

Procedural Autonomy: Frontiers in the Customization of Dispute Resolution Procedures

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Submitted in partial fulfillment of the  
requirements for the degree of  
Doctor of Science of Law  
in the School of Law

COLUMBIA UNIVERSITY

2020

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# Abstract

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Commercial parties author the substantive terms of their contracts. Of course, they do not and cannot think of everything. Epistemic limits, differentials in bargaining power, and escalating costs prevent them from addressing all possible contingencies and details. So, contract law helps out by offering a set of default terms, which fill in many gaps. Conventional contract theory says that parties will change these defaults and select transaction-specific provisions whenever doing so will increase their contractual surplus.

More and more commentators have been asking whether similar autonomy extends to procedure: can, do, and should parties also be free to author the processes used to determine their substantive rights? The existing rules of procedure could be seen as defaults that apply to the extent that parties do not opt out or stickiness does not prevent them from doing so. The articles that comprise this dissertation address these questions, with emphasis on the first two: can and do parties engage in procedural contracting.

Chapter 1 focuses on whether parties have the power, under existing law, to contract for their own procedural regimes. It does so in a narrow context: opting into enhanced review of arbitral awards. This narrow context matters to the larger project because the only Supreme Court decision in the past sixty years to arguably curtail party autonomy over procedure was *Hall Street Associates, L.L.C. v. Mattel, Inc.*, which eliminated the authority of parties to opt into greater judicial scrutiny of their arbitral awards in federal courts. Chapter 1 investigates whether *Hall Street's* limitation threatens the freedom of contract in arbitration. Analyzing not only the case but the historic trajectory of Supreme Court jurisprudence on procedural contracting, Chapter 1

concludes that *Hall Street* was a poorly decided opinion, but it does not undermine party authority over procedure in arbitration. To the contrary, it purports to bolster that freedom by encouraging parties to look to state arbitration law for enforcement of awards. That outcome might jeopardize the harmonious function of arbitration law, but it does not signal any reticence by the Court about procedural contracting.

Chapter 2 picks up on a similar but broader approach. It begins by outlining the many theoretical benefits that parties could achieve through contractually selected dispute resolution procedures. Those benefits are significant. It then conducts a high-level survey of existing empirical literature. This literature concludes that parties do precious little procedural customization in their contracts. Chapter 2 recognizes the puzzling tension between these two conclusions: if procedural customization offers significant opportunity for contractual gains, why are parties shy about making such customizations? Chapter 2 posits that one important answer could be that existing doctrine prevents or dissuades procedural customization. Accordingly, Chapter 2 revisits and broadens the doctrinal analysis conducted in Chapter 1, evaluating a wider range of precedents, including lower federal court cases and state court cases. It concludes that courts are abandoning their historic skepticism over the devolution of judicial authority and recognizing the advantages of seeing dispute resolution procedures, both outside of courts and within them, as defaults rather than immutable or mandatory rules. Although not all forms of procedural autonomy are expressly welcomed by courts, the overwhelming trend of precedent suggests that courts would validate most procedural contracts.

Chapter 3 then confronts the unsolved puzzle: why do parties seem to avoid procedural customization when such customization could provide significant contractual gains? It begins with a more thorough meta-analysis of existing empirical studies looking at procedural contracting. Many existing studies focus on only a small subset of all possible procedural innovations, so

Chapter 3 weaves the studies together to paint a broader and more comprehensive picture. It finds that, contrary to some early commentator's estimates, some parties, some of the time, engage in a diverse range of procedural customization. In other words, the general conclusions reached by many commentators about the lack of procedural contracting are imprecise. Procedural contracting does take place. The challenge has been identifying and explaining the patterns of procedural contracting.

Chapter 3 argues that the first step towards understanding the ways that transactional designers harness the potential of procedural autonomy is to recognize that procedural customization functions best to offset litigation opportunism. Such opportunism is inherent in formal dispute resolution, but it presents particular problems in the context of contract dispute resolution. After a dispute arises, parties can strategically exploit the mismatch between their *ex ante* intentions and a decision maker's ability to discern those intentions. This sort of opportunism can sap the value of the contract to the parties. Chapter 3 systematically considers the way that various forms of procedural customization function to limit or eliminate litigation opportunism.

The Chapter then concludes with a typology of procedural innovation that considers underlying key attributes of a transaction, namely the degree of environmental and behavioral uncertainty present and the frequency with which other similar parties contract in the same domain. This typology offers a compelling explanation for the patterns of procedural contracting that we observe in practice.

# Table of Contents

Acknowledgments .....	iv
Dedication .....	v
Introduction .....	1
Chapter 1: Is Less Really More?.....	4
1.1    The Rise of Procedural Ordering .....	10
1.1.1    Procedure as Public Law: Historic Skepticism of Private Procedural Ordering .....	12
1.1.2    More than Mere Contract Law: Autonomy and Private Procedural Ordering .....	15
1.1.3    The Case for Party Control: Efficiency Gains from Customized Procedure .....	20
1.1.4    The Line Between Mockery and Efficiency: Limits to Customized Procedure .....	29
1.1.5    A Rolling Stop: Understanding <i>Hall Street</i> in Light of the Trend Favoring Private Procedural Ordering.....	30
1.2    The Status of State Laws Governing Judicial Review of Arbitral Awards .....	34
1.2.1    The Status Quo: States Following Federal Law and <i>Hall Street</i> .....	35
1.2.2    A Nod to Autonomy: States Allowing for Contractually Expanded Judicial Review of Arbitral Awards .....	37
1.2.3    A Back Door Sneak Attack?: States with More Intrusive Judicial Standards of Review of Arbitral Awards .....	44
1.3    The Problems with <i>Hall Street</i> 's Reliance on States to Advance Private Procedural Ordering in the Context of Expanded Judicial Review .....	45
1.3.1    Doctrinal Problems.....	46

1.3.2	Legal Uncertainty and High Transaction Costs .....	49
1.4	Conclusion.....	52
Chapter 2: Doctrinally Permissible Options for Calibrating Procedure Through Contract.....		54
2.1	The Gains from Customizable Procedure .....	58
2.1.1	Brief Primer on the Economic Theory of Procedure in Dispute Resolution.....	60
2.1.2	The Current Default Rules of Procedure .....	66
2.1.3	The Potential Benefits of Procedural Customization Through Contract .....	70
2.2	The Limited Empirical Evidence .....	82
2.3	The Doctrinally Permissible Options for Calibrating Procedure Through Contract.....	84
2.3.1	Procedure as Public Law: Historic Skepticism of Private Procedural Ordering .....	86
2.3.2	Mere Contract Law No More: Autonomy and Private Procedural Ordering .....	90
2.3.3	State Courts, Lower Federal Courts, and Procedural Autonomy .....	98
2.4	Conclusion.....	100
Chapter 3: Anticipating Procedural Innovation: How and When Parties Calibrate Procedure Through Contract .....		102
3.1	Benefits of Private Process.....	107
3.1.1	The Design Space for Contracting and the Role of Procedural Autonomy .....	108
3.1.2	Regulating Litigation Opportunism through Procedural Customization.....	113
3.1.2.1	Limiting the Possibilities of Post-Dispute Opportunism .....	113
3.1.2.2	Reinforcing Substantive Obligations .....	116
3.1.2.2.1	Altering the Expected Value of Litigation .....	116
3.1.2.2.2	Sending Credible Signals.....	118
3.1.2.2.3	Enhancing Informal Cooperation Mechanisms .....	119

3.1.2.3	Mitigating the Risks of Litigation .....	123
3.1.2.4	Directly Reducing the Costs of Litigation .....	125
3.1.3	Summary .....	126
3.2	Current Empirical Evidence Regarding Party Procedural Customization.....	126
3.2.1	Two Comprehensive Studies of Procedural Contracting.....	128
3.2.2	Particularized Studies of Specific Procedural Contracting Terms .....	132
3.2.3	Recent Evidence Demonstrating Highly-Customized Procedural Contracting .....	135
3.2.4	Summary .....	137
3.3	Anticipating Procedural Innovation .....	138
3.3.1	The Relationship Between Uncertainty and Litigation Opportunism .....	139
3.3.2	The Relationship Between Scale and Litigation Opportunism .....	140
3.3.3	Litigation Opportunism in the Four Rough Domains of Commercial Party Transactions 141	
3.3.3.1	Low Uncertainty, High Scale – Very Low Risk of Litigation Opportunism.....	142
3.3.3.2	Low Uncertainty, Low Scale – Slightly More Risk of Litigation Opportunism.....	146
3.3.3.3	High Uncertainty, High Scale – Moderate Risk of Litigation Opportunism.....	150
3.3.3.4	High Uncertainty, Low Scale – High Risks of Litigation Opportunism .....	153
3.4	Conclusion.....	158

## Acknowledgments

The projects comprising this dissertation would not have been possible without the guidance and support provided by, Professor Robert E. Scott, who has always been a model for balancing analytical rigor with compassion and generosity. It is no exaggeration to say that I have learned more from Professor Scott than any other person in my academic career. I also owe an unpayable debt to my mentor, Professor Victor Goldberg, who has never failed to share his time, brilliance, and incisive feedback at every stage. I am tremendously grateful to Professor Kellen Richard Funk for serving, on short notice, as the third person on my committee and providing valuable feedback during the defense of this dissertation. Likewise, this project could not have come to fruition without the insight and kindness of Professor Clayton Gillette.

Beyond these professors, I also need to thank Dean Silvia Polo for her patience and support throughout my time at Columbia Law School. Then there are the many, many individuals who have contributed all the stuff that simply cannot be put into words. But I want to specifically thank Professor Thomas Carbonneau, who has been a friend, mentor, and co-author. The first part of this dissertation, and in many ways, the spirit of the entire project owes its genesis to conversations that I had with Professor Carbonneau back in 2012.

I also want to specifically thank Dr. Matthew Vadnais, Jillayne Berg, Ted Lindseth, Frances Lindseth, Steve Swanson, and Carol Swanson. Finally, I want to thank Amanda Lindseth for being my constant, my inspiration, and my support always.

# Dedication

To Amanda Eiko Lindseth, my sun, my moon, and all my stars.

# Introduction

The three chapters of this dissertation were written as independent articles related by a common theme: procedural autonomy. I have presented them in the order that I wrote them. Though they do not build on one another in a linear way, though they do evolve.

The first (Chapter 1) started as an exploration of a puzzling United States Supreme Court decision, *Hall Street Associates, L.L.C. v. Mattel, Inc.* The case confounded me for several reasons, not the least of which was that it seemed to buck against an otherwise unified and unfettered line of more than forty previous pro-arbitration Supreme Court decisions. As I explored the case and its history, I came across a foundational article in this area of scholarship, Jaime Dodge's outstanding 2011 article, *The Limits of Procedural Private Ordering*. Professor Dodge described *Hall Street* as the sole case invalidating a procedural contracting term in decades. That, in turn, set me on my path towards understanding the power and limits of procedural contracting.

I decided to write the first article focused narrowly on *Hall Street* because I wanted to understand if, as Professor Dodge suggested, the case really stood as a limit on procedural autonomy. If it did, then I wanted to understand what the limit or limits were. If it did not, I wanted to understand what the case was, in fact, doing. Ultimately, I conclude that *Hall Street* creates something of a mess for arbitration law, undercutting much of the harmony that the Court has tried to create through its expansive interpretation of the Federal Arbitration Act as preemptive. But the case does not signal any sort of hesitation by the Court over procedural contracting more generally.

The second article (Chapter 2) picks up where the first left off. I wanted, initially, to understand more broadly when and how parties customized procedure in and out of arbitration. I initially thought that this would be a relatively straight forward question. It turned out to be a thorny

thicket. Most existing empirical studies are limited in scope, focusing on only specific customizations rather than the overall phenomena of procedural contracting. But these studies share a common set of conclusions: parties do not engage in robust procedural customization.

This conclusion seemed to chaff against my intuition about the potential benefits of procedural autonomy. To better understand the puzzle, I turned to articulating the potential gains offered by procedural innovations. After detailing those gains, Chapter 2 considers one possible reason parties might avoid procedural contracting—existing doctrine does not authorize the practice. Accordingly, Chapter 2 turns to a more comprehensive analysis of the doctrinal landscape for procedural contracting. Chapter 1 had been focused narrowly on parties' ability to contract for enhanced judicial review of arbitral awards. Chapter 2 analyzes precedent to determine if any other limits to party autonomy over procedure exist. It concludes that, with a few minor possible exceptions, they do not.

The third and most recent article (Chapter 3) represents a culmination of my work in this area of law to date. It makes three advances on the prior chapters. First, it recognizes that the primary potential benefits of procedural customization aim at ameliorating one particular sort of transactional risk: the risk of litigation opportunism. Second, it conducts a meta-analysis of existing empirical studies of procedural contracting, weaving together various studies in order to paint a more comprehensive picture of the practice. It concludes that the evidence is more nuanced than many previous commentators have appreciated, showing that parties do sometimes engage in significant customizations of procedure. The third part of the article develops a typology that explains when and how parties are likely to customize procedure. It concludes that this typology seems to map quite well onto and explains the existing empirical evidence regarding procedural contracting.

There are several strands of work that I have not yet completed related to this subject area. Perhaps most obviously, the next step in the progression is a novel empirical study that seeks to test more rigorously the typology developed in Chapter 3. This, in fact, is a project that is already underway.

Additionally, as a branch of freedom of contract, procedural autonomy invites consideration of normative issues. Even assuming that doctrine permits procedural innovation, and even assuming that parties want to engage in the practice, at least some of the time, important questions about the propriety of the practice exist. Particularly in the context of disparate party transactions, procedural contracting may constitute a worrying form of oppression. Procedure is opaque, even to trained professionals, but its impact on substantive matters cannot be underestimated. Accordingly, there may be sound reasons to regulate procedural innovation, at least in some contexts. I also plan on taking up these normative issues in subsequent projects.

# Chapter 1: Is Less Really More?<sup>1</sup>

*You're flying on a trapeze without a safety net.*<sup>2</sup>

Arbitration can be a risky business. The lack of judicial oversight combined with wide-sweeping arbitrator power to grant relief sometimes leaves parties feeling vulnerable to excessive or flatly wrong judgments. In “bet the farm” cases, parties, or one of them, might crave the safety of a second set of eyes reviewing their awards.<sup>3</sup> Accordingly, parties occasionally incorporate provisions for expanded judicial review into their arbitral agreements.

But a fear of finality chafes, in the Supreme Court’s view, against an important feature of arbitration, the ease of judicial enforcement paired with highly constrained grounds for the vacatur of awards.<sup>4</sup> Indeed, according to the Court in *Hall Street Associates, L.L.C. v. Mattel, Inc.*, the

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<sup>1</sup> Henry Allen Blair, *Is Less Really More? Hall Street Associates, Private Procedural Ordering and Expanded Review of Arbitral Awards in State Courts*, 5 Y.B. Arb. & Mediation 74 (2013).

<sup>2</sup> Joanna Lin, *\$4 Billion Award May Be Record in Arbitration Case*, L.A. DAILY J., June 5, 2009 (Verdicts and Settlements), at 2 (quoting Jay McCauley, a corporate lawyer, who went on to add that “[w]e still like the benefits of arbitration . . . but boy, maybe we should think twice about having no safety net at all, no chance when things go wayward”).

<sup>3</sup> See, e.g., Brief for the Petitioner at 40, *Hall St. Assoc., L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008) (No. 06-989) (arguing that the concern is that many business managers may lose their appetite for arbitration by requiring them to “bet the company” on a process with no prospect of meaningful review); see also, e.g., Stephen P. Younger, *Agreements to Expand the Scope of Judicial Review of Arbitration Awards*, 63 ALB. L. REV. 241, 241 (1999) (recognizing “a growing concern over the ‘Russian Roulette’ nature of arbitration”); Carroll E. Neesemann, *Contracting for Judicial Review: Party-chosen Arbitral Review Standards Can Inspire Confidence in the Process, and is Good for Arbitration*, 5 DISP. RESOL. MAG. 18, 18 (1998) (expressing concern over “knucklehead awards”). In Part III, I discuss some recent evidence that suggests that many commercial parties are growing more hesitant about using arbitration to resolve at least their biggest disputes precisely because they are concerned about limited review. See *infra* Part IV(B).

<sup>4</sup> As the Tenth Circuit said in *Bowen v. Amoco Pipeline Co.*,

We would reach an illogical result if we concluded that the FAA’s policy of ensuring judicial enforcement of arbitration agreements is well served by allowing for expansive judicial review after the matter is arbitrated. The FAA’s limited review ensures judicial respect for the arbitration process and prevents courts from enforcing parties’ agreements to arbitrate only to refuse to respect the results of the arbitration. These limited standards manifest a legislative intent to further the federal policy favoring arbitration by preserving the independence of the arbitration process.

254 F.3d 925, 935 (10th Cir. 2001); see also, e.g., Thomas J. Stipanowich, *Arbitration and Choice: Taking Charge of the “New Litigation,”* 7 DEPAUL BUS. & COM. L.J. 383, 425 (2009) (describing the “spare legal framework” for the judicial enforcement of arbitral awards as resting on a “keystone” of “rigorously restrained . . . judicial confirmation, modification, or vacatur of arbitration awards”) (citing Amy J. Schmitz, *Ending a Mud Bowl: Defining Arbitration’s Finality through Functional Analysis*, 37 GA. L. REV. 123, 189-90 (2002)).

efficiency of finality trumps even contractual freedom. Parties cannot choose in their contracts to expand review of arbitral awards under the Federal Arbitration Act (FAA).<sup>5</sup>

The oddity of *Hall Street*'s holding might not be evident if the case is examined only in the context of arbitration law. Although the Court paternalistically substituted its own view of what was best for the parties in the face of clearly expressed language to the contrary,<sup>6</sup> thereby tacking away from the course set by its previous cases,<sup>7</sup> the decision purported to be strongly pro-arbitration. It recited much the same supportive language of other Supreme Court cases and proclaimed itself to be "substantiating a national policy favoring arbitration with just the limited review needed to maintain arbitration's essential virtue of resolving disputes straightaway."<sup>8</sup> Moreover, using wholesome doctrines like *ejusdem generis* and the Whole Act Rule, the Court's conclusions rested on straightforward statutory analysis of the FAA.<sup>9</sup> Accordingly, although courts and commentators debated the propriety of contractually expanding judicial review of arbitral awards prior to *Hall*

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<sup>5</sup> *Hall St. Assocs.*, 552 U.S. at 592.

<sup>6</sup> At issue in the case was a contract provision providing that:

[t]he United States District Court for the District of Oregon may enter judgment upon any award, either by confirming the award or by vacating, modifying or correcting the award. The Court shall vacate, modify or correct any award: (i) where the arbitrator's findings of facts are not supported by substantial evidence, or (ii) where the arbitrator's conclusions of law are erroneous. *Hall Street*, 128 S. Ct. 1396, 1401-02 (2008).

<sup>7</sup> See *infra* Part I(E).

<sup>8</sup> *Hall St. Assocs.*, 552 U.S. at 577.

<sup>9</sup> See Richard C. Reuben, *Personal Autonomy and Vacatur After Hall Street*, 113 PENN STATE L. REV. 1103, 1120-21 (2010). It is worth pointing out that the Court's strong focus on simple statutory construction might itself seem odd. Over the past twenty-five years, the Court has effectively rewritten the FAA, very often paying almost no heed to the statute's language or history. See, e.g., *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 283 (1995) (O'Connor, J., concurring) ("[O]ver the past decade, the Court has abandoned all pretense of ascertaining congressional intent with respect to the [FAA], building instead, case by case, an edifice of its own creation...."); Thomas Carbonneau, *Symposium Introduction: Building the Civilization of Arbitration*, 113 PENN. ST. L. REV. 983, 986 (2009) ("In its decisional law, the Court systematically rewrote the U.S. or Federal Arbitration Act (FAA)."); Margaret L. Moses, *Arbitration Law: Who's in Charge?*, 40 SETON HALL L. REV. 147, 147 (2010) ("The Supreme Court's construction of the statute, especially in the last twenty-five years, amounts to a judicially created legislative program, imposed without congressional input, that has vastly expanded the reach and focus of the original statute.").

*Street*,<sup>10</sup> comparatively little critical attention has been paid to the issue in the four years since the case was decided.<sup>11</sup>

*Hall Street*, however, is part of a bigger story and its place in that story is puzzling. In addition to countering the principle of party choice in the context of arbitration,<sup>12</sup> *Hall Street* also

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<sup>10</sup> *Hall Street* resolved a Circuit split. The Ninth and Tenth Circuits had found that parties could not, through a private agreement, either expand or contract the powers of a court presiding over their dispute. See *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*, 341 F.3d 987, 1000 (9th Cir. 2003) (en banc), cert. *dism'd*, 540 U.S. 1098 (2004) (finding that any contractual provision purporting to expand grounds on which court can vacate arbitral award is ineffectual, regardless of its wording; FAA defines judicial scope of review by statute, which private parties have “no power to alter or expand”); *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925, 934-37 (10th Cir. 2001) (same). The First, Third, and Fifth Circuits, in contrast, had found that parties had the power to define, through their contract, the underlying arbitral award itself and thus could contract for expanded judicial review. See *Gateway Techs., Inc. v. MCI Telecomms. Corp.*, 64 F.3d 993, 996-97 (5th Cir. 1995) (holding that “a contractual modification [of judicial review] is acceptable because, as the Supreme Court has emphasized, arbitration is a creature of contract and the FAA’s pro-arbitration policy does not operate without regard to the wishes of the contracting parties”); *Puerto Rico Tel. Co. v. U.S. Phone Mfg. Corp.*, 427 F.3d 21, 30-31 (1st Cir. 2005) (adopting the *Gateway* rule); *Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287, 292-97 (3d Cir. 2001) (same); see also *Prescott v. Northlake Christian Sch.*, 369 F.3d 491, 494-498 (5th Cir. 2004) (reaffirming the *Gateway* rule).

Not surprisingly, given this clear divide in the case law, a number of commentators weighed in as well. For several particularly good scholarly treatments of the subject, see, e.g., Eric Chafetz, *The Propriety of Expanded Judicial Review Under the FAA: Achieving a Balance Between Enforcing Parties’ Agreements According to Their Terms and Maintaining Arbitral Efficiency*, 8 CARDOZO J. CONFLICT RESOL. 1 (2006); Sarah Rudolph Cole, *Revising the FAA to Permit Expanded Judicial Review of Arbitration Awards*, 8 NEV. L.J. 214 (2007); Ilya Enkishev, *Above the Law: Practical and Philosophical Implications of Contracting for Expanded Judicial Review*, 3 J. AM. ARB. 61 (2004); Lee Goldman, *Contractually Expanded Review of Arbitration Awards*, HARV. NEGOT. L. REV. 171 (2003); Ann C. Hodges, *Judicial Review of Arbitration Awards on Public Policy Grounds: Lessons from the Case Law*, 16 OHIO ST. J. ON DISP. RESOL. 91 (2000); Paul F. Kirgis, *Judicial Review and the Limits of Arbitration Authority: Lessons from the Law of Contract*, 81 ST. JOHN’S L. REV. 99 (2007); Margaret M. Maggio & Richard A. Bales, *Contracting Around the FAA: The Enforceability of Private Agreements to Expand Judicial Review of Arbitration Awards*, 18 OHIO ST. J. ON DISP. RESOL. 151 (2002); Margaret Moses, *Can Parties Tell Courts What to Do? Expanded Judicial Review of Arbitral Awards*, 52 U. KAN. L. REV. 429 (2004); Bret F. Randall, *The History, Application, and Policy of the Judicially Created Standards of Review for Arbitration Awards*, 1992 BYU L. REV. 759 (1992); Amy J. Schmitz, *Ending a Mud Bowl: Defining Arbitration’s Finality Through Functional Analysis*, 37 GA. L. REV. 123 (2002); Kevin A. Sullivan, *The Problems of Permitting Expanded Judicial Review of Arbitration Awards Under the Federal Arbitration Act*, 46 ST. LOUIS U. L.J. 509 (2002); Stephen P. Younger, *Agreements to Expand the Scope of Judicial Review of Arbitration Awards*, 63 ALB. L. REV. 241 (1999).

<sup>11</sup> For excellent post-*Hall Street* commentary, however, see, e.g., Christopher R. Drahozal, *Contracting Around Hall Street*, 14 LEWIS & CLARK L. REV. 905, 914 (2010); Maureen A. Weston, *The Other Avenues of Hall Street and Prospects for Judicial Review of Arbitral Awards*, 14 LEWIS & CLARK L. REV. 929 (2010); Stephen K. Huber, *State Regulation of Arbitration Proceedings: Judicial Review of Arbitration Awards by State Courts*, 10 CARDOZO J. CONFLICT RESOL. 509, 535-36 (2009); David K. Kessler, *Why Arbitrate? The Questionable Quest for Efficiency in Arbitration After Hall Street Associates*, 8 FLA. ST. U. BUS. REV. 77 (2009); Stanley A. Leasure, *Arbitration After Hall Street v. Mattel: What Happens Next?*, 31 U. ARK. LITTLE ROCK L. REV. 273 (2009); Alan Scott Rau, *Hall Street Associates v. Mattel, Inc.: Fear of Freedom*, 17 AM. REV. INT’L ARB. 469 (2006); Richard C. Reuben, *Personal Autonomy and Vacatur After Hall Street*, 113 PENN ST. L. REV. 1103 (2009); Timothy Tyler & Archis A. Parasharami, *Finality over Choice: Hall Street Associates, L.L.C. v. Mattel, Inc. (U.S. Supreme Court)*, 25 J. INT’L ARB. 613 (2008).

<sup>12</sup> See, e.g., Richard C. Reuben, *Personal Autonomy and Vacatur After Hall Street*, 113 PENN ST. L. REV. 1103, 1105 (2010) (recognizing that *Hall Street* “constitutes arguably the most significant constraint on party autonomy in arbitration that the Court has imposed”).

bucked a more general precedential trend embracing private procedural ordering.<sup>13</sup> In recent decades, the Court has permitted parties to customize more and more dispute resolution procedures and processes. The Court has, in short, recognized the advantages of seeing procedures and processes as defaults rather than immutable or mandatory rules.<sup>14</sup> The expanding regime of private procedural ordering offers parties additional means of calibrating accuracy and efficiency to meet their *ex ante* preferences.<sup>15</sup> The extreme outlying character of *Hall Street* becomes clear when one considers that it is one of the only decisions in the last thirty years by the Supreme Court invalidating a procedural contract.<sup>16</sup>

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<sup>13</sup> Private procedural ordering allows parties to bargain over the procedural rules that will govern the resolution of any disputes that might arise between them in the future. See, e.g., Jaime Dodge, *The Limits of Procedural Private Ordering*, 97 VA. L. REV. 723, 724-25 (2011) (describing the process of modifying by contract the “spectrum of procedure” as private procedural ordering). Following the lead of other commentators who have described this form of private ordering, I will use the terms “private procedural ordering” and “procedural contracting” interchangeably. See, e.g., Judith Resnik, *Procedure as Contract*, 80 NOTRE DAME L. REV. 593, 598 (2005) (recognizing a movement from “Due Process Procedure to Contract Procedure”). Unlike some commentators, however, I am using these terms in the broadest possible sense, to include all party agreements regarding resolution of their disputes, including procedures that may be used in courts and extra-judicial procedures and processes such as arbitration, mediation, med-arb and settlement. Compare Kevin E. Davis & Helen Hershkoff, *Contracting for Procedure*, 53 WM. & MARY L. REV. 507, 511 (2011) (describing contract procedure as “the practice of setting out procedures in contracts to govern disputes . . . that will be adjudicated in the public courts”).

<sup>14</sup> The “rules versus standards” debate has occupied the attentions of scholars for many years. See, e.g., David L. Faigman, *Constitutional Adventures in Wonderland: Exploring the Debate Between Rules and Standards Through the Looking Glass of the First Amendment*, 44 HASTINGS L.J. 829, 830 (1993) (“The amount of ink spilled over debating the virtues of rules versus standards would lead the reasonable observer to believe that something momentous was at stake.”). For good contemporary discussions of the distinction, see Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 557-68 (1992) (viewing rules and standards for their economic efficiency); Jason Scott Johnston, *Bargaining Under Rules Versus Standards*, 11 J.L. ECON. & ORG. 256, 258 (1995) (examining relative efficiency of two-party bargaining under rules and standards); Russell B. Korobkin, *Behavioral Analysis and Legal Form: Rules vs. Standards Revisited*, 79 OR. L. REV. 23, 25 (2000) (“Rules establish legal boundaries based on the presence or absence of well-specified triggering facts.”); Kathleen M. Sullivan, *The Justices of Rules and Standards*, 106 HARV. L. REV. 22, 58 (1992) (“Rules aim to confine the decisionmaker to facts, leaving irreducibly arbitrary and subjective value choices to be worked out elsewhere.”); Mary C. Daly, *The Dichotomy Between Standards and Rules: A New Way of Understanding the Differences in Perceptions of Lawyer Codes of Conduct by U.S. and Foreign Lawyers*, 32 VAND. J. TRANSNAT’L L. 1117, 1124-42 (1999); FREDERICK SCHAUER, THINKING LIKE A LAWYER 13-29 (2009) (discussing the relative advantages and disadvantages of legal norms being articulated as rules or standards).

<sup>15</sup> See, e.g., Louis Kaplow, *The Value of Accuracy in Adjudication: An Economic Analysis*, 23 J. LEGAL STUDIES 307, 314 (1994) (arguing that heightened accuracy in adjudication can only be obtained at higher costs so an efficient balance has to be struck on a case-by-case basis).

<sup>16</sup> See Jamie Dodge, *supra* note 13, at 738 (describing *Hall Street* as “[t]he Court’s sole invalidation of a procedural term”).

Seen in this light, *Hall Street* represents a distinct break in the Court’s otherwise relatively unfettered march to internalize contract norms and abandon its historic skepticism over the devolution of judicial authority.<sup>17</sup> It might be tempting to read the case as a cautionary break, halting the march in order to consider some of the many and concerning repercussions of converting public and standardized procedure into private and individualized procedure.<sup>18</sup> But such a reading does not fit. The holding strives to limit rather than expand a judicial role in an otherwise private proceeding. Besides, the case does not even hint that its rejection of private procedural ordering springs from any concerns over party control of judicial processes.

The better explanation, I contend, is that the Court was not rejecting private procedural ordering at all.<sup>19</sup> Rather, its somewhat tepid reference to alternative means of enforcing contracts for expanded judicial review of arbitral awards -- “[t]he FAA is not the only way into court for parties wanting review of arbitration awards: they may contemplate enforcement under state statutory or common law, for example, where judicial review of different scope is arguable”<sup>20</sup> – suggests that the Court was instead trying to funnel innovation, at least with respect to arbitral award enforcement and review, back to the States. Less judicial review under the FAA could result in more use of state arbitration laws, which might allow for greater party autonomy.

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<sup>17</sup> See Judith Resnik, *supra* note 13, at 598--99 (describing how changes in adjudicatory practice are shifting the focus of civil procedure from “due process procedure” to “contract procedure”).

<sup>18</sup> See *infra* Part II(D).

<sup>19</sup> Professor Jamie Dodge, in her seminal article on private procedural ordering makes this point as well. In her view,

[A]lthough the Court narrowly held in *Hall Street Associates v. Mattel, Inc.* that the Federal Arbitration Act specifically preempted the modification of the standard of review in the courts, the Court expressly noted that under state law or common law parties may be able to modify the standard of judicial review.

Jamie Dodge, *supra* note 13, at 738. This “express notation” suggests, in her view, that the Court does not fundamentally think parties should be barred from contracting for expanded judicial review or similar procedural modifications. See *id.*

<sup>20</sup> *Hall St. Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 590 (2008).

In this Article, I examine the implications of this reading. I argue that barring expanded judicial review under the FAA but inviting parties to turn to state law to achieve their objectives erodes the value of arbitration and threatens its continued relevance, at least to domestic commercial disputes.<sup>21</sup> *Hall Street* is the worst of all possible worlds: it undermines party autonomy while simultaneously threatening the very virtue – finality – that it was crafted to protect.

This Article proceeds in three Parts. Part 1.1 begins by tracing the evolution and current status of private procedural ordering. Additionally, it evaluates some of the ways in which private procedural ordering generally, and expanded judicial review of arbitral awards in particular, offers the potential for significant efficiency gains. Set against the potential gains from customized procedure and process, however, are several possible externalities, which Part 1.1 also surveys. Part 1.1 concludes that *Hall Street* is best understood not as a decision opposing private procedural ordering but rather as pressing for state court innovations, at least with respect to agreements for expanded judicial review of arbitral awards.

Part 1.2 turns to a survey of state law. It observes that, although a majority of jurisdictions have arbitration laws providing for essentially identical enforcement and review to the FAA, there are signs that states have started to accept *Hall Street*'s invitation. Five states allow parties to

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<sup>21</sup> Of course, arbitration is also under attack in the consumer and, to a somewhat lesser degree, the employment context. Although the 2009 Arbitration Fairness Act has, to date, failed to pass in Congress, the Act's spirit has persisted and shows signs that it might erode at least some of the Supreme Court's pro-arbitration precedent. Congress has, in fact, enacted several "mini" versions of the Act applying to parties with weaker bargaining power. See, e.g., Department of Defense Appropriations Act, 2010, Pub. L. No. 111-118, § 8116(a), 123 Stat. 3409, 3454 (2009) (banning in certain defense contractors' employment agreements pre-dispute provisions to arbitrate sexual harassment claims); Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 § 748(n)(2), 124 Stat. 1376, 1739 (2010) (to be codified at 7 U.S.C. § 26(n)(2)); *id.* §§ 922(b), (c), 124 Stat. at 1841 (to be codified at 18 U.S.C. §§ 1514A(e)(1), (2)) (prohibiting pre-dispute agreements to arbitrate claims under whistleblower provisions of the Dodd-Frank Consumer Protection Act). Perhaps more significantly, in April 2012, the Consumer Financial Protection Bureau began soliciting comments relevant to its upcoming investigation of mandatory arbitration provisions in agreements for financial products and services. See, e.g., Ann Carns, *Consumer Agency Looking Into Mandatory Arbitration*, NEW YORK TIMES (April 25, 2012), <http://bucks.blogs.nytimes.com/2012/04/25/consumer-agency-looking-into-mandatory-arbitration/>. Congress specifically required such an investigation in Section 1028(a) of the Dodd-Frank Act.

contract for expanded judicial review. A handful of additional states have laws allowing for more searching judicial review of arbitral awards.

Part 1.3 considers the problems with *Hall Street*'s holding paired with its invitation for more reliance on state laws. It argues that a greater role for state arbitration laws in the enforcement and review of awards sits awkwardly with extant Supreme Court cases that have, with very few exceptions, federalized and standardized arbitration law. Indeed, the prospect of a greater role for state law opens the back door for states to thwart the purposes of the FAA by enacting more intrusive and disparate review standards, which, as Part II suggests, seems already to be happening. Given current state law, it is not clear that the Supreme Court, when pushed, will actually stick by its dicta in *Hall Street*. Even if it does, parties will be faced with an increasingly confusing and overlapping matrix of competing state laws as well as the FAA. Accordingly, parties who could benefit most from arbitration will be stymied by legal uncertainty and high transaction costs, which potentially reduce or eliminate any efficiency gains. Given that arbitration is no longer the only game around for commercial parties who wish to contain costs and exercise control over the course of their disputes with one another – they can, instead, use other procedural contracting options to shape the course of future litigation – *Hall Street* threatens the continued relevance of arbitration, at least to domestic commercial disputes.

## 1.1 The Rise of Procedural Ordering

*I know no safe depository of the ultimate powers of the society but the people themselves.*<sup>22</sup>

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<sup>22</sup> PHILLIP G. HENERSON, *THE PRESIDENCY THEN AND NOW* 25 (2000) (quoting Thomas Jefferson writing to William Charles Jarvis, 28 September 1820).

Historically, courts were skeptical of any private procedural choices, seeing such party-driven rulemaking as supplanting the public function of courts.<sup>23</sup> In the nineteenth and much of the early twentieth centuries, courts were not only reluctant to enforce non-judicial modes of dispute resolution like arbitration, but they also effectively prevented private parties from altering or opting out of almost all procedural rules in judicial proceedings.<sup>24</sup> As one commentator has colorfully suggested, courts followed Henry Ford's view of choice: "Any customer can have a car painted any colour that he wants so long as it is black."<sup>25</sup>

Eventually, however, starting with a somewhat grudging acceptance of arbitration and the passage of the FAA but really gaining momentum under Chief Justices Warren and Burger, judicial tides began to shift. Through an expanding menu of private procedural ordering options, courts have allowed parties the freedom to tailor process and procedure in order to increase certainty while efficiently adjusting accuracy to fit with their *ex ante* preferences.<sup>26</sup>

The following sections briefly trace the evolution of the current law governing private procedural ordering and discuss the potential gains from such ordering. This Part then highlights some of the normative implications of party choice over procedural rules. The last section in this Part concludes that whatever legitimate concerns may exist with respect to private procedural ordering, the trend of precedent has been clear: the Supreme Court favors parties' ability to

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<sup>23</sup> Several scholars have suggested that at least some of this hostility towards private procedural ordering might have been less high-minded. Professor Alan Scott Rau, for instance, has suggested that courts' traditional hostility to arbitration may have "originated in considerations of competition for business, at a time when judges' salaries still depended on fees paid by litigants." ALAN SCOTT RAU, *ARBITRATION* 57 (2d ed. 2002); see also JULIUS HENRY COHEN, *COMMERCIAL ARBITRATION AND THE LAW* 83 (1918) (recognizing the judicial competition with private tribunals and the fear that arbitration threatened a significant source of judicial business, as well as judicial jobs linked to the courts' caseloads).

<sup>24</sup> See, e.g., Michael Gruson, *Forum-Selection Clauses in International and Interstate Commercial Agreements*, 1982 U. ILL. L. REV. 133, 139 n.17 (1982) (citing *Insurance Co. v. Morse*, 87 U.S. (20 Wall.) 445, 451 (1874)) (discussing how the ouster doctrine resulted in courts refusing to enforce forum selection clauses).

<sup>25</sup> Michael L. Moffitt, *Customized Litigation: The Case for Making Civil Procedure Negotiable*, 75 GEO. WASH. L. REV. 461, 462 (2007) (arguing that "[o]ur judiciary has unfortunately embraced Henry Ford's sense of consumer choice" with respect to litigation procedural rules).

<sup>26</sup> See, e.g., Louis Kaplow, *supra* note 15, at 310 (arguing that heightened accuracy in adjudication can only be obtained at higher costs so an efficient balance has to be struck on a case-by-case basis).

structure their own procedural rules. *Hall Street* is then best understood not as a departure from this trend but rather as an effort to direct a particular type of innovation in private procedural ordering back to state courts.

### 1.1.1 Procedure as Public Law: Historic Skepticism of Private Procedural Ordering

Until the early twentieth century, courts protected their turf. They tended to see efforts by parties to provide for private procedural rules or most non-court dispute resolution processes as infringements on the proper public role of the court system.<sup>27</sup> There existed “a taboo against party autonomy in procedural matters.”<sup>28</sup> Courts primarily relied on two interlacing doctrines – the revocability and ouster doctrines – to prevent procedural contracting. Perhaps not surprisingly, both doctrines arose out of a judicial skepticism of arbitration, though at least the ouster doctrine expanded to bar other forms of private procedural ordering as well.

The revocability doctrine sprung into existence, near full gown, from dicta in Lord Edward Coke’s 1609 opinion in *Vynior’s Case*.<sup>29</sup> There, the parties had entered into a contract for repair work on several buildings.<sup>30</sup> They agreed to submit any disputes about the work to arbitration, and, as was customary at the time, a performance bond secured this agreement.<sup>31</sup> The plaintiff brought a court action, seeking to recover on the bond as well as to recover damages. The plaintiff claimed that

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<sup>27</sup> See, e.g., Thomas E. Carbonneau, *Arbitral Justice: The Demise of Due Process in American Law*, 70 TUL. L. REV. 1945, 1947 (1996) (recognizing that prior to the early twentieth century, the traditional view was that if courts were to function as the national source of justice, there was no room for “makeshift, party-confected modes of dispute resolution”); Richard C. Reuben, *Public Justice: Toward a State Action Theory of Alternative Dispute Resolution*, 85 CALIF. L. REV. 577, 599–600 (1997) (noting that judges were either wary of quality of justice available in arbitration or—because they were paid on per case basis—protective of their own pocketbooks); but see Michael H. LeRoy, *Crowning the New King: The Statutory Arbitrator and the Demise of Judicial Review*, 2009 J. DISP. RESOL. 1, 20 (2009) (surveying treatises and concluding that “English and American colonial courts were neither hostile nor blindly deferential to arbitration”).

<sup>28</sup> Linda S. Mullenix, *Another Choice of Forum, Another Choice of Law: Consensual Adjudicatory Procedure in Federal Court*, 57 FORDHAM L. REV. 291, 294 (1988).

<sup>29</sup> *Vynior v. Wilde*, (1609) 77 Eng. Rep. 595, 598–600 (K.B.).

<sup>30</sup> See *id.*

<sup>31</sup> See *id.* The common law of contract was just beginning to form at the time, so bonds often secured contractual promises. See, e.g., Paul D. Carrington & Paul Y. Castle, *The Revocability of Contract Provisions Controlling Resolution of Future Disputes Between the Parties*, 67 LAW & CONTEMP. PROBS. 207, 208 (2004) (noting that “the common law of contract was in its infancy” at the time that *Vynior v. Wilde* was decided).

the defendant had failed to comply with the arbitration agreement.<sup>32</sup> Lord Coke ruled that when there was a suit on a bond given for a submission to arbitration, the submission itself was revocable although the price of revoking was forfeiture of the bond:

Although . . . the defendant, was bound in a bond to stand to, abide, observe, etc., the rule, etc., of arbitration, etc., yet he might countermand it, *for one cannot by his act make such authority, power, or warrant not countermandable which is by the law or of its own nature countermandable.*<sup>33</sup>

Whatever Lord Coke's original intent,<sup>34</sup> *Vynior's* became a leading case "establishing the revocability doctrine."<sup>35</sup> Pursuant to this doctrine, a party to an arbitration agreement could revoke an arbitrator's authority at any time before the arbitrator rendered an award, even if the parties had agreed the delegation was irrevocable.<sup>36</sup> Although U.S. courts would usually enforce arbitration awards once issued,<sup>37</sup> following the practice of their English counterparts, they would not generally enforce executory contracts to arbitrate.<sup>38</sup> Practically, this meant that a party to an arbitration

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<sup>32</sup> See *Vynior*, 77 Eng. Rep. at 597.

<sup>33</sup> *Id.* at 601-02 (emphasis added).

<sup>34</sup> Some commentators have suggested that Lord Coke was effectively relying on agency principles. See, e.g., Paul L. Sayre, *Development of Commercial Arbitration Law*, 37 YALE L.J. 595, 598-99 (1928). Professors Paul Carrington and Paul Castle have compellingly pointed out, however, that the concept of agency had not developed at the time that *Vynior's* was decided. See Carrington & Castle, *supra* note 32, at 210. They contend, instead, that Lord Coke was likely motivated by a desire to "insure the disinterest of arbitrators" at a time when there were no real substantive constraints on arbitrator authority. *Id.*

<sup>35</sup> Harry Baum & Leon Pressman, *The Enforcement of Commercial Arbitration Agreements in the Federal Courts*, 8 N.Y.U. L.Q. Rev. 238, 240 (1930); see also, e.g., Paul L. Sayre, *Development of Commercial Arbitration Law*, 37 YALE L.J. 595, 602 (1928).

<sup>36</sup> See, e.g., *Tobey v. County of Bristol et al.*, 23 F. Cas. 1313, 1321 (C.C.D. Mass. 1845) (citing *Vynior* as authority for the proposition that arbitration submissions are revocable regardless of a stipulation to the contrary because one "cannot alter the judgment of law, to make that irrevocable, which is of its own nature revocable").

<sup>37</sup> See, e.g., *Burchell v. Marsh*, 58 U.S. 344, 349 (1854).

<sup>38</sup> See, e.g., *Red Cross Line v. Atlantic Fruit Co.*, 264 U.S. 109, 121-22 (1924) ("The federal courts--like those of the states and of England--have, both in equity and at law, denied in large measure, the aid of their processes to those seeking to enforce (sic) executory agreements to arbitrate disputes."); Jeffery W. Stempel, *Pitfalls of Public Policy: The Case of Arbitration Agreements*, 22 ST. MARY'S L.J. 259, 272 (1990). This rule was incorporated in the First Restatement of Contracts as well. RESTATEMENT (FIRST) OF CONTRACTS § 550, cmt. A (1932) ("A bargain to arbitrate, though it is not illegal, is practically unenforceable. . ."). Of course, even at the height of its power, the revocability doctrine had exceptions. See, e.g., *Red Cross Line*, 264 U.S. at 122-25 (finding that New York courts could equitably enforce arbitration agreements in their own courts under New York's arbitration statute).

agreement faced continual risk that her counterparty would renege on his promise and exercise his right to demand that a court hear any disputes.

Still, the revocability doctrine alone did not necessarily create an insuperable barrier to arbitration or other forms of procedural contracting. The doctrine mutated, however, over time into the so-called ouster doctrine. The mutation can be traced to an eighteenth century English decision, *Kill v. Hollister*.<sup>39</sup> There, while interpreting the revocability doctrine, the court allowed a judicial action over an insurance policy to proceed despite an arbitration clause on the grounds that “the agreement of the parties cannot oust this court [of jurisdiction].”<sup>40</sup> As with the dicta giving rise to the revocability doctrine itself, no authority was given for this “ouster” rule.<sup>41</sup> Nevertheless, by 1856, the rule had become justified as legitimate “judicial jealousy” over jurisdiction, and this explanation for it stuck.<sup>42</sup>

Although the ouster doctrine began as anti-arbitration rule, it quickly expanded into a more general principle precluding courts from enforcing various contractual provisions limiting redress in courts. In *Home Insurance Co. v. Morse*, for instance, the U.S. Supreme Court held that an agreement by which an insurance company waived its right to remove state cases to federal courts was not enforceable.<sup>43</sup> The Court analogized the matter to a jury trial waiver and an arbitration agreement, concluding that:

A man may not barter away his life or his freedom, [sic] or his substantial rights . . . .  
He cannot . . . bind himself in advance by an agreement, which may be specifically

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<sup>39</sup> *Kill v. Hollister*, (1746) 95 Eng. Rep. 532 (K.B.).

