a choice-of-law provision providing that New Jersey law governed the contract and an arbitration clause requiring that the “Construction Industry Dispute Resolution Procedures” of the AAA guided any disputes. A disagreement ensued, and the builder invoked the arbitration provision. In deciding not to apply New Jersey’s substantive law, the arbitrator did not consider the New Jersey Consumer Fraud Act and issued an award for the builder.

After the builder moved in Superior Court to confirm the award, the buyers cross-moved to vacate the award. The buyers, who were both experienced attorneys, argued that the arbitrator was bound by the choice-of-law clause and the general rules of contract construction to apply the Consumer Fraud Act. The Superior Court judge issued a consent order requiring that the arbitrator set forth reasons for his decision, including why the Consumer Fraud Act did not govern the outcome. The arbitrator submitted a brief justification for his award. The judge then vacated the arbitral award and remanded the matter for de novo arbitration. The disputants eventually settled out of court, more than nine months after the dispute arose.

This case demonstrates that informed parties, and even experienced attorneys, are often unaware that an arbitrator can deviate from the substantive law enumerated in a choice-of-law clause. As Shagin notes, “The homeowners assumed that New Jersey law would guide and that they would be protected by the Consumer

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64 Interview with Scott Shagin, Esq., in Newark, N.J. (Mar. 23, 2004) [hereinafter Shagin Interview II].
65 Id. The booklet enumerating the applicable arbitration procedures provided no guidance on choice-of-law provisions or the application of substantive law. AM. ARBITRATION ASS’N, CONSTRUCTION INDUSTRY DISPUTE RESOLUTION PROCEDURES (1997).
66 Shagin Interview II, supra note 64.
67 N.J. STAT. ANN. § 56:8-1 to -135 (West 2004).
68 Shagin Interview II, supra note 64.
69 Id.
70 Id.
71 Id.
72 Id.
73 Id. The vacating of an arbitrator’s award is an extremely rare occurrence. See Levin, supra note 8, at 125–57.
74 Shagin Interview II, supra note 64.
Fraud Act. The builder, the homeowners, and the site were all located in New Jersey, and the contract specifically called for New Jersey law to govern. Although such circumstances are not representative of most arbitrations, parties should at least be cognizant that such risks exist and carefully evaluate contracts containing both a choice-of-law clause and an arbitration provision.

III. GUIDANCE FOR CONTRACTUAL PARTIES AND ATTORNEYS

In structuring deals, parties often have specific reasons for including a choice-of-law clause in the underlying contract. Such reasons include the desire to maximize the predictability of their contractual relationship, to minimize litigation costs and uncertainty, and to protect and ensure certain substantive rights. Because of these considerations, choice-of-law clauses are often negotiated during the bargaining stage, and parties frequently exchange consideration to secure a favorable provision.

As we have seen, however, if the parties also include an arbitration provision in their contract, they may have unknowingly yet effectively eviscerated their choice-of-law clause. Therefore, assuming that the parties have bargained for the choice-of-law provision and expect it to have legal effect, it is imperative that the parties consider whether they truly want to arbitrate potential disputes arising under the contract. The parties must understand that the arbitrator is not bound to follow the choice-of-law provision or arguably any substantive law for that matter. So, in conceptualizing the contract, the parties must balance this trade-off with the benefits of arbitration.

75 Id.
77 Id.
78 Id. at 1093. This is obviously not the case with respect to contracts of adhesion.
79 See supra notes 47–49 and accompanying text, and text accompanying notes 56–63.
80 In addition to the ambiguity of the role that substantive law might play in resolving a dispute, arbitration proceedings have other disadvantages. As two commentators note:

In the interest of speedy adjudication, an arbitral decision is normally rendered without an opinion. Experts chosen by the parties for their familiarity with the subject matter are rarely experts in the law, and in any event are not bound to follow the law at all. Though limited
If the parties ultimately decide to include an arbitration clause and are determined that their choice-of-law govern any disputes, there are several things that Tuchmann recommends the parties include in the arbitration clause “to make the arbitration provision bulletproof.” First, they should manifest their clear intent to be bound by the substantive law of a particular state by inserting the choice-of-law language in the arbitration clause itself. Second, the arbitration clause should stipulate that the arbitrator is bound to decide the arbitration in accordance with the substantive law of the specified state. Third, the arbitration provision should state that the arbitrator is not authorized to and cannot make an award in equity. Fourth, the parties can ensure that they select an arbitrator who is more inclined to apply the substantive law of the enumerated state by specifying in the arbitration provision that the arbitrator shall be either a former judge or practicing attorney from that state. Tuchmann believes that in narrowing the field of potential arbitrators before a dispute arises, the parties will maximize the likelihood that the arbitrator will know and apply the substantive laws of the selected state. Fifth, the parties can mandate that if a party so

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Tuchmann Interview, *supra* note 24. According to Tuchmann, the more specifically and narrowly the parties draft their arbitration clauses, the less discretion an arbitrator can exercise in determining whether and to what extent to apply substantive law. *Id.* Should an arbitrator violate or disregard an express provision of the parties’ arbitration clause, the likelihood increases that a court will vacate the arbitrator’s decision as being beyond his or her powers or as being in “manifest disregard of the law.” *Id.*

*Id.* Professor Levin also endorses such an approach. Levin Interview, *supra* note 27.