<sup>40</sup> *Id.*

<sup>41</sup> *See id.*

<sup>42</sup> *See Scott v. Avery*, (1856) 10 Eng. Rep. 1121, 1138 (H.L.) (speculating that judicial hostility to arbitration “probably originated in the contests of the different courts in ancient times for extent of jurisdiction, all of them being opposed to anything that would deprive one of them of jurisdiction”); *Home Ins. Co. v. Morse*, 87 U.S. 445, 451 (1874) (citing *Scott v. Avery* as one of “numerous cases” showing that parties cannot by contract oust a court of jurisdiction).

<sup>43</sup> *Home Ins. Co.*, 87 U.S. at 451-52.

enforced, thus to forfeit his rights at all times and on all occasions, whenever the case may be presented.<sup>44</sup>

In the Court's view, privately negotiated contract provisions could not trump the role of the public adjudicatory system. If such contract provisions were enforced, the "regular administration of justice might be greatly impeded . . . ."<sup>45</sup> Soon, courts went on to find that anti-suit covenants, pre-dispute waivers of liability, and forum selection clauses were similarly barred by the ouster doctrine.<sup>46</sup> Only courts, the prevailing opinion went, possessed the ability to "protect rights and to redress wrongs" because private tribunals or other private customizations of procedure were prone to "become . . . instrument[s] of injustice, or to deprive parties of rights which they are otherwise fairly entitled to have protected."<sup>47</sup>

### 1.1.2 More than Mere Contract Law: Autonomy and Private Procedural Ordering

By the late Eighteen-century, although both the revocability and ouster doctrines were still in use in American courts, notions of party autonomy were starting to play a greater role in not only the public conscience but also in the judicial mind.<sup>48</sup> At the height of the revocability and ouster

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<sup>44</sup> *Id.* at 451.

<sup>45</sup> *Id.* at 451-52.

<sup>46</sup> See, e.g., *Mut. Reserve Fund Life Ass'n v. Cleveland Woolen Mills*, 82 F. 508, 510 (6th Cir. 1897) (finding that a contract stipulating that suits could only be brought in federal court was void because it "intended to oust the jurisdiction of all state courts"); *Knorr v. Bates et al.*, 35 N.Y.S. 1060, 1062 (N.Y. Gen. Term. 1895) (holding that a contractual limitation on the right to sue underwriters on an insurance policy was unenforceable because "a provision in a contract that the party breaking it shall not be answerable in an action is a stipulation for ousting the courts of jurisdiction, and as such, is void, upon grounds of public policy"); *Meacham v. Jamestown Franklin & Clearfield R.R. Co.*, 105 N.E. 653, 656 (1914) (Cardozo, J. concurring) (finding that an arbitration contract is an invalid attempt to oust the jurisdiction of the courts because its purpose is the same as agreements requiring litigants to submit their case to a foreign court, but noting that there may be exceptional circumstances warranting enforcement of such forum selection clauses).

<sup>47</sup> *Tobey v. County of Bristol*, 23 F. Cas. 1313, 1320-21 (C.C.D. Mass. 1845). Thus, it is fair to say that the ouster doctrine was justified both based on concerns over individual rights, such as those set out in *Morse*, and concerns about extra-individual matters such as "administrative efficiency, separation of powers, and public faith in the legitimacy of the judiciary." David Marcus, *The Perils of Contract Procedure: A Revised History of Forum Selection Clauses in the Federal Courts*, 82 *TUL. L. REV.* 973, 995 (2008) (citing and discussing *Nute v. Hamilton Mutual Ins. Co.*, 72 *Mass.* 174 (1856) as articulating this extrajudicial concern).

<sup>48</sup> See, e.g., Walter F. Pratt, Jr., *American Contract Law at the Turn of the Century*, 39 *S.C. L. REV.* 415, 415 (1988) ("During the past century, contract law, along with most of American society, has undergone a 'major transformation.'"); John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 *YALE L.J.* 625, 630 (1995) ("Contract has become the dominant doctrinal current in modern American law.").

doctrines, contract law was in its infancy, and most contracts were discrete and simple.<sup>49</sup> That began to change with rapid economic transformations in the American economy. As American courts routinely decided increasingly complex contract disputes based on the intentions of the parties,<sup>50</sup> the same principles of autonomy began gaining traction in the context of private procedural ordering.<sup>51</sup> The trend towards acceptance of procedural contracts, in fact, follows the path charted by G. Richard Shell twenty years ago in his study of contracts and the Supreme Court: the steady demise of the public policy exception to contract enforcement and, in particular, of an exception to contractual autonomy that draws from the special attributes of judicial process.<sup>52</sup>

Arguably, the first steps towards unlocking the potential of private procedural ordering started with increasing demand for arbitration.<sup>53</sup> Businesses saw the potential efficiency gains from

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<sup>49</sup> In his article on the history of commercial law in the United States, Professor Walter F. Pratt, Jr. explains that:

Contracting, like conversation, had in earlier times been rooted in the past. People who knew one another and who knew the local market, insulated as it was from dramatic shifts in the economy, faced little likelihood of changes in circumstances that would require elaborate agreements or provoke complex disputes. Railroads and cities, however, seemed to disrupt that past by bringing economic uncertainty into the local markets. Parties thus faced the tiring prospect of writing detail upon detail into each agreement if they were to account for every potential event.

Walter F. Pratt, Jr., *American Contract Law at the Turn of the Century*, 39 S.C. L. REV. 415, 428-29 (1988); see also Bruce L. Benson, *An Exploration of the Impact of Modern Arbitration on the Development of Arbitration in the United States*, 11 J.L. ECON. & ORG. 479, 489 (1995) (explaining that the doctrine of revocability set forth by Lord Coke in *Vynior* occurred before the common law of contracts was fully formed).

<sup>50</sup> Instead of being localized and discrete as they had been prior to the turn of the century, commercial transactions tended to be more complex and regional as well as national. See Allen Blair, “*You Don’t Have to be Ludwig Wittgenstein*”: *How Llewellyn’s Concept of Agreement Should Change the Law of Open-Quantity Contracts*, 37 SETON HALL L. REV. 67, 77 (2006).

<sup>51</sup> *Contra* David Marcus, *The Perils of Contract Procedure: A Revised History of Forum Selection Clauses in the Federal Courts*, 82 TUL. L. REV. 973, 1014 (2008) (arguing that, although “[i]ncreased appreciation for freedom of contract and individual autonomy and consent may have influenced the development of [forum selection clauses,] . . . these considerations played a small part, at best, especially when compared to the degree to which extraindividual concerns shaped the design of clause enforcement doctrine”).

<sup>52</sup> G. Richard Shell, *Contracts in the Modern Supreme Court*, 81 CALIF. L. REV. 431, 452-56 (1993) (detailing Supreme Court treatment of judicial access clauses and documenting judicial acceptance of *ex ante* forum selection clauses).

<sup>53</sup> See, e.g., William C. Jones, *An Inquiry Into the History of the Adjudication of Mercantile Disputes in Great Britain and the United States*, 25 U. CHI. L. REV. 445, 461-62 (1958) (“Statistics are not available and it is doubtful that they ever will be, but it is probable that in the nineteenth century arbitration in one form or another became the most important form of mercantile dispute settlement . . . in the United States . . . although courts continued, of course, to be used.”); Jeffery W. Stempel, *Pitfalls of Public Policy: The Case of Arbitration Agreements*, 22 ST. MARY’S L.J. 259, 275 (1990) (“Despite an

arbitration, but they were frustrated with court refusal to enforce arbitration agreements.<sup>54</sup>

Responding to the interests of the business community, in 1920, New York broke from traditional English arbitration law by enacting a statute that enforced pre-dispute agreements to arbitrate, ended the practice of courts hearing questions of law during the course of arbitration, and provided for only limited judicial review of the final award.<sup>55</sup> In 1925, the U.S. Congress followed New York's lead by enacting the United States Arbitration Act, later renamed the Federal Arbitration Act. Accordingly, as the Supreme Court explained, the FAA was a "response to the refusal of courts to enforce commercial arbitration agreements,"<sup>56</sup> but it also represented a more general step towards recognizing the value of autonomy in procedural choices.

That progression continued and, as due process became recognized as a waivable right, the Warren and Burger Courts tentatively embraced more and more forms of procedural private ordering.<sup>57</sup> The current era customizable procedure, however, was not ushered in until 1972 in *The Bremen v. Zapata Off-Shore Co.*,<sup>58</sup> when the Supreme Court addressed enforcement of a forum selection clause for the first time since it had endorsed the ouster doctrine in *Morse* almost

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essentially unchanging judicial hostility toward arbitration, it grew in popularity as the commercial affairs of the United States became increasingly far flung and complex.”)

<sup>54</sup> See, e.g., *Atlantic Fruit Co. v. Red Cross Line*, 276 F. 319, 322 (S.D.N.Y. 1921) (recognizing the general displeasure in the business community with courts' unwillingness to enforce arbitration agreements in the early twentieth century).

<sup>55</sup> Michael A. Scodro, *Arbitrating Novel Legal Questions: A Recommendation for Reform*, 105 YALE L.J. 1927, 1941 (1996).

<sup>56</sup> *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 125 (2001); *Southland v. Keating*, 465 U.S. 1, 13-14 (1984) (“[T]he need for the law arises from ... the jealousy of the English courts for their own jurisdiction . . . This jealousy survived for so long a period that the principle became firmly embedded in the English common law and was adopted with it by the American courts.”) (quoting H.R. Rep. No. 68-96 (1924)). The statute’s purpose was to ensure that “written provisions or agreements for arbitration of disputes arising out of contracts, maritime transactions, or commerce among the States or Territories or with foreign nations” would be “valid and enforceable.” United States Arbitration Act, 9 U.S.C. §1 (2006). For excellent accounts of the FAA’s legislative history, see James E. Berger & Charlene Sun, *The Evolution of Judicial Review Under the Federal Arbitration Act*, 5 N.Y.U. J.L. & Bus. 745 (2009); Thomas E. Carbonneau, *Judicial Approbation in Building the Civilization of Arbitration*, 113 PENN ST. L. REV. 1343, 1348 (2009) (providing a brief history of the passage of the FAA).

<sup>57</sup> Dodge, *supra* note 13, at 735 (citing *Boddie v. Connecticut*, 401 U.S. 371, 378–79 (1971); *Nat’l Equip. Rental v. Szukhent*, 375 U.S. 311, 315–16 (1964); *Alyeska Pipeline Serv. Co. v. Wilderness Soc’y*, 421 U.S. 240, 257 (1975); *D.H. Overmyer Co. v. Frick Co.*, 405 U.S. 174, 187–88 (1972)).

<sup>58</sup> *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 2 (1972).

one hundred years earlier.<sup>59</sup> *Bremen* revolutionized private procedural ordering by doing two things. First, it boldly and decisively discarded the ouster doctrine, relegating it to mere anachronism: “[the ouster doctrine] is hardly more than a vestigial legal fiction.”<sup>60</sup> Perhaps more significantly, it shifted focus to party autonomy, making the touchstone for enforcement of forum selection clauses the quality of the bargaining process.<sup>61</sup>

Following *Bremen*, the Court broke down one of the few remaining barriers standing in the way of contract procedure by abandoning any effort to distinguish between commercial and consumer contracts in *Carnival Cruise Lines v. Shute*.<sup>62</sup> There, extending its pro-autonomy decision in *Bremen*, the Court brushed past a common law rule that forum-selection clauses in “form contracts” were presumptively unenforceable and reasoned that such clauses should, instead, be enforced because consumers “benefit in the form of reduced [prices] reflecting the savings that the [firm] enjoys by limiting the fora in which it may be sued.”<sup>63</sup>

Since *Bremen* and *Shute*, party autonomy regarding pre-dispute procedural determinations flourishes in an increasingly wider range of commercial and non-commercial settings.<sup>64</sup> To the

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<sup>59</sup> See, e.g., David H. Taylor & Sara M. Cliffe, *Civil Procedure by Contract: A Convolved Confluence of Private Contract and Public Procedure in Need of Congressional Control*, 35 U. RICH. L. REV. 1085, 1095 (2002) (describing the case as “a sea-change in the way private agreement is viewed in relation to procedure”); William J. Woodward, Jr., *Finding the Contract in Contracts for Law, Forum and Arbitration*, 2 HASTINGS BUS. L.J. 1, 15 (2006) (observing that the law “changed dramatically” in *The Bremen*); Linda S. Mullenix, *supra* note 29, at 307 (“The current doctrine of consensual adjudicatory procedure . . . is based on Supreme Court pronouncements in *The Bremen*.”).

<sup>60</sup> *Bremen*, 407 at 12.

<sup>61</sup> See *id.* at 15 (finding that forum selection clauses should be enforced unless the resisting party can “clearly show that enforcement would be unreasonable and unjust, or that the clause was invalid”); see also, e.g., Henry S. Noyes, *If You (Re)Build It, They Will Come: Contracts To Remake the Rules of Litigation in Arbitration’s Image*, 30 HARV. J.L. & PUB. POL’Y 579, 597 (2007) (describing the Court as elevating the concept of freedom of contract, thereby allowing parties to bargain about how a dispute will be decided); Linda S. Mullenix et al., *Case One: Choice of Forum Clauses*, 29 NEW ENG. L. REV. 541, 543 (1995) (arguing that the Court in *The Bremen* adopted a “strongly stated federal policy favoring enforceability, subject to usual contract principles”); KEVIN M. CLERMONT, *CIVIL PROCEDURE: TERRITORIAL JURISDICTION AND VENUE* 85 n.60 (1999) (stating that *The Bremen* “shift[ed] from a jurisdictional to a contractual paradigm”).

<sup>62</sup> *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 587–88 (1991).

<sup>63</sup> *Id.* at 594 (“[I]t stands to reason that passengers who purchase tickets containing a forum clause like that at issue in this case benefit in the form of reduced fares reflecting the savings that the cruise line enjoys by limiting the fora in which it may be sued.”).

<sup>64</sup> Mullenix, *supra* note 29, at 302-03.

extent that parties want to customize procedural rules, “almost limitless” methods of modification are available to them.<sup>65</sup> For instance, in addition to entering into arbitration agreements, of course, parties can (and regularly do) include forum selection clauses,<sup>66</sup> choice of law clauses,<sup>67</sup> clauses dealing with appointment of service agents or waiver of notice,<sup>68</sup> and limitation period clauses<sup>69</sup> in their contracts. Parties can even waive the right to notice and a hearing by using cognovits notes.<sup>70</sup> Additionally, parties commonly waive the right to a trial by jury,<sup>71</sup> they modify the rules of discovery,<sup>72</sup> enter into provisions modifying burdens of proof,<sup>73</sup> and waive class action rights.<sup>74</sup>

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<sup>65</sup> Moffitt, *supra* note 26, at 465.

<sup>66</sup> See, e.g., Faith Stevelman, *Regulatory Competition, Choice of Forum, and Delaware’s Stake in Corporate Law*, 34 DEL. J. CORP. L. 57, 118 (2009) (observing that parties “commonly” contract over choice of forum “in merger agreements and other highly negotiated corporate and commercial contracts”); Theodore Eisenberg & Geoffrey Miller, *Ex Ante Choices of Law and Forum: An Empirical Analysis of Corporate Merger Agreements*, 59 VAND. L. REV. 1975, 1987 tbl.2 (2006) (finding that about 53-percent of a sample of mergers clauses included forum selection provisions).

<sup>67</sup> See, e.g., Larry E. Ribstein, *From Efficiency to Politics in Contractual Choice of Law*, 37 GA. L. REV. 363, 403 (2003) (discussing why most such clauses are enforced by courts).

<sup>68</sup> *Nat’l Equip. Rental, Ltd. v. Szukhent*, 375 U.S. 311, 315-16 (1964) (“[I]t is settled . . . that parties to a contract may agree in advance . . . to waive notice altogether.”).

<sup>69</sup> See, e.g., 7 RICHARD A. LORD, WILLISTON ON CONTRACTS § 15:12, at 264-67 (4th ed. 1997) (discussing the enforceability of such clauses); Ronald J. Mann & Travis Siebeneicher, *Just One Click: The Reality of Internet Retail Contracting*, 108 COLUM. L. REV. 984, 990 (2008) (discussing the frequency of use of such clauses in consumer contracts).

<sup>70</sup> See, e.g., *Swarb v. Lennox*, 405 U.S. 191 (1972); *D.H. Overmyer Co. v. Frick Co.*, 405 U.S. 174 (1972). The enforcement of contractual confession of judgments does not violate the defendant’s right to due process provided that there is clear and convincing evidence that the waiver of notice and hearing was voluntary, knowing, and intelligently made. *Id.* at 185-87.

<sup>71</sup> Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX. L. REV. 1581, 1595 (2005) (“Most courts will enforce contractual jury waivers.”); Theodore Eisenberg & Geoffrey P. Miller, *Do Juries Add Value? Evidence from an Empirical Study of Jury Trial Waiver Clauses in Large Corporate Contracts*, 4 J. EMPIRICAL LEGAL STUD. 539, 539 (2007) (finding that about 20-percent of a sample of merger and acquisition agreements contained a jury trial waiver provision). Significantly, even though the Court has said that the standard for evaluating jury trial waivers is constitutional rather than contractual, see *D.H. Overmyer*, 405 U.S. at 185, lower courts seem to focus on the propriety of the bargaining process to the exclusion of any other concerns, see, e.g., *IFC Credit Corp. v. United Bus. & Indus. Fed. Credit Union*, 512 F.3d 989, 993 (7th Cir. 2008) (reversing the district court’s refusal to enforce a jury waiver embedded in a sales contract on the view that “[a]s long as the price is negotiable and the customer may shop elsewhere, consumer protection comes from competition rather than judicial intervention”).

<sup>72</sup> See, e.g., Noyes, *supra* note 62, at 607 (“It is generally acknowledged that ex ante contracts to alter the rules of evidence are enforceable.”); Taylor & Cliffe, *supra* note 60, at 1086 (discussing pre-litigation agreements, in which parties to a contract “designate what evidence may or may not be presented as proof”).

<sup>73</sup> See, e.g., Robert E. Scott & George E. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L. J. 814, 857-58 (2006) (noting that it is likely that courts would enforce reasonable allocations of burdens of proof and that good empirical evidence exists that parties contract for such allocations).

<sup>74</sup> See, e.g., Theodore Eisenberg, Geoffrey P. Miller & Emily Sherwin, *Arbitration’s Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Non-consumer Contracts*, 41 U. MICH. J.L. REFORM 871, 884–86 (2008) (finding

Even procedural requirements that might seem “immutable,” such as jurisdictional requirements, have, in recent years been subject to some contractual modification.<sup>75</sup>

Although the Supreme Court has not specifically endorsed the use of all of these – and the many other potential – forms of private procedural ordering, with almost no exceptions other than *Hall Street*, the Court’s precedent “treats procedural contracts as a method for generating procedural efficiencies and increased certainty of process, resulting in broad enforcement of procedural terms.”<sup>76</sup> The trend of precedent, in short, seems unequivocally to favor party autonomy and private procedural ordering.

### 1.1.3 The Case for Party Control: Efficiency Gains from Customized Procedure

The doctrinal reality, as the previous section shows, is that public procedure is primarily comprised of default rather than mandatory rules. Even though most courts do not bother to articulate them, there are sound normative reasons rooted primarily in efficiency, to accept this reality. The potential benefits from private procedural ordering<sup>77</sup> are really just extensions of the benefits conferred by existing public procedural rules. In adversarial systems of adjudication, public procedural rules are designed to strike a balance between the interests of the plaintiff and

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that eighty percent of consumer contracts with arbitration provisions included a class-action waiver while no consumer contract subject to litigation included such a term).

<sup>75</sup> Davis & Hershkoff, *supra* note 13, at 514 (noting that recent cases arguably allow for parties to enlarge the subject matter jurisdiction of federal courts and contract around some constitutional standing barriers).

<sup>76</sup> Jamie Dodge, *supra* note 13, at 739. In fact, since the Supreme Court’s decision in *Shute*, the Court has not found that “a procedural contract violates fundamental fairness.” *Id.* at 735-36.

<sup>77</sup> Contracting parties, I assume, are rational in the sense that they only enter into contracts that they believe will make them better off. See, e.g., Robert E. Scott, *The Law and Economics of Incomplete Contracts*, 2 ANNU. REV. L. & SOC. 279, 281 (2006) (assuming that contracting parties “act rationally, within the constraints of their environment, in the sense that they wish to contract if they believe the arrangement will make them better off and not otherwise”); Robert E. Scott, *A Relational Theory of Default Rules for Commercial Contracts*, 19 J. LEGAL STUD. 597, 602 (1990) (“If we assume rationality, then it follows that, regardless of the risk attitudes of particular parties, the dominant strategy for contractual risk allocation is to maximize the expected value of the contract for both parties. Only by allocating risks in order to maximize the joint expected benefits from their contractual relationship can the parties hope to maximize their individual utility.”).

the defendant in order to provide efficiency and fairness in the resolution of disputes.<sup>78</sup> Indeed, the Federal Rules of Civil Procedure, and similar state rules of procedure, were crafted to meet both needs.<sup>79</sup>

To that end, public procedural rules provide uniformity and so-called transsubstantivity – the rules are applied and interpreted in the same manner in all cases, irrespective of the subject matter in dispute.<sup>80</sup> Uniformity and transsubstantivity aim to standardize procedure and achieve, in the aggregate, that compromise between efficiency and fairness in the widest swathe of cases possible.

Like all pre-fabricated solutions, however, the rules cannot account for the individual nuances of every actual case. In fact, the rules themselves suggest as much, recognizing that their one-size-fits-all template may not be optimal in all situations. Procedural rules, at least in the United States, leave litigants with broad discretion to conduct their affairs throughout the litigation process.<sup>81</sup> Litigants have the responsibility and freedom, for instance, to discover, gather, and

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<sup>78</sup> 1 JAMES WM. MOORE ET AL., *MOORE'S FEDERAL PRACTICE* § 1.21[1][a] (3d ed. 2008) (“The application of orderly rules of procedure does not require the sacrifice of fundamental justice, but rather the Rules must be construed to promote justice for both parties, not to defeat it. This mandate is met if substantial justice is accomplished between the parties.”); FED. R. CIV. P. 1 (“[The Rules] should be construed and administered to secure the just, speedy, and inexpensive determination of every action and proceeding.”).

<sup>79</sup> See Charles E. Clark, *The Handmaid of Justice*, 23 WASH. U. L.Q. 297, 318-19 (1938). Professor and later judge Clark was perhaps the “dominant intellectual and operational force” behind the Federal Rules of Civil Procedure. Jay S. Goodman, *On the Fiftieth Anniversary of the Federal Rules of Civil Procedure: What did the Drafters Intend?*, 21 SUFFOLK U. L. REV. 351, 356 (1987). In Clark’s view, there were “two basic principles behind” the procedural reform: “all cases should be decided on their merits rather than on procedural maneuverings and that a basic goal in litigation should be economy of time and resources.” *Id.*

<sup>80</sup> See FED. R. CIV. P. 1 (“These rules govern the procedure in all civil actions and proceedings in the United States district courts, except as stated in Rule 81.”); Paul D. Carrington, *Making Rules to Dispose of Manifestly Unfounded Assertions: An Exorcism of the Bogy of Non-Trans-Substantive Rules of Civil Procedure*, 137 U. PA. L. REV. 2067, 2079 (1989) (“[P]rocedural rules should have general applicability.”); *but see, e.g.*, Jenny S. Martinez, *Process and Substance in the “War on Terror,”* 108 COLUM. L. REV. 1013, 1018 (2008) (arguing that many procedural rules do not seem to be transsubstantive but are “driven by particular substantive concerns”).

<sup>81</sup> Robert G. Bone, *Party Rulemaking: Making Procedural Rules Through Party Choice*, 90 TEX. L. REV. 1329, 1330 (2012) (“In the American adversary system, litigants enjoy broad freedom to make their own litigation choices.”); *see also* STEPHEN C. YEAZELL, *CIVIL PROCEDURE* 138 (7th ed. 2008) (“One of the hallmarks of the U.S. law is the extent to which the rules of procedure are ‘default’ rules, rules that govern if the parties have not agreed to something else.”).

present facts to an essentially passive court.<sup>82</sup> In so doing, parties can and do make a variety of strategic choices. There is a simple justification for the almost self-evidently obvious fact that parties exercise control over many of their litigation decisions: the twin goals of efficiency and justice can be best realized by giving them control over the development of their case.<sup>83</sup> Of course, parties enjoy tremendous flexibility in tailoring discovery processes to meet their needs, including deciding how much to invest in evidence production.<sup>84</sup> But parties can control the post-dispute contours of procedure in a variety of other ways as well.<sup>85</sup> For example, litigants may enter stipulations,<sup>86</sup> consent to waiver of service of process,<sup>87</sup> amend pleadings,<sup>88</sup> waive the right to a jury trial,<sup>89</sup> substitute a magistrate judge for an Article III District Judge,<sup>90</sup> or even waive their right to appeal.<sup>91</sup> By making such post-dispute procedural choices, litigants can calibrate their litigation

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<sup>82</sup> See, e.g., Scott & Triantis, *supra* note 74, at 826 (“In the adversarial litigation system, the court chooses between the self-interested evidence presented by the parties.”).

<sup>83</sup> See, e.g., Ellen E. Sward, *Values, Ideology, and the Evolution of the Adversary System*, 64 IND. L. J. 301, 316-19 (1989) (discussing the two justifications for the adversarial system: truth-finding and preservation of individual dignity).

<sup>84</sup> See FED. R. CIV. P. 29 (providing that “[u]nless the court orders otherwise, the parties may stipulate” that certain aspects of depositions will be conducted in particular ways and that “other procedures governing or limiting discovery be modified”); Patrick E. Higginbotham, *Duty to Disclose; General Provisions Governing Discovery*, in 6 JAMES WM. MOORE, MOORE’S FEDERAL PRACTICE § 26.04[1], at 26-35 (3d ed. 2008) (“Parties may mutually stipulate to use procedures for discovery that vary from the rules....”); 8A CHARLES ALAN WRIGHT, ARTHUR R. MILLER & RICHARD L. MARCUS, FEDERAL PRACTICE AND PROCEDURE §§ 2091-2092 (3d ed. 2012) (delineating the parameters of the ability of litigants to stipulate discovery procedure).

<sup>85</sup> For a thorough discussion of post-dispute procedural stipulations, see generally Michael L. Moffitt, *Customized Litigation: The Case for Making Civil Procedure Negotiable*, 75 GEO. WASH. L. REV. 461 (2007).

<sup>86</sup> See, e.g., 73 AM. JUR. 2d *Stipulations* §15.

<sup>87</sup> See FED. R. CIV. P. 4(d) (allowing parties to waive service of process in order to save money and effort); 4A CHARLES ALLEN WRIGHT & ARTHUR MILLER, FEDERAL PRACTICE & PROCEDURE §1092.1 (3d. ed. 2012) (discussing the process for procuring waiver).

<sup>88</sup> See FED. R. CIV. P. 15 (both before and during trial).

<sup>89</sup> See FED. R. CIV. P. 39(a)(1).

<sup>90</sup> See FED. R. CIV. P. 73.

<sup>91</sup> See e.g., *Acton v. Merle Norman Cosmetics, Inc.*, No. 97-56269, 163 F.3d 605 (9th Cir. 1998) (unpublished table decision) (dismissing appeal based on a post-dispute agreement); see also 15A CHARLES ALLEN WRIGHT, ARTHUR R. MILLER & EDWARD H. COOPER, FEDERAL PRACTICE & PROCEDURE: JURISDICTION AND RELATED MATTERS §3901 (noting that “the most likely occasion for waiver arises from a settlement agreement that calls for resolution of some disputed matter by the district court, coupled with an explicit agreement that the district court decision shall be final and that all rights of appeal are waived”).

expenditures to their individual tolerances for accuracy and risk and thus maximize efficiency as well as fairness.

But as the last section demonstrated, party control of litigation is not limited to post-dispute modifications. Rather, parties regularly enter into, and courts seem very willing to enforce, *ex ante* procedural contracts.<sup>92</sup> The justification for such *ex ante* procedural ordering rests on the same underlying premise that parties are in the best position to maximize the “incentive bang for the enforcement buck.”<sup>93</sup> *Ex ante* procedural contracting simply extends the logic and the range of potential efficiency gains from customizable procedure.

To see how, it is worth recapping the path-breaking article *Anticipating Litigation in Contract Design* in which Professors Scott and Triantis suggest that contracting parties can structure procedural rules in ways that will increase their joint surplus.<sup>94</sup> According to Professors Scott and Triantis, parties vary the precision of contract provisions in order to shift costs between the time of contracting and the time of dispute in order to enhance their overall welfare.<sup>95</sup> When parties choose a relatively precise or specific rule, they are increasing their *ex ante* investment.<sup>96</sup> In other words, parties spend more money at the front end of the contracting process contemplating future contingencies and negotiating over terms specifying precise obligations in light of those contingencies. By investing more at the front end of the process, parties are hoping to leverage the information that they have about their shared contracting goals and incentives to maximize gains from trade in order to reduce *ex post* enforcement costs.<sup>97</sup> On the other hand, when parties

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<sup>92</sup> See *supra* at Part II(B).

<sup>93</sup> Robert E. Scott & George E. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L. J. 814, 856 (2006).

<sup>94</sup> *Id.* at 856-60.

<sup>95</sup> See Allen Blair, *Hard Cases Under the Convention on the International Sale of Goods: A Proposed Taxonomy of Interpretive Challenges*, 21 DUKE J. COMP. & INT'L L. 269, 301-02 (2011).

<sup>96</sup> See Jody S. Kraus & Robert E. Scott, *Contract Design and the Structure of Contractual Intent*, 84 N.Y.U L. REV. 1023, 1071 (2009).

<sup>97</sup> Jody S. Kraus & Robert E. Scott, *Contract Design and the Structure of Contractual Intent*, 84 N.Y.U L. REV. 1023, 1071 (2009) (noting that parties “are exploiting their informational advantage (they know their contractual ends and have the

choose a relatively open-textured standard, they are decreasing their *ex ante* investment and increasing their expected *ex post* enforcement costs.<sup>98</sup> Rather than spending time and money worrying about future contingencies and terms specifying precise obligations in light of those contingencies at the front end of the contracting process, parties are choosing to delegate to a future tribunal the task of specifying precise obligations. Such *ex post* or back-end specification is efficient, Professors Scott and Triantis argue, where the value to the parties of a decision maker's hindsight outweighs the value that the parties would gain by specifying *ex ante* a more precise rule to govern their contract.<sup>99</sup> In short:

By reaching the optimal combination of front-end and back-end costs, parties can minimize the aggregate contracting costs of achieving a particular gain in contractual incentives. Conversely, for any given expenditure of contracting costs, the parties can reach the highest possible incentive gains by optimizing the allocation of their investment between the front and back ends.<sup>100</sup>

This insight reveals the potential of procedural contracting.<sup>101</sup> In fact, Professors Scott and Triantis point out that parties often choose to opt out of the public adjudicatory system entirely in favor of arbitration because “the parties’ *ex ante* agreement as to procedure improves the cost-effectiveness of their prospective enforcement mechanism.”<sup>102</sup> They proceed to identify other

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right incentives to choose the best means to achieve them), but they are sacrificing the hindsight advantage that a court might have”).

<sup>98</sup> *See id.*

<sup>99</sup> Scott & Triantis, *supra* note 74 at 819, 842 (“The parties choose between front- and back-end proxy determination by comparing the informational advantage the parties may have at the time of contracting against the hindsight advantage of determining proxies in later litigation”) (“The parties may view the court’s hindsight as an advantage or disadvantage depending on how much uncertainty has been resolved by the time contract performance is due”).

<sup>100</sup> *Id.* at 817.

<sup>101</sup> *See also, e.g.,* Albert Choi and George Triantis, *Completing Contracts in the Shadow of Costly Verification*, 37 J. LEGAL STUD. 503 (2008) (demonstrating that increasing litigation costs may induce better incentives to perform contractual obligations); Alan Schwartz, *Contracting About Bankruptcy*, 13 J. L. ECON. & ORG. 127 (1997), (discussing the advantages of contracting over preferred Bankruptcy procedures).

<sup>102</sup> Scott & Triantis, *supra* note 74, at 856, n. 123 (citing Christopher R. Drahozal & Keith N. Hylton, *The Economics of Litigation and Arbitration: An Application to Franchise Contracts*, 32 J. LEGAL STUD. 549, 558 (2003) (Part of the reason that arbitration might be desirable is because it permits vague contractual terms to be interpreted and enforced by industry experts rather than generalist judges).

possible procedural contracting mechanisms and apply their insights to one example, *ex ante* modifications of burdens of proof.<sup>103</sup>

With respect to burdens of proof, as Professors Scott and Triantis argue, even if the default allocation can be rationalized,<sup>104</sup> “it is highly unlikely that it yields the efficient . . . allocation for every contract.”<sup>105</sup> They also show how these different customized allocations might benefit parties.<sup>106</sup> The same, certainly, can be said of most procedural rules. Even to the extent that existing public procedural rules can be rationalized,<sup>107</sup> it is unlikely that they optimally balance efficiency and accuracy in all cases. Fine-tuning procedure can benefit parties in at least two significant ways: by curbing post-dispute opportunism and by reinforcing substantive obligations and optimizing pre-dispute behavior.

#### 1.1.3.1 Curbing Post-Dispute Opportunism

Private procedural ordering can help maximize the joint surplus from contracting by reducing the expected costs of future disputes. Customized procedural rules might achieve this gain by limiting or eliminating certain kinds of costly post-dispute behavior, such as escalating the costs of discovery or engaging in abusive motion practice.<sup>108</sup>

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<sup>103</sup> *Id.* at 857-71.

<sup>104</sup> They argue that they are “hard pressed,” along with most other commentators, to rationalize the default allocation. *Id.* at 866.

<sup>105</sup> *Id.*

<sup>106</sup> See *id.* at 867-78.

<sup>107</sup> I presume that most such rules are soundly underpinned by a desire to replicate what parties would have chosen for themselves if they had thought about them – they are, in other words, so-called “majoritarian” defaults – or they exist in order to protect vulnerable parties or non-parties. See, e.g., Ian Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L. J. 541, 596 (2003) (“The justification for a default rule is that it does for parties what they would have done for themselves had their contracting costs been lower.”); Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 91 (1989) (explaining penalty defaults).

<sup>108</sup> See generally, e.g., David Rosenberg & Steven Shavell, *A Model in Which Suits Are Brought for Their Nuisance Value*, 5 INT’L REV. L. & ECON. 3 (1985). Parties face a collective-action problem during discovery. In a highly simplified model, each party could choose to be abusive or reasonable with its discovery requests. Jointly, the parties would be best served by both employing reasonable discovery requests. Individually, however, each party would do better if it employed abusive discovery techniques while the other was reasonable. Because both parties know this, they face a Prisoner’s Dilemma, which results in an equilibrium where both parties are worse off than if they had been reasonable. The same basic model applies to abusive motion practice. See Ronald J. Gilson & Robert H. Mnookin, *Disputing*

Pre-dispute private procedural ordering, in fact, is far more effective than post-dispute ordering in this regard for at least three reasons. First, before a dispute, parties cannot accurately predict what side of what issues they will each take. This uncertainty affords the parties a degree of objectivity that they lack by the time that a dispute fomented, allowing them to make less emotionally charged choices about procedures and processes that will maximize their joint welfare.<sup>109</sup> Second, pre-dispute, and particularly at the outset of contracting, transfer payments are much more feasible. Accordingly, even asymmetric procedural advantages can be considered so long as the benefited party can purchase such advantages from the other at an agreed upon price.<sup>110</sup> Finally, before a dispute arises, and again especially during contract negotiations, parties enjoy the cooperative benefits of a deal-making ethos. Thus, they are less likely to succumb to various cognitive biases that might impede negotiating mutually beneficial procedural terms.<sup>111</sup>

By delimiting through contract the range of strategic procedural choices available before a dispute arises, the parties can enhance the overall value of their agreements. This sort of customization offers nearly limitless scope and potential for value-maximization.

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*Through Agents: Cooperation and Conflict Between Lawyers in Litigation*, 94 COLUM. L. REV. 509, 514-15 (1994); John K. Setear, *The Barrister and the Bomb: The Dynamics of Cooperation, Nuclear Deterrence, and Discovery Abuse*, 69 B.U. L. REV. 569, 584-86 (1989).

<sup>109</sup> See, e.g., Bruce L. Hay, *Procedural Justice--Ex Ante vs. Ex Post*, 44 UCLA L. REV. 1803, 1828-31 (1997) (describing the difference between *ex ante* and *ex post* perspectives when information differs); Christopher R. Drahozal, "Unfair" Arbitration Clauses, 2001 U. ILL. L. REV. 695, 743 (2001) (noting that "because no dispute has yet arisen, the parties can consider the range of possible disputes that might arise in agreeing on a dispute resolution forum"). *But see* Robert G. Bone, *Agreeing to Fair Process: The Problem with Contractarian Theories of Procedural Fairness*, 83 B.U. L. REV. 485, 526-29 (2003) (criticizing some of the assumptions about information access that underlie typical *ex ante* arguments).

<sup>110</sup> See Drahozal, *supra* note 110, at 746 ("[P]redispute arbitration agreements provide greater opportunities for making transfer payments than do postdispute arbitration agreements.").

<sup>111</sup> See generally, e.g., Russel Korobkin, *Psychological Impediments to Mediation Success: Theory and Practice*, 21 OHIO ST. J. ON DISP. RESOL. 281 (2006) (discussing a range of cognitive biases that can prevent successful post-dispute negotiations).

### 1.1.3.2 Reinforcing Substantive Obligations and Optimizing Pre-Dispute Behavior

Pre-dispute procedural contracting also provides parties with additional means of reinforcing or defining their substantive obligations to and behavior towards one another.<sup>112</sup> Parties already regularly negotiate over substantive terms that might be difficult to verify in subsequent litigation.<sup>113</sup> For instance, parties often include terms that are conditioned on vague or difficult to prove states like “best efforts.” The high costs of proving (or disproving) these states in court can function as a disincentive for parties to bring a claim and, at the very least, negatively impact the expected value of any claim. Parties might conversely contract for very precise obligations that are easily verifiable in court. Such terms can function to dissuade opportunistic shirking or holdups during performance of the contract. Alternatively, they can deter parties from filing nuisance claims or claims that have only marginal factual support. Such gains can be realized by reducing the likelihood of future litigation altogether or by narrowing the range of disputes in any future litigation.

But procedural contracting offers parties even more options for calibrating their substantive obligations to one another and optimizing behavior prior to a dispute arising. Aware of the rules that will govern any future disputes at the time of contracting, and knowing that these rules will

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<sup>112</sup> The divergence between *ex ante* and *ex post* optimal litigation decisions has been extensively analyzed in the law and economics literature. See generally, e.g., Steven Shavell, *The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System*, 26 J. LEGAL STUD. 575 (1997); STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 392-401 (2004). Suffice it to say here that procedural rules impact how parties evaluate their post-dispute payoffs and thus impact when (or if) parties assert their claims and how they make strategic choices during litigation.

<sup>113</sup> Information may be said to be unobservable if the other contracting party cannot perceive it. Information may be observable but not verifiable if the other party can perceive it but cannot, at a reasonable case, prove that information to a court or other third party. See, e.g., Robert E. Scott, *A Theory of Self-Enforcing Indefinite Agreements*, 103 COLUM. L. REV. 1641, 1642 n.2 (2003); see also Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765, 1791-95 (1996) (discussing the distinction between observable information, which is information that it is both possible and worthwhile for transactors to obtain, and verifiable information, which is information that it is worthwhile for transactors to prove to a designated third-party neutral in the event of a dispute). Parties often include in their contracts terms that might be cheap to observe but costly to verify. See Albert Choi & George Triantis, *Completing Contracts in the Shadow of Costly Verification*, 37 J. LEGAL STUD. 503 (2008); Albert Choi & George Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 YALE L.J. 848 (2010); see also, e.g., Louis Kaplow, *A Model of the Optimal Complexity of Legal Rules*, 11 J.L. ECON. & ORG. 150, 150-63 (1995); Louis Kaplow & Steven Shavell, *Accuracy in the Determination of Liability*, 37 J.L. & ECON. 1, 1-15 (1994).

affect their litigation behavior and the outcome of litigation, parties can tailor their respective pre-dispute actions.<sup>114</sup> For instance, agreeing that expert testimony will be given by a third-party-appointed neutral rather than through party appointed advocates might incentivize greater compliance with performance standards pre-dispute.<sup>115</sup> Or, opting into expanded review of arbitral awards could be seen as a means of increasing accuracy (and costs) and thus deterring more questionable claims.<sup>116</sup>

These simple examples do not exhaust the numerous possibilities.<sup>117</sup> The fundamental point, however, is that parties can use customized procedural devices in combination with carefully tailored substantive obligations to reduce opportunities for *ex post* opportunism and to incentivize pre-dispute behaviors that increase their joint surplus. In addition to benefiting the parties directly, customized procedure might also reduce the public costs associated with the court system, at least to the degree that private and public costs are correlated.<sup>118</sup> Finally, there are potential spillover benefits to the public adjudication system, at least with some forms of procedural contracting, such as expanded judicial review of arbitral awards.<sup>119</sup>

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<sup>114</sup> Procedural contracting can help overcome the “acoustic separation” between the *ex ante* understanding that parties have about how their future disputes will be adjudicated and their *ex post* understanding. See, e.g., Meir Dan-Cohen, *Decision Rules and Conduct Rules: On Acoustic Separation in Criminal Law*, 97 HARV. L. REV. 625 (1984); see also, generally, Bruce Hay, *Procedural Justice: Ex Ante Vs. Ex Post*, 44 UCLA L. REV. 1803 (1997).

<sup>115</sup> See, e.g., Robert G. Bone, *Party Rulemaking: Making Procedural Rules Through Party Choice*, 90 TEX. L. REV. 1329, 1356 (2012) (offering a similar example).

<sup>116</sup> See, e.g., Steven Shavell, *The Appeals Process as a Means of Correction*, 24 J. LEGAL STUD. 379 (1995).

<sup>117</sup> See generally, e.g., Daphna Kapelluk and Alon Klement, *Contracting Around Twombly*, 60 DEPAUL L. REV. 1 (2010) (discussing possible advantages of modifying the *Twombly* pleading standard by contract).

<sup>118</sup> See, e.g., Bone, *supra* note 116, at 1356; *Cable Connection, Inc. v. DirectTV, Inc.*, 190 P.3d 586, 606 (Cal. 2008) (discussing among the advantages of allowing parties to contract for expanded judicial review of arbitral awards the reduced burdens on the court system).

<sup>119</sup> See *Cable Connection*, 190 P.3d at 606 (“This procedure better advances the state of the law and facilitates the necessary beneficial input from experts in the field.”) (quoting Dan C. Hulea, *Contracting to Expand the Scope of Review of Foreign Arbitral Awards: An American Perspective*, 29 BROOK. J. INT’L L. 313, 355 (2003)).

#### 1.1.4 The Line Between Mockery and Efficiency: Limits to Customized Procedure

Set against the potential benefits of private procedural ordering are very real concerns, of course, about the implications of subverting public process to personal autonomy. Espousing one aspect of this concern in his customary charismatic style, Judge Kozinski said that he would have qualms about enforcing a procedural contract opting into expanded judicial review of arbitral awards “if the agreement provided that the district judge would review the award by flipping a coin or studying the entrails of a dead fowl.”<sup>120</sup> Provocative as such *reductio ad absurdum* thought experiments can be, the hard work of actually finding the line between mockery and the potential efficiency gains discussed in the previous section, however, can be daunting.<sup>121</sup>

In a nutshell, most concerns over private procedural ordering fall into one of four categories, the first two of which focus on the immediate parties and the second two of which are societal: (1) doubts about consent in the context of consumer or weaker party transactions;<sup>122</sup> (2) worries that procedural machinations will be used to gain covert substantive advantages, particularly in the context of consumer or weaker party transactions;<sup>123</sup> (3) concerns that private procedural ordering will hinder the structural role of private enforcement in our governmental

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<sup>120</sup> *Lapine Tech. Corp. v. Kyocera Corp.*, 130 F.3d 884, 891 (9th Cir. 1997) (Kozinski, J., concurring).

<sup>121</sup> See David H. Taylor and Sara M. Cliffe, *Civil Procedure by Contract: A Convolved Confluence of Private Contract and Public Procedure in Need of Congressional Control*, 35 U. RICH. L. REV. 1085, 1090 (2002) (“So where is the line between mockery and efficiency? Or, should there be any line at all? That is, should a public dispute resolution system be altered by private agreement?”).

<sup>122</sup> See, e.g., Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 WASH. U. L.Q. 637, 642–43 (1996) (“[I]t is critical to distinguish between commercial arbitration voluntarily agreed to by parties of approximately equal bargaining power, and commercial arbitration forced upon unknowing consumers, franchisees, employees or others through the use of form contracts.”); Richard C. Reuben, *First Options, Consent to Arbitration, and the Demise of Separability: Restoring Access to Justice for Contracts with Arbitration Provisions*, 56 S.M.U. L. REV. 819, 822 (2003) (arbitration “has the capacity to reduce, if not altogether eliminate access to the courts and to the law.”).

<sup>123</sup> See Dodge, *supra* note 13 at 734 (expressing the concern that parties might use procedural contracts to inappropriately modify substantive rights and incentives to exercise those rights).

system;<sup>124</sup> and (4) worries that private procedural ordering will impede dissemination of information that can be used to public benefit.<sup>125</sup>

Though all four concerns pose legitimate challenges to private procedural ordering and warrant careful consideration, a full analysis of how they fare against the potential benefits discussed in the previous section is beyond the scope of this Article. Whatever the merits of these challenges, as the next section explains, *Hall Street* was not relying on them. Nothing in the Court's analysis suggests that it was troubled in the slightest by the principles of autonomy underlying private procedural ordering.