Tuchmann Interview, *supra* note 24.

*Id.*

*Id.*

*Id.* Shagin notes that waiting until a dispute has arisen before deciding whether an arbitrator must be a former judge or attorney will not solve the parties’ pre-dispute substantive law concerns. E-mail from Scott Shagin, Esq., to Matthew Savare (Mar. 25, 2004) (on file with author) [hereinafter Shagin e-mail]. He argues: By the time an arbitral dispute has arisen, attorneys for each side will assess the relative merits of the case and the potential for a favorable
elected, he or she can move to vacate the award if the arbitrator did not conform to their choice-of-law.\textsuperscript{87} Tuchmann acknowledges, however, that such a strategy may no longer be viable in light of recently decided cases.\textsuperscript{88} Finally, if a party alleges that the arbitrator did not follow the contract's choice of law, the parties can require a de novo arbitration proceeding conducted by a panel of three arbitrators.\textsuperscript{89} Although such contractually mandated procedures for appellate review could be appealing to certain parties, the process is expensive, time consuming, and not a generally accepted practice.\textsuperscript{90} 

IV. CONCLUSION

There is scant judicial or legislative guidance relating to the role that substantive law should play in an arbitration proceeding.\textsuperscript{91} Although arbitrators feel an obligation to follow the parties’ choice-

\textsuperscript{87} Tuchmann Interview, supra note 24.
\textsuperscript{88} Id. See, e.g., Kyocera Corp. v. Prudential-Bache Trade Servs., Inc., 341 F.3d 987 (9th Cir. 2003), cert. dismissed, 540 U.S. 1098 (2004). In Kyocera, the parties included a provision in their arbitration clause that required the court to “vacate, modify or correct any award: (i) based upon any of the grounds referred to in the Federal Arbitration Act, (ii) where the arbitrators' findings of fact are not supported by substantial evidence, or (iii) where the arbitrators' conclusions of law are erroneous.” Id. at 990–91. Kyocera filed an unsuccessful motion to vacate the arbitrators' award, and on appeal, alleged at least twenty-five grounds for vacatur due to purported errors of law and unsubstantiated findings of fact. Id. at 994. The United States Court of Appeals for the Ninth Circuit, citing the FAA, stated that vacatur is only permissible in the narrowest of circumstances, such as when an award is procured by fraud, when an arbitrator is guilty of corruption or misconduct, or when an arbitrator exceeds his or her powers. Id. at 997. Regarding the final condition, the Ninth Circuit emphasized that “arbitrators exceed their powers . . . not when they merely interpret or apply the governing law incorrectly, but when the award is ‘completely irrational,’ or exhibits a ‘manifest disregard of law.’” Id. (internal citations omitted). Ultimately, the Court held that a federal court could only review an arbitrator’s decision in accordance with the limited reasons enumerated in the FAA. Id. at 1000. As such, “[p]rivate parties have no power to alter or expand those grounds, and any contractual provision purporting to do so is, accordingly, legally unenforceable.” Id.; see also Bargenquast v. Nakano Foods, Inc., 243 F. Supp. 2d 772, 776 (N.D. Ill. 2002) (holding that “parties may not contractually expand the scope of judicial review of arbitration awards”).

\textsuperscript{89} Tuchmann Interview, supra note 24.
\textsuperscript{90} Id.
\textsuperscript{91} See Levin, supra note 8, at 110.
of-law provision, there is no such requirement enumerated in the federal or state statutes or the AAA’s procedures.\textsuperscript{92} Thus, in any given arbitration, it is unclear to what extent arbitrators will apply the substantive laws selected by the parties or whether they are bound to apply any substantive law at all. Because arbitrators generally do not issue lengthy written opinions substantiating their awards, parties may have to divine this reasoning.\textsuperscript{93} Furthermore, arbitral awards are afforded great deference by the courts and can only be vacated under exceptional circumstances.\textsuperscript{94}

Therefore, before mandating arbitration in a contract, parties should weigh the practice’s numerous potential benefits with all the possible tradeoffs. Although commentators have discussed other disadvantages of arbitration,\textsuperscript{95} they have devoted less attention to the uncertainties concerning the application of substantive law. Unfortunately, parties and attorneys often are unaware that arbitrators are not bound to follow their choice-of-law provision or apply any substantive law. It is imperative that parties negotiate their contracts with their eyes wide open and draft their documents precisely. If parties understand the nuances in contracts containing both a choice-of-law clause and an arbitration provision, they can attempt to make their contracts “bulletproof” by manifesting a clear desire for an arbitrator to abide by the substantive law that they have selected.

As this Article has demonstrated, however, even the most careful contractual drafting will not necessarily avoid the problem. At best, parties can mitigate their risks. The key issue is that parties educate themselves that such risks are possible.

\textsuperscript{92} See supra notes 47–49 and accompanying text.
\textsuperscript{93} See supra note 30 and accompanying text.
\textsuperscript{94} See supra notes 26–27, 88 and accompanying text.
\textsuperscript{95} See supra note 80.