#### 1.1.5 A Rolling Stop: Understanding *Hall Street* in Light of the Trend Favoring Private Procedural Ordering

The trend of precedent is clear: courts, and the Supreme Court in particular, strongly favor private procedural ordering. Although there was initial reluctance to the notion of party control over procedure and processes, that reluctance ultimately gave way to more modern notions of party autonomy and contract. Since *Bremen*, the Court has, with really only one notable exception, continued to advance party autonomy as the new touchstone of process and procedure.<sup>126</sup>

The notable exception, of course, is *Hall Street*. With little hesitation, the *Hall Street* Court narrowly construed the FAA to limit party freedom and autonomy. Given that one could fairly view arbitration as the apotheosis of private procedural ordering – as it allows parties the freedom to opt

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<sup>124</sup> See e.g., *Nebraska Ass'n of Pub. Emps.*, 477 N.W.2d 577, 581-83 (1991) (basing refusal to enforce pre-dispute arbitration agreements on Nebraska cases decided in the 1800s, and relying on pre-FAA cases in warning that arbitration will “open a leak in the dyke of constitutional guarantees which might some day carry all away”) (quoting *Phoenix Ins. Co. v. Zlotky*, 92 N.W. 736 (Neb. 1902)); J. Maria Glover, *The Structural Role of Private Enforcement Mechanisms in Public Law*, 53 WM. & MARY L. REV. 1137, 1167-70 (2012) (noting how procedural contracting can negatively impact the role of private enforcement by changing “stakes of litigation and therefore discourage suit in the first place”).

<sup>125</sup> 1 JOHN HENRY WIGMORE, *EVIDENCE IN TRIALS AT COMMON LAW*, § 7a, at 605 (Peter Tillers ed. 1983) (“It is arguable that the proceedings in courts are not there solely for the convenience of the parties and that it is important for social reasons to maintain the solemnity and dignity of judicial proceedings regardless of the wishes of the parties.”).

<sup>126</sup> See *supra* at Part II(B).

out of the public set of procedural rules and protections altogether – a closer consideration of the case in the context of private procedural ordering is warranted.

On one level, *Hall Street* surprisingly countered Supreme Court arbitration precedent, which had been at the avant-garde of private procedural ordering.<sup>127</sup> The case elevated an advantage – finality – to the status of an “essential virtue” while dislodging the cornerstone of the arbitral process – freedom of contract.<sup>128</sup> Up until *Hall Street*, the mantra that “arbitration is a creature of contract,”<sup>129</sup> reflected the decisional history of the Court, which, consistent with other procedural contracting cases, had recognized the primacy of party autonomy.<sup>130</sup>

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<sup>127</sup> See Rachel S. Portnoy, Comment, *Embracing the Alternative: Cable Connection, Inc. v. DIRECTV, Inc. Puts the Alternative Back into Alternative Dispute Resolution*, Comment, 44 NEW ENG. L. REV. 991, 998 (2010) (“The *Hall Street* ruling came as a surprise to many.”).

<sup>128</sup> See *Hall Street Assocs. LLC v. Mattel, Inc.*, 552 U.S. 576, 588 (2008) (stating that the ruling was “substantiating a national policy favoring arbitration with just the limited review needed to maintain arbitration’s *essential virtue* of resolving disputes straightaway”) (emphasis added).

<sup>129</sup> Courts and commentators have recognized the fundamental contractual nature of arbitration, often employing this phrase. See, e.g., *United Steelworkers v. Am. Mfg. Co.*, 363 U.S. 564, 570-71 (1960) (Brennan, J., concurring) (“To be sure, since arbitration is a creature of contract, a court must always inquire, when a party seeks to invoke its aid to force a reluctant party to the arbitration table, whether the parties have agreed to arbitrate the particular dispute.”); *Puleo v. Chase Bank USA, N.A.*, 605 F.3d 172, 194 (3d Cir. 2010) (“As we have stressed, ‘[a]rbitration is fundamentally a creature of contract, and an arbitrator’s authority is derived from an agreement to arbitrate.’” (quoting *Allstate Settlement Corp. v. Rapid Settlements, Ltd.*, 559 F.3d 164, 169 (3d Cir. 2009))); *Edstrom Indus., Inc. v. Companion Life Ins. Co.*, 516 F.3d 546, 552 (7th Cir. 2008) (“But precisely because arbitration is a creature of contract, the arbitrator cannot disregard the lawful directions the parties have given them. If they tell him to apply Wisconsin law, he cannot apply New York law.”), *abrogated by Affymax, Inc. v. Ortho-McNeil-Janssen Pharms., Inc.*, 660 F.3d 281 (7th Cir. 2011); MyLinda K. Sims & Richard A. Bales, *Much Ado About Nothing: The Future of Manifest Disregard After Hall Street*, 62 S.C. L. REV. 407, 410 (2010) (“[Section 2] also establishes that arbitration is a creature of contract law and that arbitrational provisions should be viewed in this light.”); Scott D. Marrs & Sean P. Milligan, *What You Always Wanted to Know About Arbitration: Five Arbitration Issues Recently Decided by the Courts*, 73 TEX. B. J. 634, 634 (2010) (“Because arbitration is a creature of contract, the rights and obligations of the parties and the arbitrators are, to an important extent, borne out of the arbitration clause itself.”).

<sup>130</sup> See, e.g., *Southland v. Keating*, 465 U.S. 1, 7 (1984) (“[N]egotiation by experienced and sophisticated businessmen . . . absent some compelling and countervailing reason . . . should be honored by the parties and enforced by the courts.”) (quoting *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 12 (1972)); *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 219 (1985) (“[T]he overriding goal of the Arbitration Act was [not] to promote the expeditious resolution of claims . . . but merely the enforcement . . . of privately negotiated arbitration agreements.”); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 947 (1995) (internal quotation marks omitted) (“[T]he basic objective [of the FAA] is not to resolve disputes in the quickest manner possible, no matter what the parties’ wishes . . . but to ensure that commercial arbitration agreements . . . are enforced according to their terms.”); see also, e.g., Margaret Moses, *Can Parties Tell Courts What to Do? Expanded Judicial Review of Arbitral Awards*, 52 U. KAN. L. REV. 429, 444 (2004) (“[The] position that the FAA permits expanded judicial review appears . . . consistent with both legislative intent and Supreme Court decisions emphasizing the importance of enforcing arbitral agreements in accordance with their terms.”); Richard C. Reuben, *Personal Autonomy and Vacatur After Hall Street*, 113 PENN STATE L. REV. 1103, 1106 (2010) (“The Court’s ruling was surprising to some, especially because the Court had previously held that party autonomy, not efficiency, was the touchstone of arbitration under the FAA.”).

Though the speed and finality of arbitration can frequently be an important – perhaps even decisive – advantage for parties, arbitration offers a number of other advantages as well.<sup>131</sup> Prizing one advantage as “essential” while undercutting the premise at the core of procedural contracting, that parties are in the best position to gauge what combination of processes and procedures will best maximize their joint surplus, was shortsighted. Just because parties might reasonably be willing to trade off some speed and finality in exchange for opportunities to correct legal (or factual) errors through expanded judicial review, they are not necessarily opting out of the other advantages that arbitration can offer. For instance, parties might well believe that arbitration can be a superior way to manage the presentation of complex and industry-specific facts through a process that allows for the selection of decision makers with expertise and mature judgment in the subject area. Especially in large transactions, however, in which enormous sums may be tied up for many years, legal accuracy might be of paramount concern to contracting parties.

Read expansively, then, *Hall Street*'s refusal to allow parties the freedom to make these sorts of trade-off choices – the same sorts of trade-off choices that parties make with respect to other forms of procedural contracting – could signal the Court's interest in halting the advance of private procedural ordering. I argue, however, that this reading does not make sense for at least two reasons.

First, the *Hall Street* Court makes virtually no reference to policy rationales at all, and it most certainly does not implicate, in any sense, any of the four categories of concerns over procedural contracting referenced in the previous section. The Court makes no mention of disparities in party bargaining power – indeed, it would have been hard pressed to do so given that the parties in *Hall Street* were both sophisticated businesses. Similarly, the Court does not even

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<sup>131</sup> THOMAS E. CARBONNEAU, CASES AND MATERIALS ON ARBITRATION LAW AND PRACTICE 11-13 (2009 5th Ed.) (discussing some of these advantages).

hint that expanded judicial review would somehow sneak substantive advantages in through the procedural back door. And, perhaps more tellingly, the Court makes no reference to expanded judicial review somehow undermining the proper functioning of the public adjudicatory system. Significantly, the opportunity for the Court to suggest that contractually expanded review constituted an improper commandeering of the judicial process existed. Judge Richard Posner, for instance, had argued, albeit in dicta, that parties could not contract for expanded judicial review of their arbitral awards because “federal jurisdiction cannot be created by contract.”<sup>132</sup> Variants of this argument gained traction in the debates over expanded judicial review prior to the Court’s ruling in *Hall Street*.<sup>133</sup> Nevertheless, the Court did not engage the argument at all.

Second, and far more significantly, the Court left open “other avenues” by which parties could seek expanded judicial review of their awards.<sup>134</sup> Although this portion of the case was merely dicta, and arguably included only because of the clumsy presentation of the case on appeal,<sup>135</sup> the Court’s invitation for a greater state law role is capacious. In holding that Section 10 provides the “exclusive regime[]” for review of awards under the FAA, the Court made clear that it did “not purport to say that [Section 10] exclude[s] more searching review based on authority outside the statute as well.”<sup>136</sup> Such an invitation does not indicate that the Court was shying away from procedural contracting or party autonomy at all. Instead, this language suggests only that the Court believed that this autonomy should be fostered and developed under state rather than

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<sup>132</sup> *Chicago Typographical Union v. Chicago Sun-Times, Inc.*, 935 F.2d 1501, 1505 (7th Cir. 1991).

<sup>133</sup> See, e.g., Alan Scott Rau, *Contracting Out of the Arbitration Act*, 8 AM. REV. INT’L ARB. 225, 227-30 (1997) (describing the extent to which this argument had been wielded in the debate to date and famously calling it “the very reddest of red herrings”).

<sup>134</sup> *Hall Street Assocs. LLC v. Mattel, Inc.*, 552 U.S. 576, 590 (2008)

<sup>135</sup> The parties never raised the application of the FAA to the agreement as an issue until the case was presented to the Supreme Court. Moreover, save for a fairly spare reference at the Court of Appeals, the parties had not addressed the possibility review should be governed not by the FAA but instead by the district court’s Rule 16 case management powers. See *id.*

<sup>136</sup> *Id.*

federal law. As the next section goes on to discuss, the evidence indicates that, for better or worse, states are beginning to embrace the freedom that *Hall Street* offers to them.

## 1.2 The Status of State Laws Governing Judicial Review of Arbitral Awards

*Pay attention to where you are going because without meaning you might get nowhere.*<sup>137</sup>

As the last Part concluded, the U.S. Supreme Court in *Hall Street* “left the door ajar for alternate routes to an expanded scope of review.”<sup>138</sup> Although *Hall Street* did so only in dicta, the Court’s invitation for a greater state law role in the enforcement and review of arbitral awards has to be taken seriously in order to square *Hall Street*’s holding with the broader trend of precedent favoring private procedural ordering.

Accordingly, this Part briefly surveys the current status of state laws governing judicial review. It observes that, although most states’ arbitration laws closely parallel the FAA and many courts thus expressly follow *Hall Street* or decline to allow contractually expanded judicial review for reasons similar to those offered in *Hall Street*, there are signs that states are starting to experiment with more intrusive and different standards for judicial review of arbitral awards. Five states have parted ways with *Hall Street* and allow for parties to contract into expanded judicial review. A handful of additional states have laws allowing courts to review arbitral awards for at least some errors of law or facts or both.

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<sup>137</sup> A. A. Milne, *Winnie-The-Pooh: Unbouncing of Tigger 5* (1928).

<sup>138</sup> *Cable Connection, Inc. v. DirectTV, Inc.*, 190 P.3d 586, 596 (Cal. 2008).

### 1.2.1 The Status Quo: States Following Federal Law and *Hall Street*

The history of the development of state laws governing arbitration follows a somewhat convoluted path.<sup>139</sup> After a failed attempt by the National Conference of Commissioners on State Laws (“NCCUSL”) to forward a workable Uniform Arbitration Act (“UAA”) in 1926, the uniform drafters took another stab in 1956.<sup>140</sup> For the purposes of this Article, the key point is that the 1956 UAA and the 2000 UAA track the provisions of the FAA, particularly with respect to judicial enforcement and review, very closely.<sup>141</sup> At present, 39 states have enacted either the 1956 or the

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<sup>139</sup> See Stephen K. Huber, *State Regulation of Arbitration Proceedings: Judicial Review of Arbitration Awards by State Courts*, 10 CARDOZO J. CONFL. RESOL. 509, 520 (2009) (discussing this development and observing that “[t]he adoption of state statutory standards for judicial review of arbitration awards [was] more complex” than the adoption of the FAA).

<sup>140</sup> See *id.*; REV. UNIF. ARB. ACT § 12 (1956) (In 2000, the UAA was revised, though the relevant language regarding judicial enforcement and review remained virtually unchanged.).

<sup>141</sup> See Huber, *supra* note 141 at 520. Section 10 of the FAA, dealing with vacatur of awards, provides in pertinent part:

- (a) [T]he United States court . . . may make an order vacating the [arbitration] award upon the application of any party to the arbitration --
- (1) where the award was procured by corruption, fraud, or undue means;
  - (2) where there was evident partiality or corruption in the arbitrators, or either of them;
  - (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the \*897 controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
  - (4) 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. 9 U.S.C. § 10(a) (2006).

In comparison, the Section 12 of the 1956 UAA provides in pertinent part:

- (a) Upon application of a party, the court shall vacate an award where:
- (1) The award was procured by corruption, fraud or other undue means;
  - (2) There was evident partiality by an arbitrator appointed as a neutral or corruption in any of the arbitrators or misconduct prejudicing the rights of any party;
  - (3) The arbitrators exceeded their powers;
  - (4) The arbitrators refused to postpone the hearing upon sufficient cause being shown therefor or refused to hear evidence material to the controversy or otherwise so conducted the hearing, contrary to the provisions of Section 5, as to prejudice substantially the rights of a party; or
  - (5) There was no arbitration agreement and the issue was not adversely determined in proceedings under Section 2 and the party did not participate in the arbitration hearing without raising the objection; but the fact that the relief was such that it could not or would not be granted by a court of law or equity is not ground for vacating or refusing to confirm the award.

UNIF. ARB. ACT § 12 (1956); see *also* REV. UNIF. ARB. ACT § 23 (2000) (adopting substantially similar grounds for vacatur).

2000 UAA, and three more states have introduced the 2000 UAA in 2013.<sup>142</sup> Of the remaining states, only three have arbitration laws that are not either patterned after the UAA or the FAA: Alabama, New Hampshire, and West Virginia.<sup>143</sup>

Many of these states either expressly follow *Hall Street* or rely on similar reasoning to prevent parties from contracting for expanded judicial review.<sup>144</sup> Others have held that the statutory grounds for vacatur are exclusive without specifically holding that the grounds may not be expanded by contract.<sup>145</sup> In short, most states construe their arbitration laws in much the same manner as the FAA.<sup>146</sup> As the next two sections demonstrate, however, there is reason to believe that, in the wake of *Hall Street*, states are beginning to experiment with different and potentially more intrusive review standards.

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<sup>142</sup> See UNIFORM LAW COMMISSION, <http://www.uniformlaws.org/Act.aspx?title=Arbitration%20Act%20%282000%29> (last visited Apr. 10, 2013).

<sup>143</sup> See ALA. CODE § 6-6-14 (2013) (providing that an award “cannot be inquired into or impeached for want of form or for irregularity . . . unless the arbitrators are guilty of fraud, partiality, or corruption in making it”); N.H. REV. STAT. ANN. § 542:8 (2013) (allowing vacatur for “fraud, corruption, or misconduct by the parties or by the arbitrators, or on the ground that the arbitrators have exceeded their powers,” but also allowing review for “plain mistake”); W.VA. CODE § 55-10-4 (2012) (dictating that award may not be set aside “except for errors apparent on its face, unless it appears to have been procured by corruption or other undue means, or by mistake, or that there was partiality or misbehavior in the arbitrators, or any of them, or that the arbitrators so imperfectly executed their powers that a mutual, final and definite award upon the subject matter submitted was not made”).

<sup>144</sup> See, e.g., HL 1, LLC v. Riverwalk, LLC, 15 A.3d 725, 735 (Me. 2011) (following *Hall Street*); Brookfield Country Club, Inc. v. St. James-Brookfield, LLC, 696 S.E.2d 663, 666 (Ga. 2010) (same); Pugh’s Lawn Landscape Co., 320 S.W.3d 252, 259–60, 261 (Tenn. 2010) (same); John T. Jones Constr. Co. v. City of Grand Forks, 665 N.W.2d 698, 704 (N.D. 2003) (holding that “parties to an arbitration agreement cannot contractually expand the scope of judicial review beyond that provided by [the Uniform Arbitration Act as adopted by North Dakota]”); Chicago SouthShore & S. Bend R.R. v. N. Ind. Commuter Transp. Dist., 289 Ill.App.3d 533, 224 Ill. Dec. 595, 682 N.E.2d 156, 159 (1997), *rev’d on other grounds*, 184 Ill.2d 151, 234 Ill. Dec. 395, 703 N.E.2d 7 (1998) (“The subject matter jurisdiction of the trial court to review an arbitration award is limited and circumscribed by statute. The parties may not, by agreement or otherwise, expand that limited jurisdiction.”); Brucker v. McKinlay Transp., Inc., 557 N.W.2d 536, 540 (Mich. 1997) (holding that an arbitration agreement that provides for judicial confirmation must conform to the statute because parties may not privately create a role for public institutions).

<sup>145</sup> See, e.g., Sch. Comm. of Pittsfield v. United Educators of Pittsfield, 784 N.E.2d 11, 16 (Mass. 2003) (stating that unless a statutorily enumerated ground for vacatur is established, courts are “strictly bound by the arbitrator’s factual findings and conclusions of law, even if they are in error,” and that “[a]rbitration would have little value if it were merely an intermediate step between a grievance and litigation in the courts”); Schnurmacher Holding, Inc. v. Noriega, 542 So.2d 1327, 1329-30 (Fla. 1989) (stating that the grounds for judicial review of an arbitration award are extremely limited by statute and do not include error of law).

<sup>146</sup> See Stephen Willis Murphy, Note, *Judicial Review of Arbitration Awards Under State Law*, 96 Va. L. Rev. 887, 891 (2010) (surveying state laws and finding a “majority rule” whereby at least 38 states restrictively read their arbitration laws effectively consistent with the FAA).

## 1.2.2 A Nod to Autonomy: States Allowing for Contractually Expanded Judicial Review of Arbitral Awards

Currently, California, Connecticut, Alabama, Texas and New Jersey part ways with *Hall Street*. These five states offer parties the freedom to contractually expand the grounds for judicial review of arbitral awards. The following subsections briefly recap the law in these jurisdictions and the justifications they have given for separating themselves from *Hall Street*.

### 1.2.2.1 California

Shortly after *Hall Street*, California seized on the invitation for states to provide an alternative to the FAA's exclusive grounds for vacatur. In *Cable Connection, Inc. v. DIRECTV, Inc.*, the California Supreme Court (California Court) concluded that parties were free, under California's arbitration statute, to contract for expanded judicial review of arbitral awards. In reaching this conclusion, the California Court rejected *Hall Street's* reasoning and concluded that *Hall Street's* invitation was consistent with its view that the FAA did not preempt state procedural laws in state court proceedings. Both findings are worth a closer examination, as they provide a model for how other states might justify departures from the FAA.

The California Court was presented with an arbitration agreement governed by state law.<sup>147</sup> According to this agreement, the arbitrators did not have "the power to commit errors of law or legal reasoning, and the award [could] be vacated or corrected on appeal to a court of competent jurisdiction for any such error."<sup>148</sup> Plaintiffs argued, before the arbitrators, that they were entitled to

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<sup>147</sup> *Cable Connection, Inc. v. DIRECTV, Inc.*, 44 Cal. 4th 1334, 1340-41 (Cal. 2008). Interestingly, the agreement actually provided that "[t]he arbitrators shall apply California substantive law to the proceeding, except to the extent Federal substantive law would apply to any claim," and it directed that the arbitration proceedings were to be governed by federal law and the rules of the American Arbitration Association. *Id.* at 1340. The Court, however, concluded, in a footnote, that "[b]ecause the parties proceeded in state court under the CAA, . . . judicial review of the award is governed by state law, though the arbitration proceedings are governed by federal procedural law and AAA rules under the terms of the contract." *Id.* at 1341 n. 2.

<sup>148</sup> *Id.* at 1341 n.3

class-wide arbitration under the agreement, and the arbitrators agreed.<sup>149</sup> Defendant, DIRECTTV, then filed a motion to vacate in state court on several grounds, including most significantly that the award was the product of errors of law and thus subject to judicial review.<sup>150</sup>

The trial court agreed with DIRECTTV and vacated the award, but the Court of Appeals reversed, finding that the trial court had exceeded its authority by engaging in a merits review of the arbitrator's decision.<sup>151</sup> In reaching its conclusion, the Court of Appeals relied on two previous cases that had determined that expanded judicial review provisions were unenforceable.<sup>152</sup> Essentially, these cases advanced the contention that expanded review was impermissible because: (1) like the Court in *Hall Street*, they believed that expanded review "would undermine the benefits of arbitration and the goals of the Act to reduce expense and delay in resolving disputes";<sup>153</sup> and (2) they believed that judicial review would either be meaningless to or would improperly interfere with the arbitral process because arbitrators are not "ordinarily constrained to decide according to the rule of law."<sup>154</sup>

Confronted with these lower courts' decisions and the U.S. Supreme Court's then-fresh ruling in *Hall Street*, the California Court first clarified that under state law parties can contractually agree to judicial review of an arbitration award.<sup>155</sup> While admitting the similarities between the statutory schemes for enforcement of arbitral awards in the CAA and the FAA,<sup>156</sup> the California

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<sup>149</sup> See *id.* at 1342.

<sup>150</sup> See *id.*

<sup>151</sup> See *id.* at 1343.

<sup>152</sup> See *id.* (citing *Oakland–Alameda Cnty. Coliseum Auth. v. CC Partners*, 101 Cal. App. 4th 635, 645 (2002); *Crowell v. Downey Cmty. Hosp. Found.*, 115 Cal. Rptr. 2d 810 (2002)).

<sup>153</sup> *Crowell*, 115 Cal. Rptr. 2d at 815.

<sup>154</sup> *Id.* at 814.

<sup>155</sup> See *Cable Connection Inc.*, 44 Cal. 4th at 1340.

<sup>156</sup> See *id.* at 1344 (explaining that both "the CAA and the FAA provide only limited grounds for judicial review of an arbitration award," and noting the similarities between the grounds for vacatur or modification in §§ 1286.2 (a) and 1286.6 of the CAA and those listed in §§ 10-11 of the FAA).

Court cited its 1992 decision in *Moncharsh v. Heily & Blasé* to bolster the proposition that, in drafting the CAA, the legislature “adopt[ed] the position taken in case law . . . ‘that in the absence of some limiting clause in the arbitration agreement, the merits of the award, either on questions of fact or of law, may not be reviewed except as provided in the statute.’”<sup>157</sup> According to the California Court, *Moncharsh* established a California rule “that the parties may obtain judicial review of the merits by express agreement” under the CAA.<sup>158</sup> Because the language used by the parties in the pending case evidenced their unequivocal intent to exclude legal errors from the scope of the arbitrators’ powers, such errors fell within the scope of judicial review under California law.<sup>159</sup>

The California Court then turned to the pressing question of whether *Hall Street* preempted this construction of the CAA.<sup>160</sup> The California Court acknowledged U.S. Supreme Court precedent finding that “state laws invalidating arbitration agreements on grounds applicable only to arbitration provisions contravene the policy established by Section 2 of the FAA.”<sup>161</sup> Nevertheless, it found that “the United States Supreme Court does not read the FAA’s procedural provisions to apply to state court proceedings.”<sup>162</sup> To reach this conclusion, it relied on its previous holding that “[t]he language used in [S]ections 3 and 4 and the legislative history of the FAA suggest that the sections were intended to apply only in federal court proceedings.”<sup>163</sup> Because the same language limiting applicability of those sections to a “United States district court” with jurisdiction under Title 28 of the United States Code exists in Sections 9 through 11, the California Court similarly

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<sup>157</sup> *Id.* at 1356 (citing *Moncharsh v. Heily & Blasé*, 3 Cal. 4th 1, 23 (1992)) (emphasis added).

<sup>158</sup> *Id.* at 1340.

<sup>159</sup> *See id.* at 1350.

<sup>160</sup> *See id.*

<sup>161</sup> *Id.* at 1351 (citing *Cronus Invs., Inc. v. Concierge Svcs.*, 35 Cal.4th 376, 389 (2005), among other cases).

<sup>162</sup> *Id.*

<sup>163</sup> *Id.*

characterized the FAA's enforcement and review provisions as "procedural" and thus only applicable to the federal courts.<sup>164</sup>

### 1.2.2.2 Alabama

In a very brief 2010 ruling, the Alabama Supreme Court (Alabama Court) in *Raymond James Fin. Servs., Inc. v. Honea* expressed solidarity with California and found that the FAA's review provisions were "procedural" and thus not necessarily applicable in state court proceedings.<sup>165</sup> In reaching this conclusion, the Alabama Court had to reevaluate its earlier position that "a party desiring judicial review of an arbitration award in a proceeding subject to the [FAA] is limited to arguments based on those grounds enumerated in 9 U.S.C. § 10."<sup>166</sup> Finding "good and sufficient reasons 'to retreat from that position,'" the Alabama Court concluded that "[u]nder the Alabama common law, courts must rigorously enforce contracts, including arbitration agreements, according to their terms in order to give effect to the contractual rights and expectations of the parties."<sup>167</sup>

Perhaps the most interesting feature of the decision, however, relates to the fact that the parties had expressly agreed that "any unsettled dispute or controversy will be resolved by arbitration in accordance with the FAA."<sup>168</sup> Moreover, unlike the situation facing the California Court in *Cable Connections*, there was "no evidence indicating that either [of the parties] ever contemplated review under the common law [of Alabama] as opposed to the FAA."<sup>169</sup> Accordingly,

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<sup>164</sup> *Id.* at 1352.

<sup>165</sup> *Raymond James Fin. Servs. Inc. v. Honea*, 55 So.3d 1161, 1168-69 (Ala. 2010) ("§10 represents procedural as opposed to substantive law. We are accordingly at liberty to decide whether to apply §10 in state court proceedings on motions to vacate or to confirm an arbitration award.") (citing to *Cable Connection* in a footnote).

<sup>166</sup> *Horton Homes, Inc. v. Shaner*, 999 So.2d 462, 467 n. 2 (Ala. 2008) (reiterating *Birmingham News Co. v. Horn*, 901 So.2d 27, 46 (2004)).

<sup>167</sup> *Hornea*, 55 So.3d at 1169 (quoting *Birmingham News Co. v. Horn*, 901 So.2d at 46-47).

<sup>168</sup> *Id.* at 1167.

<sup>169</sup> *Id.* at 1168. Although this was the argument of one of the parties, the Court never disagreed with it.

the Alabama Court's determination that the FAA did not govern the review of the award is unusual, to put it mildly. While claiming to be bound by parties' intentions, the Alabama Court seemed to side step them, at least with respect to what law governed.

### 1.2.2.3 Connecticut

Although the matter is not free from doubt, it appears that courts in Connecticut also disagree with *Hall Street*. In a decision released only two months after *Hall Street*, the Connecticut Supreme Court (Connecticut Court) said in a footnote that “[p]arties to agreements remain, however, free to contract for expanded judicial review of an arbitrator’s findings.”<sup>170</sup> This dicta seemed to reaffirm a position taken earlier by the Connecticut Court in its 2006 *Stutz v. Shepard* decision.<sup>171</sup> In *Stutz*, the Connecticut Court unceremoniously upheld a contractual provision that invested a court with the power to review an arbitral award under a “clearly erroneous” standard.<sup>172</sup> Although it provided virtually no analysis, the context suggests that the Connecticut Court simply viewed the provision as within the permissible scope of freedom of contract.<sup>173</sup> In an unpublished case, the Connecticut Superior Court relied on these two decisions to conclude that a provision providing for expanded judicial review of an arbitral award for de novo review of law (but not facts) was enforceable.<sup>174</sup> Again, the court did not engage in any searching analysis but it simply concluded that *Hall Street* limited its holding to the FAA and thus was not applicable to the Connecticut arbitration statute.<sup>175</sup>

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<sup>170</sup> *HH East Parcel, LLC v. Handy & Harman, Inc.*, 947 A.2d 916, 926 n.16 (Conn. 2008).

<sup>171</sup> *See Stutz v. Shepard*, 901 A.2d 33 (Conn. 2006).

<sup>172</sup> *See id.* at 39.

<sup>173</sup> *See id.*

<sup>174</sup> *See East Greyrock, LLC v. OBC Assocs., Inc.*, No. X08CV044002173S, 2010 WL 3448075 at \*4 n.9 (Conn. Super. Ct. Aug. 2, 2010).

<sup>175</sup> *See id.*

#### 1.2.2.4 Texas

The most recent departure from *Hall Street* happened in 2011 when the Texas Supreme Court (Texas Court) decided *Nafta Traders, Inc. v. Quinn*.<sup>176</sup> In many respects, the Texas Court's decision parallels the decisions of the California and Alabama Supreme Courts. There are, however, two notable differences in the analysis.

First, although the Texas Court recognized that the statutory grounds for vacating an award under the Texas Arbitration Act (TAA) and FAA are virtually identical, it hooked its conclusion that the TAA permits parties to contract for expanded review on "excess of authority."<sup>177</sup> According to the Texas Court, the U.S. Supreme Court mistakenly overlooked this ground for review in the FAA, which can encompass situations where the "parties have agreed that an arbitrator should not have authority to reach a decision based on reversible error--in other words, that an arbitrator should have no more power than a judge."<sup>178</sup> In the Texas Court's view, this express statutory ground for review coupled with the underlying purposes of the Federal and Texas Acts – "to ensur[e] that private agreements are enforced according to their terms" – rendered *Hall Street*'s analysis and conclusion flawed.<sup>179</sup>

The second notable feature of *Nafta* has to do with its handling of the preemption question. Unlike the agreements at issue in *Cable Connections* and *Raymond James*, the agreement in *Nafta* was silent about whether it was to be governed by state or federal law.<sup>180</sup> Accordingly, the Court had to figure out how and why to apply Texas law to it. The Court's solution was to say that, effectively, both the FAA and the TAA applied, concurrently.<sup>181</sup> Because, in the Court's analysis,

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<sup>176</sup> See *Nafta Traders, Inc. v. Quinn*, 339 S.W.3d 84 (Tex. 2011).

<sup>177</sup> See *id.* at 92, 95.

<sup>178</sup> *Id.* at 92.

<sup>179</sup> *Id.* at 94 (citations omitted).

<sup>180</sup> See *id.* at 101.

<sup>181</sup> See *id.*

the FAA did not preempt the TAA, and because the TAA allowed for parties to contract into expanded judicial review, it did not matter if the parties chose Texas or federal law to apply to the agreement.<sup>182</sup>

#### 1.2.2.5 New Jersey

New Jersey is the only state that validates party freedom to contract for expanded judicial review by statute: “nothing in this act shall preclude the parties from expanding the scope of judicial review of an award by expressly providing for such expansion in a record.”<sup>183</sup> This statutory provision was passed before *Hall Street* and was included “to make it clear that parties may expand the scope of judicial review by providing for such expansion in a record, following the ruling of *Tretina Printing, Inc. v. Fitzpatrick Associates, Inc.*, 135 N.J. 349 (1994).”<sup>184</sup>

Interestingly, however, the Court in *Tretina* did not actually hold that parties could contract for expanded judicial review, but instead, in a rather convoluted decision, elevated a prior concurring opinion to the status of the “current standard” for judicial review of arbitral awards in New Jersey.<sup>185</sup>

That concurrence had stated in a rather off-handed way that:

For those who think the parties are entitled to a greater share of justice, and that such justice exists only in the care of the court, I would hold that the parties are free to expand the scope of judicial review by providing for such expansion in their contract.<sup>186</sup>

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<sup>182</sup> See *id.*

<sup>183</sup> See N.J. STAT. ANN. § 2A:23B-4c (West Supp. 2013).

<sup>184</sup> N.J. S. Comm. Statement, S.B. 514, 210th Leg. (2002).

<sup>185</sup> See *Tretina Printing, Inc. v. Fitzpatrick Assocs. Inc.*, 640 A.2d 788, 792-93 (N.J. 1994) (finding that the correct standard of judicial review of arbitral awards in New Jersey was stated by the Chief Justice’s concurring opinion in *Perini Corp. v. Greate Bay Hotel & Casino, Inc.*, 610 A.2d 364 (N.J. 1992)).

<sup>186</sup> *Id.* at 793.

Making it clear just how much of a “side” comment this was, the Chief Justice went on to quip that he doubted that many would include such expanded review provisions and, if they did, “they should abandon arbitration and go directly to the law courts.”<sup>187</sup>

Because its origins are so murky, it is difficult to discern what policies underlie the rule. Nonetheless, regardless of its questionable genesis, the statute is clear: parties may contract for expanded judicial review of their arbitral awards under New Jersey law.

### 1.2.3 A Back Door Sneak Attack?: States with More Intrusive Judicial Standards of Review of Arbitral Awards

While most states continue to interpret their arbitration laws essentially the same as the FAA, as the previous section shows, there are signs that this might be changing. In addition to the five states that have parted ways with *Hall Street* in terms of the permissibility of contractual expansions of judicial review, a handful of states have interpreted their arbitration laws in ways that provide for more intrusive judicial review than is allowed under the FAA.

Some states, for instance, have embraced a manifest disregard of the law and fact standard of review.<sup>188</sup> Others allow for review of either law<sup>189</sup> or fact<sup>190</sup> but not both. Accordingly, at least a handful of states seem to have embraced the freedom that *Hall Street* suggests they

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<sup>187</sup> *Id.*

<sup>188</sup> See, e.g., *Welty v. Brady*, 2005 WY 157, ¶¶ 20-25, 123 P.3d 920, 926-28 (Wyo. 2005) (noting that under Wyoming law, “manifest mistake of fact or law” is a permissible ground for vacating arbitral award); see also Stephen Willis Murphy, *Judicial Review of Arbitration Awards Under State Law*, 96 VA. L. REV. 887, 893-94 (2010) (surveying state law and finding that seven states allow for review of law and fact).

<sup>189</sup> See, e.g., *Sherman v. Graciano*, 872 A.2d 1045, 1046 (N.H. 2005) (“An award may be vacated for plain mistake when it is determined that an arbitrator misapplied the law to the facts.”); see also Murphy, *supra* note 190, at 893-94 (surveying state law and finding that 11 states allow for review law).

<sup>190</sup> See, e.g., *Spiska Eng'g v. SPM Thermo-Shield*, 730 N.W.2d 638, 643, 647 (S.D. 2007) (concluding that the South Dakota arbitration statute allowed for limited factual review in addition to legal review in order to ensure that the arbitrator was “arguably construing or applying the contract”); IOWA CODE § 679A.12(f) (2013) (allowing for vacatur if “[s]ubstantial evidence on the record as a whole does not support the award”).

have to construct standards of judicial review that are different from and in many cases more intrusive than the exclusive standards of the FAA.

### 1.3 The Problems with *Hall Street's* Reliance on States to Advance Private Procedural Ordering in the Context of Expanded Judicial Review

*There must have been a moment, at the beginning, were we could have said – no. But somehow we missed it.*<sup>191</sup>

As it stands, parties who wish to contract for expanded judicial review of their arbitral awards must do so against a backdrop of interlocking statutory frameworks, state-versus-federal conflicts, and a constant deluge of confusing and often confused state and federal court decisions. While *Hall Street* might have opened “other avenues” for parties who want the security of appellate review of their arbitral awards, those avenues look an awful lot like a nearly incomprehensible maze of winding side streets, dead ends, and one ways.

This Part considers the problems posed by *Hall Street's* invitation for more state law involvement in the enforcement and review of arbitral awards. It begins by surveying some of the most significant doctrinal doubts posed by such involvement. It then considers how parties are likely to respond to the doctrinal uncertainty, particularly in light of the fact that many of the benefits that used to be available only in arbitration are now obtainable in litigation through other forms of procedural contracting. Ultimately, this Part concludes that the trend of commercial parties leaning away from arbitration to resolve their domestic disputes with one another is likely to continue and

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<sup>191</sup> TOM STOPPARD, ROSENCRANTZ AND GUILDENSTERN ARE DEAD 125 (1994).

even accelerate so long as *Hall Street*'s invitation for greater state law remains good law.<sup>192</sup> *Hall Street* neither meaningfully fosters party autonomy nor provides the efficiency of clear-cut finality.

### 1.3.1 Doctrinal Problems

“The idea of states serving as laboratories for testing alternative approaches to perceived problems is too well known to require amplification here.”<sup>193</sup> But whatever benefits attach to federalism generally, Supreme Court precedent in the context of arbitration law has been decidedly anti-federalist.<sup>194</sup> At least since *PrimaPaint Corp. v. Flood & Conklin Manufacturing Co.*, it has been established that the provisions of the FAA preempt inconsistent state laws in cases in federal court.<sup>195</sup> Eighteen years later, the Court went further, in *Southland Corp. v. Keating*, and held that Section 2 of the FAA also applies in state court and preempts any conflicting state laws.<sup>196</sup> But the Court has also stated that the FAA does not occupy the field of arbitration law.<sup>197</sup> Moreover, it has

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<sup>192</sup> Importantly, I am not suggesting that arbitration will decrease with respect to trans-border disputes. To the contrary, the ease of enforcement of awards pursuant to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, which obligates each nation to enforce arbitral awards regardless of where they are rendered, will likely continue to make international arbitration relevant to commercial parties, even in the wake of *Hall Street*. See United Nations Convention on the Recognition & Enforcement of Foreign Arbitral Awards art. 1, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 3, available at <http://treaties.un.org/doc/publication/UNTS/Volume%20330/v330.pdf>; see also United Nations, Status of Convention on the Recognition and Enforcement of Foreign Arbitral Awards, United Nations Treaty Collection, [http://treaties.un.org/pages/ViewDetails.aspx?src=TREATY&mtdsg\\_no=XXII-1&chapter=22&lang=en](http://treaties.un.org/pages/ViewDetails.aspx?src=TREATY&mtdsg_no=XXII-1&chapter=22&lang=en) (last visited Aug. 17, 2012) (listing the countries that are participants to the agreement).

<sup>193</sup> Stephen K. Huber, *State Regulation of Arbitration Proceedings: Judicial Review of Arbitration Awards by State Courts*, 10 CARDOZO J. CONFLICT RESOL. 509, 512 (2009) (arguing “that potential improvements in the arbitration process are better tried initially at the state rather than the federal level, due to lower degree of risk if a change is deemed not to be successful”); see also *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) (coining the phrase).

<sup>194</sup> Ronald G. Aronovsky, *The Supreme Court and the Future of Arbitration: Towards a Preemptive Federal Arbitration Procedural Paradigm?*, 42 SW. U. L. REV. 131, 131 (2012) (“The United States Supreme Court in recent years has embraced an increasingly robust view of the FAA’s preemptive power in a series of often controversial arbitration law decisions reflecting the Court’s evolving view about the meaning of the federal “pro-arbitration policy.”); Christopher R. Drahozal, *In Defense of Southland: Reexamining the Legislative History of the Federal Arbitration Act*, 78 NOTRE DAME L. REV. 101, 102 (2002) (“In *Southland*, the Court effectively ‘federalized’ United States arbitration law, ‘restrict[ing] state legislative rights’ so as ‘to guarantee the unobstructed enforcement of arbitration agreements.’”) (quoting THOMAS E. CARBONNEAU, *CASES AND MATERIALS ON THE LAW AND PRACTICE OF ARBITRATION* 162 (2d ed. 2000)) (internal quotation marks omitted)).

<sup>195</sup> *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 405-06 (1967).

<sup>196</sup> *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984).

<sup>197</sup> *Volt Info. Scis. v. Bd. of Trs.*, 489 U.S. 468, 477 (1989) (“The FAA contains no express preemptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration.”).

at least suggested that other provisions of the FAA, including Sections 3 and 4, which deal with stays pending arbitration and actions to compel arbitration, might not apply in state court.<sup>198</sup>

The rather confused state of preemption outside of Section 2 renders *Hall Street's* invitation somewhat questionable. It seems beyond cavil that in any federal court proceeding, all of the terms of the FAA apply, unless, perhaps, the parties have specified that state law will govern.<sup>199</sup> It is not at all clear, however, that parties can specify that state law will govern if that law permits parties to contract for expanded judicial review.

As Professor Christopher Drahozal has compellingly pointed out, the authority for such opting into state law draws most of its force from *Volt Information Sciences, Inc. v. Board of Trustees of the Leland Stanford Junior University*.<sup>200</sup> But the Court in *Volt* did not say that parties could opt out of the FAA; instead, it said only that parties could incorporate state law as a term in their arbitral contracts.<sup>201</sup> By so doing, parties can transmute state laws that would otherwise be preempted into an enforceable term of their arbitration contract. If this “incorporation-by-reference” reading of *Volt* is correct, then parties that chose a state law allowing for contractually expanded judicial review are really just incorporating such expanded review into their contracts, which *Hall Street* expressly says that they cannot do.<sup>202</sup> The only way that the Supreme Court could allow parties to successfully resort to state law, at least in federal court, in order to effectuate

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<sup>198</sup> *Id.* at 477 n. 6 (“[W]e have never held that §§ 3 and 4 . . . are nonetheless applicable in state court.”); *Southland Corp.*, 465 U.S. at 6 n. 10 (“[W]e do not hold that §§ 3 and 4 of the Arbitration Act apply to proceedings in state courts.”); see also, e.g., Stephen K. Huber, *State Regulation of Arbitration Proceedings: Judicial Review of Arbitration Awards by State Courts*, 10 CARDOZO J. CONFLICT RESOL. 509, 530 (2009) (arguing that the Court’s treatment of FAA preemption is “limited” and that “[o]nly sections 1 and 2 of the FAA preempt state law”).

<sup>199</sup> See 1 IAN R. MACNEIL ET AL., *FEDERAL ARBITRATION LAW: AGREEMENTS, AWARDS, AND REMEDIES UNDER THE FEDERAL ARBITRATION ACT* § 10.8.2.2, at 10:80 (1995 & Supp. 1999) (“In federal courts, all the sections of the comprehensive FAA will govern.”).

<sup>200</sup> *Volt*, 489 U.S. at 477; see Christopher R. Drahozal, *Contracting Around Hall Street*, 14 LEWIS & CLARK L. REV. 905, 919 (2010).

<sup>201</sup> See Drahozal, *supra* note 202, at 919; see *Volt*, 489 U.S. at 475 (“[B]y incorporating the California rules of arbitration into their agreement, the parties had agreed that arbitration would not proceed in situations which fell within the scope of CALIF.CODE CIV.PROC.ANN. § 1281.2(c) (West 1982).”).

<sup>202</sup> See Drahozal, *supra* note 202, at 919.

their preference for expanded review would be for it to hold that *Volt* permits parties to opt out of FAA Sections 9 and 10. Such an extreme reading of *Volt*, notwithstanding the dicta in *Hall Street*, seems a stretch.

Of course, many arbitral enforcement proceedings occur in state rather than federal court, so perhaps the problems with realizing *Hall Street*'s invitation in federal courts do not matter all that much. Indeed, at least according to the courts in *Cable Connections*, *Raymond James*, and *Nafta*, FAA Section 10 is merely procedural and does not, therefore, preempt state arbitral review laws.<sup>203</sup> The proposition that Section 10 is a procedural provision that should not apply in state court rests on the premise that the law of review and vacatur "does not challenge the determination that the parties had an enforceable arbitration agreement."<sup>204</sup>

This argument, however, overlooks the fact that review and vacatur rules could easily undermine the very goal of finality that the Court in *Hall Street* held to be the "essential virtue" of arbitration.<sup>205</sup> Although the current status of state laws, as Part III demonstrated, might not pose a significant threat to the finality of arbitral awards, the potential for such a threat exists and some states already seem to be moving towards review standards that are much more intrusive than those provided by federal law.<sup>206</sup> Accordingly, it is far from certain that, if pushed, the Supreme Court will stick by its dicta in *Hall Street* and back away from the *sine qua non* of the decision: limited judicial review ensures the sanctity of the arbitral process.

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<sup>203</sup> See *supra* Part III(B)(1); see also, e.g., *S. Cal. Edison Co. v. Peabody W. Coal Co.*, 977 P.2d 769, 773-74 (Ariz. 1999) ("Each state is free to apply its own procedural requirements so long as those procedures do not defeat the purposes of the act."); *Wells v. Chevy Chase Bank*, F.S.B., 768 A.2d 620, 627 (Md. 2001) (noting that state "procedural rules govern appeals, unless those rules undermine the goals and principles of the FAA").

<sup>204</sup> Jill I. Gross, *Over-Preemption of State Vacatur Law: State Courts and the FAA*, 3 J. AM. ARB. 1, 32 (2004).

<sup>205</sup> See *supra* Part III(C); see also, e.g., Stephen L. Hayford, *Federal Preemption and Vacatur: The Bookend Issues Under the Revised Uniform Arbitration Act*, 2001 J. DISP. RESOL. 67, 75 (arguing that vacatur laws should be narrow enough to avoid providing parties with "a vehicle for easily escaping the arbitration bargain").

<sup>206</sup> See also generally Stephen K. Huber, *State Regulation of Arbitration Proceedings: Judicial Review of Arbitration Awards by State Courts*, 10 CARDOZO J. CONFLICT RESOL. 509 (2009) (arguing that state law could provide a mechanism for broadening the scope of judicial review).

In short, even though *Hall Street* comprehends a greater role for state law in the enforcement and review of arbitral awards, and it does so with the goal, I have argued, of furthering private procedural ordering, doctrinal complications might well pose an insuperable barrier to such a role. At the very least, these doctrinal complications have to raise the suspicions of any parties wanting to take advantage of *Hall Street's* invitation.

### 1.3.2 Legal Uncertainty and High Transaction Costs

There are a number of reasons, of course, why parties choose to arbitrate. At bottom, however, arbitration purports to be the ultimate form of representativeness: both the process and the content of the dispute are based on negotiation between the parties. The flexibility of arbitration enables parties to define the scope of the dispute and to specify the form and substance of the proceedings that will resolve it. Contracting parties may, thus, construct a dispute resolution mechanism that optimally aligns their incentives with their preferred contractual norms. In this sense, as I have already suggested, arbitration can be seen as the apotheosis of private procedural ordering.<sup>207</sup>

Given the significant potential benefits of arbitration, the fact that commercial parties are leaning away from using it to resolve their domestic disputes with one another might, on first glance, be puzzling.<sup>208</sup> Recent empirical evidence confirms, however, the trend.<sup>209</sup> This evidence

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<sup>207</sup> See *supra* Part II(E)..

<sup>208</sup> See, e.g., 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) (concluding from their findings that “sophisticated actors prefer litigation to arbitration”).

<sup>209</sup> See generally David B. Lipsky, *How Corporate America Uses Conflict Management: The Evidence From a New Survey of the Fortune 1000*, 30 ALTERNATIVES TO HIGH COST LITIG. 139 (2012) (summarizing the results of a Cornell University survey and noting a decline of 25% in the use of commercial arbitration since a previous survey 14 years earlier); Raymond G. Bender Jr., *Just and Accurate: Confronting Limited Appeal Rights in Arbitration*, 30 ALTERNATIVES TO HIGH COST LITIG. 146 (2012) (discussing the same survey as well as a different but similar survey conducted by the Rand Institute).

suggests that the principle reason for the trend has to do, in fact, with limited appeal rights.<sup>210</sup>

Indeed, when *Hall Street* was decided, several amici argued that parties would “flee from arbitration if expanded review” was not open to them.<sup>211</sup> The Court was not sympathetic, saying that it could not tell the future,<sup>212</sup> but it seems that, four years on, the amici were right.

Of course, some of the decline in the use of arbitration might stem from more general economic factors. After all, “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.”<sup>213</sup> In the wake of the financial crisis, businesses might be more sensitive to costs, which are not necessarily lower in arbitration.<sup>214</sup>

I suggest, however, that, consistent with the arguments in Part I, parties desire the freedom to tailor their dispute resolution processes in ways that optimize their joint welfare. For a period of time, arbitration was the only game in town. Parties faced a binary choice between accepting the public court system and its attendant procedural rules or they could opt out and resolve their disputes in arbitration. Private process, however, “has migrated in surprising ways into the public courts: despite public rules of procedure, judicial decisions increasingly are based on private rules of procedure drafted by the parties before a dispute has arisen.”<sup>215</sup> Procedural contracting offers commercial parties many of the advantages that once seemed the exclusive prerogative of arbitration while still providing them with the right to appeal, a right that the empirical evidence strongly suggests many commercial parties highly value.

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<sup>210</sup> See Bender, *supra* note 211 (noting that in both surveys corporate counsel highlight limited appeal rights as the biggest reason for shying away from arbitration).

<sup>211</sup> See *Hall Street Associates LLC v. Mattel, Inc.*, 552 U.S. 576, 588-89 (2008).

<sup>212</sup> See *id.*

<sup>213</sup> Christopher R. Drahozal & Stephen J. Ware, *Why Do Businesses Use (or Not Use) Arbitration Clauses?*, 25 OHIO ST. J. ON DISP. RESOL. 433, 435 (2010).

<sup>214</sup> See *id.*

<sup>215</sup> Kevin E. Davis & Helen Hershkoff, *Contracting for Procedure*, 53 WM. & MARY L. REV. 507, 510-11 (2011).

While arbitration has arguably become more like litigation,<sup>216</sup> litigation has become more flexible like arbitration. The comparative advantages that arbitration once offered have become smaller, and, at the margins, commercial parties are accordingly not seeing the “large cost (or other)” advantages that they once might have.<sup>217</sup>

*Hall Street*'s invitation for parties to turn to state law to give them the flexibility that they crave does not help. In fact, it makes matters much worse. It does not help because, as the previous section argued, a high degree of legal uncertainty shrouds the ultimate enforceability of contractually expanded review provisions under state law. Moreover, the inconsistent and differing constructions of state laws – with different limitations and scopes – makes uncovering the right state law to apply to an agreement difficult and expensive. Legal search costs coupled with uncertainty mean that parties cannot rely on *Hall Street*'s dicta to give them the private procedural ordering advantages that they want.

Worse, the possibility that state laws, with differing and potentially more intrusive judicial review standards might haunt arbitral awards that parties would prefer to leave settled could well chase away commercial parties who would have otherwise stuck with arbitration. After all, as the Court in *Hall Street* quite rightly recognized, one of the great advantages of arbitration can be its finality. Even in the absence of a right to contract for expanded judicial review, many parties might have preferred arbitration, but *Hall Street*'s inelegant effort to provide for procedural contracting

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<sup>216</sup> See, e.g., Stephen L. Hayford & Carroll E. Neesemann, *A Response to RUAA Critics: Codifying Modern Arbitration Law, Without Preemption*, 8 No. 4 DISP. RES. MAG. 15, 17 (Summer 2002) (“Modern arbitration has, to a degree, become judicialized, that is, it has come somewhat to resemble litigation in court.”); Thomas E. Carbonneau, *National law and the Judicialization of Arbitration: Manifest Destiny, Manifest Disregard, or Manifest Error*, in INTERNATIONAL ARBITRATION IN THE 21ST CENTURY: TOWARDS “JUDICIALIZATION” AND UNIFORMITY? THE 12TH SOKOL COLLOQUIUM 115, 130 (Richard Lillich and Charles N. Brower eds. 1994) (suggesting that arbitration might be becoming “an engine of adjudication indistinguishable from its judicial counterpart).

<sup>217</sup> See, e.g., Thomas J. Stipanowich and J. Ryan Lamare, *Living with ADR: Evolving Perceptions and Use of Mediation, Arbitration and Conflict Management in Fortune 1,000 Corporations*, unpublished draft available on SSRN (March 2013) (noting that respondents to a survey in 1997 cited cost savings as a primary driver in the increased use of arbitration while respondents to a survey in 2011 cited rising costs as a primary reason for the decline in the use of arbitration).

through state laws has the unintended consequence of casting a pall over finality as well as practically undermining party autonomy.

#### **1.4 Conclusion**

Contrary to the holding of the Supreme Court in *Hall Street*, I have argued that less party freedom to contract for expanded review of arbitral awards under the FAA does not equal more stability for arbitration. Although *Hall Street* is best understood not as a break from but rather a continuation of the Court's strong support for private procedural ordering, the case manages to undermine party autonomy while simultaneously threatening its state goal of valuing finality. By pushing for greater state involvement in procedural contracting, at least with respect to judicial review of arbitral awards, the Court further unsettled an already fraught area of law – federal preemption in the context of arbitration. Accordingly, even if some states allow for contractually expanded judicial review of arbitral awards, parties who want to take advantage of such provisions are hampered by uncertainty and high legal search costs. Perhaps more significantly, if states take on a greater role in establishing standards of judicial review for arbitral awards, the possibility exists that such standards will actually undermine the finality of awards.

## Chapter 2: Doctrinally Permissible Options for Calibrating Procedure Through Contract<sup>1</sup>

*Nothing is of more immediate practical importance to a lawyer than the rules that govern his own strategies and maneuvers; and nothing is more productive of deep and philosophical puzzles than the question of what those rules should be.*<sup>2</sup>

For a long time, arbitration was the only game in town for parties who wanted more flexibility in the adjudication of their disputes. They faced a dichotomous choice between accepting the public court system and its attendant procedural rules or opting out entirely and resolving their disputes in arbitration. Private process, however, “has migrated in surprising ways into the public courts: despite public rules of procedure, judicial decisions increasingly are based on rules of procedure drafted by the parties . . . .”<sup>3</sup> This sort of private procedural ordering gives parties the ability to unbundle the off-the-rack procedures applied in public courts and bargain about individual rules.<sup>4</sup> Customized procedure, in short, offers parties much of the flexibility that once seemed the

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<sup>1</sup> Henry Allen Blair, *Promise and Peril: Doctrinally Permissible Options for Calibrating Procedure Through Contract*, 95 Neb. L. Rev. 787 (2016).

<sup>2</sup> RONALD A. DWORKIN, *A MATTER OF PRINCIPLE* 72 (1985).

<sup>3</sup> Kevin E. Davis & Helen Hershkoff, *Contracting for Procedure*, 53 WM. & MARY L. REV. 507, 510-11 (2011).

<sup>4</sup> Private procedural ordering allows parties to bargain over the procedural rules that will govern the resolution of any disputes that might arise between them in the future. See, e.g., Jaime Dodge, *The Limits of Procedural Private Ordering*, 97 VA. L. REV. 723, 724-25 (2011) (describing the process of modifying by contract the “spectrum of procedure” as private procedural ordering). Following the lead of other commentators who have described this form of private ordering, I will use the terms “private procedural ordering” and “procedural contracting” interchangeably. See, e.g., Judith Resnik, *Procedure as Contract*, 80 NOTRE DAME L. REV. 593, 598 (2005) (recognizing a movement from “Due Process Procedure to Contract Procedure”). Unlike some commentators, however, unless otherwise specified, I use these terms in the broadest possible sense, to include all party agreements regarding resolution of their disputes, including procedures that may be used in courts and extrajudicial procedures and processes such as arbitration, mediation, med-arb and settlement. Cf. Davis & Hershkoff, *supra* note 2 (describing contract procedure as “the practice of setting out procedures in contracts to govern disputes . . . that will be adjudicated in the public courts”); Erin A. O’Hara O’Connor & Christopher R. Drahozal, *Carve-Outs and Contractual Procedure*, in VAND. L. AND ECON. RES. Paper No. 13-16, at 2 (June 14, 2013) <https://ssrn.com/abstract=2279520> or <http://dx.doi.org/10.2139/ssrn.2279520> [<https://perma.unl.edu/C9GT-ZCYM>].

prerogative of arbitration while maintaining the advantages of public adjudication, including, most significantly, rights to appeal and public subsidization. While arbitration has arguably become more like litigation,<sup>5</sup> litigation may be becoming more like arbitration.<sup>6</sup>

The promise of more flexible public adjudication presents parties with significant benefits.<sup>7</sup> If public procedure is seen as a set of defaults rather than immutable or mandatory rules, then parties may negotiate over the contents not only of their substantive obligations but also of their preferred enforcement mechanisms.<sup>8</sup> A default regime allows parties to design organizational frameworks within which the integrity of a contractual relationship is decided and maintained, calibrating accuracy and efficiency to meet their preferences.<sup>9</sup> Pre-dispute procedural contracting

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<sup>5</sup> See, e.g., Thomas J. Stipanowich, *Punitive Damages and the Consumerization of Arbitration*, 92 Nw. U. L. Rev. 1, 8 (1997) (arguing that arbitration has evolved into something of a “civil court of general jurisdiction”); Thomas J. Stipanowich, *Arbitration: The “New Litigation,”* 2010 U. ILL. L. REV. 1, 52 (calling arbitration the “new litigation”).

<sup>6</sup> Douglas Shontz, Fred Kipperman & Vanessa Soma, *Business-to-Business Arbitration in the United States*, RAND (2011), <http://www.rand.org/pubs/techni-calreports/TR781.html> [<https://perma.unl.edu/9L2Y-P6ZG>], at i; see also, e.g., Henry S. Noyes, *If You (Re)build It, They Will Come: Contracts to Remake the Rules of Litigation in Arbitration's Image*, 30 HARV. J.L. & PUB. POL'Y 579, 622 (2007).

<sup>7</sup> Indeed, innovating through contract generally is a pervasive phenomenon. See generally Kevin E. Davis, *Contracts as Technology*, 88 N.Y.U. L. REV. 83, 85 (2013) (arguing that contractual innovation is a form of technological progress that spurs economic growth).

<sup>8</sup> For a particularly good introduction to the subject of default rules, see Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989) (applying game theory to the question of how lawmakers should create contract default rules to facilitate efficient contracts); see also, e.g., Ian Ayres, *Making a Difference: The Contractual Contributions of Easterbrook and Fischel*, 59 U. CHI. L. REV. 1391 (1992) (reviewing FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991)); Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821 (1992) (discussing the default rule approach to gap-filling); Jules L. Coleman et al., *A Bargaining Theory Approach to Default Provisions and Disclosure Rules in Contract Law*, 12 HARV. J.L. & PUB. POL'Y 639 (1989) (applying an economic analysis to default rules); Jason Scott Johnston, *Strategic Bargaining and the Economic Theory of Contract Default Rules*, 100 YALE L.J. 615 (1990) (employing game theory, but challenging Ayres and Gertner's conclusions); *Symposium on Default Rules and Contractual Consent*, 3 S. CAL. INTERDISC. L.J. 1 (1993) (featuring seventeen pieces on theoretical perspectives on contract default rules).

<sup>9</sup> See, e.g., Louis Kaplow, *The Value of Accuracy in Adjudication: An Economic Analysis*, 23 J. LEGAL STUD. 307, 314 (1994) [hereinafter Kaplow, *Accuracy in Adjudication*] (showing that heightened accuracy in adjudication can only be obtained at higher costs so an efficient balance has to be struck on a case-by-case basis).

allows parties to create additional incentives for performance, avoid opportunistic and socially wasteful *ex post* litigation spending, and limit risk by leveraging their collective interests and shared ignorance about what the future may hold. Post-dispute procedural contracting allows parties to tailor the adjudication process in light of their unique and potentially differing evaluations of a dispute in order to constrain litigation expenditures and mitigate risk.

Given the potential gains from finely tuned procedure, it is puzzling that current empirical evidence suggests that few parties explore the full range of customization theoretically available to them.<sup>10</sup> Indeed, while the evidence we have is far from perfect, it seems to indicate that parties are doing precious little fine-tuning, at least *ex ante*. Although parties routinely engage in a few sorts of coarse pre-dispute customizations—choosing to arbitrate or engage in some other form of alternative dispute resolution, waiving rights to a jury, picking a law to govern their deals and selecting a forum for their disputes—it does not appear that parties regularly attempt more precise calibrations of procedure. It is less clear how often and to what extent parties may be engaging in fine-tuning of procedure after a dispute has arisen, though commentators have speculated that such agreements are similarly rare.<sup>11</sup>

One key explanation for the relative dearth of fine-grained procedural customization, and the explanation that many commentators rely on, might be that the practice constitutes a radical departure from current doctrine.<sup>12</sup> It might be that the costs of innovating in the face of doctrinal

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<sup>10</sup> See *infra* Part 2.2.

<sup>11</sup> See, e.g., Robert G. Bone, *Party Rulemaking: Making Procedural Rules Through Party Choice*, 90 TEX. L. REV. 1329, 1342 (2012) (finding few examples of agreements entered into after filing, other than extensions of time for filing and similar modest adjustments to scheduling); David A. Hoffman, *Whither Bespoke Procedure?*, 2014 U. ILL. L. REV. 389, 393 (suggesting that procedure-related agreements are not as common as generally imagined).

<sup>12</sup> See, e.g., Scott Dodson, *Party Subordination in Federal Litigation*, 83 GEO WASH L. REV. 1, 6-7(2014) (arguing that "parties fall at the bottom of the power hierarchy" and parties' attempts "to alter otherwise applicable procedures ... are wholly unenforceable absent some legal authorization for judicial enforcement").

norms or trying to change those norms are simply too steep for any single party to bear, especially given worries about freeriding.<sup>13</sup>

This Article evaluates this doctrinal explanation for the puzzle created by the gap between the potential gains of customized procedure and the apparent reality that parties do little of it, at least before a dispute arises. It concludes that a close look at the doctrine does not bear this story out. To the contrary, while express authorization for many forms of customized procedure does not exist, the current trend of doctrine could not be clearer: courts seem ready to enforce parties' autonomous procedural choices. Accordingly, there are minimal risks that a court will refuse to enforce or abide by a procedural customization so long as it does not suffer from some fundamental contract formation flaw, like unconscionability or fraud.

The conclusion reached in this Article leaves the animating puzzle unsolved. It also leaves significant and important normative questions about the desirability of private procedural ordering unanswered. I take up these two matters in separate articles.<sup>14</sup> But in this Article, by precisely articulating the benefits of the practice, surveying the existing empirical evidence about it and addressing its doctrinal feasibility in detail, I hope to clear a path to a better understanding of the promise and peril of procedural contracting.

This Article proceeds in three parts.

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<sup>13</sup> See *infra* note 131 and accompanying text. Essentially, innovators have a hard time excluding others from taking advantage of their work. If the innovation is valuable, others can copy it easily. By itself, this problem might dissuade some potential innovators, who have to spend time and money designing the innovation. But the free rider problem is exacerbated by the fact that innovators also disproportionately bear the risks that go along with adopting customizations.

<sup>14</sup> I provide an informal model that offers an explanation to the puzzle in Henry Allen Blair, *Anticipating Procedural Customization*, where I evaluate when and the extent to which parties rationally might seek to modify default rules of procedure and conclude that in arms' length deals, parties are unlikely to seek radical departures from the defaults. I then evaluate the normative implications of procedural contracting in Henry Allen Blair, *The Line Between Mockery and Efficiency: The Normative Implications of Private Process*, [hereinafter Blair, *Normative Implications*] where I conclude that the most concerning objections to private process map onto general concerns about assent in disparate contracts generally and thus cannot and should not be viewed in isolation from that larger subject.

In Part 2.1, I analyze the potential efficiency gains for parties from private procedural ordering. I begin by rehearsing the basic economic justifications for procedural rules and then turn to sketching the core features of current public procedural rules. Next I outline the benefits that parties might realize from seeing public procedural rules as defaults that can be varied.

In Part 2.2, I present the existing empirical evidence regarding the degree to which parties seem to engage in procedural contracting. This evidence, while imperfect, indicates that outside of a few traditional and relatively coarse areas of customization, parties seem uninterested in exploring the promise of fine-tuned procedure, at least *ex ante*. The evidence suggests, however, that parties may be doing more individualized and tailored procedural contracting *ex post*.

In Part 2.3, I evaluate the contention that there are doctrinal limits to private procedural ordering. I conclude that, although courts have not expressly sanctioned many specific forms of procedural customization, particularly before a dispute arises, the overall trend of doctrine supports procedural innovations.

## 2.1 The Gains from Customizable Procedure

*Due to these multiple and moving targets, the optimal design of ad- judication may be more roundabout than building a road up a treacherous mountain: at least the mountain stands still.*<sup>15</sup>

No two disputes look the same. The path to resolving each dispute, then, is unique. That path will vary based on the substantive law implicated—which in a contract dispute depends not only on default contract rules but also on the parties' agreement—the procedural rules applied, the resources each side has and is willing to invest in dispute resolution, each side's estimation of the

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<sup>15</sup> Louis Kaplow, *Information and the Aim of Adjudication: Truth or Consequences*, 67 STAN. L. REV. 1303 (2015) [hereinafter Kaplow, *Truth or Consequences*].

merits of the dispute, and each side's sensitivity to risk. The kaleidoscopic number of combinations of these interrelated elements defies generalization.<sup>16</sup>

Viewing public procedure as primarily comprised of default rather than mandatory rules empowers parties to represent their own interests when confronting an infinitely variable future. Contractible procedure rests not only the content of a dispute but also the process by which a dispute will be resolved on negotiation between the parties. In other words, procedural customization puts the parties in control, allowing them to define the scope of the dispute and to specify the form and substance of the proceedings that will resolve it. Being closer to the unique facts and circumstances surrounding their deal, contracting parties may construct a dispute resolution mechanism that optimally aligns their incentives, reduces expected dispute resolution costs, and mitigates risk.

The following sections explore these benefits in more detail. The first sets the stage by briefly articulating an economic perspective on procedure generally, showing that procedural rules must strike a balance between increased accuracy and increased costs, taking into account the needs of the parties to a dispute as well as the broader society. The second then specifically describes several core features of the current set of procedural rules in public courts. It argues that the default rules of civil procedure achieve this balance, in the main, by relying on standards implemented *ex post* by adjudicators with the benefit of hindsight. Relying on the first two, the third section connects the dots and outlines some of the efficiency gains that might be realized through private procedural ordering.

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<sup>16</sup> See, e.g., Samuel C. Damren & Lisa A. Brown, *Every Case is Unique, but Commercial Cases Are More So-Don't Ever Forget That*, 93 MICH. B.J., Aug. 2014, at 22, <https://www.michbar.org/file/journal/pdf/pdf4article2416.pdf> [<https://perma.unl.edu/58ZT-TWHH>] ("There is no single template that adequately describes-and no single strategy for winning-commercial litigation. Each case is different."); cf David R. Carlisle & Bruce A. Blitman, *Tips for Managing the "Mega-Mediation"*, 67 DISP. RESOL. J., no. 4, 2013, at 1 ("There is no such thing as a simple or typical mediation. Every case you mediate will present unique challenges . . . Just like snowflakes and fingerprints, no two mediations . . . will be the same.").

### 2.1.1 Brief Primer on the Economic Theory of Procedure in Dispute Resolution

Adjudication can be costly. So what are parties purchasing when they choose to invest in it? Most fundamentally, they are buying a resolution to their dispute. More precisely, they are hoping to buy a reasonably accurate resolution to their dispute. This is where procedure factors into the mix. In adversarial systems of adjudication, perhaps the primary role of procedure is to produce results that optimally enforce the substantive law.<sup>17</sup> Optimal enforcement strikes the best balance possible in a given case between accurate outcomes and the increased costs of reaching such outcomes.<sup>18</sup>

Accurate outcomes are valuable not only to the parties-providing fair, equitable, and hopefully even dignified closure-but to society as a whole. So long as adjudicators accurately enforce substantive law, rational actors expect to face liability to the degree that they behave unlawfully. As a result, they conform their behavior to the substantive standard.<sup>19</sup> It follows that, to the extent that procedure reduces the risk of outcome error, it also reduces the incidence of unlawful behavior and corresponding social costs.<sup>20</sup>

Still, accurate outcomes are not all that interest parties or society at large. Assuming that the goals of adjudication are fostering productive activity, restraining harmful conduct and avoiding undue expenses, then the key to assessing the success of adjudication rests on its consequences,

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<sup>17</sup> See ROBERT G. BOON, CIVIL PROCEDURE: THE ECONOMICS OF CIVIL PROCEDURE 128-48 (2003) (explaining expected error costs and the error cost analysis in more detail); Todd J. Zywicki & Anthony B. Sanders, *Posner, Hayek, and the Economic Analysis of Law*, 93 IOWA L. REV. 559-602 (2008).

<sup>18</sup> See, e.g., *Goldberg v. Kelly*, 397 U.S. 254 (1970) (balancing the risk of error and the cost of additional procedure in determining the due process right to an evidentiary hearing).

<sup>19</sup> RICHARD A. POSNER, REGULATION (AGENCIES) VERSUS LITIGATION (COURTS): AN ANALYTICAL FRAMEWORK 11-25 (Daniel P. Kessler ed., 2011); Louis Kaplow Steven Shavell, *Fairness Versus Welfare*, 114 HARV. L. REV. 961, 1166 (2001) (stating that "a primary reason to permit individuals to sue is that the prospect of suit provides an incentive for desirable behavior in the first instance" and also noting that in some cases the prospect of suit deters future conduct).

<sup>20</sup> See, e.g., Joanna C. Schwartz, *Introspection Through Litigation*, 90 NOTRE DAME L. REV. 1055, 1058 (2015) (describing how some organizations use information obtained from litigation to adjust behavior going forward).

not accuracy per se.<sup>21</sup> Perfectly accurate adjudicative outcomes should, usually, correspond with the best consequences. But accuracy is expensive, so there is, in the real world, always a tradeoff. Sometimes that tradeoff does not pay. Parties, and society, have to balance their appetite for accuracy against its increased costs.<sup>22</sup> Procedures designed to reduce outcome error, like extra layers of appellate review or more searching discovery, necessarily cost more.<sup>23</sup> Moreover, many such procedures create opportunities for a mismatch between a socially optimal level of investment and private incentives to overinvest in litigation.<sup>24</sup> Because individual parties do not completely internalize the costs of their litigation choices, and because such choices take place incrementally over time, the decision to incur some litigation costs may be individually rational while still being socially wasteful.<sup>25</sup> To achieve proportionality – an optimal level of litigation investment – any system of procedure must strive to balance the sum of both parties' expected process costs against the private and social value of enhanced accuracy.<sup>26</sup>

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<sup>21</sup> See, e.g., Kaplow, *Accuracy in Adjudication*, *supra* note 8 (arguing that the primary goal of adjudication should be to incentivize *ex ante* socially optimal primary behavior not to achieve accurate outcomes); Kaplow, *Truth or Consequences*, *supra* note 14, at 1306 (explaining that "[t]he value of truth in adjudication depends on its consequences, and valuing various outcomes is outside the realm of truth per se").

<sup>22</sup> Even Professor Solum, who has argued persuasively and passionately that procedural justice requires consideration of more than the tradeoff of costs and accuracy acknowledges that this tradeoff is an essential part of procedural justice. See, e.g., Lawrence B. Solum, *Procedural Justice*, 78 S. CAL. L. REV. 181, 183 (2004) (noting that procedural justice requires, in part, "a reasonable balance between cost and accuracy").

<sup>23</sup> See, e.g., Kaplow, *Truth or Consequences*, *supra* note 14, at 1335; see also, e.g., Jonathan T. Molot, *The Feasibility of Litigation Markets*, 89 IND. L. J. 171, 174 (2014) (noting that procedures designed to enhance accuracy often have the opposite of their intended effect, costing too much and accordingly forcing parties to make second-best litigation choices).

<sup>24</sup> Richard A. Posner, *An Economic Approach to the Law of Evidence*, 51 STAN. L. REV. 1477, 1486 (1999) (discussing the possibility that parties will either underinvest or overinvest in the search for evidence, relative to the social optimum).

<sup>25</sup> See, e.g., Steven Shavell, *The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System*, 26 J. LEGAL STUD. 575, 577-78 (1997) (noting that many litigants consider only the benefits they garner and the costs they incur and not the benefits of the lawsuit that they do not capture or the costs that their behavior imposes on others). As Professors Grundfest and Huang have demonstrated, parties invest in litigation in increments rather than all at once. See Joseph A. Grundfest & Peter H. Huang, *The Unexpected Value of Litigation: A Real Options Perspective*, 58 STAN. L. REV. 1267, 1293-98 (2006). This fact results in plaintiffs having a counterintuitive incentive, under some conditions, to file suit in cases in which neither they nor society expect a positive return. See *id.* at 1277, 1299-305 (explaining that a lawsuit with a negative expected value is equivalent to an out-of-the-money call option that a plaintiff will rationally pursue as long as the price of the option is low and the volatility of the claim's value is high).

<sup>26</sup> See Zywicki & Sanders, *supra* note 16, at 559-602. Although dispute resolution unequivocally implicates the interests of society, particularly in some domains like civil rights cases, most commentators and the rules themselves seem to prioritize the private interests of the parties. See, e.g., 1 JAMES WM. MOORE ET. AL., MOORE'S FEDERAL PRACTICE § 1.21[1]

So far as the parties themselves are concerned, at least, optimal resolutions are frequently found in full settlements.<sup>27</sup> In fact, much of the literature on the law and economics of adjudication suggests that a full settlement is usually a first, best solution for parties.<sup>28</sup> As the old saw goes, a bad settlement is often better than a good trial.<sup>29</sup> Assuming that parties are rational and are not acting strategically to influence current or future actions of one another or third parties or alter legal rules,<sup>30</sup> they will calculate a settlement value by multiplying the probability of success on the merits in a given case by the value of an anticipated judgment in that case net of transaction costs.<sup>31</sup>

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[a] (3d ed. 2008) ("The application of orderly rules of procedure does not require the sacrifice of fundamental justice, but rather the Rules must be construed to promote justice for both parties, not to defeat it. This mandate is met if substantial justice is accomplished between the parties."); FED. R. CIV. P. 1 (stating that the Federal Rules of Civil Procedure "should be construed and administered to secure the just, speedy, and inexpensive determination of every action and proceeding").

<sup>27</sup> See, e.g., John Barkai, Elizabeth Kent & Pamela Martin, *A Profile of Settlement*, 42 CT. REV. 34, 34 (2006) (observing that generally less than 3% of filed cases reach trial verdict). Significantly, there is a good deal of debate in the literature about the socially optimal level of litigation versus settlement. See generally, e.g., Steven Shavell, *The Level of Litigation: Private Versus Social Optimality of Suit and of Settlement*, 19 INT'L R. L. & ECON. 99 (1999). The trouble is that when parties spend on litigation, they do not take into account the costs that such an action will require of others. On the other hand, when parties spend on litigation, they also do not take into account the impact that this will have on incentives to reduce harm in the future or other positive externalities. See *id.* Despite the fact that the default rules of procedure seem to espouse belief that settlements generally enhance social welfare, see, for example, FED. R. CIV. P. 16 (requiring pretrial settlement conferences) and FED. R. CIV. P. 68 (imposing legal costs on a party who refuses a settlement offer that turns out to have been more favorable than a trial outcome), several commentators have persuasively argued that, in some circumstances, settlement can lower social welfare. See, e.g., Ezra Friedman & Abraham L. Wickelgren, *Chilling, Settlement, and the Accuracy of the Legal Process*, 26 J.L. ECON. & ORG. 144 (2010).

<sup>28</sup> I distinguish here between a full settlement and various sorts of partial settlements, which are actually forms of ex post procedural contracting. See *infra* Part 1.2.3.

<sup>29</sup> See, e.g., *In re Warner Commc'ns Sec. Litig.*, 618 F. Supp. 735, 740 (S.D.N.Y. 1985), *affd*, 798 F.2d 35 (2d Cir. 1986) (noting "the familiar axiom that a bad settlement is almost always better than a good trial").

<sup>30</sup> See, e.g., Robert Cooter et al., *Bargaining in the Shadow of the Law: A Testable Model of Strategic Behavior*, 11 J. LEGAL STUD. 225, 226 (1982) (noting that problems with figuring out how to divide a settlement surplus may lead to strategic bargaining that undermines the settlement). This simple model of settlement also only applies in one-shot cases. The equation will necessarily look different if one of the parties is acting to influence third parties or the outcome in future similar cases or if one of the parties is trying to change the law.

<sup>31</sup> According to Posner:

The plaintiffs minimum offer is the expected value of the litigation to him plus his settlement costs, the expected value of the litigation being the present value of the judgment if he wins, multiplied by the probability (as he estimates it) of his winning, minus the present value of his litigation expenses. The defendant's maximum offer is the expected cost of the litigation to him and consists of his litigation expenses, plus the cost of an adverse judgment multiplied by the probability as he estimates it of the plaintiffs winning (which is equal to one minus the probability of his winning), minus his settlement costs.

Richard A. Posner, *An Economic Approach to Legal Procedure and Judicial Administration*, 2 J. LEGAL STUD. 399, 418 (1973); see also, e.g., George L. Priest, *Reexamining the Selection Hypothesis: Learning from Wittman's Mistakes*, 14 J. LEGAL STUD. 215, 217 (1985). For the sake of simplicity, my textual formulation ignores the time value of money, conflates

Adjudication should only happen if the plaintiffs minimum settlement value exceeds the defendant's maximum settlement value and there is, accordingly, no surplus over which the parties can bargain.<sup>32</sup> Generally, such a divide will exist only if the parties have differing estimates of the probability of success on the merits or differing estimates of an anticipated judgment.<sup>33</sup> Indeed, a substantial number of commentators and even courts have implied that adjudication results from grave analytical errors.<sup>34</sup> With the goal of aligning the parties' respective views of the dispute, many of the current default rules of civil procedure, particularly related to discovery and pretrial management, work to educate the parties about the likely outcome of any adjudication.<sup>35</sup>

Of course, in reality, full settlements are not always reached. Not only do parties make analytical errors, but, in the rough and tumble of actual disputes, there are a number of reasons why even rational parties might reach different expected judgment values and thus choose to

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settlement costs and litigation expenses and characterizes them as transaction costs, and assumes that parties are risk-neutral. It also does not address the problem of risk versus uncertainty, where risk can be quantified and uncertainty cannot be. *SEE FRANK H. KNIGHT, RISK, UNCERTAINTY, AND PROFIT* 259 (London Sch. Econ. & Pol. Sci. ed., 7th prtg. 1948) (1921) ("When our ignorance of the future is only partial ignorance, incomplete knowledge and imperfect inference, it becomes impossible to classify instances objectively.").

<sup>32</sup> Thomas J. Miceli, *Settlement Strategies*, 27 J. LEGAL STUD. 473, 474 (1998) ("In the differing perceptions model, a *bargaining* process is envisioned in which the parties arrive at a settlement amount somewhere between their reservation prices. Thus, when a settlement occurs, the parties share the surplus from settlement.").

<sup>33</sup> In a simple model of settlement, this leads to the intuitive conclusion that cases with high transaction costs relative to the stakes are more likely to settle while cases with low transaction costs relative to the stakes are more likely to proceed to adjudication. *See, e.g., Grundfest & Huang, supra* note 24, at 1299-305 (showing how a case with a negative expected judgment value can still have substantial settlement value); Posner, *supra* note 2, at 419 n.29 (1973) (asserting that empirical evidence exists to show that higher stakes cases are more likely to be litigated).

<sup>34</sup> *See, e.g., Marek v. Chesny*, 473 U.S. 1, 10 (1985) ("In short, settlements rather than litigation will serve the interests of plaintiffs as well as defendants."); *G. Heileman Brewing Co. v. Joseph Oat Corp.*, 871 F.2d 648, 664 (7th Cir. 1989) ("Settling litigation is valuable, and courts should promote it."); Robert Cooter et al., *supra* note 29, at 225 (stating that trial "represents a bargaining breakdown."); Robert D. Cooter & Daniel L. Rubinfeld, *Economic Analysis of Legal Disputes and Their Resolution*, 27 J. ECON. LITERATURE 1067, 1074 (1989) (noting that trials result from "mistaken prediction[s]" made by parties); Russell Korobkin & Chris Guthrie, *Psychological Barriers to Litigation Settlement: An Experimental Approach*, 93 MICH. L. REV. 107, 108 (1994) (noting that most scholars believe "that trials represent mistakes-breakdowns in the bargaining process-that leave the litigants and society worse off than they would have been had settlement been reached").

<sup>35</sup> *See, e.g., Robert G. Bone, "To Encourage Settlement": Rule 68, Offers of Judgment, and the History of the Federal Rules of Civil Procedure*, 102 Nw. U.L. REV. 1561 (2008) (examining the evolution of Rule 68 and its ability to encourage settlement).

adjudicate rather than fully settle.<sup>36</sup> For the purposes of this Article, at least three of these reasons are particularly relevant.

First, judging is difficult.<sup>37</sup> In the adversarial system, courts make factual determinations with substantially less than complete confidence, getting information from the self-interested parties. Courts are therefore doomed to experience shortages of quality information regarding what the relevant facts are.<sup>38</sup> As a result, judges, by definition busy generalists, may have a hard time discerning the wheat from the chaff.<sup>39</sup> The risk of judicial error can be significant and this risk has to be rolled into the parties' respective estimate of success on the merits.<sup>40</sup> Parties may not estimate a common base rate, however, for the probability that a judge will make a mistake, and any difference they have will ultimately impact their reasonable estimates of success on the merits.

Second, the scarcity of high-quality information impedes the parties' ability to estimate success on the merits. The ultimate judgment that results from adjudication is the product of the parties' interactive strategies in presenting evidence to the court. This presentation occurs incrementally over time. At least at the outset, the parties are likely to have asymmetric information

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<sup>36</sup> See, e.g., Maya Steinitz, *How Much Is That Law Suit in the Window? Pricing Legal Claims*, 66 VAND. L. REV. 1889, 1893-94 (2013) (arguing that valuation of legal claims is characterized by extreme uncertainty, extreme information asymmetry, extreme agency problems, and the problem of effort provision). Of course, parties may also act irrationally. Among other things, parties might try to recover sunk costs and thus make poor investment decisions. See Samuel Issacharoff & George Loewenstein, *Second Thoughts About Summary Judgment*, 100 YALE L.J. 73, 113 (1990) ("Although economists exhort decision-makers to ignore sunk costs and to attend only to the prospective benefits and costs of alternative courses of action, few attain this ideal. Instead, individuals often incur further losses ('throw good money after bad') or take great risks in order to recover those losses.").

<sup>37</sup> See, e.g., Chris Guthrie, *Misjudging*, 7 NEV. L.J. 420, 428 (2007) (arguing that judges have three sets of "blindness": informational blindness, cognitive blindness, and attitudinal blindness).

<sup>38</sup> See ALEX STIEN, *FOUNDATIONS OF EVIDENCE LAW* 34-35, 73-106 (2005) (analyzing the sources of uncertainty in fact finding); ADRIAN VERMEULE, *JUDGING UNDER UNCERTAINTY: AN INSTITUTIONAL THEORY OF LEGAL INTERPRETATION* 4 (2006) (describing judicial ascertainment of the law as "choice under uncertainty" that implicates "limited information and bounded rationality").

<sup>39</sup> See, e.g., Marin K. Levy, *Judicial Attention as a Scarce Resource: A Preliminary Defense of How Judges Allocate Time Across Cases in the Federal Courts of Appeals*, 81 GEO. WASH. L. REV. 401, 407-13 (2013) (describing how federal appellate judges spread their deliberative efforts across cases, thereby economizing on decision making resources).

<sup>40</sup> See Lea Brilmayer, *Wobble, or the Death of Error*, 59 S. CAL. L. REV. 363, 367-69 (1986) (stating that errors in both fact finding and applications of the law are inevitable and explaining why).

about the salient features of the dispute. In fact, parties may not have complete access to information about their own conduct at the outset of a lawsuit. In complex organizations, information is decentralized and held by a variety of people at different levels separated hierarchically and often geographically from one another.<sup>41</sup> Even as the case progresses and more information comes to light, each side's strategic maneuvering may undermine the credibility or completeness of the information or merely reinforce self-serving optimism.<sup>42</sup> This noise can make it difficult for parties to arrive at common present forecasts of the value of a future judgment.

Third, agency problems or frictions related to agency may stymie the parties' ability to accurately forecast adjudicative outcomes. Of course, the interests of lawyers and their clients may differ. A robust literature discusses the traditional formulation of the principal agent problem in the context of lawyers and their clients.<sup>43</sup> But subtler, though not necessarily less significant, imbalances of information between lawyers and parties, as well as frictions in exchanging information, can weaken the accuracy of estimates about the merits of a dispute. Parties presumably know more about the facts and circumstances surrounding their dispute. Lawyers

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<sup>41</sup> See, e.g., Schwartz, *supra* note 19 (arguing that lawsuits help produce information for organizations that otherwise would not be available to them).

<sup>42</sup> See, e.g., Linda Babcock et al., *Biased Judgments of Fairness in Bargaining*, 85 AM. ECON. REV. 1337, 1338 (1995) (using the same experiment to find causation); Robert D. Cooter & Daniel L. Rubinfeld, *An Economic Model of Legal Discovery*, 23 J. LEGAL STUD. 435, 444–50 (1994) (noting that one cost of discovery is the error in parties' decision making attributable to the discovery of information that makes them unduly optimistic or pessimistic about their likelihood of success at trial); George Loewenstein et al., *Self-Serving Assessments of Fairness and Pre-trial Bargaining*, 22 J. LEGAL STUD. 135, 139 (1993) (finding a positive correlation between self-serving bias and failure to settle). The strategic advantages that can sometimes come with systematic optimism have also been explored. See, e.g., Oren Bar-Gill, *The Evolution and Persistence of Optimism in Litigation*, 22 J.L. ECON. & ORG. 490, 491 (2006) (discussing optimistic lawyers who succeed in extracting favorable settlements by credibly threatening to resort to costly litigation); Daniel Klerman & Yoon-Ho Alex Lee, *Inferences from Litigated Cases*, 43 J. LEGAL STUD. 209, 216–21 (2014) (concluding that a more pro-plaintiff rule might assign a higher probability of plaintiff success, thus giving a plaintiff a credible threat to go to trial and convincing the defendant to settle); George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1, 17 (1984) (“Where either the plaintiff or defendant has a ‘powerful’ case, settlement is more likely because the parties are less likely to disagree about the outcome.”).

<sup>43</sup> See generally, e.g., James A. Cohen, *Lawyer Role, Agency Law, and the Characterization “Officer of the Court,”* 48 BUFF L. REV. 349 (2000); Grace M. Giesel, *Client Responsibility for Lawyer Conduct: Examining the Agency Nature of the Lawyer–Client Relationship*, 86 NEB. L. REV. 346 (2007).

presumably know more about the law and processes that will be used to resolve the dispute. An accurate forecast of the merits of a dispute depends on a clear picture and balancing of all three: facts, substantive law, and procedural law. But lines of communication between parties and their lawyers are not always clear and the risk of errors in the exchange of vital information creates additional hurdles.

In short, adjudication constitutes a nontrivial part of dispute resolution and procedural rules must account not only for settlement effects but also for the quality of the adjudicatory process itself. Procedural rules must strive to balance accuracy and efficiency, particularly in light of the reasons why parties might have differing estimates of the value of their respective positions, while fairly accounting for the interests of both parties and the larger society. Designing a set of procedural rules that accomplishes this difficult balance in the widest swath of cases possible was the animating goal of the current rules of civil procedure.

### **2.1.2 The Current Default Rules of Procedure**

Our existing rules of civil procedure were born during a period of renewed faith in centralized government as the guardian of social justice.<sup>44</sup> Congress passed the Rules Enabling Act (REA) in 1934.<sup>45</sup> The REA authorized the Supreme Court to create a single procedural regime for federal courts. The Court, in turn, delegated its task to an Advisory Committee, which set out to draft a procedural code that limited the impact of process itself.<sup>46</sup> Because the reformers were moved by pragmatic instrumentalism, they saw procedure exclusively as a means of finding facts

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<sup>44</sup> See Stephen N. Subrin, *The New Era in American Civil Procedure*, 67 A.B.A. J. 1648, 1651 (1981) (“The federal rules [of civil procedure] ultimately were passed as New Deal legislation.”); Laurens Walker, *The End of the New Deal and the Federal Rules of Civil Procedure*, 82 IOWA L. REV. 1269, 1272–80 (1997) (describing influence of New Deal principles such as nationalism, expertise, and social reform on the Rules Enabling Act). Notably, the reform effort that led to the REA began nearly thirty years earlier. Roscoe Pound popularized the effort in 1906 in his famous address to the American Bar Association, *The Causes of Popular Dis- satisfaction with the Administration of Justice*, 29 A.B.A. REP. 395 (1906).

<sup>45</sup> Pub. L. No. 73-415, 48 Stat. 1064 (1934) (codified as amended at 28 U.S.C. § 2072 (2012)).

<sup>46</sup> Appointment of Committee to Draft Unified System of Equity and Law Rules, 295 U.S. 774, 774–75 (1935).

and accurately enforcing substantive law.<sup>47</sup> Procedure, in other words, was deemed a value-neutral means of enforcing substantive rights.<sup>48</sup> Procedural rules, the reformers accordingly believed, should be general in nature and “trans-substantive,” meaning that a single set of rules could apply to all civil cases without regard to essence of the dispute.<sup>49</sup> Uniformity and trans-substantivity aimed to standardize procedure and achieve, in the aggregate, the compromise between efficiency and accuracy discussed in the previous section.<sup>50</sup>

Practically accommodating the hopeful expansiveness of the ideal of trans-substantivity, however, was no easy task. Indeed, designing a set of fixed rules that could optimally balance accuracy and costs across an almost infinitely diverse range of future disputes was impossible. Instead, the reformers opted to entrust judges with broad discretion to put the rules of procedure into action in individual cases.<sup>51</sup>

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<sup>47</sup> See Robert G. Bone, *Mapping the Boundaries of a Dispute: Conceptions of Ideal Lawsuit Structure from the Field Code to the Federal Rules*, 89 COLUM. L. REV. 1, 80–98 (1989); see also, e.g., Judith Resnik, *The Privatization of Process: Requiem for and Celebration of the Federal Rules of Civil Procedure at 75*, 162 PENN. L. REV. 1791, 1795 (2014) (noting that the Rules, “with their functionalist, anti-formalist” underpinnings, committed “to easing barriers to entry through trans-substantive, uniform, national provisions that expanded opportunities for information exchange, vested discretion in trial judges, and aimed for efficient decision making focused on the merits of claims.”).

<sup>48</sup> Of course, the myth that procedure was value-neutral and independent from substance quickly became a concern for many commentators. See generally, e.g., Abram Chayes, *The Role of the Judge in Public Law Litigation*, 89 HARV. L. REV. 1281 (1976); Robert M. Cover, *For James Wm. Moore: Some Reflections on a Reading of the Rules*, 84 YALE L. J. 718 (1971).

<sup>49</sup> Robert G. Bone, *Making Effective Rules: The Need for Procedure Theory*, 61 OKLA. L. REV. 319, 324 (2008); see also, e.g., Marc Galanter, *The Vanishing Trial: An Examination of Trials and Related Matters in Federal and State Courts*, 1 J. EMPIR. L. STUD. 459, 519 (2004) (“Modern procedure has conferred on trial court judges broader unreviewed (and perhaps unreviewable) discretion.”).

<sup>50</sup> See Charles E. Clark, *The Handmaid of Justice*, 23 WASH. U. L.Q. 297, 318–19 (1938). Professor (and later, judge) Clark was perhaps the “dominant intellectual and operational force” behind the Federal Rules of Civil Procedure. Jay S. Goodman, *On the Fiftieth Anniversary of the Federal Rules of Civil Procedure: What Did the Drafters Intend?*, 21 SUFFOLK U. L. REV. 351, 357 (1987). In Clark’s view, there were “two basic principles behind” the procedural reform: “all cases should be decided on their merits rather than on procedural maneuverings and that a basic goal in litigation should be economy of time and resources.” *Id.*

<sup>51</sup> See, e.g., Amalia D. Kessler, *Our Inquisitorial Tradition: Equity Procedure, Due Process, and the Search for an Alternative to the Adversarial*, 90 CORNELL L. REV. 1181 (2005) (noting how the Rules retrieved equity as a source of procedural discretion); Thomas O. Main, *Traditional Equity and Contemporary Procedure*, 78 WASH. L. REV. 429 (2003) (arguing for broad use of equitable discretion); Jeffrey W. Stempel, *Complex Litigation at the Millennium: Ulysses Tied to the Generic Whipping Post: The Continuing Odyssey of Discovery “Reform”*, 64 LAW & CONTEMP. PROB. 197, 232–34 (Spring/Summer 2001) (advocating broad trial judge discretion to tailor discovery to individual cases).

“[I]t is only a slight exaggeration to say that federal procedure, especially at the pretrial stage, is largely the trial judge’s creation subject to minimal appellate review.”<sup>52</sup> In economic terms, the reformers opted to create a procedural rule set comprised predominately of open- textured standards rather than rules.<sup>53</sup> Accordingly, public procedural rules in the United States delegate to a judge the task of specifying precise obligations in light of the contingencies arising after a dispute has fomented.<sup>54</sup> This delegation occurs both expressly and through the use of vague language inviting flexible interpretation.

For example, Rule 16 expressly authorizes judges to hold pretrial conferences and “take appropriate action” with respect to a diverse range of matters, including pleading, discovery,

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<sup>52</sup> Robert G. Bone, *Who Decides? A Critical Look at Procedural Discretion*, 28 CAR- DOZO L. REV. 1961 (2006); see also, e.g., Marc Galanter, *The Vanishing Trial: An Examination of Trials and Related Matters in Federal and State Courts*, 1 J. EMPIR. LEG. STUD. 459, 519 (2004) (“Modern procedure has conferred on trial court judges broader unreviewed (and perhaps unreviewable) discretion”).

<sup>53</sup> The “rules versus standards” debate has occupied the attentions of scholars for many years. See, e.g., David L. Faigman, *Constitutional Adventures in Wonderland: Exploring the Debate Between Rules and Standards Through the Looking Glass of the First Amendment*, 44 HASTINGS L.J. 829, 830 (1993) (“[T]he amount of ink spilled over debating the virtues of rules versus standards would lead the reasonable observer to believe that something momentous was at stake.”). For good contemporary discussions of the distinction, see FREDERICK SCHAUER, *THINKING LIKE A LAWYER* 13–29 (2009) (discussing the relative advantages and disadvantages of legal norms being articulated as rules or standards); Mary C. Daly, *The Dichotomy Between Standards and Rules: A New Way of Understanding the Differences in Perceptions of Lawyer Codes of Conduct by U.S. and Foreign Lawyers*, 32 VAND. J. TRANSNAT’L L. 1117, 1124–42 (1999); Jason Scott Johnston, *Bargaining Under Rules Versus Standards*, 11 J.L. ECON. & ORG. 256, 258 (1995) (examining relative efficiency of two-party bargaining under rules and standards); Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 557–68 (1992) (viewing rules and standards for their economic efficiency); Russell B. Korobkin, *Behavioral Analysis and Legal Form: Rules vs. Standards Revisited*, 79 OR. L. REV. 23, 25 (2000) (“Rules establish legal boundaries based on the presence or absence of well-specified triggering facts.”); Kathleen M. Sullivan, *The Justices of Rules and Standards*, 106 HARV. L. REV. 22, 58 (1992) (“Rules aim to confine the decision maker to facts, leaving irreducibly arbitrary and subjective value choices to be worked out elsewhere.”). For purposes of this analysis, it is enough to say that rules and standards differ only to the extent to which effort to give substance to a legal command gets expended before or after a dispute has arisen. See Kaplow, *Truth or Consequences*, *supra* note 14.

<sup>54</sup> Importantly, these standards tend to remain open-textured over time. See, e.g., Bone, *supra* note 51, at 1970 (“Moreover, case precedent offers little constraint in this area because balancing tests and discretionary decisions are normally too fact-specific to support generalizations.”); Stephen N. Subrin, *How Equity Conquered Common Law: The Federal Rules of Civil Procedure in Historical Perspective*, 135 U. PA. L. REV. 909, 957 (1987) (noting that usually whether precedent about discretionary Rules of Civil Procedure exists does not function to minimize discretion). Precedent, in short, does not operate to harden these standards into rules. See, e.g., H. Allen Blair, *Hard Cases Under the Convention on the International Sale of Goods: A Proposed Taxonomy of Interpretative Challenges*, 21 DUKE J. COMP. & INT’L L. 269, 312 (2011) (recognizing the possibility that the value of open-textured standards could be eroded if they are hardened into rules through precedent); Kaplow, *Truth or Consequences*, *supra* note 14, at 1313 n.10 (“More broadly, it is useful to view the creation of precedent as a particular means of collecting information to give content to the law.”).

settlement, summary judgment, and trial.<sup>55</sup> The Rule envisages a key role of a judge as that of settlement facilitator,<sup>56</sup> but it provides almost no substantive guidance, leaving it instead up to an individual judge to effectuate the goals of “expediting the disposition of the action” and “discouraging wasteful pretrial activities.”<sup>57</sup>

Rule 19 is example of a provision that contains such vague language as to allow judges wide latitude to decide particular cases.<sup>58</sup> Rule 19(a), dealing with compulsory joinder, relies on open-ended language, such as “interest” and “impair or impede,” to define the circumstances under which an absentee should be joined. When applying the Rule to a particular case, a judge has discretion to decide whether the absentee’s interest is sufficiently significant and whether that interest would be impaired or impeded if the absentee were not joined. In making her decision, the judge can consider a range of case-specific management considerations in making those decisions.<sup>59</sup>

There are many other Rules that either expressly delegate discretion to judges or implicitly give judges discretion to put the rules into effect in particular cases.<sup>60</sup> Cataloguing them is beyond the scope of this Article, but the fundamental point is that “[t]he Federal Rules of the 1930s are founded upon judicial discretion.”<sup>61</sup>

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<sup>55</sup> FED. R. CIV. P. 16(c).

<sup>56</sup> See FED. R. CIV. P. 16(a)(2) (regarding management); FED. R. CIV. P. 16(a)(5) (regarding settlement); 3 MOORE ET. AL., *supra* note 25, §§ 16.02, 16.03[1][a] (“Rule 16 is explicitly intended to encourage active judicial management . . . judges are encouraged to actively participate in designing case-specific plans to position litigation as efficiently as possible for disposition by settlement, motion, or trial.”).

<sup>57</sup> FED. R. CIV. P. 16(a)(1), (3).

<sup>58</sup> FED. R. CIV. P. 19(a).

<sup>59</sup> FED. R. CIV. P. 19(b)(1).

<sup>60</sup> See, e.g., Subrin, *supra* note 53, at 923 n.76 (1987) (identifying thirty-six provisions in the *Federal Rules of Civil Procedure* that expressly delegate discretion to trial court judges).

<sup>61</sup> Judith Resnik, *Changing Practices, Changing Rules: Judicial and Congressional Rulemaking on Civil Juries, Civil Justice, and Civil Judging*, 49 ALA. L. REV. 133, 201 (1997).

### 2.1.3 The Potential Benefits of Procedural Customization Through Contract

Despite the aspirations of the reformers who revolutionized procedure pursuant to the REA, no fixed set of rules could possibly account for the individual nuances of every case. Accordingly, as the previous section pointed out, many of our public procedural rules delegate to judges the task of specifying precise obligations after a dispute has arisen. Perhaps more importantly, however, the rules also leave litigants with broad discretion in conducting their affairs throughout the litigation process.<sup>62</sup>

For instance, after a dispute arises and adjudication has begun, parties enjoy tremendous flexibility in tailoring discovery processes to meet their needs, including deciding how much to invest in evidence production.<sup>63</sup> But parties can control the post-dispute contours of procedure in a variety of other ways as well.<sup>64</sup> For example, litigants may enter stipulations,<sup>65</sup> consent to waiver of service of process,<sup>66</sup> amend pleadings,<sup>67</sup> waive the right to a jury trial,<sup>68</sup> substitute a magistrate judge for an Article III District Judge,<sup>69</sup> or even waive their right to appeal.<sup>70</sup> Alternatively, parties

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<sup>62</sup> Bone, *supra* note 10, at 1330 (“In the American adversary system, litigants enjoy broad freedom to make their own litigation choices.”); see also STEPHEN C. YEAZELL, *CIVIL PROCEDURE* 138 (7th ed. 2008) (“One of the hallmarks of the U.S. law is the extent to which the rules of procedure are ‘default’ rules, rules that govern if the parties have not agreed to something else.”).

<sup>63</sup> See FED. R. CIV. P. 29 (providing that “[u]nless the court orders otherwise, the parties may stipulate” that certain aspects of depositions will be conducted in particular ways and that “other procedures governing or limiting discovery be modified”); Patrick E. Higginbotham, *Duty to Disclose: General Provisions Governing Discovery*, in 6 MOORE ET. AL., *supra* note 25, § 26.04[1] (“Parties may mutually stipulate to use procedures for discovery that vary from the rules . . . .”); 8A CHARLES ALAN WRIGHT, ARTHUR R. MILLER & RICHARD L. MARCUS, *FEDERAL PRACTICE & PROCEDURE: FEDERAL RULES OF CIVIL PROCEDURE* §§ 2091–92 (3d ed. 2012) (delineating the parameters of the ability of litigants to stipulate discovery procedure).

<sup>64</sup> For a thorough discussion of post-dispute procedural stipulations, see generally Michael L. Moffitt, *Customized Litigation: The Case for Making Civil Procedure Negotiable*, 75 GEO WASH. L. REV. 461 (2007) and J.J. Prescott & Kathryn E. Spier, *A Comprehensive Theory of Civil Settlement*, 91 N.Y.U. L. REV. 59 (2016).

<sup>65</sup> See, e.g., 73 AM. JUR. 2D *Stipulations* § 15.

<sup>66</sup> See FED. R. CIV. P. 4(d) (allowing parties to waive service of process in order to save money and effort); 4A WRIGHT, MILLER, & MARCUS, *supra* note 62, § 1092.1 (discussing the process for procuring waiver).

<sup>67</sup> See FED. R. CIV. P. 15 (allowing amendment both before and during trial).

<sup>68</sup> See FED. R. CIV. P. 39(a)(1).

<sup>69</sup> See FED. R. CIV. P. 73.

<sup>70</sup> See, e.g., *Acton v. Merle Norman Cosmetics, Inc.*, 163 F.3d 605 (9th Cir. 1998) (unpublished table decision) (dismissing appeal based on a post-dispute agreement); see also 15A CHARLES ALLEN WRIGHT, ARTHUR R. MILLER &

might settle on the question of liability, or postpone that question, but continue to litigate the issue of damages.<sup>71</sup> Or parties might enter into a high-low agreement, which allows a defendant to put a cap on the upper end possible liability (the “high”) in exchange for guaranteeing a minimum payment (the “low”).<sup>72</sup> Of course, finally and most conclusively, parties may resolve their dispute altogether through a full settlement, giving up claimed legal rights, on one hand, for some consideration on the other. By making any of these post-dispute procedural commitments, litigants can calibrate their litigation expenditures to meet their individual tolerances for risk and accuracy.

Most commentators do not object to party control of litigation after a dispute has arisen. Not only is such control expressly allowed by the rules in many instances,<sup>73</sup> but the parties agree to alterations of the default rules with their “eyes wide open” and with approval of a supervising judge.<sup>74</sup>

Some commentators contrast this sort of *ex post* party agreement with an *ex ante* agreement, suggesting that the latter raises more serious due process concerns. But the analytical distance between *ex post* modifications and *ex ante* modifications of public procedures is exaggerated.<sup>75</sup> As Professors Kapeliuk and Klement have persuasively argued, any mutual commitment to constrain, extend, or substitute the set of permissible actions defined by a

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EDWARD H. COOPER, FEDERAL PRACTICE & PROCEDURE: JURISDICTION AND RELATED MATTERS § 3901 (3d ed. 2012) (noting that “the most likely occasion for waiver arises from a settlement agreement that calls for resolution of some disputed matter by the district court, coupled with an explicit agreement that the district court decision shall be final and that all rights of appeal are waived”).

<sup>71</sup> See, e.g., Drury Stevenson, *Reverse Bifurcation*, 75 U. CIN. L. REV. 213, 216 (2006) (explaining “reverse bifurcation” as a process in which the parties have a trial on damages first and then settle on remaining liability issues once the stakes of the dispute are understood).

<sup>72</sup> *High-Low Agreement*, BLACK’S LAW DICTIONARY (9th ed. 2009).

<sup>73</sup> See, for example, FED. R. CIV. P. 26, which requires the parties to confer and results in an agreed upon scheduling order under Rule 16.

<sup>74</sup> See Hoffman, *supra* note 10, at 396.

<sup>75</sup> See generally Daphna Kapeliuk & Alon Klement, *Changing the Litigation Game: An Ex Ante Perspective on Contractualized Procedures*, 91 TEX. L. REV. 1475 (2013).

procedural rule modifies the procedural rule and hence the litigation game.<sup>76</sup> This is true no matter when the commitment occurs.<sup>77</sup> Although in a sense parties *ex post* might be in a position to better value certain trade offs that they are making, this certainty itself comes at its own steep price. More information, which leads to the greater certainty, is not free. Parties might well trade greater certainty for lower costs *ex post*. And, although judicial approval of a customized procedure might be clearer *ex post*, a court will always have the opportunity to evaluate, expressly or impliedly, an *ex ante* customized procedure as well, policing customized procedures for due process concerns and fundamental contract flaws.

Indeed, stripped of the superficial appeal of a distinction between *ex post* and *ex ante* procedural modifications, it becomes evident that the economic justifications for each rest on the same underlying pre- mise: parties are in the best position to maximize the “incentive bang for the enforcement buck.”<sup>78</sup> *Ex ante* procedural contracting simply extends the logic and the range of potential efficiency gains from *ex post* customizable procedure.

To see how, it is worth recapping the path-breaking article *Anticipating Litigation in Contract Design* in which Professors Scott and Triantis suggest that contracting parties can structure procedural rules in ways that will increase their joint surplus.<sup>79</sup> According to Professors Scott and Triantis, when dealing with their substantive contractual obligations, parties may effectively substitute costly and fact-intensive adjudication for specific rules by varying the precision

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<sup>76</sup> Technically, as Professors Kapeliuk and Klement point out, a procedural decision is different than a procedural commitment. Some of the default rules of procedure authorize parties to make decisions and when a party makes such a decision it is not actually changing the litigation game. But, if a party commits itself to a particular decision, the litigation game is changed.

<sup>77</sup> See *id.* at 1482 (“An *ex ante* or an *ex post* commitment to constrain, to extend, or to add to the original set of permissible actions defined by the rule modifies the rule, and thus changes the litigation game that would have taken place absent such commitment.”).

<sup>78</sup> Robert E. Scott & George E. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814, 856 (2006).

<sup>79</sup> *Id.* at 856–60.

of contract provisions.<sup>80</sup> When parties choose a relatively precise or specific rule, they are increasing their *ex ante* investment.<sup>81</sup> In other words, parties spend more money at the front end of the contracting process contemplating future contingencies and negotiating over terms specifying precise obligations in light of those contingencies. More precise rules require less from the adjudicatory process. By investing more at the front end of the process, parties are hoping to leverage the information that they have about their shared contracting goals and incentives to maximize gains from trade in order to reduce *ex post* enforcement costs.<sup>82</sup> If a fight arises in the future, a court or adjudicator should be able to resolve that fight relatively easily and cheaply in light of the specific rules that the parties have chosen.

On the other hand, when parties choose a relatively open-textured standard, they are decreasing their *ex ante* investment and increasing their expected *ex post* enforcement costs.<sup>83</sup> Rather than spending time and money worrying about future contingencies and terms specifying precise obligations in light of those contingencies at the front end of the contracting process, parties are choosing to delegate to a future tribunal the task of specifying precise obligations. Such *ex post* back-end specification is efficient, Professors Scott and Triantis argue, where the value to the parties of a decision maker's hindsight outweighs the value that the parties would gain by specifying *ex ante* a more precise rule to govern their contract.<sup>84</sup>

In short,

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<sup>80</sup> See Blair, *supra* note 53, at 301–02.

<sup>81</sup> See Jody S. Kraus & Robert E. Scott, *Contract Design and the Structure of Contractual Intent*, 84 N.Y.U. L. Rev. 1023, 1071 (2009).

<sup>82</sup> *Id.* (noting that parties “are exploiting their informational advantage (they know their contractual ends and have the right incentives to choose the best means to achieve them), but they are sacrificing the hindsight advantage that a court might have”).

<sup>83</sup> See *id.*

<sup>84</sup> Scott & Triantis, *supra* note 77, at 819 (“The parties choose between front- and back-end proxy determination by comparing the informational advantage the parties may have at the time of contracting against the hindsight advantage of determining proxies in later litigation.”); *id.* at 842 (“The parties may view the court’s hindsight as an advantage or disadvantage depending on how much un- certainty has been resolved by the time contract performance is due.”).

[b]y reaching the optimal combination of front-end and back-end costs, parties can minimize the aggregate contracting costs of achieving a particular gain in contractual incentives. Conversely, for any given expenditure of contracting costs, the parties can reach the highest possible incentive gains by optimizing the allocation of their investment between the front and back ends.<sup>85</sup>

This insight reveals the potential of procedural contracting.<sup>86</sup> In fact, Professors Scott and Triantis point out that parties often choose to opt out of the public adjudicatory system entirely in favor of arbitration because “the parties’ *ex ante* agreement as to procedure improves the cost effectiveness of their prospective enforcement mechanism.”<sup>87</sup> They then go on to identify other possible procedural contracting mechanisms and apply their insights to one example, *ex ante* modifications of burdens of proof.<sup>88</sup>

With respect to burdens of proof, as Professors Scott and Triantis argue, even if the default allocation can be rationalized,<sup>89</sup> “it is highly unlikely that it yields the efficient . . . allocation for every contract.”<sup>90</sup> They go on to show how several different customized allocations might benefit parties.<sup>91</sup>

The same fundamental point holds for other procedural rules. Even to the extent that existing public procedural rules can be rationalized, it is unlikely that they optimally balance

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<sup>85</sup> *Id.* at 817.

<sup>86</sup> See also Albert Choi & George Triantis, *Completing Contracts in the Shadow of Costly Verification*, 37 J. LEGAL STUD. 503 (2008) [hereinafter Choi & Triantis, *Completing Contracts*] (demonstrating that increasing litigation costs may induce better incentives to perform contractual obligations); Alan Schwartz, *Contracting About Bankruptcy*, 13 J.L. ECON. & ORG. 127 (1997) (discussing the advantages of contracting over preferred Bankruptcy procedures).

<sup>87</sup> Scott & Triantis, *supra* note 77, at 856. Part of the reason that arbitration might be desirable is because it permits vague contractual terms to be interpreted and enforced by industry experts rather than generalist judges. See *id.* at 856 n.123 (citing Christopher R. Drahozal & Keith N. Hylton, *The Economics of Litigation and Arbitration: An Application to Franchise Contracts*, 32 J. LEGAL STUD. 549, 558 (2003) for this proposition).

<sup>88</sup> *Id.* at 857–71.

<sup>89</sup> They argue that they are “hard pressed,” along with most other commentators, to rationalize the default allocation. *Id.* at 866.

<sup>90</sup> *Id.*

<sup>91</sup> See *id.* at 867–78.

efficiency and accuracy in all cases.<sup>92</sup> Recall that most public procedural rules are open-textured standards. While such standards can and do have value to parties in some circumstances, more precise rules can also create value. Fine-tuning procedure can benefit parties in at least four significant and interrelated ways: (1) curbing post-dispute opportunism; (2) reinforcing substantive obligations and optimizing pre-dispute behavior; (3) mitigating risk; and (4) directly reducing the costs of adjudication.<sup>93</sup>

### 2.1.3.1 Curbing Post-Dispute Opportunism

Private procedural ordering can help maximize the joint surplus from contracting by reducing the expected costs of future disputes.<sup>94</sup> Customized procedural rules might achieve this gain by limiting or eliminating certain kinds of costly post-dispute behavior, such as escalating the costs of discovery or engaging in abusive motion practice or constraining the range of matters over which the parties might disagree.<sup>95</sup>

With respect to both discovery and abusive motion practice, parties face a collective-action problem. In a highly simplified model, each party could choose to be abusive or reasonable with its discovery requests or its motion practice. Jointly, the parties would be best served by both acting

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<sup>92</sup> This is true even though I presume that most such rules are soundly underpinned by a desire to replicate what parties would have chosen for themselves if they had thought about them—they are, in other words, so-called “majoritarian” defaults—or they exist in order to protect vulnerable parties or nonparties. See, e.g., Ayres & Gertner, *supra* note 7, at 91 (explaining penalty defaults); Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 596 (2003) (“The justification for a default rule is that it does for parties what they would have done for themselves had their contracting costs been lower.”).

<sup>93</sup> For purposes of analysis, it is useful to think about these independently, but in reality, they are very closely related. For instance, mechanisms that reinforce substantive obligations and thus limit the range of future disputes altogether also necessarily function to curb post-dispute opportunism. Curbing post-dispute opportunism functions to reduce overall litigation costs. Reducing overall litigation costs mitigates risk. The fundamental point is that these four benefits are mutually reinforcing and often positively correlated.

<sup>94</sup> See, e.g., Bruce L. Hay, *Civil Discovery: Its Effects and Optimal Scope*, 23 J. LEGAL STUD. 481, 500–01 (1994) (discussing how plaintiffs may use discovery strategically to impose costs on the defendant).

<sup>95</sup> See Ronald J. Gilson & Robert H. Mnookin, *Disputing Through Agents: Cooperation and Conflict Between Lawyers in Litigation*, 94 COLUM. L. REV. 509, 514–15 (1994); David Rosenberg & Steven Shavell, *A Model in Which Suits Are Brought for Their Nuisance Value*, 5 INT’L REV. L. & ECON. 3 (1985) (providing a formal analysis of the impact of nuisance suits); John K. Setear, *The Barrister and the Bomb: The Dynamics of Cooperation, Nuclear Deterrence, and Discovery Abuse*, 69 B.U. L. REV. 569, 584–86 (1989).

reasonably. Individually, however, each party would do better if it employed abusive techniques while the other was reasonable. Because both parties know this, and thus know that the other is likely to defect and employ abusive techniques, they face a Prisoner's Dilemma. The equilibrium is for both parties to defect, acting abusively, even though that leaves them both worse off than if they had simply acted reasonably. By binding themselves, in advance of any dispute, to a more limited slate of discovery options or more limited motion practice, the parties can reduce the opportunity for this Prisoner's Dilemma to sap individual resources.<sup>96</sup>

With respect to the range of matters over which parties might disagree, customized procedure might limit the discursive space within which disputes take place, such as by mandating the use of joint experts, binding the parties to factual stipulations, or even bifurcating the adjudication of liability and damages, allowing parties to gain information about the stakes of a dispute before considering the question of liability.<sup>97</sup> Each of these mechanisms allows parties to short-circuit incentives for one side or the other to engage in jointly wasteful posturing or distraction tactics.<sup>98</sup> Parties can focus a future fact finder on the issues that are most relevant or most likely to be relevant.

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<sup>96</sup> The same logic could apply to waivers of the right to appeal. Parties might well dispense with a right to appellate review, even before a dispute arises, because they believe that the collective value of enhanced accuracy is not worth the costs.

<sup>97</sup> See, e.g., Drury Stevenson, *Reverse Bifurcation*, 75 U. CIN. L. REV. 213, 216 (2006) (discussing bifurcation of damages and liabilities).

<sup>98</sup> As Gordon Tullock argued years ago, error costs are likely to be higher in more adversarial systems. See Gordon Tullock, *The Case Against the Common Law*, in 9 THE SELECTED WORKS OF GORDON TULLOCK 422 (C.K. Rowley ed. 2005) (“[The adversary system] places little or no value on searching for the truth. It is a combat system in which winning is the sole objective.”). Professor Tullock’s models analyzed this issue in a binary manner, comparing inquisitorial systems with the American adversarial system, but through various issue limiting agreements, parties can reduce the space within which the adversarial contest takes place and garner many of the error reduction and perhaps rent-seeking reduction benefits that Professor Tullock associated with inquisitorial systems of adjudication. See, e.g., *id.* at 423 (suggesting that there is no reason to believe that self-interested parties competing in the litigation process will bring a social benefit).

Other mechanisms are also imaginable,<sup>99</sup> but at bottom, procedural contracts can limit or raise the expected costs of future disputes by preventing parties from strategically gaming the asymmetry between what the parties can observe and what a court can verify.<sup>100</sup> By delimiting through contract, usually before a dispute arises, the range of strategic procedural choices or the space within which a dispute can occur, the parties may be able to enhance the overall value of their agreements.

### 2.1.3.2 Reinforcing Substantive Obligations

A key *ex ante* goal of contracting in general is reducing the likelihood of a dispute occurring in the first instance. Pre-dispute procedural contracting also provides parties with additional means of reinforcing or defining their substantive obligations to and behavior towards one another. The divergence between *ex ante* and *ex post* optimal litigation decisions has been extensively analyzed in the law and economics literature.<sup>101</sup> Suffice it to say that procedural rules impact how parties evaluate their post-dispute payoffs and thus impact when, or if, parties assert their claims and how they make strategic choices during litigation.<sup>102</sup>

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<sup>99</sup> For example, fee-shifting agreements and burden-shifting agreements could also raise the price of bringing non-meritorious or speculative claims and thus limit opportunities for extortionate lawsuits, thus actually reducing the overall expected costs of dispute resolution.

<sup>100</sup> Information may be said to be observable if the other contracting party can perceive it. Information may be observable but not verifiable if the other party can perceive it but cannot, at a reasonable case, prove that information to a court or other third party. See, e.g., Robert E. Scott, *A Theory of Self-Enforcing Indefinite Agreements*, 103 COLUM. L. REV. 1641, 1642 n.2 (2003); see also Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765, 1791–95 (1996) (discussing the distinction between observable information, which is information that it is both possible and worthwhile for transactors to obtain, and verifiable information, which is information that it is worthwhile for transactors to prove to a designated third-party neutral in the event of a dispute). Parties often include in their contracts terms that might be cheap to observe but costly to verify. See Choi & Triantis, *Completing Contracts*, *supra* note 85; Albert Choi & George Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 YALE L. J. 848 (2010); see also, e.g., Louis Kaplow, *A Model of the Optimal Complexity of Legal Rules*, 11 J. L. ECON. & ORG. 150, 150–63 (1995); Louis Kaplow & Steven Shavell, *Accuracy in the Determination of Liability*, 37 J. L. & ECON. 1, 1–15 (1994).

<sup>101</sup> See generally, e.g., STEVEN SHAVELL, *FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW* 392–401 (2004); Steven Shavell, *The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System*, 26 J. LEGAL STUD. 575 (1997).

<sup>102</sup> See, e.g., Kapeliuk, *supra* note 74, at 1482–83 (noting that just as the prospect of full settlement has an impact on the selection of cases that are litigated, so too does the choice of procedural rules).

Parties already regularly negotiate over substantive terms that might be difficult to verify in subsequent litigation. For example, parties often include terms that condition on vague or difficult to prove states like "best efforts." The high costs of proving (or disproving) these states in court can function as a disincentive for parties to bring a claim and, at the very least, negatively impact the expected value of any claim. Parties might conversely contract for very precise obligations that are easily verifiable in court. Such terms can function to dissuade opportunistic shirking or holdups during performance of the contract. Alternatively, they can deter parties from filing nuisance claims or claims that have only marginal factual support. Such gains can be realized by reducing the likelihood of future litigation altogether or by narrowing the range of disputes in any future litigation. But pre-dispute procedural contracting offers parties even more options for calibrating their substantive obligations to one another and optimizing behavior. Aware of the rules that will govern any future disputes at the time of contracting, and knowing that these rules will affect their litigation behavior and the outcome of litigation, parties can tailor their respective pre-dispute actions.<sup>103</sup> For instance, agreeing that expert testimony or an expert opinion will be given by a neutral third party rather than through party-appointed advocates could incentivize greater compliance with performance standards pre-dispute or, at the least, change the parties' incentives in deciding what claims to bring and how much to invest in proving claims once they have been asserted.<sup>104</sup> Agreeing to give a defendant the right to exercise an option making any settlements unenforceable could reduce litigation holdup problems, eliminating the incentive for plaintiffs to bring negative

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<sup>103</sup> Procedural contracting, in other words, can help overcome the "acoustic separation" between the *ex ante* understanding that parties have about how their future disputes will be adjudicated and their *ex post* understanding. See, e.g., Meir Dan-Cohen, *Decision Rules and Conduct Rules: On Acoustic Separation in Criminal Law*, 97 HARV. L. REV. 625 (1984); see also, generally, Bruce Hay, *Procedural Justice: Ex Ante Vs. Ex Post*, 44 UCLA L. REV. 1803 (1997).

<sup>104</sup> See, e.g., *AMF Inc. v. Brunswick Corp.*, 621 F. Supp. 456, 458 (E.D.N.Y. 1985) (in a settlement between competitors, parties agreed to submit any future dispute involving an advertised claim of data based comparative superiority to a neutral third party expert to provide a non-binding opinion); Bone, *supra* note 10, at 1356 (offering a similar example).

expected value lawsuits.<sup>105</sup> Or, opting into expanded review of arbitral awards could be seen as a means of increasing accuracy (and costs) and thus deterring more questionable claims.<sup>106</sup>

Pre-dispute procedural contracting also provides the parties with additional means to signal credibly about reliability, propensity for litigation, or other similar matters. For instance, a manufacturer could signal confidence in its product by offering to bear the burden of proof in any lawsuit for breach.<sup>107</sup> Or, to borrow an example from another context, Professors Daphna Kapeliuk and Alon Klement suggest that a prospective tenant might signal reliability by agreeing to let the landlord quickly obtain provisional relief in the event of a default.<sup>108</sup>

These simple examples do not exhaust the numerous possibilities.<sup>109</sup> Essentially, procedural contracting simply illustrates the "well-appreciated general conclusion that a party may benefit by removing future options, since this form of commitment can have advantageous incentive effects."<sup>110</sup> Parties can use customized procedural devices in combination with carefully

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<sup>105</sup> See generally, e.g., David Rosenberg & Steven Shavell, *A Solution to the Problem of Nuisance Suits: The Option to Have the Court Bar Settlement*, 26 INT'L REV. L. & ECON. 42 (2006).

<sup>106</sup> See, e.g., Steven Shavell, *The Appeals Process as a Means of Correction*, 24 J. LEGAL STUD. 379 (1995).

<sup>107</sup> A variety of other customizations to burdens of proof can also be envisaged. A rich literature exists exploring the connections between the burden of proof, risk of error, primary behavior, and cost of litigation. See, e.g., Bruce L. Hay & Kathryn E. Spier, *Burdens of Proof in Civil Litigation: An Economic Perspective*, 26 J. LEGAL STUD. 413 (1997) (analyzing burden of proof as an instrument for reducing the cost of litigation); Gideon Parchomovsky & Alex Stein, *The Distortionary Effect of Evidence on Primary Behavior*, 124 HARV. L. REV. 518 (2010) (explaining people's primary behavior as motivated by the burdens of proof and other evidentiary requirements); Posner, *supra* note 23, at 1502–07 (using the economic analysis of the burden of proof as a tool for reducing the cost of errors and error-avoidance as a total sum); David Rosenberg, *The Causal Connection in Mass Exposure Cases: A "Public Law" Vision of the Tort System*, 97 HARV. L. REV. 849, 861–67 (1984) (carrying out economic analysis of the burden of proof and identifying the limits of the "preponderance" standard in tort cases with uncertain causation); Chris W. Sanchirico, *Games, Information, and Evidence Production: With Application to English Legal History*, 2 AM. L. & ECON. REV. 342 (2000) (developing an account of proof burdens that uses evidence production as a proxy for determining the harmfulness of primary behavior); Chris W. Sanchirico, *Relying on the Information of Interested—and Potentially Dishonest—Parties*, 3 AM. L. & ECON. REV. 320 (2001) (analyzing the proof burdens' effect on primary behavior).

<sup>108</sup> Daphna Kapeliuk & Alon Klement, *Contractualizing Procedure* 3, 24–25 (Dec. 31, 2008) (unpublished manuscript) (on file with author) (suggesting that parties can signal private information by agreeing to custom procedural clauses).

<sup>109</sup> See generally, e.g., Daphna Kapeliuk & Alon Klement, *Contracting Around Twombly*, 60 DEPAUL L. REV. 1 (2010) (discussing possible advantages of modifying the *Twombly* pleading standard by contract).

<sup>110</sup> Rosenberg & Shavell, *supra* note 104, at 43 (noting that a stock example of this maxim is "that an advancing army might want to burn bridges behind it, so that its troops will fight aggressively and that the enemy will take heed of this").

tailored substantive obligations to incentivize pre-dispute behaviors that increase their joint contracting surplus.

### 2.1.3.3 Mitigating Risk

Litigation can be risky. Parties often find themselves wedged between climbing costs and unpredictable awards. Of course, if the risk premium of pursuing litigation exceeds whatever gains a party expects, that party should be willing to fully settle. But, as previously discussed, there are many reasons why parties might want to cabin the riskiness of dispute resolution but still continue their fight.<sup>111</sup> Various forms of procedural contracting can function to hedge against outlier outcomes, providing a benefit for both parties.

For instance, parties might opt to waive a jury. Although use of a judge as a factfinder may also reduce the overall costs of adjudication by eliminating the time and effort that goes into empaneling a jury and streamlining presentation of evidence, perhaps the most important reason parties choose to try a case to a judge is that judges may also be more predictable and conservative decision makers.<sup>112</sup>

More innovatively, parties might reach some form of award-modification agreement.<sup>113</sup> Most commonly, such modifications take the form of so-called high-low agreements, in which a defendant agrees to pay the plaintiff a minimum recovery in return for the plaintiff's agreement to accept a maximum amount regardless of the outcome of the trial.<sup>114</sup> Such agreements could be simple, with two payoff alternatives, or more complicated, with multiple payoffs contingent on

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<sup>111</sup> See *infra* 2.1.1.

<sup>112</sup> A sizeable literature addresses the possibility that juries are less predictable and more extreme in their decisions. See, e.g., John Lande, *Failing Faith in Litigation? A Survey of Business Lawyers' and Executives' Opinions*, 3 HARV. NEGOT. L. REV. 1, 21, 33–34 (1998) (presenting evidence from interviews and surveys suggesting that juries are less accurate and more extreme); Cass R. Sunstein, *Deliberative Trouble? Why Groups Go to Extremes*, 110 YALE L.J. 71, 102–03 (2000) (discussing reasons why juries might be more extreme).

<sup>113</sup> See Prescott, *supra* note 63, at 85–98 (discussing in detail various forms of award modification agreements).

<sup>114</sup> J.J. Prescott et al., *Trial and Settlement: A Study of High-Low Agreements*, 57 J.L. & ECON. 699, 700 (2014).

various outcomes.<sup>115</sup> It is even possible to imagine an award modification in which the function is continuous and differentiable across outcomes. For example, a defendant might offer to compensate a plaintiff with a fixed transfer payment plus 25% of whatever a jury ultimately awards in exchange for the plaintiff giving up its opportunity to capture the full amount of a jury award.<sup>116</sup>

#### **2.1.3.4 Reducing the Direct Costs of Litigation**

Litigation can, of course, be expensive. Avoiding wasteful, offsetting litigation expenditures after a dispute has already arisen may be a key goal for parties to procedural contracts. In a sense, this goal is an analogue to the first—curbing post-dispute opportunism. In many instances, the symmetrical lack of knowledge about the future may make it easier for parties to lash themselves to the mast, as it were, and commit before a dispute to avoiding opportunistic exploitation of one another. But even after litigation has commenced, the threat of excessive costs may inspire parties to come up with ways to reduce their effort and increase efficiency.<sup>117</sup>

At the simplest, parties can and do modify procedure by adjusting the timing and other pedestrian aspects of litigation. These minor procedure-modification agreements reduce costs by allowing the parties to disperse their obligations sensibly, avoiding what can be an expensive bunching of deadlines or what can be an inefficient overlap of deadlines. But parties go further than this and often simplify or streamline the process by which their dispute will be resolved in additional ways, such as waiving rights to present oral testimony and treating a summary judgment

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<sup>115</sup> See, e.g., Prescott, *supra* note 63, at 92 (citing Verdict and Settlement Summary, *Clemente v. Duran*, No. L-003405-04, 2006 WL 4643243 (N.J. Super. Ct. Law Div. Dec. 18, 2006) in which the parties agreed to a three-tiered set of payoffs dependent on how much fault a jury attributed to the defendant).

<sup>116</sup> See *id.* at 94 (offering a similar example).

<sup>117</sup> See Prescott et al., *supra* note 113, at 728–30 (recognizing further that “parties may not need high-low agreements to limit excessive rent seeking when they can do so directly through explicit contractual limitations on [litigation] activities that are costly”).

proceeding as a trial on the merits, agreeing to a trial on stipulated facts, agreeing to expedited trials with a magistrate judge, waiving rights to appeal, and similar agreements.

These sorts of commitments to procedural modifications, although taking place after a dispute has arisen, function in much the same way as pre-contractual modifications do. These commitments trade off procedural rights provided by the default rules of civil procedure that one or both parties may have for other perceived or real benefits, essentially making those procedural rights alienable.

## 2.2 The Limited Empirical Evidence

Several commentators have conducted empirical evaluations of the degree to which parties engage in various forms of procedural contracting.<sup>118</sup> For the most part, these commentators focus their attentions on a limited subset of possible procedural customizations, looking for evidence about how frequently parties incorporate specific provisions into their deals. Accordingly, their methodologies and conclusions are not precisely the same. Nevertheless, the overall picture presented by these empirical studies suggests that even sophisticated commercial parties rarely engage in fine-grained procedural customization, at least before a dispute arises.<sup>119</sup> To be sure, several coarse forms of customization are common—choice of law clauses,<sup>120</sup> forum selection

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<sup>118</sup> See, e.g., Christopher R. Drahozal & Stephen J. Ware, *Why Do Businesses Use (or Not Use) Arbitration Clauses?*, 25 OHIO ST. J. DISP. RESOL. 433, 449–67 (2010) (analyzing material contracts filed with the SEC); Christopher R. Drahozal & Erin O'Hara O'Connor, *Unbundling Procedure: Carve-Outs from Arbitration Clauses*, 66 FLA. L. REV. 1945, 1972 (2014) (compiling a sample of a variety of contracts filed with the SEC); Theodore Eisenberg & Geoffrey Miller, *Ex Ante Choices of Law and Forum: An Empirical Analysis of Corporate Merger Agreements*, 59 VAND. L. REV. 1975, 1983–94 (2006) (analyzing merger agreements filed with the SEC); Theodore Eisenberg & Geoffrey P. 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 (2007) (analyzing material contracts filed with the SEC); Hoffman, *supra* note 10, at 403–16 (studying CEP employment contracts); Erin O'Hara O'Connor et al., *Customizing Employment Arbitration*, 98 IOWA L. REV. 133, 136–37 (2012) (same); W. Mark C. Weidemaier, *Customized Procedure in Theory and Reality*, 72 WASH. & LEE. L. REV. 1865 (2015) (collecting contracts that were exhibits to SEC filings).

<sup>119</sup> See, e.g., Weidemaier, *supra* note 117, at 1889.

<sup>120</sup> See, e.g., Eisenberg & Miller, *supra* note 117, at 1987 tbl.2 (all merger agreements in sample designate governing law); see also Hoffman, *supra* note 10, at 410 (finding over 1,000 contracts each year in text-based search of SEC material contracts).

clauses,<sup>121</sup> clauses choosing arbitration,<sup>122</sup> clauses choosing arbitration but providing some sort of “carve-outs” that allow parties to go court in some subset of disputes,<sup>123</sup> jury trial waivers,<sup>124</sup> and sometimes attorney fee provisions.<sup>125</sup> But “[w]hat parties almost never do is write contracts that dictate procedure at the granular level of pre-trial and trial practice.”<sup>126</sup> The majority of contracts, it seems, do not address matters of pleading, discovery, the rules of evidence, burdens of proof, or other more innovative forms of procedural customization.

For a variety of reasons, this empirical evidence may be somewhat suspect. As Christopher Drahozal and Erin O’Hara O’Connor have argued, customization commonly occurs through carve-outs from arbitration protocols.<sup>127</sup> These carve-outs are hard to detect in standard searches and the databases of commercial contracts containing arbitration carve-outs is limited. Moreover, with the exception of the comprehensive survey conducted by Professor Weidemaier, who collected a

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<sup>121</sup> 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, 1504 tbl.11 (2009) (finding that 38.9% of a sample of commercial contracts included choice of forum clause); Eisenberg & Miller, *supra* note 117, at 1987 (finding that 52.5% of a sample of merger agreements included choice of forum clause); see also Hoffman, *supra* note 10, at 407–08 (concluding based on text search of SEC filings that “a plurality of contracts choose forum”).

<sup>122</sup> See, e.g., Drahozal & O’Hara O’Connor, *supra* note 117, at 1973 (finding that 47.5% of a sample of technology contracts included an arbitration clause, again with substantial variation across contract type); O’Hara O’Connor et al., *supra* note 117, at 161 tbl.1 (2012) (finding that 51.5% of a sample of CEO employment contracts required arbitration of some or all disputes).

<sup>123</sup> For example, O’Hara O’Connor et al. found such carve-outs in nearly half of a sample of CEO employment contracts. O’Hara O’Connor et al., *supra* note 117, at 167–68. Likewise, Drahozal and O’Hara O’Connor found routine use of carve-outs in arbitration clauses in samples of joint venture, technology, and franchise agreements. Drahozal & O’Hara O’Connor, *supra* note 117, at 21–31.

<sup>124</sup> Theodore Eisenberg & Geoffrey P. Miller, Do Juries Add Value?: Evidence from an Empirical Study of Jury Trial Waiver Clauses in Large Corporate Contracts (Cornell Law Sch. Legal Studies Research Paper Series, Working Paper No. 06-044, 2006), <http://ssrn.com/abstract=946465> [<https://perma.unl.edu/NWS7-Z3YM>] (finding about 20% of 2,800 commercial contracts contained jury trial waivers, although also finding substantial variance across contract type, ranging from 1.9% to 64.5%).

<sup>125</sup> See Theodore Eisenberg & Geoffrey P. Miller, *The English Versus the American Rule on Attorney Fees: An Empirical Study of Public Company Contracts*, 98 CORNELL L. REV. 327, 350–52 (2013) (finding that 37.1% of the contracts in their sample adopted the American rule, while 36.4% adopted the English rule).

<sup>126</sup> Weidemaier, *supra* note 117, at 1938.

<sup>127</sup> Drahozal & O’Hara O’Connor, *supra* note 117, at 1949–50.

dataset of over 400 contracts and hand coded them, most of the extant studies rely on text searches that may well overlook more nuanced customized terms.<sup>128</sup>

Nevertheless, while the empirical evidence we have may not be perfect, it seems to point in the same direction—parties do not seem to engage in robust customization of procedure. Considering the impressive value-maximizing opportunities presented by procedural customization, as discussed in Part II, this empirical evidence is puzzling to say the least.

## 2.3 The Doctrinally Permissible Options for Calibrating Procedure Through

### Contract

*Any customer can have a car painted any colour that he wants so long as it is black.*<sup>129</sup>

The question is why parties seem not to engage in procedural customization. One important part of the answer is that only parties who have a primary contractual relationship are likely to be able to bargain for customized procedures as an ancillary part of their agreement. Parties are unlikely to bargain *ex ante* for procedural contracts in isolation. If this intuition is correct, then only a limited subset of all disputes in courts would even have the potential of implicating customized procedures.<sup>130</sup>

As important as this answer is, however, it does not account for the dearth of procedural innovation and fine-tuning within the remaining set of disputes where customization could occur. It

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<sup>128</sup> See Weidemaier, *supra* note 117, at 1871.

<sup>129</sup> Moffitt, *supra* note 63, at 462 (2007) (arguing that “[o]ur judiciary has unfortunately embraced Henry Ford’s sense of consumer choice” with respect to litigation procedural rules).

<sup>130</sup> See, e.g., *U.S. District Courts—Judicial Business 2014*, U.S. COURTS, <http://www.uscourts.gov/Statistics/JudicialBusiness/2014/us-district-courts.aspx> [<https://perma.unl.edu/DA34-254G>] (showing that less than 10% of civil cases filed in federal court over the past five years are categorized as contract disputes); *Examining the Work of State Courts: An Analysis of 2010 State Court Caseloads*, CT. STATISTICS PROJECT (Dec. 2012) [http://www.courtstatistics.org/other-pages/~media/microsites/files/csp/data%20pdf/csp\\_dec.ashx](http://www.courtstatistics.org/other-pages/~media/microsites/files/csp/data%20pdf/csp_dec.ashx) [<https://perma.unl.edu/LYW4-F6VS>] (showing that in seventeen general jurisdiction courts approximately 61% of civil cases filed in 2010 were contract disputes).

is possible, of course, that parties are stuck using suboptimal defaults for any number of reasons. But the first, and perhaps most fundamental as many commentators suggest, is that the practice of procedural customization might constitute a radical change to current doctrinal norms.<sup>131</sup>

The costs of innovating in the face of those norms or trying to change those norms might simply be too steep for any single party to bear, especially given worries about freeriding.<sup>132</sup>

Historically, in fact, courts were skeptical of private procedural ordering, preferring to limit parties to the off-the-rack set of rules supplied by the sovereign.<sup>133</sup> Party-driven rulemaking was seen as a dangerous threat to the legitimate public function of courts.<sup>134</sup> This wary view of nonjudicial, nonpublic dispute resolution is perhaps most evident in the way that courts treated arbitration during the nineteenth and much of the early twentieth centuries. Essentially, courts refused to enforce nonjudicial modes of dispute resolution.<sup>135</sup> Using the same logic, they also effectively prevented

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<sup>131</sup> See generally, e.g., Dodson, *supra* note 11. Importantly, in this Article, I do not address a related and important question: when, if ever, is the practice of procedural customization normatively desirable or permissible. I take up this question in a forthcoming article, H. Allen Blair, *The Line Between Mockery and Efficiency: The Normative Implications of Private Process*. See Blair, *Normative Implications*, *supra* note 13.

<sup>132</sup> See *supra* note 11. Essentially, innovators have a hard time excluding others from taking advantage of their work. If the innovation is valuable, others can copy it easily. By itself, this problem might dissuade some potential innovators, who have to spend time and money designing the innovation. But, the free rider problem is exacerbated by the fact that innovators also disproportionately bear the risks that go along with adopting customizations.

<sup>133</sup> See, e.g., Richard C. Reuben, *Public Justice: Toward a State Action Theory of Alternative Dispute Resolution*, 85 CAL. L. REV. 577, 599–600 (1997) (noting that judges were either wary of quality of justice available in arbitration or—because they were paid on per case basis—protective of their own pocketbooks).

<sup>134</sup> Several scholars have suggested that at least some of this hostility towards private procedural ordering might have been less high-minded. Professor Alan Scott Rau, for instance, has suggested that courts' traditional hostility to arbitration may have "originated in considerations of competition for business, at a time when judges' salaries still depended on fees paid by litigants." ALAN SCOTT RAU, *ARBITRATION* 57 (2d ed. 2002); see also JULIUS HENRY COHEN, *COMMERCIAL ARBITRATION AND THE LAW* 83 (1918) (recognizing the judicial competition with private tribunals and the fear that arbitration threatened a significant source of judicial business, as well as judicial jobs linked to the courts' caseloads).

<sup>135</sup> The history of arbitration itself has been difficult to completely uncover. See, e.g., Douglas Yarn, *A Cautionary Tale of Isomorphism Through Institutionalism*, 108 PENN. ST. L. REV. 929, 937 (2004) ("It is a matter that seems to fall in the gap between social and legal historians."). The fundamental point, however, is that courts were highly skeptical of non-judicial forms of dispute resolution.

private parties from altering or opting out of almost all procedural rules in public judicial proceedings.<sup>136</sup>

Eventually, however, beginning with a grudging acceptance of arbitration and the passage of the Federal Arbitration Act (FAA), but really gaining momentum under Chief Justices Warren and Burger, judicial tides began to turn. Through an expanding array of private procedural ordering options, courts have steadily allowed parties more and more freedom to tailor process and procedure in order to increase certainty while efficiently adjusting accuracy to fit with their *ex ante* preferences.<sup>137</sup>

The first two subsections below briefly trace the evolution of the law governing private procedural ordering, focusing primarily on the U.S. Supreme Court. The third subsection looks at trends in lower courts and state courts. In total, these sections demonstrate that good reason exists to believe that courts would enforce a wide range of procedural contracts. Although some uncertainty persists about the contractibility of specific procedural rules, a clear trend favoring parties' ability to structure their own procedural paths exists.

### **2.3.1 Procedure as Public Law: Historic Skepticism of Private Procedural Ordering**

Until the early twentieth century, courts protected their turf. They tended to see efforts by parties to provide for most non-court dispute resolution, as well as other forms of private procedural ordering, as infringements on the proper public role of the court system.<sup>138</sup> As one

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<sup>136</sup> *But see* Michael H. LeRoy, *Crowning the New King: The Statutory Arbitrator and the Demise of Judicial Review*, 2009 J. DISP. RESOL. 1, 20 (surveying treatises and concluding that “English and American colonial courts were neither hostile nor blindly deferential to arbitration”).

<sup>137</sup> *See, e.g.*, Louis Kaplow, *Accuracy in Adjudication*, *supra* note 8, at 310 (arguing that heightened accuracy in adjudication can only be obtained at higher costs so an efficient balance has to be struck on a case-by-case basis).

<sup>138</sup> *See, e.g.*, Thomas E. Carbonneau, *Arbitral Justice: The Demise of Due Process in American Law*, 70 TUL. L. REV. 1945, 1947 (1996) (recognizing that prior to the early twentieth century, the traditional view was that if courts were to function as the national source of justice, there was no room for “makeshift, party-confected modes of dispute resolution”); Reuben, *supra* note 132, at 599–600 (noting that judges were either wary of quality of justice available in arbitration or— because they were paid on per case basis—protective of their own pocketbooks). *But see* LeRoy, *supra* note 135, at 20 (surveying treatises and concluding that “English and American colonial courts were neither hostile nor blindly deferential to arbitration”).

commentator has observed, there existed “a taboo against party autonomy in procedural matters.”<sup>139</sup> Courts primarily relied on two interlacing doctrines—the revocability and ouster doctrines—to prevent procedural contracting. Perhaps not surprisingly, both doctrines arose out of a judicial skepticism of arbitration, though at least the ouster doctrine expanded over time to bar other forms of private procedural ordering as well.

The revocability doctrine sprung into existence, near full gown, from dicta in Lord Edward Coke’s 1609 opinion in *Vynior’s Case*.<sup>140</sup> There, the parties had entered into a contract for repair work on several buildings.<sup>141</sup> They agreed to submit any disputes about the work to arbitration, and, as was customary during the period, a performance bond secured this agreement.<sup>142</sup> The plaintiff brought a court action, seeking to recover on the bond as well as to recover damages. The plaintiff claimed that the defendant had failed to comply with the arbitration agreement.<sup>143</sup> Lord Coke ruled that when there was a suit on a bond securing a submission to arbitration, the submission itself was revocable although the price of revoking was forfeiture of the bond:

[a]lthough . . . the defendant, was bound in a bond to stand to, abide, observe, etc., the rule, etc., of arbitration, etc., yet he might countermand it, for one cannot by his act make such authority, power, or warrant not countermandable which is by the law or of its own nature countermandable.<sup>144</sup>

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<sup>139</sup> Linda S. Mullenix, *Another Choice of Forum, Another Choice of Law: Consensual Adjudicatory Procedure in Federal Court*, 57 *FORDHAM L. REV.* 291, 294 (1988).

<sup>140</sup> *Vynior’s Case*, 77 *Eng. Rep.* 595, 599–600 (K.B. 1609).

<sup>141</sup> *See id.*

<sup>142</sup> *See id.* The common law of contract was just beginning to form at the time, so bonds often secured contractual promises. *See, e.g.*, Paul D. Carrington & Paul Y. Castle, *The Revocability of Contract Provisions Controlling Resolution of Future Disputes Between the Parties*, 67 *LAW & CONTEMP. PROBS.* 207, 208 (2004) (noting that “the common law of contracts was in its infancy” at the time that *Vynior’s Case* was decided).

<sup>143</sup> *See id.*

<sup>144</sup> *Vynior’s Case*, (1609) 77 *Eng. Rep.* 595, 601–02 (K.B.) (emphasis added).

Whatever Lord Coke's original intent,<sup>145</sup> *Vynior's* became a leading case "establishing the revocability doctrine."<sup>146</sup> Pursuant to this doctrine, a party to an arbitration agreement could revoke an arbitrator's authority at any time before the arbitrator rendered an award, even if the parties had agreed the delegation was irrevocable.<sup>147</sup> Although U.S. courts would usually enforce arbitration awards once issued,<sup>148</sup> following the practice of their English counterparts, they would not generally enforce executory contracts to arbitrate.<sup>149</sup> Practically, this meant that a party to an arbitration agreement faced continual risk that her counterparty would renege on his promise and exercise his right to demand that a court hear any disputes.

Although the revocability doctrine alone did not necessarily create an insuperable barrier to arbitration or other forms of procedural contracting, it mutated over time into the so-called ouster doctrine. The mutation can be traced to an eighteenth century English decision, *Kill v. Hollister*.<sup>150</sup>

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<sup>145</sup> Some commentators have suggested that Lord Coke was effectively relying on agency principles to find that the principle could revoke the agent's authority at any time. See, e.g., Paul L. Sayre, *Development of Commercial Arbitration Law*, 37 YALE L.J. 595, 598–99 (1928). Professors Paul Carrington and Paul Castle have compellingly, pointed out, however, that the concept of agency had not developed fully when *Vynior's Case* was decided. See Carrington & Castle, *supra* note 141, at 210. They contend, instead, that Lord Coke was likely motivated by a desire to "insure the disinterest of arbitrators" at a time when there were no real substantive constraints on arbitrator authority. *Id.*

<sup>146</sup> Harry Baum & Leon Pressman, *The Enforcement of Commercial Arbitration Agreements in the Federal Courts*, 8 N.Y.U. L.Q. 238, 240 (1930); see also, e.g., Sayre, *supra* note 144, at 602 (stating that *Vynior's Case* has "generally been regarded as the original and controlling authority for revocability").

<sup>147</sup> See, e.g., *Tobey v. County of Bristol*, 23 F. Cas. 1313, 1321 (C.C.D. Mass. 1845) (citing *Vynior's Case* as authority for the proposition that arbitration submissions are revocable regardless of a stipulation to the contrary because one "cannot alter the judgment of law, to make that irrevocable, which is of its own nature revocable").

<sup>148</sup> See, e.g., *Burchell v. Marsh*, 58 U.S. (17 How.) 344, 349 (1854).

<sup>149</sup> See, e.g., *Red Cross Line v. Atl. Fruit Co.*, 264 U.S. 109, 120–21 (1924) ("The federal courts—like those of the states and of England—have, both in equity and at law, denied in large measure, the aid of their processes to those seeking to enforce [sic] executory agreement to arbitrate disputes."); Jeffery W. Stempel, *Pitfalls of Public Policy: The Case of Arbitration Agreements*, 22 ST. MARY'S L.J. 259, 272 (1990). This rule was incorporated in the First Restatement of Contracts as well. RESTATEMENT (FIRST) OF CONTRACTS § 550 cmt. A (1932) ("A bargain to arbitrate, though it is not illegal, is practically unenforceable. . . ."). Of course, even at the height of its power, the revocability doctrine had exceptions. See, e.g., *Red Cross Line*, 264 U.S. at 122–25 (1924) (finding that New York courts could equitably enforce arbitration agreements in their own courts under New York's arbitration statute).

<sup>150</sup> *Kill v. Hollister*, (1746) 95 Eng. Rep. 532 (K.B.). Notably, some commentators have suggested that the inverse historical evolution occurred: the ouster doctrine preceded the revocability doctrine. See, e.g., Julius Henry Cohen & Kenneth Dayton, *The New Federal Arbitration Law*, 12 VA. L. REV. 265, 283 (1926) (explaining revocability as "rooted originally in the jealousy of courts for their jurisdiction"). The order of development is not particularly significant for purposes of my argument.

There, while interpreting the revocability doctrine, the court allowed a judicial action over an insurance policy to proceed despite an arbitration clause on the grounds that “the agreement of the parties cannot oust this court [of jurisdiction].”<sup>151</sup> The revocability doctrine, then, allowed courts to ignore the parties’ delegation of authority to an arbitrator. As with the dicta giving rise to the revocability doctrine itself, no authority was given for this “ouster” rule.<sup>152</sup> Nevertheless, by 1856, the rule had become justified as legitimate “judicial jealousy” over jurisdiction, and this explanation for it stuck.<sup>153</sup>

The ouster doctrine began as anti-arbitration rule, but it quickly expanded into a more general principle precluding courts from enforcing various contractual provisions limiting redress in courts. In *Home Insurance Co. v. Morse*, for instance, the U.S. Supreme Court held that an agreement by which an insurance company waived its right to remove state cases to federal courts was not enforceable.<sup>154</sup> The Court analogized the matter to a jury trial waiver and an arbitration agreement, concluding that

[a] man may not barter away his life or his freedom, [sic] or his substantial rights . . . . He cannot . . . bind himself in advance by an agreement, which may be specifically enforced, thus to forfeit his rights at all times and on all occasions, whenever the case may be presented.<sup>155</sup>

In the Court’s view, privately negotiated contract provisions could not trump the role of the public adjudicatory system. If such contract provisions were enforced, the “regular administration of justice might be greatly impeded . . . .”<sup>156</sup> Soon, courts went on to find that antisuit covenants, pre-

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<sup>151</sup> *Id.*

<sup>152</sup> *See id.*

<sup>153</sup> *See Home Ins. Co. v. Morse*, 87 U.S. (20 Wall.) 445, 451 (1874) (citing *Scott v. Avery*, (1856) 10 Eng. Rep. 1121 (H.L.) as one of “numerous cases” showing that parties cannot by contract oust a court of jurisdiction); *Scott*, 10 Eng. Rep. 1121 (speculating that judicial hostility to arbitration “probably originated in the contests of the different courts in ancient times for extent of jurisdiction, all of them being opposed to anything that would deprive one of them of jurisdiction”).

<sup>154</sup> *Morse*, 87 U.S. at 451–52.

<sup>155</sup> *Id.* at 451.

<sup>156</sup> *Id.* at 451–52.

dispute waivers of liability, and forum selection clauses were similarly barred by the ouster doctrine.<sup>157</sup> Only courts, the prevailing opinion went, possessed the ability to “protect rights and to redress wrongs” because private tribunals or other private customizations of procedure were prone to “become . . . instrument[s] of injustice, or to deprive parties of rights which they are otherwise fairly entitled to have protected.”<sup>158</sup>

### 2.3.2 Mere Contract Law No More: Autonomy and Private Procedural Ordering

By the late eighteenth century, however, although both the revocability and ouster doctrines were still in use in American courts, notions of party autonomy were starting to play a greater role in not only the public conscience but also in the judicial mind.<sup>159</sup> At the height of the revocability and ouster doctrines, contract law was in its infancy, and most contracts were discrete and simple.<sup>160</sup> That began to change with rapid economic transformations in the American

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<sup>157</sup> See, e.g., *Mut. Reserve Fund Life Ass'n v. Cleveland Woolen Mills*, 82 F. 508, 510 (6th Cir. 1897) (finding that a contract stipulating that suits could only be brought in federal court was void because it “intended to oust the jurisdiction of all state courts”); *Nute v. Hamilton Mut. Ins. Co.*, 72 Mass. (6 Gray) 174, 184 (1856) (refusing to enforce a forum selection provision because forum choice was fixed by law “upon considerations of general convenience and expediency”); *Meacham v. Jamestown Franklin & Clearfield R.R. Co.*, 105 N.E. 653, 656 (1914) (Cardozo, J., concurring) (finding that an arbitration contract is an invalid attempt to oust the jurisdiction of the courts because its purpose is the same as agreements requiring litigants to submit their case to a foreign court, but noting that there may be exceptional circumstances warranting enforcement of such forum selection clauses); *Knorr v. Bates*, 35 N.Y.S. 1060, 1062 (N.Y. Gen. Term. 1895) (holding that a contractual limitation on the right to sue underwriters on an insurance policy was unenforceable because “a provision in a contract that the party breaking it shall not be answerable in an action is a stipulation for ousting the courts of jurisdiction, and, as such, is void, upon grounds of public policy”).

<sup>158</sup> *Tobey v. Cty. of Bristol*, 23 F. Cas. 1313, 1320–21 (C.C.D. Mass. 1845). Thus, it is fair to say that the ouster doctrine was justified both based on concerns over individual rights, such as those set out in *Morse*, 87 U.S. at 451–52 and concerns about extra-individual matters such as “administrative efficiency, separation of powers, and public faith in the legitimacy of the judiciary.” David Marcus, *The Perils of Contract Procedure: A Revised History of Forum Selection Clauses in the Federal Courts*, 82 TUL. L. REV. 973, 995 (2008) (citing and discussing *Nute*, 72 Mass. 174, as articulating this extrajudicial concern).

<sup>159</sup> See, e.g., John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 630 (1995) (“Contract has become the dominant doctrinal current in modern American law.”); Walter F. Pratt, Jr., *American Contract Law at the Turn of the Century*, 39 S.C. L. REV. 415, 415 (1988) (“During the past century, contract law, along with most of American society, has undergone a ‘major transformation.’”).

<sup>160</sup> In his article on the history of commercial law in the United States, Professor Walter F. Pratt, Jr. explains that:

Contracting, like conversation, had in earlier times been rooted in the past. People who knew one another and who knew the local market, insulated as it was from dramatic shifts in the economy, faced little likelihood of changes in circumstances that would require elaborate agreements or provoke complex disputes. Railroads and cities, however, seemed to disrupt that past by bringing economic uncertainty into the local markets. Parties thus faced the tiring prospect of writing detail upon detail into each agreement if they were to account for every potential event.

economy. As American courts routinely decided increasingly complex contract disputes based on the intentions of the parties,<sup>161</sup> the same principles of autonomy began gaining traction in the context of private procedural ordering.<sup>162</sup> G. Richard Shell identified the trend towards acceptance of procedural contracts more than twenty years ago in his study of contracts and the Supreme Court, where he documented the steady demise of the public policy exception to contract enforcement and, in particular, of an exception to contractual autonomy that draws from the special attributes of judicial process.<sup>163</sup>

Certainly arbitration played a key role in unlocking the potential of private procedural ordering.<sup>164</sup> Businesses saw the potential efficiency gains from arbitration, but they were frustrated with court refusal to enforce arbitration agreements.<sup>165</sup> Calls for the legal system to value freedom of contract fueled much of the reform effort. As Julius Henry Cohen, the chief draftsman of the Federal Arbitration Act (FAA), explained, “everybody today feels very strongly that the right of

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Pratt, *supra* note 158, at 428–29; see also Bruce L. Benson, *An Exploration of the Impact of Modern Arbitration Statutes on the Development of Arbitration in the United States*, 11 J.L. ECON. & ORG. 479, 489 (1995) (explaining that the doctrine of revocability set forth by Lord Coke in *Vynior’s Case* occurred before the common law of contracts was fully formed).

<sup>161</sup> Instead of being localized and discrete as they had been prior to the turn of the century, commercial transactions tended to be more complex and regional as well as national. See Allen Blair, “*You Don’t Have to be Ludwig Wittgenstein*”: *How Llewellyn’s Concept of Agreement Should Change the Law of Open-Quantity Contracts*, 37 SETON HALL L. REV. 67, 77–78 (2006).

<sup>162</sup> *But see* Marcus, *supra* note 157, at 1014 (arguing that, although “[i]ncreased appreciation for freedom of contract and individual autonomy and consent may have influenced the development of [forum selection clauses,] . . . these considerations played a small part at best, especially when compared to the degree to which extraindividual considerations shaped the design of clause enforcement doctrine”).

<sup>163</sup> G. Richard Shell, *Contracts in the Modern Supreme Court*, 81 CAL. L. REV. 431, 452–56 (1993) (detailing the Supreme Court’s treatment of judicial access clauses and documenting judicial acceptance of *ex ante* forum selection clauses).

<sup>164</sup> See, e.g., William C. Jones, *An Inquiry Into the History of the Adjudication of Mercantile Disputes in Great Britain and the United States*, 25 U. CHI. L. REV. 445, 461–62 (1958) (“Statistics are not available and it is doubtful that they ever will be, but it is probable that in the nineteenth century arbitration in one form or another became the most important form of mercantile dispute settlement . . . in the United States . . . although courts continued, of course, to be used.”); Stempel, *supra* note 148, at 275 (“Despite an essentially unchanging judicial hostility toward arbitration, it grew in popularity as the commercial affairs of the United States became increasingly far flung and complex.”).

<sup>165</sup> See, e.g., *Atl. Fruit Co. v. Red Cross Line*, 276 F. 319, 322 (S.D.N.Y. 1921) (recognizing the general displeasure in the business community with courts’ unwillingness to enforce arbitration agreements in the early twentieth century).

freedom of contract which the Constitution guarantees to men, includes the right to dispose of any controversy which may arise out of the contract in their own fashion.”<sup>166</sup>

Responding to the interests of the business community, in 1920, New York broke from traditional English arbitration law by enacting a statute that enforced pre-dispute agreements to arbitrate, ended the practice of courts hearing questions of law during the course of arbitration, and provided for only limited judicial review of the final award.<sup>167</sup> In 1925, the U.S. Congress followed New York’s lead by enacting the United States Arbitration Act, later renamed the Federal Arbitration Act.

The Supreme Court would eventually point out that the FAA was a “response to the refusal of courts to enforce commercial arbitration agreements.”<sup>168</sup> But the Act did far more. It also represented a more general step towards recognizing the value of autonomy in procedural choices. A House Report on the bill introducing the FAA explained its genesis in concerns about freedom of contract:

Arbitration agreements are purely matters of contract, and the effect of the bill is simply to make the contracting party live up to his agreement. . . . An arbitration agreement is placed upon the same footing as other contracts, where it belongs. . . . This bill declares simply that such agreements for arbitration shall be enforced, and provides a procedure in the Federal courts for their enforcement.<sup>169</sup>

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<sup>166</sup> *Arbitration of Interstate Commercial Disputes: Joint Hearings Before the Sub-comms. of the Comms. on the Judiciary on S. 1005 and H.R. 646*, 68th Cong. 14 (1924) (statement of Julius Henry Cohen).

<sup>167</sup> Michael A. Scodro, *Arbitrating Novel Legal Questions: A Recommendation for Reform*, 105 YALE L.J. 1927, 1941 (1996).

<sup>168</sup> *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 125 (2001); *Southland v. Keating*, 465 U.S. 1, 13–14 (1984) (quoting H.R. REP. NO. 68-96, at 1–2 (1924) (“[T]he need for the law arises from . . . the jealousy of the English courts for their own jurisdiction. . . . This jealousy survived for so long a period that the principle became firmly embedded in the English common law and was adopted with it by the American courts.”)). The statute’s purpose was to ensure that “written provisions or agreements for arbitration of disputes arising out of contracts, maritime transactions, or commerce among the States or Territories or with foreign nations” would be “valid and enforceable.” United States Arbitration Act, 43 Stat. 883 (1925). For excellent accounts of the FAA’s legislative history, see James E. Berger & Charlene Sun, *The Evolution of Judicial Review Under the Federal Arbitration Act*, 5 N.Y.U. J.L. & Bus. 745 (2009); Thomas E. Carbonneau, *Judicial Approval in Building the Civilization of Arbitration*, 113 PENN. ST. L. REV. 1343, 1348 (2009) (providing a brief history of the passage of the FAA).

<sup>169</sup> H.R. REP. No. 68-96, at 1–2.

Numerous commentators as well as Supreme Court decisions have confirmed the central importance of freedom of contract to the law of arbitration.<sup>170</sup>

That progression continued and, with more and more norms of due process becoming waivable rights, the Warren and Burger Courts embraced an expanding range of procedural private ordering options.<sup>171</sup> Arguably, the current era customizable procedure was ushered by the Supreme Court's 1972 decision in *The Bremen v. Zapata Off-Shore Co.*<sup>172</sup> There, the Court addressed enforcement of a forum selection clause in the context of an international transaction, but the key rationales of the Court are hardly limited to that context.<sup>173</sup>

*The Bremen* revolutionized private procedural ordering by doing three things. First, it boldly and decisively discarded the ouster doctrine, relegating it to mere anachronism: “[the ouster doctrine] is hardly more than a vestigial legal fiction.”<sup>174</sup> Notably, this sweeping language by the Court, unconstrained in any way, makes it evident that, whatever doctrinal logic animated the ouster doctrine, that logic has outlived its usefulness, even outside of forum selection clauses. More significantly, and consistent with this expansive revolution in private process, the case honed in on party autonomy, making the touchstone for enforcement of forum selection clauses the

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<sup>170</sup> THOMAS E. CARBONNEAU, *THE LAW AND PRACTICE OF ARBITRATION* 49 (5th ed. 2014) (noting that freedom of contract is the “primary legal concept” in the law of arbitration); see also, e.g., ALAN REDFREN ET AL., *LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION* 265 (4th ed. 2004) (citing UNCITRAL Arbitration Rules Art. 19(1)) (“Party autonomy is the guiding principle” in arbitration); *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ.*, 489 U.S. 468, 472 (1989) (noting that arbitration “is a matter of contract”); *Granite Rock Co. v. Int’l Bhd. of Teamsters*, 561 U.S. 287, 299 (2010) (same); *Stolt-Nielsen S.A. v. AnimalFeeds Int’l Corp.*, 559 U.S. 662, 681 (2010) (“[A]rbitration ‘is a matter of consent, not coercion.’” (quoting *Volt*, 489 U.S. at 479))

<sup>171</sup> Dodge, *supra* note 3, at 734–35 (citing *Boddie v. Connecticut*, 401 U.S. 371, 378–79 (1971), *Nat’l Equip. Rental v. Szukhent*, 375 U.S. 311, 315–16 (1964), *Aly-eska Pipeline Serv. Co. v. Wilderness Soc’y*, 421 U.S. 240, 257 (1975), and *D.H. Overmyer Co. v. Frick Co.*, 405 U.S. 174, 187–88 (1972)).

<sup>172</sup> 407 U.S. 1, 2 (1972).

<sup>173</sup> See, e.g., David H. Taylor & Sara M. Cliffe, *Civil Procedure by Contract: A Convolved Confluence of Private Contract and Public Procedure in Need of Congressional Control*, 35 U. RICH. L. REV. 1085, 1095 (2002) (describing the case as “a sea-change in the way private agreement is viewed in relation to procedure”); William J. Woodward, Jr., *Finding the Contract in Contracts for Law, Forum and Arbitration*, 2 HASTINGS BUS. L.J. 1, 15 (2006) (observing that the law “changed dramatically” in *The Bremen*); Linda S. Mullenix, *supra* note 138, at 306–07 (“The current doctrine of consensual adjudicatory procedure . . . is based on Supreme Court pronouncements in *The Bremen*.”).

<sup>174</sup> 407 U.S. 1, 12 (1972).

quality of the bargaining process.<sup>175</sup> Finally, “[e]schew[ing] a provincial solicitude for the jurisdiction of domestic forums,” the Court linked party autonomy with greater predictability and stability in commercial relationships.<sup>176</sup> In other words, the Court reconceptualized procedural rights, ceasing to look at them from a vertical, individual-government perspective and focusing, instead, on seeing them from a horizontal, individual-individual perspective and thus as alienable.<sup>177</sup> Parties should be free, so long as they are bargaining at arms-length, to trade off procedural rights for other benefits.

Importantly, not only did *The Bremen* radically alter the law of more than just forum selection clauses in spirit but it also did so in practice. At least tacitly, it endorsed party choice over other procedures, since a forum court’s procedural rules will apply.<sup>178</sup> By allowing parties to contract for the forum in which their future disputes will be heard, the Court was in fact allowing parties to shop for bundles of procedural rules that they might prefer.

Following *The Bremen*, the Court has not looked back during its march to internalize contract norms and abandon its historic skepticism over the devolution of judicial authority.<sup>179</sup> Instead, the Court has taken multiple opportunities to reinforce the instrumental character of procedure and its malleability at the hands of parties.<sup>180</sup> For instance, in *Mitsubishi Motors Corp. v.*

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<sup>175</sup> See *id.* at 15 (finding that forum selection clauses should be enforced unless the resisting party can “clearly show that enforcement would be unreasonable and unjust, or that the clause was invalid”); see also, e.g., Noyes, *supra* note 5, at 597 (describing the Court as elevating the concept of freedom of contract, thereby allowing parties to bargain about how a dispute will be decided); Linda S. Mullenix et al., *Case One: Choice of Forum Clauses*, 29 NEW ENG. L. REV. 517, 541 (1995) (arguing that the Court in *The Bremen* adopted a “strongly stated federal policy favoring enforceability, subject to usual contract principles”); KEVIN M. CLERMONT, CIVIL PROCEDURE: TERRITORIAL JURISDICTION AND VENUE 85 n.60 (1999) (stating that *The Bremen* “shift[ed] from a jurisdictional to a contractual paradigm”).

<sup>176</sup> *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 630 (1985) (construing *The Bremen*).

<sup>177</sup> See, e.g., Susan Rose-Ackerman, *Inalienability and the Theory of Property Rights*, 85 COLUM. L. REV. 931, 931 n.2 (1985) (listing a number of works that consider the traditional view of property rights and the law).

<sup>178</sup> See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 122 & cmt. a (2013).

<sup>179</sup> See Resnik, *supra* note 3, at 598–99 (describing how changes in adjudicatory practice are shifting the focus of civil procedure from “due process procedure” to “contract procedure”).

<sup>180</sup> See, e.g., *Mathews v. Eldridge*, 424 U.S. 319, 347–49 (1976) (using a balancing approach to resolve the question of whether the denial of an opportunity to be heard violates due process).

*Soler Chrysler-Plymouth, Inc.*—one of a number of cases putting the nail in the coffin of subject matter inarbitrability—the Court made it clear that it would allow parties to trade off judicial procedures for efficiency:

By agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum. It trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration.<sup>181</sup>

Although the Court in *Mitsubishi* framed up the dispute as one involving unique “international” considerations, “[w]ithin a few years, the international aura of the reasoning dissipated and eventually vanished.”<sup>182</sup> Soon, the arbitrability of statutory disputes was no longer predicated on the international character of the transaction, and the Court began recognizing that virtually any sort of civil dispute could be arbitrated.<sup>183</sup>

Using this same instrumental logic, the Court later broke down one of the few remaining barriers inhibiting the continued expansion of private procedural ordering by abandoning any effort to distinguish between commercial and consumer contracts in *Carnival Cruise Lines v. Shute*.<sup>184</sup> There, extending its pro-autonomy decision in *The Bremen*, the Court brushed past a common law rule that forum selection clauses in “form contracts” were presumptively unenforceable and reasoned that such clauses should, instead, be enforced because consumers “benefit in the form

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<sup>181</sup> 473 U.S. 614, 628 (1985); see also, e.g., *Metro E. Ctr. for Conditioning & Health v. Qwest Commc’ns Int’l, Inc.*, 294 F.3d 924, 928–29 (7th Cir. 2002) (“One aspect of personal liberty is the entitlement to exchange statutory rights for something valued more highly.”).

<sup>182</sup> THOMAS E. CARBONNEAU, *TOWARD A NEW FEDERAL LAW ON ARBITRATION* 39 (2014); see also, e.g., *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 624 (1986) (“We granted certiorari primarily to consider whether an American court should enforce an agreement to resolve antitrust claims by arbitration when that agreement arises from an international transaction.”).

<sup>183</sup> See CARBONNEAU, *supra* note 181, at 39–41. Professor J. Maria Glover has argued for a far more restrictive reading of *Mitsubishi*, contending that the case sought to foster “claim-facilitative procedures, both as a descriptive matter and a normative one.” J. Maria Glover, *Disappearing Claims and the Erosion of Substantive Law*, 124 *YALE L.J.* 3052, 3063–64 (2015). Professor Glover’s argument, while innovative, does press against the grain of the decision as a whole. See generally Steven W. Feldman, *Italian Colors and Freedom of Contract Under the Federal Arbitration Act: Has the Supreme Court Enabled Disappearing Claims and the Erosion of Substantive Law?*, 2016 *MICH. ST. L. REV.* 109 (offering a compelling rebuttal to Professor Glover’s reading of *Mitsubishi*).

<sup>184</sup> 499 U.S. 585, 587–88 (1991).

of reduced [prices] reflecting the savings that the [firm] enjoys by limiting the fora in which it may be sued.”<sup>185</sup>

Even the two Supreme Court cases in the past thirty years arguably suggesting some limitation to party autonomy over procedural choices—*Hall Street Associates, L.L.C. v. Mattel* and *Atlantic Marine Construction Co. v. U.S. District Court*—do more to vindicate this freedom than restrict it.

*Hall Street Associates v. Mattel* has been heralded by some as the sole decision to invalidate a procedural contract. But a careful read of the case shows that, to the contrary, it actually advances the logic of party autonomy and freedom to tailor procedure.<sup>186</sup> In *Hall Street*, the Court was faced with a contractual provision expanding the scope of judicial review of arbitral awards.<sup>187</sup> While the Court did invalidate this provision, holding that the grounds for review of arbitral awards under the FAA were complete and exclusive,<sup>188</sup> the Court did not even hint that its rejection of the customized procedure sprung from any concerns over party control of judicial processes.<sup>189</sup> Instead, the Court merely funneled innovation with respect to expanded judicial review of arbitral awards back to States: “[t]he FAA is not the only way into court for parties

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<sup>185</sup> *Id.* at 594 (“[I]t stands to reason that passengers who purchase tickets containing a forum clause like that at issue in this case benefit in the form of reduced fares reflecting the savings that the cruise line enjoys by limiting the fora in which it may be sued.”).

<sup>186</sup> *Hall St. Assocs. v. Mattel*, 128 S. Ct. 1396, 1408 (2008); see Dodge, *supra* note 3, at 738 (describing *Hall Street Associates v. Mattel, Inc.* as “[t]he Court’s sole invalidation of a procedural term”).

<sup>187</sup> At issue in the case was a contract provision providing that:

[t]he United States District Court for the District of Oregon may enter judgment upon any award, either by confirming the award or by vacating, modifying or correcting the award. The Court shall vacate, modify or correct any award: (i) where the arbitrator’s findings of facts are not supported by substantial evidence, or (ii) where the arbitrator’s conclusions of law are erroneous.

*Hall St. Assocs.*, 128 S. Ct. at 1401–02.

<sup>188</sup> *Id.* at 1408.

<sup>189</sup> It is worth noting that several Circuits had relied on the dubious and outmoded notion that contracting for expanded judicial review constituted an impermissible attempt to control federal court jurisdiction.

wanting review of arbitration awards: they may contemplate enforcement under state statutory or common law, for example, where judicial review of different scope is arguable.”<sup>190</sup> The Court was not rejecting private procedural ordering at all.<sup>191</sup>

*Atlantic Marine* appears at first glance to support party autonomy, as the Court enforced a restrictive forum selection clause in the parties’ contract.<sup>192</sup> Some commentators have suggested, however, that the manner in which the Court enforced the clause indicates a skepticism about party autonomy in procedural matters.<sup>193</sup> Essentially, the argument is that, although the Court enforced the clause, it did so on restrictive grounds. Many lower courts had taken to enforcing restrictive forum selection clauses through motions to dismiss for improper venue or through motions to dismiss for failure to state a claim.<sup>194</sup> The Supreme Court in *Atlantic Marine* rejected this approach, and instead concluded that the proper enforcement mechanism was a motion to transfer venue.<sup>195</sup> Still, the fundamental outcome of the case favored party choice and there is little reason, as even commentators sympathetic to a restrictive reading of *Atlantic Marine* concede, to believe that the Court intended the decision to signal any sort of concern about party autonomy over procedural matters.<sup>196</sup>

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<sup>190</sup> *Hall St. Assocs.*, 128 S. Ct. at 1406.

<sup>191</sup> Professor Jamie Dodge, in her seminal article on private procedural ordering makes this point as well. In her view, although the Court narrowly held in *Hall Street Associates v. Mattel, Inc.* that the Federal Arbitration Act specifically preempted the modification of the standard of review in the courts, the Court expressly noted that under state law or common law parties may be able to modify the standard of judicial review.

Dodge, *supra* note 3, at 738. This express notation suggests, in her view, that the Court does not fundamentally think parties should be barred from contracting for expanded judicial review or similar procedural modifications. *See id.*

<sup>192</sup> *Atl. Marine Constr. Co. v. U.S. Dist. Court*, 134 S. Ct. 568 (2013).

<sup>193</sup> *See, e.g.,* Scott Dodson, *Atlantic Marine and the Future of Party Preference*, 66 HASTINGS L.J. 675, 677 (2015) (“The Court’s decision implicitly, though inconsistently, endorses the principle of party subordination.”).

<sup>194</sup> 5B WRIGHT ET. AL., *supra* note 62, § 1352 nn.4–5 (citing cases).

<sup>195</sup> *Atl. Marine Constr. Co.*, 134 S. Ct. at 579.

<sup>196</sup> *See, e.g.,* Dodson, *supra* note 192, at 684, 691 (describing the case as a “small-triumph” for the principle of party subordination and recognizing that the Court was likely “focused on the particular statutory regime of venue” rather than on party autonomy in procedural matters).

In short, since *The Bremen*, virtually every word from the Supreme Court suggests that parties have virtually unfettered ability to customize procedure.<sup>197</sup> Although the Supreme Court has not specifically endorsed many potential forms of private procedural ordering, with no notable exceptions the Court's precedent "treats procedural contracts as a method for generating procedural efficiencies and increased certainty of process, resulting in broad enforcement of procedural terms."<sup>198</sup> The trend of precedent, in short, seems unequivocally to favor party autonomy and private procedural ordering.

### 2.3.3 State Courts, Lower Federal Courts, and Procedural Autonomy

State courts and lower federal courts also seem to agree that parties are free within broad limits to agree on simplified procedures for the decision of their case.<sup>199</sup> In a variety of instances, parties do, in fact, take advantage of this ability, including when contracting for forum,<sup>200</sup> choice of law,<sup>201</sup> appointment of service agents or waiver of notice,<sup>202</sup> and limitation periods.<sup>203</sup> Additionally, parties regularly waive the right to notice and a hearing by using cognovits notes,<sup>204</sup> and waive the

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<sup>197</sup> Mullenix, *supra* note 138, at 302–03.

<sup>198</sup> Dodge, *supra* note 3, at 739. In fact, since the Supreme Court's decision in *Carnival Cruise Lines v. Shute*, 499 U.S. 585 (1991), the Court has not found that "a procedural contract violates fundamental fairness." Dodge, *supra* note 3, at 725, 736.

<sup>199</sup> See, e.g., *DDI Seamless Cylinder Int'l, Inc. v. Gen. Fire Extinguisher Corp.*, 14 F.3d 1163, 1166 (7th Cir. 1994).

<sup>200</sup> See, e.g., Eisenberg & Miller, *supra* note 117, at 1987 tbl.2 (finding that about 53% of a sample of mergers clauses included forum selection provisions); Faith Stelman, *Regulatory Competition, Choice of Forum, and Delaware's Stake in Corporate Law*, 34 DEL. J. CORP. L. 57, 118 (2009) (observing that parties "commonly" contract over choice of forum "in merger agreements and other highly negotiated corporate and commercial contracts").

<sup>201</sup> See, e.g., Larry E. Ribstein, *From Efficiency to Politics in Contractual Choice of Law*, 37 GA. L. REV. 363, 403 (2003) (discussing why most such clauses are enforced by courts).

<sup>202</sup> *Nat'l Equip. Rental, Ltd. v. Szukhent*, 375 U.S. 311, 315–16 (1964) ("[I]t is settled . . . that parties to a contract may agree in advance . . . to waive notice altogether.").

<sup>203</sup> See, e.g., 7 RICHARD A. LORD, *WILLISTON ON CONTRACTS* § 15:12, at 264–67 (4th ed. 1997) (discussing the enforceability of such clauses); Ronald J. Mann & Travis Siebeneicher, *Just One Click: The Reality of Internet Retail Contracting*, 108 COLUM. L. REV. 984, 990 (2008) (discussing the frequency of use of such clauses in consumer contracts).

<sup>204</sup> See, e.g., *Swarb v. Lennox*, 405 U.S. 191 (1972); *D.H. Overmyer Co., Inc. v. Frick Co.*, 405 U.S. 174 (1972). The enforcement of contractual confession of judgments does not violate the defendant's right to due process provided that there is clear and convincing evidence that the waiver of notice and hearing was voluntary, knowing, and intelligently made. *D.H. Overmyer*, 405 U.S. at 185–87.

right to a trial by jury.<sup>205</sup> Even procedural requirements that might seem “immutable,” such as jurisdictional requirements, have, in recent years arguably been subject to some contractual modification.<sup>206</sup>

The Texas Supreme Court offered a particularly clear justification for procedural customization outside of arbitration in a jury waiver dispute between a lessor and two tenants.<sup>207</sup> Effectively, the court argued that allowing parties room to customize public court litigation was better than shunting parties wanting room to customize out of the public system altogether into arbitration.

In the case, Prudential was the building lessor, and the tenants were Francesco Secchi, a native of Italy, and his wife Jane, a native of England. Neither was educated beyond the eighth grade. The Secchis argued that jury waivers are contrary to public policy, because they give nongovernment actors “the power to alter the fundamental nature of the civil justice system by private agreement.”<sup>208</sup> The Texas Supreme Court rejected that argument, noting that precedent already allows parties to contract for the law that will apply and the forum in which litigation will take place, and lets them waive the due-process based requirements for personal jurisdiction. “Public policy,” the Court said, “that permits parties to waive trial altogether connected with this Lease, or any of its provisions” surely does not forbid waiver of trial by jury.

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<sup>205</sup> Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX. L. REV. 1581, 1595 (2005) (“Most courts will enforce contractual jury waivers.”); Eisenberg & Miller, *supra* note 123 (finding that about 20% of a sample of merger and acquisition agreements contained a jury trial waiver provision). Significantly, even though the Court has said that the standard for evaluating jury trial waivers is constitutional rather than contractual, see *D.H. Overmyer*, 405 U.S. at 185, lower courts seem to focus on the propriety of the bargaining process to the exclusion of any other concerns, see, for example, *IFC Credit Corp. v. United Bus. & Indus. Fed. Credit Union*, 512 F.3d 989, 993 (7th Cir. 2008) (reversing the district court’s refusal to enforce a jury waiver embedded in a sales contract on the view that “[a]s long as the price is negotiable and the customer may shop else- where, consumer protection comes from competition rather than judicial intervention”).

<sup>206</sup> Davis & Hershkoff, *supra* note 2, at 513–14 (noting that recent cases arguably allow for parties to enlarge the subject matter jurisdiction of federal courts and contract around some constitutional standing barriers).

<sup>207</sup> *In re The Prudential Ins. Co.*, 148 S.W.3d 124 (Tex. 2004).

<sup>208</sup> *Id.* at 131.

[I]f parties are willing to agree to a non-jury trial, we think it preferable to enforce that agreement rather than leave them with arbitration as their only enforceable option. By agreeing to arbitration, parties waive not only their right to trial by jury but their right to appeal, whereas by agreeing to waive only the former right, they take advantage of the reduced expense and delay of a bench trial, avoid the expense of arbitration, and retain their right to appeal. The parties obtain dispute resolution of their own choosing in a manner already afforded to litigants in their courts. Their rights, and the orderly development of the law, are further protected by appeal. And even if the option appeals only to a few, some of the tide away from the civil justice system to alternate dispute resolution is stemmed.<sup>209</sup>

Like the U.S. Supreme Court, then, state courts and lower federal courts seem to view procedural autonomy as a hallmark of contractual freedom, allowing parties the ability to customize procedures to fit their particular dispute resolution needs.

## 2.4 Conclusion

I have argued that parties can enjoy significant benefits if procedure is seen as a set of defaults rather than immutable or mandatory rules. Allowing parties to unbundle off-the-rack procedures in public courts gives them flexibility to trade off accuracy and efficiency to meet their *ex ante* preferences. Parties can optimize their contracts so that, given the particular nature of their relationship, they limit opportunities for post-dispute opportunism, enhance incentives to perform their contractual obligations, mitigate risks, and, to the extent that a dispute arises, minimize the costs of dispute resolution. Given these theoretical benefits, it is tempting to predict that parties will engage in such fine-tuning of procedure regularly. The empirical evidence, however, indicates the contrary. Although parties do engage in some coarse forms of procedural customization, they do not seem to consistently tailor procedures, at least before a dispute arises. One possible reason for this could be that existing doctrine blocks attempts at customization. I have considered this argument, however, and rebutted it, showing that doctrine not only seems to allow for party

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<sup>209</sup> *Id.* at 130.

customization, but fully supports it. Parties are doctrinally free to modify procedure in innovative and expansive ways.

This conclusion leaves the fundamental puzzle unanswered, but it does clarify the promise and peril of procedural contracting, offering a clearer path to understanding both the practical and normative issues surrounding the practice.

## Chapter 3: Anticipating Procedural Innovation: How and When Parties Calibrate Procedure Through Contract<sup>1</sup>

*A more complete theory of contract design would anticipate all possible back-end processes and the interaction among them.*<sup>2</sup>

Commercial parties author the substantive terms of their contracts.<sup>3</sup> A growing number of commentators have been asking whether similar autonomy extends to procedure: can, do, and should parties also be free to author the processes used to determine their substantive rights?<sup>4</sup>

The implications of customizable procedure are profound.<sup>5</sup> The notion that transacting parties can create their own procedural rules governing the back-end of the contracting process

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<sup>1</sup> Forthcoming, Henry Allen Blair, *Anticipating Procedural Innovation: How and When Parties Calibrate Procedure Through Contract*, 72 OKLA. L. REV. \_\_ (2020).

<sup>2</sup> Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814, 822 (2006).

<sup>3</sup> In this article, I focus on contracts between sophisticated parties with relatively equal bargaining power. See, e.g., Robert E. Scott, *The Law and Economics of Incomplete Contracts*, 2 ANN. REV. L. & SOC. SCI. 279, 281 (2006) (“Contracts involving individual consumers raise separate issues that challenge the assumption that their commitments are voluntary, rational and informed.”); Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 543-44 (2003) (explaining the problems with considering contract law as applying to the “entire continuum from standard form contracts between firms and consumers to commercial contracts among businesses” and advancing an argument for focus on “business contracts”). I do not, however, do this in order to perpetuate a Willistonian, unitary approach to contract law. See HANOCH DAGAN & MICHAEL HELLER, *THE CHOICE THEORY OF CONTRACTS* 8 (2017) (explaining how Samuel Williston “elevated commercial transactions to the core of contract, and, as a byproduct, substantially obscured the generative role of diverse contract types.”). To the contrary, as I discuss in greater detail in a separate forthcoming article, *The Line Between Mockery and Efficiency: The Normative Implications of Private Process*, the most compelling normative objections to private process involve contracts between disparate parties, which involve a differing balance of values. That conclusion compels another: procedural contracts between commercial parties and individuals should be subject to closer scrutiny.

<sup>4</sup> The growing literature on private procedural ordering owes a great debt to pioneering work done in a number of articles, including

<sup>5</sup> By “customizable” procedure, I mean “procedural contracting” or “private procedural ordering,” all terms which encompass mechanisms parties use to control the processes used to resolve disputes. See, e.g., Jaime Dodge, *The Limits of Procedural Private Ordering*, 97 VA. L. REV. 723, 724-25 (2011) (describing the process of modifying by contract the “spectrum of procedure” as private procedural ordering). In previous work, I have used these terms interchangeably and in the broadest possible sense, to include all party agreements about procedure, including but not limited to arbitration, mediation, med-arb, and settlement. See Robin Effron, *Ousted: The New Dynamics of Privatized Procedure*

unlocks an additional dimension of design choices.<sup>6</sup> Theory already recognizes many ways that parties fine-tune their substantive commitments, keeping in mind the possibility of future disagreements.<sup>7</sup> By calibrating the completeness of contractual terms, for instance, parties regulate when and by whom content will be determined.<sup>8</sup> Parties do this by mixing rules and standards. They trade off *ex ante* investments in drafting precise obligations for *ex post* specification of vague or open-ended obligations by a court or tribunal.<sup>9</sup> Procedural fine-tuning extends the same logic, giving parties additional governance mechanisms to address exchange hazards.<sup>10</sup>

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*and Judicial Discretion*, 98 B.U. L. REV. 88 (2018) (similarly using the term “private procedural ordering” to refer to both pre- and post-dispute customizations of procedure); compare Kevin E. Davis & Helen Hershkoff, *Contracting for Procedure*, 53 WM. & MARY L. REV. 507, 511 (2011) (describing contract procedure as “the practice of setting out procedures in contracts to govern disputes . . . that will be adjudicated in the public courts”); Erin O’Hara O’Connor & Christopher R. Drahozal, *Carve Outs and Contractual Procedure*, at 2. In this article, however, I am focusing on *ex ante* procedural contracting.

<sup>6</sup> See, e.g., Scott & Triantis, *supra* note 2 (recognizing the importance of dispute resolution on contract design and calling for “further research into the interaction between contract and litigation, as well as future investigation into the effect of other back-end processes, such as arbitration, renegotiation, and settlement.”); Gillian K. Hadfield, *Judicial Competence and the Interpretation of Incomplete Contracts*, 23 J. LEGAL STUD. 159, 162 (1994) (recognizing that parties can anticipate and adjust for legal errors in their initial contract).

<sup>7</sup> See, e.g., Schwartz & Scott, *supra* note 3, at 546 (arguing that it is futile “to pursue either distributional goals or contractual fairness” in contracts between firms, as “firms will contract away from redistributive or fair legal rules that do not maximize joint surplus”); Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX. L. REV. 1581, 1583–84 (2005) (defining the cost of a contract as the *ex ante* negotiating and drafting costs, plus the probability of litigation multiplied by the sum of the parties’ litigation costs, the judiciary’s litigation costs, and judicial error costs); Scott & Triantis, *supra* note 2 (noting that investment in *ex ante* contract design generally reduces *ex post* contract enforcement costs, and that less investment in *ex ante* contract design generally increases *ex post* contract enforcement costs); Steven Shavell, *On the Writing and the Interpretation of Contracts*, 22 J.L. ECON. & ORG. 289 (2006) (discussing the role of back-end contract interpretation in influencing how parties design contracts *ex ante*); Albert Choi & George Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 YALE L.J. 848, 852 (2010) (“[D]rawing on the line of scholarship that analyzes the rules-standards dichotomy in the design of legal rules, recent work frames the choice between vague and precise contract terms as a tradeoff in information costs: precise contract provisions raise contracting costs on the front end, but reduce enforcement costs at the back end.”).

<sup>8</sup> Scott & Triantis, *supra* note 2, at 818 (“[T]he choice between precise terms and vague terms thus reduces to who chooses [obligations] and when they are chosen: the parties at the time of contracting or the court at trial.”).

<sup>9</sup> Jody S. Kraus & Robert E. Scott, *Contract Design and the Structure of Contractual Intent*, 84 N.Y.U. L. REV. 1023, 1071 (2009) (noting that parties “are exploiting their informational advantage (they know their contractual ends and have the right incentives to choose the best means to achieve them), but they are sacrificing the hindsight advantage that a court might have”).

<sup>10</sup> I use the term “exchange hazards” in a broad sense to mean the vulnerabilities that firms face when engaging with exchange partners. See, e.g., OLIVER E. WILLIAMSON, *THE MECHANISMS OF GOVERNANCE* 12 (1996).

Despite these benefits, commentators have suggested that lawyers and potential litigants do not think of most of the rules of litigation as defaults.<sup>11</sup> At least on cursory inspection, a good deal of empirical evidence seems to support the proposition that parties conceptualize procedural rules as primarily mandatory or immutable.<sup>12</sup> Empirical studies to date have suggested that parties commonly agree on where they will litigate and who will decide the dispute, but they rarely enter into *ex ante* agreements about how they will litigate, at least not in any detail.<sup>13</sup> Stated differently, no one doubts that parties make a handful of coarse, modular customizations by selecting bundles of pre-fabricated procedures through choice of forum clauses, including arbitration, and choice of law clauses.<sup>14</sup> Parties sometimes also opt out of other bundles of procedures by waiving rights to a jury, to appeal, or to class actions.<sup>15</sup> But most of the existing empirical studies end here, concluding that before a dispute arises, in or out of arbitration, parties simply do not do much fine-tuning of the processes by which their disputes will be adjudicated.<sup>16</sup>

A closer and holistic examination of the evidence, however, yields a more nuanced picture. First, parties occasionally assign different bundles of procedures to different claims, choosing, for instance, to arbitrate one category of dispute and litigate another.<sup>17</sup> This claim-by-claim customization, while still modular, may refine contract design more profoundly than previously

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<sup>11</sup> Henry S. Noyes, *If You (Re)build It, They Will Come: Contracts to Remake the Rules of Litigation in Arbitration's Image*, 30 HARV. J.L. & PUB. POL'Y 579, 612 (2007).

<sup>12</sup> See, e.g., David A. Hoffman, *Whither Bespoke Procedure?*, 2014 U. ILL. L. REV. 389, 394 (“[E]ven in circumstances where we would expect them to, parties almost never use contract terms to vary their post-dispute procedural contests.”); Erin O’Hara O’Connor et al., *Customizing Employment Arbitration*, 98 IOWA L. REV. 133, 136-37 (2012) (finding that parties to CEO employment contracts rarely customized arbitration provisions); *infra*, Part II.

<sup>13</sup> See *infra*, Section 3.2.

<sup>14</sup> See *infra*, Section 3.2.

<sup>15</sup> See *infra*, Section 3.2.

<sup>16</sup> See Henry Allen Blair, *Promise and Peril: Doctrinally Permissible Options for Calibrating Procedure Through Contract*, 95 NEB. L. REV. 787, 813-15 (2017) (reviewing the existing empirical studies); *infra* Part II.

<sup>17</sup> Christopher R. Drahozal & Erin O’Hara O’Connor, *Unbundling Procedure: Carve-Outs from Arbitration Clauses*, 66 FLA. L. REV. (2014) (studying the circumstances in which parties who include arbitration clauses in their contracts carve out certain categories of disputes for resolution in courts); Matthew Jennejohn, *The Private Order of Innovation Networks*, 68 STAN L. REV. 281, 359 (2016) (same).

acknowledged by many commentators. Additionally, when parties opt for arbitration, they sometimes engage in greater adaptation of procedure, for instance, by specifying qualifications for an arbitrator, limiting the arbitrator's authority, or authorizing the arbitrator to use a standard of decision other than law.<sup>18</sup> Finally, at least some of the time, some parties design robust and highly tailored procedural systems that readjust accuracy and efficiency to meet their deal-specific preferences.<sup>19</sup> These procedural systems distribute dispute resolution at various levels to different decision makers, some private and some public. Often, they create feedback loops that function to ratchet up trust and information sharing while narrowing the domains within which conflict can fester.

In short, knitting together various strands of empirical evidence shows that more intentional and deal-specific procedural customization takes place than previously thought. The challenge then becomes identifying and explaining the patterns of *ex ante* procedural contracting.<sup>20</sup>

I argue that patterns emerge once we focus on the different risks that parties are trying to mitigate or eliminate in variegated types of transactions. As Professor Matthew Jennejohn has persuasively argued, “[p]arties not only have to navigate more than one type of transaction cost [or exchange risk], but they must also choose how to combine different types of governance tools into a coherent portfolio—the multivalent contract.”<sup>21</sup>

This article sketches an initial theoretical framework for thinking about the role procedural customization plays in creating such a multivalent contract. It argues, first, that procedural customization functions most effectively to offset one particular transaction risk—litigation

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<sup>18</sup> See *infra*, Section 3.2.

<sup>19</sup> See *infra*, Section 3.2.

<sup>20</sup> See, e.g., W. Mark C. Weidemaier, *Customized Procedure in Theory and Reality*, 72 WASH & LEE L. REV. 1865, 1873-75 (2015) (introducing three possible explanations for the gap between theory and practice, concluding that none fare well, and concluding that “The “[t]he question remains, however, why parties do not embrace customized procedure more fully”); *infra* Section 3.

<sup>21</sup> Jennejohn, *supra* note 17.

opportunism. It then argues that the desirability of procedural choice turns, in significant part, on underlying key attributes of the transaction, namely the degree of environmental and behavioral uncertainty present and the frequency with which other similar parties contract in the same domain. These attributes of the transaction determine the degree of litigation opportunism risk present and thus the value of procedural customization in any given circumstance. The core intuition of this article can be seen as an extension of the logic used in a growing literature showing that transaction type indicates which interpretation regime should govern contract interpretation.<sup>22</sup>

This article advances these arguments in three parts.

Section 3.1 begins by recounting the benefits of procedural autonomy. Theory already explains how parties author their substantive obligations with an eye toward the possibility of future disagreements. Section 3.1 builds on this premise and demonstrates that procedural customization can give contract designers additional tools with which to address litigation opportunism and incentivize compliance with substantive terms of the deal.

Section 3.2 surveys the existing empirical evidence on procedural contracting. Most individual empirical studies conclude that parties rarely craft their own *à la carte* rules or engage in any fine-tuning of the procedures used to resolve their disputes. Accordingly, many commentators have decided that procedural customization is a theoretical phenomenon, interesting only because of its absence in practice. Section 3.2 turns, however, to an integrative appraisal of existing empirical work. In looking across studies, this analysis reveals underappreciated pockets of procedural contracting. By weaving together various threads of existing research, Section 3.2 paints a more comprehensive, if still contingent, picture of the reality of procedural autonomy.

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<sup>22</sup> See, e.g., Theodore Eisenberg & Geoffrey P. 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 (2007) (arguing that preference for arbitration depends, in part, on transaction type); Adam Badawi, *Interpretive Preferences and the Limits of the New Formalism*, 6 BERKELEY BUS. L.J. 1 (2009); Ronald J. Gilson, Charles F. Sabel, and Robert E. Scott, *Text and Context: Contract Interpretation as Contract Design*, 100 CORNELL L. REV. 23 (2014).

Section 3.3 anticipates procedural innovation by identifying key features in the transactional environment that incline contracting parties to choose particular procedural governance mechanisms. Section 3.3 borrows from recent literature addressing contracts for innovation to distinguish between different types of commercial party transactions, which can be usefully segregated into four rough domains oriented along two axes—uncertainty and scale.<sup>23</sup> In general, a positive correlation exists between the degree of uncertainty and the risk of litigation opportunism. In general, as scale increases, parties rely less and less on formal methods of contract enforcement, turning instead to industry-provided norms, trade associations, and specialized arbitral tribunals. Accordingly, parties tend to rely less on formal contracts and formal enforcement, so worries about litigation risk are diminished. In short, the quadrants of the transactional space for contract design present varying degrees of litigation opportunism risk, and contract designers will predictably confront that risk through procedural tailoring in different ways.

### 3.1 Benefits of Private Process

*[The contract] creates guardrails for the relationship. It doesn't solve all things but it shows what the[] parties can do and that's important because there is a lot of uncertainty and a lot of chaos.*<sup>24</sup>

Contract design aims to secure incentives for parties in business relationships that require commitments over time. Central to the problem transactional attorneys face, then, is the need to adapt to unforeseen (and often unforeseeable) events that arise after contract formation. The greater the uncertainty about the future, the more difficult it becomes for transactional attorneys to anticipate and provide for contingencies in a way that courts or tribunals can readily interpret and

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<sup>23</sup> See Gilson, Sabel & Scott, *supra* note 22.

<sup>24</sup> See Gilson, Sabel & Scott, *supra* note 22.

enforce.<sup>25</sup> Contract theory has been devoted to understanding how parties adjust contractual obligations in light of this uncertainty. To that end, theorists have attempted to diagnosis exchange hazards and make headway on thinking about governance mechanisms available to mitigate or eliminate them. Procedural customization constitutes another set of tools in the contract designer's toolbox.

The following sections explore the promise of procedural contracting. The first briefly situates procedural contracting in relationship to other recent efforts to appreciate how parties address variegated transactional risks. The remaining sections explore the ways that customizations of procedure can be effective at addressing one particular exchange hazard—litigation opportunism.

### 3.1.1 The Design Space for Contracting and the Role of Procedural Autonomy

More than thirty years ago, Professor Ronald Gilson asked the question “[w]hat do business lawyers really do?”<sup>26</sup> In a costless world, contract design would be straight-forward process of pinning down efficient obligations in every possible future situation.<sup>27</sup> Of course, the world is not costless. Instead, contracts are always incomplete.<sup>28</sup> Transaction costs include all of the many

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<sup>25</sup> See *id.* at 986.

<sup>26</sup> Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239, 241 (1984). Earlier answers to a similar question – “what good is contract law?” – had not been kind to lawyers. See, e.g., Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 58 (1963) (noting that business interviewees complained that lawyers often got in the way of their business dealings, and that they preferred to do business by handshake rather than by contract). Interviews indicated that written contracts were often highly-standardized documents that were largely confined to the drawer once drafted by the legal department and then rarely consulted to resolve disputes. *Id.* at 61.

<sup>27</sup> See Robert E. Scott & George Triantis, *Incomplete Contracts and the Theory of Contract Design*, 56 CASE W. RES. L. REV. 187, 190 (2004) (distinguishing between “obligational” complete contracts and “informationally” complete contracts).

<sup>28</sup> See, e.g., Robert E. Scott, *Rethinking the Default Rule Project*, 6 VA. J. 84, 85 (2003) (“As an organizing principle, the notion that contract rules are defaults inevitably leads to the conclusion that all contracts are inevitably incomplete.”); Schwartz & Scott, *supra* note 3, at 595 (“There is an infinite number of possible future states and a very large set of possible partner types. When the sum of possible states and partner types is infinite and contracting is costly, contracts must contain gaps. Parties cannot write contracts about everything.”); Richard Craswell, *The “Incomplete Contracts” Literature and Efficient Precautions*, 56 CASE WES. RES. L. REV. 151, 155 (2005); Oliver Hart & John Moore, *Incomplete Contracts and Renegotiation*, 56 ECONOMETRICA 755 (1988); Avery Katz, *Contractual Incompleteness: A Transactional*

expenses associated with addressing contractual incompleteness.<sup>29</sup> Accordingly, Professor Gilson refocused contract theory by recognizing that deal lawyers are really transaction cost engineers, constructing frameworks governing their clients' relationships while economizing on expenses.<sup>30</sup> Such lawyers confront exchange hazards in a world of incomplete contracting through governance mechanisms.<sup>31</sup>

Still, despite many advances in contract theory since Professor Gilson's seminal article, the space for contract design remains something of a mystery.<sup>32</sup> "[W]e know very little about the factors that influence how parties in the real world design their contracts."<sup>33</sup> Early contract theory tended to focus on only one type of governance mechanism—vertical integration—as a means of

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*Perspective*, 56 CASE WES. RES. L. REV. 169 (2005); Kathryn E. Spier, *Incomplete Contracts and Signaling*, 23 RAND J. ECON. 432 (1992).

<sup>29</sup> See OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONSHIP CONTRACTING* 78 n.7 (1985); R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 15 (1960) (transaction costs are resources spent "to discover who it is that one wishes to deal with . . . and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on").

<sup>30</sup> Gilson, *supra* note 26, at 241, 302; see also, e.g., Victor Fleischer, *Essay, Deals: Bringing Corporate Transactions into the Law School Classroom*, 2002 COLUM. BUS. L. REV. 475, 478 (describing the Deals course at Columbia Law School started by Ronald Gilson, Victor Goldberg, and David Schizer and discussing how it rested on the notion of lawyers focusing on deal mechanics in order to minimize transaction costs); See, e.g., VICTOR P. GOLDBERG, *FRAMING CONTRACT LAW: AN ECONOMIC PERSPECTIVE* 2 (2006) ("[T]he basic presumption that there are gains from trade is the economic foundation for a facilitative law of contract."). Ronald Coase's two most renowned papers teach that transaction costs are a central determinant of legal and organizational boundaries. See Ronald H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937) (considering the boundaries of firms); Coase, *supra* note 29, at \_\_ (arguing that in the absence of transaction costs parties will bargain to efficient results). As Coase later explained, however, the so-called Coase Theorem should be understood as a "stepping stone on the way to an analysis of an economy with positive transaction costs." Ronald H. Coase, *The Institutional Structure of Production*, 82 *AM. ECON. REV.* 713, 717 (1992); see also, e.g., OLIVER E. WILLIAMSON, *CONTRACT, GOVERNANCE AND TRANSACTION COSTS* 5-7 [hereinafter WILLIAMSON, *CONTRACT, GOVERNANCE AND TRANSACTION COSTS*] (Gengxaun Chen, ed., 2017) ("[I]f transaction costs are zero then parties . . . would costlessly bargain to an efficient result whichever way the property rights are assigned at the outset. In that event, the emperor really did have no clothes: externalities and frictions would vanish. That being preposterous, the real message was this: 'study the world of positive transaction costs.'").

<sup>31</sup> See, e.g., Oliver E. Williamson, *Comparative Economic Organization: The Analysis of Discrete Structural Alternatives*, 36 *ADMIN. SCI. Q.* 269, 277 (1991) ("The discriminating alignment hypothesis to which transaction-cost economics owes much of its predictive content holds that transactions, which differ in their attributes, are aligned with governance structures, which differ in their costs and competencies, in a discriminating (mainly, transaction-cost-economizing) way."); Jennejohn, *supra* note 17, at 294 ("Any theory of contract design must have answers for two questions: First, what hazards to exchange must transacting parties confront? And second, what governance tools can parties use to eliminate, or at least check, those hazards?"); Gilson, Sabel & Scott, *supra* note 22.

<sup>32</sup> Robert E. Scott, *Contract Design and the Shading Problem*, 99 *MARQ. L. REV.* 1, 3 (2015).

<sup>33</sup> *Id.*

offsetting one type of exchange risk—hold-ups.<sup>34</sup> But governance problems relate to contractual externalities of various kinds, of which holds-ups are just one, and hold-up problems manifest in a wide range of specific forms.<sup>35</sup> As a result, more and more scholars have been investigating particularized forms of exchange risks and the mechanisms that parties use to address those risks.

For instance, recent work related to the braiding of formal and informal contract enforcement has demonstrated how parties use combinations of complementary governance mechanisms to address the challenges they face in contexts of high innovation where it would be difficult or impossible to prescribe a fixed outcome for a given collaboration.<sup>36</sup> This work replaces a binary, either-or approach to formal and informal contract enforcement with an understanding of governance mechanisms as a collection of tools that can be combined—mixed and matched—to confront alliance hazards. In at least some innovative contexts, formal and informal enforcement mechanisms can be effectively braided together to mutually reinforce one another.<sup>37</sup>

Similarly, Professors Scott and Triantis’s landmark article *Anticipating Litigation in Contract Design* explores how parties balance *ex ante* and *ex post* specification of contract terms to “maximize the incentive bang for the contracting buck.”<sup>38</sup> By reaching the optimal combination of front-end and back-end costs, parties can minimize the aggregate costs of achieving a particular

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<sup>34</sup> Oliver E. Williamson was at the forefront of this work. Williamson developed this theory in a series of articles that were then consolidated and expanded in his seminal book, *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS* (1975). See also, e.g., Oliver E. Williamson, *Markets and Hierarchies: Some Elementary Considerations*, 63 *AM. ECON. REV.* 316-25 (1973) (explaining the variables that likely influence a firm’s decision to either purchase goods on the spot market or produce the goods internally); Oliver E. Williamson, *The Vertical Integration of Production: Market Failure Considerations*, 61 *AM. ECON. REV.* 112-23 (1971) (same); WILLIAMSON, *CONTRACT, GOVERNANCE AND TRANSACTION COSTS*, *supra* note 30.

<sup>35</sup> Bengt Holmstrom & John Roberts, *The Boundaries of the Firm Revisited*, 12 *J. OF ECON. PERSP.*, 73, 86 (1998).

<sup>36</sup> See generally, e.g., Ronald J. Gilson, Charles Sabel & Robert E. Scott, *Braiding: The Interaction of Formal and Informal Contracting in Theory, Practice, and Doctrine*, 110 *COLUM. L. REV.* 1377 (2010) [hereinafter Gilson, Sabel & Scott, *Braiding*]; Ronald J. Gilson, Charles Sabel & Robert E. Scott, *Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration*, 109 *COLUM. L. REV.* 431 (2009) [hereinafter Gilson, Sabel & Scott, *Contracting for Innovation*].

<sup>37</sup> Professors Bozovic and Hadfield make a similar argument. See Hadfield & Bozovic, *supra* note 24, at 981.

<sup>38</sup> Scott & Triantis, *supra* note 2, at 823.

gain in contractual incentives.<sup>39</sup> Professors Scott and Triantis demonstrate how these tradeoffs help parties address particular contracting problems. For example, vague terms, which reduce upfront contracting costs by increasing backend costs, can be valuable when a parties' inputs would be difficult or impossible to verify or even observe *ex ante* but will become clear by the time of performance. The critical point is that, like the braiding literature, *Anticipating Litigation* clarified thinking about governance problems by dissolving the binary choice between *ex ante* specification and *ex post* enforcement, showing how a more complicated balancing of design techniques could serve the interest of transacting parties.

In the same spirit as these efforts, procedural customization gives parties additional governance strategies for dealing with various instantiations of opportunism inherent in the *ex post* adjudication of breach of contract claims—“shading.”<sup>40</sup> Shading occurs because the legal conclusion that a party has breached can only be made after the parties present self-interested evidence to a court or tribunal. Looking at that imperfect evidence, a court has to make a comparative, probabilistic assessment of each side's behavior. The potential of adjudicatory errors drives some parties to exploit the litigation process.<sup>41</sup>

Regulating shading through substantive terms in the contract proves difficult because exogenous factors determine which party will behave opportunistically, and any effort to design the contract to preclude one party from asserting an opportunistic claim inevitably increases the risk of strategic behavior by the counterparty.<sup>42</sup> Ultimately, using substantive contract terms “to try to induce cooperative behavior from an uncooperative actor is like trying to pick up mercury; every

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<sup>39</sup> *Id.* at 817.

<sup>40</sup> Scott, *supra* note 32, at 6; see also, e.g., Juliet P. Kostritsky, *Plain Meaning vs. Broad Interpretation: How the Risk of Opportunism Defeats a Unitary Default Rule for Interpretation*, 96 Ky. L.J. 43, 56 (2007–2008).

<sup>41</sup> See, e.g., Alan Schwartz, *Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies*, 21 J. LEGAL STUD. 271, 317 (1992).

<sup>42</sup> Scott, *supra* note 32, at 6.

provision stipulated or contingency appended just creates another source of contention open to various interpretations and is thus subject to manipulation in court.”<sup>43</sup> Opportunistic litigation behavior can also be difficult to observe and even more difficult to verify.<sup>44</sup>

Procedural customizations, however, can make headway on shading problems. In this regard, pre-dispute private procedural ordering can be far more effective than post-dispute private ordering for at least three reasons. First, before a dispute, parties cannot accurately predict how a dispute will arise or what side of the issues they will each take. This uncertainty affords the parties a degree of objectivity that they lack by the time that a dispute fomented, allowing them to make less emotionally charged choices about procedures and process that will maximize their joint welfare.<sup>45</sup> In contrast, procedural customizations post-dispute can become part of the strategic gaming that generates litigation opportunism.

Second, transfer payments are much more feasible pre-dispute, and particularly at the outset of contracting, accordingly, even asymmetric procedural advantages can be considered so long as the benefited party can purchase such advantages from the other at an agreed upon price.<sup>46</sup> In other words, more complex procedural customizations are possible because the parties can include such customizations as part of the package of other rights and obligations that they are trading.

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<sup>43</sup> Scott Masten, *Equity, Opportunism and the Design of Contractual Relations*, 144 J. INST’L & THEORETICAL ECON. 180, 183 (1988).

<sup>44</sup> Scott, *supra* note 32, at 6.

<sup>45</sup> See, e.g., Bruce L. Hay, *Procedural Justice--—Ex Ante vs. Ex Post*, 44 UCLA L. REV. 1803, 1828-39 (1997) (describing the difference between *ex ante* and *ex post* perspectives when information differs); Christopher R. Drahozal, “*Unfair*” *Arbitration Clauses*, 2001 U. ILL. L. REV. 695, 743 (2001) (noting that “because no dispute has yet arisen, the parties can consider the range of possible disputes that might arise in agreeing on a dispute resolution forum”). *But see* Robert G. Bone, *Agreeing to Fair Process: The Problem with Contractarian Theories of Procedural Fairness*, 83 B.U. L. REV. 485, 526-29 (2003) (criticizing some of the assumptions about information access that underlie typical *ex ante* arguments).

<sup>46</sup> See *id.* (“[P]re-dispute arbitration agreements provide greater opportunities for making transfer payments than do post-dispute arbitration agreements.”).

Finally, before a dispute arises and, again, especially during contract negotiations, parties enjoy the cooperative benefits of a deal-making ethos. They are thus less likely to succumb to various cognitive biases that might impede negotiating mutually beneficial procedural terms.<sup>47</sup> The relational norms inherent in pre-dispute bargaining can embolden the parties to make more even-handed decisions.

### 3.1.2 Regulating Litigation Opportunism through Procedural Customization

Pre-dispute procedural contracting can address variations on shading in at least four ways: (1) eliminating or reducing the possibilities of post-dispute opportunism; (2) reinforcing substantive obligations and thus disincentivizing shading; (3) mitigating the risks of litigation generally and consequently alleviating the harm of shading; and (4) directly reducing the costs of litigation.

#### 3.1.2.1 Limiting the Possibilities of Post-Dispute Opportunism

Contract disputes arise because a party has become disenchanted with the bargain that it originally struck. Whatever events precipitate the regret, if the dispute boils over into formal litigation, the parties must argue to an adjudicator about the legal meaning of their actions.<sup>48</sup> In other words, breach is a legal conclusion that an adjudicator reaches after hearing each side's arguments and reviewing the facts presented.<sup>49</sup>

The trouble is that judging whether a breach has occurred or not can be quite challenging.<sup>50</sup> Proof costs are high, and errors are common.<sup>51</sup> Perhaps most significantly,

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<sup>47</sup> See generally, e.g., Russel Korobkin, *Psychological Impediments to Mediation Success: Theory and Practice*, 21 OH.OHIO ST. J. ON DISP. RES. RESOL. 281 (2006) (discussing a range of cognitive biases that can prevent successful post-dispute negotiations).

<sup>48</sup> Of course, parties always have the opportunity to settle their dispute, but they will do so in light of predictions about how an adjudication would proceed. See, e.g., Blair, *supra* note 16, at 793-96 (discussing the economics of settlement and the importance of adjudication to settlement).

<sup>49</sup> Scott, *supra* note 32, at 9.

<sup>50</sup> See, e.g., Chris Guthrie, *Misjudging*, 7 NEV. L.J. 420, 428 (2007) (arguing that judges have three sets of "blindness": informational blindness, cognitive blindness, and attitudinal blindness).

<sup>51</sup> Scott & Triantis, *supra* note 2, at 816 n.4.

adjudicators get their information from self-interested parties. Adjudicators are therefore doomed to experience shortages of quality information regarding the relevant facts.<sup>52</sup> Moreover, the parties themselves may sincerely believe their own cover stories. As Professor Scott has explained, “It is very difficult for parties engaged in iterative acts of performance to interpret correctly the behaviors of their counterparty.”<sup>53</sup> Cooperation may be mistaken for defection and defection for cooperation. This can lead to retaliations (and counter-retaliations), which can, in turn, result in a tangle of allegations.<sup>54</sup> Finally, deals that once seemed wise may, in the light of subsequent events or better reason, seem foolhardy. The prospect of suffering large *ex post* losses can produce a form of amnesia in which both parties are convinced that their behavior remains consistent with their contractual obligations.<sup>55</sup> The earnestness of such after-the-fact justifications can muddle the ability of adjudicators to make important credibility determinations.

In all the noise, the very real possibility of strategic maneuvering arises. Parties may leverage the difficulties with assessing breach in order to extort rents on their counterparties.<sup>56</sup> Customized procedural rules, however, can directly limit or eliminate certain kinds of costly post-dispute

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<sup>52</sup> See ALEX STIEN, FOUNDATIONS OF EVIDENCE LAW 34-35, 73-106 (2005) (analyzing the sources of uncertainty in fact finding); ADRIAN VERMEULE, JUDGING UNDER UNCERTAINTY: AN INSTITUTIONAL THEORY OF LEGAL INTERPRETATION 4 (2006) (describing judicial ascertainment of the law as “choice under uncertainty” that implicates “limited information and bounded rationality”).

<sup>53</sup> Scott, *supra* note 32, at 13; Lisa Bernstein, *Beyond Relational Contracts: Social Contracts and Network Governance in Procurement Contracts*, 7 J. LEGAL ANALYSIS 561, 578 (2015) (“The biggest threat to continued cooperation is the possibility that a transactor will misclassify an act of cooperation as an act of defection and thus set off a series of actions and reactions that lead to the disintegration of the contracting relationship.”).

<sup>54</sup> Hadfield & Bozovic, *supra* note 24, at 986 (discussing this noise in the context of contracts for innovation); Bernstein, *supra* note 53.

<sup>55</sup> Scott, *supra* note 32, at 14.

<sup>56</sup> See, e.g., Bruce L. Hay, *Civil Discovery: Its Effects and Optimal Scope*, 23 J. LEGAL STUD. 481, 500-01 (1994) (discussing how plaintiffs may use discovery strategically to impose costs on the defendant); Ronald J. Gilson & Robert H. Mnookin, *Disputing Through Agents: Cooperation and Conflict Between Lawyers in Litigation*, 94 COLUM. L. REV. 509, 514-15 (1994); David Rosenberg & Steven Shavell, *A Model in Which Suits Are Brought for Their Nuisance Value*, 5 INT’L REV. L. & ECON. 3 (1985) (providing a formal analysis of the impact of nuisance suits); John K. Setear, *The Barrister and the Bomb: The Dynamics of Cooperation, Nuclear Deterrence, and Discovery Abuse*, 69 B.U. L. REV. 569, 584-86 (1989).

behavior, such as escalating the costs of discovery or engaging in abusive motion practice.<sup>57</sup>

Customized procedure can also cabin post-dispute opportunism by constraining the range of matters over which the parties might disagree in the first place.

With respect to both discovery and abusive motion practice, parties face a collective-action problem. In a highly simplified model, each party could choose to be abusive or reasonable with its discovery requests or its motion practice. Jointly, the parties would be best served by both acting reasonably. Individually, however, each party would do better if it employed abusive techniques while the other was reasonable. Because both parties know this, and thus know that the other is likely to defect and employ abusive techniques, they face a prisoner's dilemma. The equilibrium is for both parties to defect, acting abusively, even though that leaves both parties worse off than if they had simply acted reasonably. By binding themselves, in advance of any dispute, to a more limited slate of discovery options or more limited motion practice, the parties can reduce the opportunity for this prisoner's dilemma to sap individual resources.<sup>58</sup>

With respect to the range of matters over which parties might disagree, customized procedure can limit the discursive space within which disputes take place, such as by mandating the use of joint experts, binding the parties to factual stipulations, or even bifurcating the adjudication of liability and damages, allowing parties to gain information about the stakes of a

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<sup>57</sup> Concerns over discovery costs, of course, have motivated various changes to the public rules of procedure. See, e.g., *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 558 (2007) (adopting new heightened plausibility pleading standards because "proceeding to . . . discovery can be expensive" and "the success of judicial supervision in checking discovery abuse has been on the modest side"); Stephen N. Subrin & Thomas O. Main, *The Fourth Era of American Civil Procedure*, 162 U. PA. L. REV. 1839, 1850 (2014) ("Since 1980, the Federal Rules have been amended numerous times: the scope of discovery was narrowed; numerical limits restricted the amount of discovery; and new discovery conferences, pre-trial conferences, mandatory disclosures, and sanction rules encouraged closer judicial supervision of discovery."); Jay Tidmarsh, *The Litigation Budget*, 68 VAND. L. REV. 1, 4 n.8 (2015) ("Amendments in the Federal Rules of Civil Procedure in 1980, 1983, 1993, 2000, and 2006 were principally designed to accomplish the related aims of limiting discovery and enhancing judicial power to manage litigation.").

<sup>58</sup> The same logic could apply to waivers of the right to appeal. Parties might well dispense with a right to appellate review, before a dispute arises, because they believe that the collective value of enhanced accuracy is not worth the costs.

dispute before considering the question of liability.<sup>59</sup> Each of these mechanisms short-circuits incentives for one side or the other to engage in jointly wasteful posturing or distraction tactics. Instead, parties can focus a future fact finder on the issues that are most relevant or most likely to be relevant.

Other mechanisms are imaginable. The fundamental point is that procedural contracts can directly prevent parties from strategically gaming the asymmetry between what the parties can observe and what an adjudicator can verify.

### **3.1.2.2 Reinforcing Substantive Obligations**

In addition to directly eliminating or limiting the possibilities of post-dispute opportunism, procedural customizations can work in tandem with other governance mechanisms to reinforce substantive obligations. By reducing the likelihood of a dispute occurring in the first instance, such procedural terms can indirectly reduce post-dispute opportunism. The alteration of procedural rules can reinforce substantive commitments in at least three ways: (1) changing the expected value of the litigation and thus indirectly influencing when or how a party might shirk its substantive obligations; (2) sending credible signals about the likelihood of shirking; and (3) enhancing informal cooperation.

#### **3.1.2.2.1 Altering the Expected Value of Litigation**

Procedure factors into whether a party will engage in conduct constituting a breach or even conduct pushing the boundaries of what the substantive terms permit. This is so because procedural rules impact how parties evaluate their post-dispute payoffs and thus influence when,

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<sup>59</sup> See, e.g., Drury Stevenson, *Reverse Bifurcation*, 75 U. CIN. L. REV. 213, 216 (2006) (discussing bifurcation of damages and liabilities).

or if, parties assert their claims and how they make strategic choices during litigation.<sup>60</sup> The path to a dispute resolution will vary based on the substantive law, the parties' agreement, the procedural rules applied, the resources each side has and is willing to invest in dispute resolution, each side's estimation of the merits of the dispute, and each side's sensitivity to risk.<sup>61</sup> By tweaking procedural rules, parties can adjust the expected payoffs of litigation and thus the incentives to perform, breach, or shirk.

Parties commonly calibrate the difficulty of proving (or disproving) compliance with contractual terms by varying the precision of their substantive obligations. When parties include vague or difficult-to-prove states like "best efforts," the high costs associated with evidence production to an adjudicator can dissuade parties from fighting. In contrast, when parties specify their obligations in precise terms that are verifiable in a court at low cost, would-be breachers may think twice about shirking or engaging in other opportunistic misconduct.

Pre-dispute procedural contracting offers parties even more options for incentivizing parties to comply with their substantive obligations. Procedural contracting, in other words, can help overcome the "acoustic separation" between the *ex ante* understanding that parties have about how their future disputes will be adjudicated and their *ex post* understanding.<sup>62</sup> For instance, agreeing that expert testimony or an expert opinion will be given by a neutral third party rather than through party-appointed advocates could incentivize greater compliance with performance standards pre- dispute or, at the very least, change the parties' incentives in deciding what claims to bring and how much to invest in proving claims once they have been asserted. Agreeing to give

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<sup>60</sup> See generally, e.g., STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 392-401 (2004) [HEREINAFTER SHAVELL, FOUNDATIONS]; Steven Shavell, *The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System*, 26 J. LEGAL STUD. 575 (1997).

<sup>61</sup> Blair, *supra* note 16, at 792.

<sup>62</sup> See, e.g., Meir Dan-Cohen, *Decision Rules and Conduct Rules: On Acoustic Separation in Criminal Law*, 97 HARV. L. REV. 625 (1984); see also, generally, Hay, *supra* note 45.

a defendant the right to exercise an option making any settlements unenforceable could reduce litigation holdup problems, eliminating the incentive for plaintiffs to bring negative value lawsuits.<sup>63</sup>

Or, opting into expanded review of arbitral awards could be seen as a means of increasing accuracy (and costs) and thus deterring more questionable claims.<sup>64</sup> Other mechanisms are imaginable, such as fee-shifting agreements and burden-shifting agreements, which could also raise the price of bringing non-meritorious or speculative claims and thus limit opportunities for extortionate lawsuits.

### 3.1.2.2.2 Sending Credible Signals

Procedural customization can also provide credible signals regarding the parties' willingness to cooperate or the strength of their respective positions. Parties already signal their type by providing (or disclaiming) warranties.<sup>65</sup> But they could go further. For instance, a manufacturer could signal confidence in its product by offering to bear the burden of proof in any lawsuit for breach.<sup>66</sup> Or it might otherwise disarm itself by trading another litigation right—perhaps the right to a chosen forum, to remove a case to federal court, or to obtain certain discovery—in order to demonstrate the strength of its position. Alternatively, a tenant could signal reliability by agreeing to let the landlord quickly obtain provisional relief in the event of a default.<sup>67</sup> Or, as

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<sup>63</sup> See generally, e.g., David Rosenberg & Steven Shavell, *A Solution to the Problem of Nuisance Suits: The Option to Have the Court Bar Settlement*, 26 INT'L REV. L. & ECON. 42 (2006).

<sup>64</sup> See, e.g., Steven Shavell, *The Appeals Process as a Means of Correction*, 24 J. LEGAL STUD. 379 (1995). Importantly, under the Federal Arbitration Act ("FAA"), parties cannot opt into enhanced judicial review of arbitral awards. See *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008). But Section 10 of the FAA, which governs judicial review of arbitral awards, may not be preemptive. See *id.* at 590. Accordingly, parties may be able to seek enhanced judicial review in state courts. See Henry Allen Blair, *Is Less Really More? Hall Street Associates, Private Procedural Ordering and Expanded Review of Arbitral Awards in State Courts*, 5 Y.B. ONON ARB. & MEDIATION 74, 97-105 (2013) (discussing five states that allow for parties to opt into enhanced judicial review).

<sup>65</sup> See generally, e.g., Esther Gal-Or, *Warranties as Signals of Quality*, 22 CANADIAN J. ECON. 50 (1989).

<sup>66</sup> A variety of other customizations to burdens of proof can also be envisaged. A rich literature exists exploring the connections between the burden of proof, risk of error, primary behavior, and cost of litigation. See, Blair, *supra* note 16, at 810-11 n.106 (citing key articles).

<sup>67</sup> Daphna Kapeliuk & Alon Klement, *Contractualizing Procedure* 3, 24-25 (Dec. 31, 2008) (unpublished manuscript) (on file with author) (suggesting that parties can signal private information by agreeing to custom procedural clauses).

frequently happens, a borrower could signal her intent to repay by stipulating to a default judgment in the case of non-payment through a cognovit clause.<sup>68</sup>

The point is that by voluntarily committing to abandon what otherwise could be a useful litigation right, parties can convey information to their contracting partners.<sup>69</sup> Such signals can reinforce substantive commitments and thus minimize the risks of litigation opportunism.

### 3.1.2.2.3 Enhancing Informal Cooperation Mechanisms

Finally, pre-dispute procedural customizations could help clarify the informal norms governing the parties' interactions in a particular context. Conventionally understood, litigation resolves a dispute by empowering a third-party neutral—a judge or an arbitrator—to render a final and binding decision on the merits. The threat of litigation motivates parties to hew closely to their contractual obligations because they will be sanctioned when they do not.<sup>70</sup> Relational contract theory recognizes, however, that parties often perform not because of the threat of legal sanction but because of informal and shared norms of behavior.<sup>71</sup> But, as Lon Fuller once suggested, the threat of sanctions and compliance with some overarching sense of morality do not exhaust the

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<sup>68</sup> See, e.g., Eric A. Posner & Richard M. Hynes, *The Law and Economics of Consumer Finance*, 4 AM. L. & ECON. REV. 168, 174-75 (2002).

<sup>69</sup> See generally, e.g., Avraham Tabbach & Shay Lavie, *A Theory of Litigation Signals*, 58 SANTA CLARA L. REV. 1 (2018). Professors Tabbach and Lavie provide a comprehensive theory of litigation signaling, though primarily in the context of post-dispute stipulations. The logic of many of their arguments, however, can usefully be extended to pre-dispute customizations. Although the accuracy of some signals may be more difficult to determine *ex ante*, as described at the outset,

<sup>70</sup> See SHAVELL, FOUNDATIONS, *supra* note 60 for a comprehensive statement of the existing economics of public law enforcement, almost all of which concerns deterrence. See also, e.g., RICHARD A. POSNER, REGULATION (AGENCIES) VERSUS LITIGATION (COURTS): AN ANALYTICAL FRAMEWORK 11-25 (Daniel P. Kessler ed., 2011); Louis Kaplow & Steven Shavell, *Fairness Versus Welfare*, 114 HARV. L. REV. 961, 1166 (2001) (stating that “a primary reason to permit individuals to sue is that the prospect of suit provides an incentive for desirable behavior in the first instance” and also noting that in some cases the prospect of suit deters future conduct).

<sup>71</sup> See, e.g., Benjamin Klein, *Why Hold-Ups Occur: The Self-Enforcing Range of Contractual Relationships*, 34 ECON. INQUIRY 444, 449–50 (1996); Janet T. Landa, *A Theory of the Ethnically Homogenous Middleman Group: An Institutional Alternative to Contract Law*, 10 J. LEGAL STUD. 349 (1981).

possible reasons for why parties comply with law.<sup>72</sup> Instead, law and informal norms may work in tandem.

Legal rules may be seen as nudging parties toward compliance with the informal and shared norms.<sup>73</sup> The growing literature on braiding informal and formal enforcement mechanisms rests on this notion. Rather than being rivalrous, informal and formal governance mechanisms can be combined to provide a framework for building and enhancing trust over time. Formally imposed penalties, often focusing on information sharing and constitutive rules, including rights on termination, are used to grow relational expectations and norms. These norms, in turn, allow non-contractible terms of a deal to be renegotiated or shaped by incentives to avoid informal penalties such as the loss of a relationship or reputation.

It may also be possible to conceive of the parties' agreement as influencing the mental frames, categories, or schema by which individuals understand and construct the social world.<sup>74</sup> For instance, Professors Oliver Hart and John Moore propose a more expressly psychological role for contracts.<sup>75</sup> In their model, one party is motivated to underperform on non-contractible terms of a deal if she is aggrieved by her counterparty's own exercise of discretion in performance.<sup>76</sup> Contracts can help avoid this outcome by anchoring expectations and feelings of entitlement. In turn, contracts delimit what might be called grievement risk—the range of justifiable loss that disappointed parties are likely to experience.

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<sup>72</sup> “Much that is written today seems to assume that our larger society is enabled to function by a combination of the individual's moral sense and social control through the threatened sanctions of state-made law. We need to remind ourselves that we constantly orient our actions toward one another by signposts that are set neither by ‘morals,’ in any ordinary sense, nor by words in law-books.” Lon L. Fuller, *Human Interaction and the Law*, 14 AM. J. JURIS. 1, 36 (1969).

<sup>73</sup> See generally Gilson, Sabel & Scott, *Contracting for Innovation*, *supra* note 36.

<sup>74</sup> See, e.g., Jack Balkin, *The Proliferation of Legal Truths*, 26 HARV. J.L. PUB. POL'Y 5, 5–10 (2003); Cass R. Sunstein, *How Law Constructs Preferences*, 86 GEORGETOWN L.J. 2637, 2638–44 (1998).

<sup>75</sup> Oliver Hart & John Moore, *Contracts as Reference Points*, 123 Q.J. ECON. 1, 1–3 (2008).

<sup>76</sup> *Id.* at 5–7.

No matter the precise theoretical underpinnings, recognizing that contracts play critical roles in fostering informal norms, contract designers commonly include coordination provisions. These provisions mitigate the risk of misunderstanding by structuring the means of efficient collaboration and clarifying each party's roles.<sup>77</sup> Contractual coordination provisions reflect a behavior-based orientation. Such provisions specify the mutual goals of both parties and provide both concrete as well as more aphoristic ways that they can align their efforts.<sup>78</sup> The threat of third-party involvement operates to nudge the parties into compliance.

Procedurally, many forms of alternative dispute resolution rest on the same core intuition: parties may need nudges from third parties to reduce the risks of corrosive disputes caused by conflicting interests or misunderstandings, but they do not necessarily need formal enforcement. However, additional forms of pre-dispute procedural customizations could amplify the effects of braiding, coordination provisions, and alternative dispute resolution commitments.

For instance, in some circumstances, it makes rational sense for parties to condition their behavior on some observable, random feature of the world—in other words, to correlate an equilibrium. The fundamental insight of correlated equilibria is that if parties have sufficiently rich opportunities to communicate, they can sometimes create the possibility of additional stable strategies where neither party has an incentive to defect.<sup>79</sup> Professors Jennifer Brown and Ian Ayres use this idea to explain a function of mediation.<sup>80</sup> They demonstrate that a mediator

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<sup>77</sup> Steven R. Salbu, S. R., *Evolving Contract as a Device for Flexible Coordination and Control*, AM. BUS. LAW L.J., 34(3), 329–384 (1997).

<sup>78</sup> *Id.*

<sup>79</sup> See generally Robert J. Aumann, *Correlated Equilibrium as an Expression of Bayesian Rationality*, 55 ECONOMETRICA 1 (1987); Robert J. Aumann, *Subjectivity and Correlation in Randomized Strategies*, 1 J. MATH. MATHEMATICAL ECON. 67 (1974); see also, e.g., Richard H. McAdams, *The Expressive Power of Adjudication*, 2005 U. ILL. L. REV. 1043, 1050-57 (2017).

<sup>80</sup> Jennifer Gerarda Brown & Ian Ayres, *Economic Rationales for Mediation*, 80 VA. L. REV. 323 (1994).

randomly choosing between alternative resolutions of a dispute can produce a solution that enhances value for both disputants.

While Professors Brown and Ayres demonstrate their point by considering a battle of the sexes game, the insight applies to other game theoretic impasses, including, perhaps most usefully for the purposes of thinking about pre-dispute procedural innovations, hawk/dove games.<sup>81</sup> In a hawk/dove game, each player selects between an aggressive strategy—“Hawk”—where she demands her way—and a passive strategy—“Dove”—where she defers to others. In a two-person version, both players rank the four possible outcomes as follows, starting with the best: (1) playing Hawk against Dove; (2) playing Dove against Dove; (3) playing Dove against Hawk; and (4) playing Hawk against Hawk. The pure strategy equilibria are Hawk/Dove and Dove/Hawk because, although Dove against Dove is attractive, each party could fare better by defecting and playing Hawk while the other plays Dove.

While both parties would prefer to play Hawk, the worst outcome by far would be for both to do so. In short, both parties agree on the worst outcome and recognize that they each have an incentive to choose a strategy that could lead to that outcome. But parties cannot necessarily coordinate a solution merely between themselves, unless they both commit to never play Hawk. Instead, however, parties can commit to give a decision maker, post-dispute, limited authority to

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<sup>81</sup> Conventionally described, players in a battle of the sexes game choose between Strategy O and Strategy B where matching the strategies (OO or BB) produces a higher payoff for both players than failing to match (OB or BO). The two matching outcomes are equilibria. The players each prefer reaching either equilibrium to either of the two non-equilibrium outcomes. But the gains from each matching equilibrium are not equally shared, so the each party prefers one over the other. If each player selects the strategy necessary to produce her desired outcome (for instance Player 1 picks O and Player 2 picks B), the result is one of the non-equilibrium outcomes, which hurts both parties. Without a means of predictably and credibly correlating on strategy, both parties lose either by failing to agree or by misjudging what the other party will do. Professors Brown and Ayres argue that a mediator can help resolve this impasse by randomizing recommendations and thus giving each party roughly a fifty-percent likelihood of achieving her preferred outcome. They go on to formally prove that, given payoffs of 1 and 5 for each equilibria outcome, this solution produces more than a three-fold improvement over an unmediated mixed-strategy approach. *Id.* at 375-76.

prevent a disastrous clash of wills—that is, prevent both parties from simultaneously playing Hawk—while giving each party roughly an equal chance of reaping the benefits of being a Hawk.

In short, pre-dispute procedural commitments can help focus parties on solutions to coordination problems without significant investment in fact discovery or presentation of evidence. Mediation requirements might serve this function as might highly streamlined arbitration procedures, like, for example, some simplified baseball arbitrations, where parties are limited to little or no presentation of evidence.

### 3.1.2.3 Mitigating the Risks of Litigation

Parties often find themselves wedged between climbing costs and unpredictable judgments. Of course, if the risk premium of pursuing litigation exceeds whatever gains a party expects, that party should be willing to fully settle. But, as I have discussed elsewhere, there are many reasons why parties might want to rein in the riskiness of dispute resolution but still continue their fight.<sup>82</sup> Various forms of procedural contracting can function to hedge against outlier outcomes, reducing the risks posed by shading and thus opening up possibilities for more useful litigation.

For instance, parties might opt to waive a jury. Although the use of a judge as a factfinder may reduce the overall costs of adjudication by eliminating the time and effort that goes into empaneling a jury and streamlining presentation of evidence, perhaps the most important reason parties choose to try a case to a judge is that judges may also be more predictable and conservative decision makers. A sizeable literature addresses the possibility that juries are less predictable and more extreme in their decisions.<sup>83</sup> Eliminating a jury, then, can stabilize litigation expectations.

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<sup>82</sup> Blair, *supra* note 16, at 779-80.

<sup>83</sup> See, e.g., John Lande, *Failing Faith in Litigation? A Survey of Business Lawyers' and Executives' Opinions*, 3 HARV. NEGOT. L. REV. 1, 21, 33-34 (1998) (presenting evidence from interviews and surveys suggesting that juries are less

Parties may carry this logic further and opt to waive recourse to public courts and judges in favor of being able to choose their own adjudicator in arbitration. Arbitration may be quicker and cheaper than resorting to courts and thus conserve on litigation costs,<sup>84</sup> but perhaps more importantly, arbitration enables the parties to choose a decision maker with greater expertise in the subject matter of the dispute.<sup>85</sup> Essentially, opting into arbitration and specifying arbitrator expertise can render litigation even more predictable than trying a case to a judge, in certain circumstances.

In addition to selecting a decision maker, parties might reach some form of award-modification agreement. So-called baseball arbitration or final offer arbitration provides a good example. In baseball arbitration, parties each submit a “final” offer of judgment. The arbitrator has no power to award anything other than one of the two offers.<sup>86</sup> Baseball or final offer arbitration functions not only to delimit arbitrator discretion but also to incentivize parties to make more reasonable demands. If one party’s demand is seen as excessive or extreme by an arbitrator, the arbitrator will likely opt for the other party’s final offer. This sort of dispute resolution simultaneously curtails risks of adjudicator error and dissuades at least the most extreme forms of opportunistic litigation posturing.

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accurate and more extreme); Cass R. Sunstein, *Deliberative Trouble? Why Groups Go to Extremes*, 110 YALE L.J. 71, 102-03 (2000) (discussing reasons why juries might be more extreme).

<sup>84</sup> See, e.g., Christopher R. Drahozal & Stephen J. Ware, *Why Do Businesses Use (or Not Use) Arbitration Clauses?*, 25 OHIO ST. J. ON DISP. RESOL. 433, 451 (2010).

<sup>85</sup> See, e.g., Richard W. Naimark & Stephanie E. Keer, *International Private Commercial Arbitration: Expectations and Perceptions of Attorneys and Business People: A Forced-Rank Analysis*, 30 INT’L BUS. LAW. 203, 203–04 (2002) (identifying arbitrator expertise as a factor in choosing arbitration over other forms of adjudication); DOUGLAS SHOTZ ET. AL., RAND INSTITUTE FOR CIVIL JUSTICE, BUSINESS-TO-BUSINESS ARBITRATION IN THE UNITED STATES: PERCEPTIONS OF CORPORATE COUNSEL 16 (2011), available at [http://www.rand.org/content/dam/rand/pubs/technical\\_reports/2011/RAND\\_TR781.pdf](http://www.rand.org/content/dam/rand/pubs/technical_reports/2011/RAND_TR781.pdf) (reporting that almost 70% of corporate-counsel survey respondents listed the ability to control the arbitrator’s qualifications as an attribute that encourages arbitration).

<sup>86</sup> The process was first proposed by Carl Stevens in 1966. See generally, Carl Stevens, *Is Compulsory Arbitration Compatible with Bargaining?*, 5 INDUS. REL. 38 (1966).

Other similar modifications are imaginable. The key point is that parties can bracket risks associated with litigation by stipulating ahead of time to certain procedures. Doing so allows them to prevent extreme outcomes by eliminating risks associated with a decision maker's discretion or risks associated with extortionate demands by a counterparty.

### 3.1.2.4 Directly Reducing the Costs of Litigation

Perhaps most intuitively, parties can agree on pre-dispute customizations that directly reduce the costs of litigation. Avoiding wasteful, offsetting litigation expenditures can be a critical advantage to procedural contracting.

Parties already modify procedure *ex post* by adjusting the timing and other pedestrian aspects of litigation. These minor post-dispute procedure-modification agreements reduce costs by allowing the parties to disperse their obligations sensibly, avoiding what can be an expensive bunching or inefficient overlapping of deadlines. But parties can do more to simplify or streamline the process by which their dispute will be resolved *ex ante* through waivers of rights to present oral testimony, waivers of objections to personal jurisdiction, agreements to treat a summary judgment proceeding as a trial on the merits, agreements to expedited trials with a magistrate judge or to expedited arbitration processes, agreeing to sets of stipulated facts, waiving rights to appeal, setting limits on discovery, and other similar mechanisms.

More innovatively, parties could cap their expenditures through litigation budgets, which could be absolute or scaled to the amount in controversy.<sup>87</sup> Essentially, each party could present a proposed litigation budget. A court or tribunal would examine the proposed budgets, in light of the needs of the case, and lock in the amount that each party can spend on the litigation. A variation of this system has been used by British courts since 2013.<sup>88</sup>

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<sup>87</sup> Tidmarsh, *supra* note 47, at 4 n.8.

<sup>88</sup> These are called Precedent H Cost Budgets. CPR 3.12–.18 (effective Apr. 1, 2013).

As with other sorts of procedural alteration, the point is that parties can directly reduce the costs of litigation. By reducing costs, parties can eliminate or at least reduce the harm caused by any post-dispute opportunism.

### 3.1.3 Summary

Contract enforcement has long been underappreciated in contract design. For years, contract theory treated judicial competence as a binary proposition: either courts could verify compliance with a contract variable or they could not.<sup>89</sup> But verifiability of contractual performance by a court or tribunal is a matter of degree, not dichotomy.<sup>90</sup> In circumstances where adjudicators are more prone to errors, parties have greater room to engage in costly post-dispute opportunism or shading.

Pre-dispute procedural customization can offer parties a variety of mechanisms for confronting this sort of litigation opportunism. Individually or in combination, these mechanisms can work with substantive contract design to maximize the incentive gains from trade. We might then expect to see parties engaging in regular and robust procedural customization. As the next Part discusses, however, the story is more complicated.

## 3.2 Current Empirical Evidence Regarding Party Procedural Customization

Given the potential benefits of procedural customization to address litigation opportunism, it would be easy to predict that parties have a lot to gain from routinely fine-tuning procedure in their contracts. Much of the existing empirical evidence, however, does not support this prediction. Instead, public procedural rules seem to exert a strong gravitational pull. As a result, a number of

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<sup>89</sup> See, e.g., Hadfield, *supra* note 6.

<sup>90</sup> *Id.*

empirical studies have attempted, expressly or implicitly, to gain insight into what Professor David Hoffman has dubbed “the procedural dog that hasn’t barked.”<sup>91</sup>

It is important to note, up front, the limitations of existing evidence. Only two studies, to date, purport to paint a comprehensive picture of pre-dispute procedural customization.<sup>92</sup> Other studies tend to focus on isolated procedural modification provisions or groups of provisions. Few studies differentiate data sets based on transaction type. Accordingly, the extant empirical evidence remains tentative and incomplete.

This Part, however, reviews the existing evidence holistically and reveals a general, though still nascent, picture of procedural contracting. That picture turns out to be more complicated and nuanced than early analyses suggested. As early studies showed, parties routinely customize procedure through the selection or omission of coarse bundles of rules. But contrary to what has sometimes been assumed, this does not exhaust the range of customization we see in practice. Instead, parties occasionally make more granular, albeit modular, customizations, such as applying different bundles of procedures on a claim-by-claim basis and thus enhancing the resolution of contract procedure. Moreover, if parties opt out of the public dispute resolution system and into arbitration, they commonly engage in more *à la carte* tailoring, particularly when it comes to details about arbitrators and the standards of decision they use. Perhaps most intriguingly, some parties, some of the time, fashion extensive and detailed procedural frameworks that distribute dispute resolution work among various entities, provide for informal and formal enforcement, and offer

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<sup>91</sup> Hoffman, *supra* note 12.

<sup>92</sup> Some limited empirical work has been conducted to evaluate the extent to which parties engage in post-dispute customization. Some commentators have speculated, however, that post-dispute customization is also rare. See, e.g., Robert G. Bone, *Party Rulemaking: Making Procedural Rules Through Party Choice*, 90 TEX. L. REV. 1329, 1342 (2012) (finding few examples of agreements entered into after filing, other than extensions of time for filing and similar modest adjustments to scheduling); Hoffman, *supra* note 12, at 393 (suggesting that procedure-related agreements are not as common as generally imagined).

intricate opportunities for information sharing and trust building while reducing the space within which conflict can fester.

This section reviews the evidence, starting with the two comprehensive studies. It then turns to a brief overview of what more specialized studies can tell us generally about procedural contracting. It next summarizes recent work demonstrating that parties do, from time to time, engage in more robust and extensive procedural contracting, creating a bespoke framework within which the integrity and meaning of their contracts is tested and refined. This Part concludes by tying all the threads together to provide a mosaic of procedural contracting.

### 3.2.1 Two Comprehensive Studies of Procedural Contracting

The first study to examine the waterfront of procedural contracting was by Professor Hoffman in 2014.<sup>93</sup> While extremely useful as a starting point, this study ultimately carries only limited empirical weight, as Professor Hoffman himself acknowledged. Professor Hoffman conducted broad key-word searches of material contracts filed with the SEC.<sup>94</sup> Accordingly, his research is unable to provide precision about the frequency with which customizations occur or any consistent patterns of customization. Instead, his work allows for general inferences about the relative prevalence of particular procedural terms, but the results are necessarily impressionistic.<sup>95</sup> While he provides some of his text searches, he does not give enough information to allow subsequent researchers to entirely replicate his findings. Nevertheless, because he was the first person to systematically evaluate a wide range of procedural customizations, the conclusion he

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<sup>93</sup> Professor Hoffman's review is extensive, but it excludes analysis of arbitration clauses. As a result, his conclusions omit consideration of an important facet of procedural contracting. Hoffman, *supra* note 12, at 395. His justification for omitting arbitration is that the more informal nature of arbitration allows for easier *ex post* tailoring of procedural rules and thus makes it cheaper to forgo negotiations about procedural modifications *ex ante*. See *id.* at 405. This argument, however, overlooks other frictions that might impede post-dispute customizations and minimizes the importance of pre-dispute customization on the performance incentives of the parties.

<sup>94</sup> *Id.* at 13. Professor Hoffman also conducted a hand-coded analysis of 1200 credit card agreements, but my interest in this paper is on procedural autonomy between commercial parties.

<sup>95</sup> *Id.* at 22.

reaches is foundational: “[E]ven in circumstances where we’d expect them to, parties almost never use [*ex ante*] contract terms to vary their post-dispute procedural contests.”<sup>96</sup>

Still, it is worth noting that Professor Hoffman’s own findings may caution against reading his conclusion for all it is worth. Indeed, despite his conclusion, he references a number of examples of particularized customizations including:

- Approximately a dozen contracts requiring particular claims to be pled as affirmative defenses.<sup>97</sup>
- A “handful” of examples of parties seeking to control court jurisdiction by waiving the right to remove or stipulating to personal jurisdiction.<sup>98</sup>
- Instances of parties limiting their counterparties’ ability to produce documents in suits with third parties—typically, in indemnification agreements.<sup>99</sup>
- Dozens of examples of contracts where parties are provided inspection rights for particular classes of documents, whether or not in formal litigation.<sup>100</sup>
- Examples of parties contracting over evidence preservation obligations.<sup>101</sup>
- Hundreds of contracts varying burdens of proof, particularly in indemnification agreements.<sup>102</sup>
- And dozens of examples of contracts modifying evidentiary rules in court proceedings.<sup>103</sup>

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<sup>96</sup> *Id.* at 28.

<sup>97</sup> *Id.* at 22 n. 115.

<sup>98</sup> *Id.* at 20 n. 111-12.

<sup>99</sup> *Id.* at 125 n.131.

<sup>100</sup> *Id.* at 126 n. 132.

<sup>101</sup> *Id.* at 126 n. 133.

<sup>102</sup> *Id.* at 127 n. 139-40 (citing Scott & Triantis, *supra* note 2, at 867 n. 165.).

<sup>103</sup> *Id.* at 30-31.

Perhaps most significantly, Professor Hoffman recognizes that parties to arbitration agreements tend to engage in more individualized customization.<sup>104</sup> For instance, he finds that “in many arbitration agreements, the parties specified the particulars of discovery.”<sup>105</sup> Additionally, he concludes that “parties often contract to permit hearsay testimony in arbitration” or waive other formal rules of evidence.<sup>106</sup> In short, he finds, overall, that arbitration clauses generally provide more “bespoke procedural clauses, and that removing such contracts from the overall sample depressed rates at which bespoke procedure occurred.”<sup>107</sup>

In 2015, Professor Mark Weidemaier extended Professor Hoffman’s work by collecting and hand coding a data set of 402 material contracts that were attached as exhibits to corporate SEC filings between January 1, 2000, and December 31, 2012.<sup>108</sup> He examined these contracts for a broad range of procedural terms, and by considering changes over time, he was able to make some inferences about behavioral shifts caused by disruptive events or alterations in party attitudes.<sup>109</sup> Professor Weidemaier’s findings provide additional details about how parties customize procedure.

Perhaps most significantly, he finds that parties do routinely engage in several forms of customization. In particular, in 76.1% of his sample, parties included an arbitration or forum selection clause, accordingly incorporating bundles of procedures.<sup>110</sup> Parties also routinely

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<sup>104</sup> Importantly, as discussed in note 96, *supra*, Professor Hoffman does not focus on arbitration clauses, arguing that they present different issues. He nevertheless draws several conclusions about the prevalence of procedural customization in arbitration.

<sup>105</sup> *Id.* at 25.

<sup>106</sup> *Id.* at 32 (noting that he uncovered more than 200 arbitration agreements so doing).

<sup>107</sup> *Id.* at 39 (speaking particularly about the Credit Card Database but speculating that the finding there implied a more general trend).

<sup>108</sup> *Weidemaier, supra* note 20, at 1906.

<sup>109</sup> *See id.*

<sup>110</sup> *See id.* at 1912. Procedural rules are generally provided by the forum. This number differs to some degree from other empirical studies. *See infra* n. 110.

included other provisions that chose between groups of procedures or opted out of procedures, including jury trial waivers in 15.2% of contracts where arbitration was not chosen,<sup>111</sup> carve-ins in 23.2% of contracts where arbitration was not chosen,<sup>112</sup> and attorney fee shifting provisions in a significant minority of all contracts.<sup>113</sup> Indeed, even in contracts “without arbitration or forum selection clauses [] most include at least one other procedural modification” that has the effect of selecting or opting out of a set of procedural rules.<sup>114</sup>

He also observes, as did Professor Hoffman, that parties engage in more *à la carte* specification of procedural terms in arbitration than they do in public court litigation.<sup>115</sup> Parties who opt for arbitration commonly contract over the number of arbitrators and their qualifications or expertise, arbitration costs, and at least some aspects of the hearing, including, most frequently, the location of the hearing.<sup>116</sup> A significant minority of parties also contract over standards of decision, which regulate the authority an arbitrator has to decide the merits of a dispute, or contract over bundles of discovery, pleading, and evidentiary rules.<sup>117</sup>

Notwithstanding his findings, Professor Weidemaier concludes that “[w]hat contracts almost never do—in either arbitration or litigation—is dictate the particulars of pre-trial and trial

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<sup>111</sup> *Weidemaier, supra* note 20, at 1922, tab. 4.

<sup>112</sup> *Id.* Professor Weidemaier defines a “carve-in” as a provision that sends “narrow questions, such as those involving scientific or financial matters, for binding resolution by private experts.” *Id.* at 1912. As Professor Weidemaier notes, such provisions are, —at least sometimes, —interpreted by courts as limited scope arbitration provisions. *Compare, e.g., Evanston Ins. Co. v. Cogswell Props., LLC*, 683 F.3d 684, 693-94 (6th Cir. 2012) (appraisal process did not constitute arbitration) and *Salt Lake Tribune Pub. Co. v. Mgmt. Planning, Inc.*, 390 F.3d 684, 689-92 (10th Cir. 2004) (same) with *Fit Tech, Inc. v. Bally Total Fitness Holding Corp.*, 374 F.3d 1, 7-8 (1st Cir. 2004) (noting a clause providing for “final determination” of certain valuation issues by accounting firm constituted arbitration).

<sup>113</sup> *Weidemaier, supra* note 20, at 1922, tab. 4.

<sup>114</sup> *Id.* at 1912-13.

<sup>115</sup> See *id.* at 1929 (“Taking these arbitration-specific clauses into account, parties who agree to arbitrate adopt, on average, significantly more additional customized procedures (3.4) than parties who designate a judicial forum as the default setting for resolving disputes (0.83).”).

<sup>116</sup> See *id.* at 1925-30.

<sup>117</sup> See *id.* at 1929.

practice.”<sup>118</sup> Instead, parties rely on the procedural rules of the forum that they have chosen to specify terms like pleading rules, evidence gathering, burdens of proof, and other similar issues.<sup>119</sup>

As Professor Hoffman’s conclusion did, however, Professor Weidemaier’s may overstate his own findings. While it appears from both studies that robust procedural tailoring is comparatively rare and parties primarily engage in modular customizations of procedure, parties do, sometimes, contract over more fine-grained procedural rules, especially in arbitration.

### 3.2.2 Particularized Studies of Specific Procedural Contracting Terms

Outside of the studies discussed in the previous section, other empirical investigations into procedural contracting focus on limited subsets of possible procedural customizations, looking for evidence about how frequently parties incorporate specific provisions into their deals. Accordingly, their methodologies and conclusions differ. Nevertheless, in combination, these studies yield a general picture of the practice of procedural contracting. With some exceptions discussed shortly, that picture generally reinforces the conclusion that most procedural customization is modular.<sup>120</sup>

A good deal of evidence demonstrates that many commercial parties engage coarse forms of customization, primarily selecting between or abandoning bundles of procedural rights.<sup>121</sup> Parties, in short, commonly choose where their disputes will be heard and who will resolve them. They almost always contract for choice of law clauses,<sup>122</sup> regularly include forum selection

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<sup>118</sup> *Id.* at 1872; *see also id.* at 1931 (“Yet, aside from forum selection and choice of law clauses, [procedural contracting] rarely happens.”).

<sup>119</sup> *See id.*

<sup>120</sup> *See, e.g.,* O’Hara O’Connor et al., *supra* note 12, at 137 (“[D]espite the robust academic literature on the subject, real-world customization is largely absent, although we find some evidence that it is slowly increasing over time.”); Drahozal & O’Hara O’Connor, *supra* note 17, at 1955-61, 1990-91 (“[Parties do almost] nothing to change the rules of procedure that would apply as a matter of default in these fora . . .”).

<sup>121</sup> *See* Drahozal & O’Hara O’Connor, *supra* note 17, at 1955-61, 1990-91 (describing procedural contracting primarily as a choice between litigation and arbitration, supplemented by an election to reserve certain claims or remedies for an alternate forum).

<sup>122</sup> *See, e.g., Ex Ante Choices, supra* note 110, at 1987 tbl.2 (all merger agreements in sample designate governing law); *see also* Hoffman, *supra* note 12, at 410 (finding over 1,000 contracts each year in text-based search of SEC material contracts); Theodore Eisenberg & Geoffrey P. Miller, *The Flight to New York: An Empirical Study of Choice of Law and*

clauses,<sup>123</sup> frequently include clauses choosing arbitration,<sup>124</sup> often contract for clauses choosing arbitration but providing some sort of “carve-outs” that allow parties to go court in some subset of disputes,<sup>125</sup> commonly include jury trial waivers,<sup>126</sup> and sometimes contract for attorney fee provisions.<sup>127</sup>

Importantly, however, several of these studies observe that procedural customizations vary significantly depending on the transaction type or the category of dispute at issue.<sup>128</sup> For instance, Professors Erin O’Hara O’Connor and Christopher R. Drahozal have observed that parties in four types of transactions – technology contracts, CEO employment contracts, joint-venture contracts,

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*Choice of Forum Clauses in Publicly-Held Companies’ Contracts*, 30 CARDOZO L. REV. 1475, 1504 (2009) (finding that all contracts studied contained choice of law clauses).

<sup>123</sup> Findings vary from study to study, but the numbers seem to consistently support the conclusion that at least a third of commercial contracts include a forum selection clause. See, e.g., *id.* at 1504 tbl.11 (finding that 38.9% of a sample of commercial contracts included choice of forum clause); *Ex Ante Choices*, *supra* note 110, at 1987 (finding that 52.5% of a sample of merger agreements included choice of forum clause); see also Hoffman, *supra* note 12, at 407-08 (concluding based on text search of SEC filings that “a plurality of contracts choose forum”); Steven M. Davidoff, *Delaware’s Competitive Reach*, 9 J. EMP. LEG. STUD. 92 (2012) (finding that 60% of the merger agreements in the sample selected Delaware as their choice of forum).

<sup>124</sup> See, e.g., O’Hara O’Connor et al., *supra* note 120, at 161 tbl.1 (2012) (finding that 51.5% of a sample of CEO employment contracts required arbitration of some or all disputes); Drahozal & O’Hara O’Connor, *supra* note 17, at, at 1973 (finding that 47.5% of a sample of technology contracts included an arbitration clause, with substantial variation across contract types); E.g., Matthew C. Jennejohn, *Contract Adjudication in a Collaborative Economy*, 5 VA. L. & Bus. REV. 173, 197 (2010) (“[Parties to collaborative agreements] resort to arbitration far more often than commercial parties resolving disputes relating to more traditional types of commercial contracts.”).

<sup>125</sup> For example, O’Hara O’Connor et al. found such carve-outs in nearly half of a sample of CEO employment contracts. O’Hara O’Connor et al., *supra* note 17, at 167-68. Likewise, Drahozal and O’Hara O’Connor found routine use of carve-outs in arbitration clauses in samples of joint venture, technology, and franchise agreements. Drahozal & O’Hara O’Connor, *supra* note 17, at 21-31.

<sup>126</sup> Theodore Eisenberg & Geoffrey P. Miller, *Do Juries Add Value?: Evidence from an Empirical Study of Jury Trial Waiver Clauses in Large Corporate Contracts*, (2006) CORNELL L. FAC. PUB. paper 67, at 3 (finding about 20% of 2,800 commercial contracts contained jury trial waivers, although also finding substantial variance across contract type, ranging from 1.9% to 64.5%).

<sup>127</sup> See Theodore Eisenberg & Geoffrey P. Miller, *The English Versus the American Rule on Attorney Fees: An Empirical Study of Public Company Contracts*, 98 CORNELL L. REV. 327, 350-52 (2013) (finding that 37.1% of the contracts in their sample adopted the American rule, while 36.4% adopted the English rule).

<sup>128</sup> Theodore Eisenberg, Geoffrey P. Miller and Emily Sherwin, *Arbitration’s Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 MICH. J.L. REFORM 871 (2008) (reviewing literature finding rates of arbitration clause utilization varies widely with contract type); Drahozal & Ware, *supra* note 84, at 457-67, 470-72 (contesting Eisenberg’s results and further arguing for differences between kinds of markets); Christopher R. Drahozal & Quentin R. Wittlock, *Franchising, Arbitration, and the Future of the Class Action*, 3 ENTREPRENEURIAL BUS. L.J. 275, 278 (2009).

and franchise contracts – use arbitration clauses with very particular carve-outs.<sup>129</sup> These parties seek to protect their information and intellectual property rights through public courts rather than through arbitration.<sup>130</sup> Specifically, they find that parties frequently opt to have claims related to their noncompete, confidentiality, and non-solicitation clauses, as well as their trademark, copyright, patent rights, and trade secrets resolved in courts.<sup>131</sup>

Moreover, some customizations that seem generic or coarsely modular may, in combination, reflect more precise tailoring than previous studies suggested. For example, one recent and important paper, by Darius Palia and Robert Scott, collects evidence indicating that sophisticated parties often pair jury trial waivers with forum and choice of law clauses selecting New York.<sup>132</sup> In isolation, each mechanism would appear to be merely a coarse modular refinement of procedure that could easily be lumped in with other routine but minor customizations. The paper concludes, however, that sophisticated parties are more carefully refining their contracts in order “to reduce the back end costs of litigation, especially the costs of contract interpretation disputes.”<sup>133</sup> Essentially, the hypothesis is that this combination of modular procedural alterations allows parties to lock the content of their contracts by selecting a jurisdiction that uses textualist contract interpretation rules and avoiding the uncertainty associated with lay factfinders.<sup>134</sup> These provisions, in other words, are not mere boilerplate that appears in standard M&A templates. Nor are these provisions merely macro-level choices about bundles of procedure. Parties, instead,

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<sup>129</sup> See Erin O’Hara O’Connor & Christopher R. Drahozal, *The Essential Role of Courts for Supporting Innovation*, 92 TEX. L. REV. 2177, 2185 (2014).

<sup>130</sup> See *id.* at 2181.

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

<sup>132</sup> See, e.g., Darius Palia and Robert E. Scott, *Ex Ante Choice of Jury Waiver Clauses in Mergers*, 17 AM. LAW AND ECON. REV. 566, 586 (2015).

<sup>133</sup> *Id.* at 585.

<sup>134</sup> *Id.* at 586.

seem to be evaluating their transaction-specific needs and tailoring their agreements to meet those needs by carefully selecting bundles of rules and procedures.

In short, particularized studies of procedural customization demonstrate that parties regularly customize procedure through selection or omission of bundles of pre-fabricated procedures. But this does not exhaust the waterfront of customization. Instead, at least some of the time, some parties are making more concerted modular changes than previously recognized, thoughtfully pairing various procedural regimes with substantive provisions in order to maximize gains from trade.

### 3.2.3 Recent Evidence Demonstrating Highly-Customized Procedural Contracting

Finally, some of the time, parties engage in robust and highly customized procedural contracting. Parties often use more granular, if still modular, claim-by-claim selection of procedures. But particularly in alliance agreements where parties pool their specific capabilities in order to mutually exploit strategic interdependency, they also regularly create intricate procedural regimes. These regimes distribute dispute resolution among various decision makers, some private and some public, and provide feedback loops that generate additional information, bolster trust, and minimize the discursive space within which ongoing disputes can fester.

The segregation of disputes into various categories allows parties to direct different types of disputes to different tribunals with different sets of rules and levels of expertise.<sup>135</sup> This resembles the coarser sorts of customization that earlier empirical literature identified, through the use of forum selection clauses or arbitration clauses, but it takes place at a higher degree of resolution.<sup>136</sup>

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<sup>135</sup> See, e.g., Drahozal & O'Hara O'Connor, *supra* note 17, at 1966-69 (analyzing the use of bifurcated dispute resolution provisions in a variety of agreement types). Professors Drahozal and O'Hara provide a foundational starting point for the phenomena of "carve-outs."

<sup>136</sup> See, e.g., Jennejohn, *supra* note 17, at 362 (showing that in a sample set of 146 agreements, over one-third bifurcated or trifurcated dispute resolution between different adjudicators).

This sort of granular customization seems to increase as deals become more complex and collaborative.<sup>137</sup>

At some point, when the outcome of a collaboration becomes impossible to specify *ex ante*, parties layer in informal escalation procedures, often requiring that disagreements be addressed by higher levels of management when subordinates become deadlocked. More formal modes of dispute resolution function as a backstop if an impasse cannot be overcome.<sup>138</sup> As Professor Stipanowich noted nearly twenty years ago,

As lawyers and contracting parties have become more familiar with various strategies for out-of-court resolution of disputes, they have explored the possibilities of combining two or more approaches in multi-step dispute resolution programs. Such stepped ‘filtering systems’ — increasingly visible in construction, commercial and employment contracts as well as the voluntary system employed by e-Bay for resolution of thousands of buyer/seller disputes — begin with informal negotiation and, if necessary, proceed to mediation; arbitration or litigation remains a last resort. Anecdotal evidence suggests that it is a rare dispute that survives the initial steps of such programs.<sup>139</sup>

This staged dispute resolution process not only helps resolve conflicts, but it also generates information and fosters ongoing engagement.<sup>140</sup>

Professors Cathy Hwang and Matthew Jennejohn have observed a similar distributed dispute resolution process in merger and acquisition agreements.<sup>141</sup> They note that pre-closing disputes are often sent to specialized courts in Delaware, where injunctive relief is readily available.<sup>142</sup> Post-closing disputes are frequently bifurcated, with routine contract-based disputes being sent to state or federal courts but contingent consideration disputes – disputes arising out of

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<sup>137</sup> *See id.*

<sup>138</sup> *See id.*

<sup>139</sup> Thomas Stipanowich, *Contract and Conflict Management*, 2001 WIS. L. REV. 831, 853 (2001).

<sup>140</sup> *See infra* 110.

<sup>141</sup> Cathy Hwang & Matthew Jennejohn, *Deal Structure*, 113 NORTHWESTERN U. L. REV. 279, 328-29 (2018).

<sup>142</sup> *Id.* at 328.

a purchase price adjustment or an earn out, for instance – being sent to arbitration, often before accountants.<sup>143</sup>

Professor Andrew Verstein has also documented a related phenomenon in the context of construction disputes, where he observes the functioning of dispute resolution boards in construction contracts.<sup>144</sup> Dispute boards are panels of neutral experts selected by the parties and convened at the start of a construction project.<sup>145</sup> These boards allow parties to delegate *ex post* specification of terms to decision makers who are more experienced than generalized courts while preserving the possibility of escalating a dispute that is not satisfactorily resolved by the board to an arbitrator.<sup>146</sup> While a board's decision does not become binding as an adjudication, it provides transactional stability to parties by resolving uncertainty on a rolling basis, thereby generating ongoing information and the ingredients for trust.

The critical point is that, at least sometimes, parties create highly tailored enforcement systems. These systems often involve the modular selection of bundles of procedures to apply to different categories of disputes. These systems are frequently more granular than some previous literature on carve-outs has appreciated. In addition, these systems layer in multiple opportunities for informal exchanges of information and resolution. Combined, these systems demonstrate that parties are making bespoke decisions about where and how their disputes will be resolved.

### 3.2.4 Summary

The totality of empirical evidence currently available demonstrates greater frequency and diversity of procedural contracting than early commentators supposed. While the evidence suggests that, most of the time, parties customize procedure by choosing between or opting out

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<sup>143</sup> *Id.*

<sup>144</sup> See generally, Andrew Verstein, *Ex Tempore Contracting*, 55 WM. & MARY L. REV. 1869 (2014).

<sup>145</sup> *Id.* at 1896.

<sup>146</sup> See *id.* at 1875.

of bundles of procedures, there are several important caveats. First, parties engage in more atomistic, albeit modular, customizations in some situations, for instance assigning some categories of disputes to one decision maker and other categories of disputes to another decision maker. Additionally, parties who choose to opt out of the public adjudicatory system and arbitrate their disputes often engage in more *a la carte* customizations. Finally, in some situations, parties design complicated and intricate dispute resolution regimes that blend informal and formal enforcement mechanisms to solve disputes, minimize the incidence of them, and generate ongoing information and trust.

### 3.3 Anticipating Procedural Innovation

As the previous section shows, parties can and do customize procedure in dramatic ways. But the diversity of design decisions we see in practice has, to date, not been mapped into predictable patterns. As a result, some commentators have overlooked the pockets where most procedural contracting takes place. To gain a clearer picture of how transactional designers can and do harness the power of procedural customization, I argue that we must recognize the impact of the transactional environment on contract design.<sup>147</sup>

A growing literature on contract interpretation provides a valuable starting point. Borrowing the typology advanced by Professors Gilson, Sabel, and Scott, such commercial party transactions can be usefully segregated into rough quadrants oriented along two axes, uncertainty and scale.<sup>148</sup> The risk of litigation opportunism differs in these four domains. As a result, rational commercial parties should respond to that risk using procedural customization in different but predictable ways.

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<sup>147</sup> Notably, some commentators have begun similar projects. See, e.g., Drahozal & Ware, *supra* note 84, at 457–67 (noting that arbitration clauses are most prevalent in ordinary contracts between businesses but are less likely to be found in contracts outside of the ordinary course of business, e.g., loan commitments and merger agreements).

<sup>148</sup> See Gilson, Sabel & Scott, *supra* note 22.

The following sections sketch an initial theory about when, how, and why parties will turn to procedural customization as the mix of uncertainty and scale changes. These sections provide the starting point for a future, more focused empirical investigation. But, as these sections conclude, the theory seems to map fairly well onto the existing evidence that we have about procedural autonomy.

### 3.3.1 The Relationship Between Uncertainty and Litigation Opportunism

As a general matter, uncertainty and litigation opportunism are positively correlated. Uncertainty, as used here, refers to the degree of disruption to commercial practices caused by unforeseeable technological or market changes. As is customary in the literature, uncertainty should be distinguished from risk.<sup>149</sup> The latter can be quantified while the former cannot. Contracts are conventionally thought of as regulating rights and obligations. When uncertainty is low, parties, at the time of contracting, are in the position to understand or articulate well-defined rights and obligations in every relevant state of the world. Parties can develop, in other words, a shared and reasonably unambiguous understanding of what counts as performance.<sup>150</sup> They may do this through state contingent contracts that rely on complete and formal specification of contract terms with fewer open-ended standards.<sup>151</sup> Or, in thicker markets, they may do this through relatively stable and shared industry norms.<sup>152</sup>

In either case, when uncertainty is low, parties can estimate risks and address them *ex ante* at low cost, minimizing any future work of courts or tribunals should a dispute arise and

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<sup>149</sup> The conventional distinction between uncertainty and risk applies here. See, *generally e.g.*, FRANK KNIGHT, RISK, UNCERTAINTY AND PROFIT (1921) (distinguishing between threats where the likelihood of the peril is nonquantifiable (uncertainty) and quantifiable (risk)); see also, *e.g.*, PETER CLARKE, KEYES: THE RISE, FALL, AND RETURN OF THE 20<sup>TH</sup> CENTURY'S MOST INFLUENTIAL ECONOMIST 154–57 (2009).

<sup>150</sup> See Hadfield & Bozovic, *supra* note 24, at 984.

<sup>151</sup> See Gilson, Sabel & Scott, *supra* note 22.

<sup>152</sup> See, *e.g.*, Macaulay, *supra* note 26, at 62-65.

should the parties opt to seek formal enforcement. The parties agree on what performance is owed and only face difficulties of proof with respect to whether that performance was actually delivered.<sup>153</sup> Adjudicators are less mistake-prone and parties less likely to encourage them, resulting in less enforcement uncertainty. In short, the risks of litigation opportunism are minimal.

As uncertainty rises, however, so too does the risk of a divergence between what an adjudicator can verify and what the parties actually intended at the time of contract formation. Uncertainty can emerge and grow in long-term contracts, transactions with extremely unpredictable outcomes, or contracts in which the parties' ultimate goal is not clear, such as firms collaborating to discover new applications of cutting-edge research.<sup>154</sup> With this emergence, both task and price specifications become more difficult. It may be too expensive or even impossible for the parties to foresee and then describe appropriately the contractual outcomes for most possible future states of the world that might materialize. At the most extreme levels of uncertainty, in contexts where parties are aligning to develop a new product or service, Professors Gilson, Sabel, and Scott have demonstrated that parties shift contracting to something that is capable of generating actions and setting terms of the exchange rather than specifying outcomes.<sup>155</sup>

Greater levels of uncertainty open the door to one or both sides strategically exploiting the gap between verifiability and the parties' original intentions. In short, as uncertainty rises, so too does the risk of litigation opportunism.

### 3.3.2 The Relationship Between Scale and Litigation Opportunism

The relationship between scale and litigation opportunism is more subtle. In general, though, greater scale tends to result in less room for opportunism. Scale refers to the number of

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<sup>153</sup> Hadfield & Bozovic, *supra* note 24, at 984.

<sup>154</sup> See generally Gilson, Sabel & Scott, *Contracting for Innovation*, *supra* note 36.

<sup>155</sup> See generally *id.*

similar parties are engaged in the same category of transaction.<sup>156</sup> The more parties that share a particular set of contracting goals or challenges, the more likely it is that they or some trade association of which they are a part will have created standardized solutions that benefit from network and learning effects.<sup>157</sup> These informal (or, more precisely, less formal, in the case some arbitration) enforcement mechanisms can be far more efficient than traditional public law and state-run courts at regulating parties' conduct.<sup>158</sup>

As scale decreases, however, standardized solutions to contracting problems become more difficult. With declining scale, parties have to rest more weight on formal contracts and formal modes of enforcement because the prerequisites for relational norms are weaker. Increasing reliance on contracts and legal enforcement creates more room for litigation opportunism.

### 3.3.3 Litigation Opportunism in the Four Rough Domains of Commercial Party Transactions

While no hard boundaries exist, the two axes of uncertainty and scale roughly divide the world of commercial party transactions into quadrants. Each of these quadrants has a different litigation opportunism risk profile, and thus rational contract designers will harness the power of

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<sup>156</sup> See Gilson, Sabel & Scott, *supra* note 22; Hadfield & Bozovic, *supra* note 24, at 983-85 (distinguishing between "well-developed industrial settings and relatively stable competitive environments" and "relationships aimed at innovation" which are "subject to pervasive uncertainty").

<sup>157</sup> Common use of a term or rule can create increasing returns for users. Brian Arthur is responsible for much of the leading work on increasing returns in the context of product markets. See *generally* W. BRIAN ARTHUR, INCREASING RETURNS AND PATH DEPENDENCE IN THE ECONOMY (1995) (collection of his works). Network externalities exist where "the utility that a user derives from consumption of a good increases with the number of other agents consuming the good." Mark A. Lemley & David McGowan, *Legal Implications of Network Economic Effects*, 86 CAL. L. REV. 479, 483 (1998). A distinction can be drawn between learning effects and network effects. See Marcel Kahan and Michael Klausner, *Standardization and Innovation in Corporate Contracting (Or "The Economics of Boilerplate")*, 83 VIR. L. REV. 713, 717 (1997). Learning effects arise when a firm adopts a contract term that has been commonly used in the past, regardless of whether other firms will continue using it in the future. See, e.g., *id.* at 718-23.

<sup>158</sup> See, e.g., Barak D. Richman, *Firms, Courts, and Reputation Mechanisms: Towards a Positive Theory of Private Ordering*, 104 COLUM. L. REV. 2328, 2329 (2004).

procedural customization differently in each. At the simplest, because procedural contracting is most effective at addressing litigation opportunism, when the risks of such opportunism are low, we would expect to see little procedural customization, and what customization takes place should be simple. Conversely, when the risks of litigation opportunism are higher, we would expect to see more and more tailored procedural customization.

### 3.3.3.1 Low Uncertainty, High Scale – Very Low Risk of Litigation Opportunism

The most typical transactions in our economy involve contracts where many similar parties engage in routine transactions that may involve risk but typically involve little uncertainty. These sorts of contracts commonly relate to commodities or routine sales of simple goods.<sup>159</sup> In these environments, parties have little use for formal, written contracts, and even less use for formal enforcement of the contracts that exist.<sup>160</sup> As a result, the risks of litigation opportunism are quite low, and rational contract designers will not invest in many procedural customizations.

More concretely, in contexts of low-uncertainty and high-scale, written contracts are standardized documents, which often get relegated to the drawer once drafted by the legal department and then rarely consulted to resolve disputes.<sup>161</sup> The transacting parties operate within large, well-developed industrial settings and relatively stable competitive environments. This allows them to appeal to established informal norms for interpreting and adjusting their behavior rather than courts.<sup>162</sup> Stewart Macaulay famously described this process in 1963:

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<sup>159</sup> See, e.g., CHRISTIN BÜHRING-UHLE, *ARBITRATION AND MEDIATION IN INTERNATIONAL BUSINESS* 136 (1996).

<sup>160</sup> See, e.g., O'Hara O'Connor & Drahozal, *supra* note 129, at 2177 ("In most commercial exchange, formal legal principles and court systems play a surprisingly small role for transacting parties.").

<sup>161</sup> See, e.g., Macaulay, *supra* note 26, at 61; Hadfield & Bozovic, *supra* note 24, at 992-95.

<sup>162</sup> Informal modes of enforcement can be quite effective in many circumstances. As Professor Macaulay discussed nearly thirty years ago, lived commercial practice often depends on non-legal relationship governance:

Most problems are avoided without resort to detailed planning or legal sanctions because usually there is little room for honest misunderstandings or good faith differences of opinion about the nature and quality of a seller's performance. Although the parties fail to cover all foreseeable contingencies, they will exercise care to see that both understand the primary obligation on each side. Either products are standardized with an accepted description or specifications are written calling for production to certain tolerances or results. Those who write and read specifications are experienced professionals who will know the customs of their industry and those of the industries with which they deal. Consequently, these customs can fill gaps in the express agreements of the parties.<sup>163</sup>

Professors Gillian Hadfield and Iva Bozovic conducted a similar updated survey study in 2016 that confirms the same conclusions, at least for parties in contexts of low-uncertainty and high-scale.<sup>164</sup> These parties were engaged in the sale or manufacturing of standardized products with characteristics that are relatively easy to specify, such as candies, brake systems, motorcycle wheels, plastic bags, and undergarments.<sup>165</sup> Professors Hadfield and Bozovic found that these parties “paid little attention to formal contract terms” and “did not see courts as a significant means

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Contract planning and contract law, at best, stand at the margin of important long-term continuing business relations. Business people often do not plan, exhibit great care in drafting contracts, pay much attention to those that lawyers carefully draft, or honor a legal approach to business relationships. There are business cultures defining the risks assumed in bargains, and what should be done when things go wrong. People perform disadvantageous contracts today because often this gains credit that they can draw on in the future. People often renegotiate deals that have turned out badly for one or both sides. They recognize a range of excuses much broader than those accepted by most legal systems.

Stewart Macaulay, *An Empirical View of Contract*, 1985 Wis. L. Rev. 465, 467-68 (1985); see also, e.g., Russell J. Weintraub, *A Survey of Contract Practice and Policy*, 1992 Wis. L. Rev. 1, 5 (1992) (suggesting that “it is a delusion to assume that commercial conduct is primarily controlled by what is ‘legal’”); James J. White, *Contract Law in Modern Commercial Transactions, An Artifact of Twentieth Century Business Life?*, 22 WASHBURN L.J. 1, 1-2 (1982) (conducting an empirical study of chemical and pharmaceutical companies and offering the “thesis that contract law is a much less significant determinant of commercial behavior in complex transactions than the typical law student, contracts professor, or lawyer dares believe”).

<sup>163</sup> See, e.g., Macaulay, *supra* note 26, at 62-63.

<sup>164</sup> See Hadfield & Bozovic, *supra* note 24, at 992-95.

<sup>165</sup> *Id.* at 992.

of enforcing contractual obligation.”<sup>166</sup> Instead, as Macaulay found, these businesses looked to industry and relational norms to adapt to contingencies and respond to the behavior of their contracting partners.<sup>167</sup>

Even when uncertainty rises slightly, if the scale is great enough and the community of transactors is relatively insular, the community can opt out of public courts and into trade-association-run private legal systems – often arbitration – to resolve disputes.<sup>168</sup> Accordingly to Professor Bernstein, these sorts of systems may exist in “over fifty industries, including diamonds, grain, feed, independent films, printing, binding, peanuts, rice, cotton, burlap, rubber, hay and tea.”<sup>169</sup>

These specialist arbitral institutions, however, are often geared towards bolstering informal modes of enforcement. They supply expert decision makers who rely predominately on codified industry trade rules rather than publicly created rules (or industry norms or usages of trade).<sup>170</sup> Moreover, the parties rarely turn to public court enforcement of the awards of these tribunals, depending instead on extralegal sanctions, such as the threat of expulsion from the industry

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<sup>166</sup> *Id.* at 992, 994.

<sup>167</sup> *Id.* at 993; see also, e.g., Howell E. Jackson, *Regulation in a Multisectoral Financial Services Industry: An Exploratory Essay*, 77 WASH. U. L. Q. 319, 341 (1999) (noting prepayment and security as methods for insuring against nonperformance); Thomas J. Stipanowich, *Arbitration: The “New Litigation,”* 2010 U. ILL. L. REV. 1, 58 (citing mediation as an alternative mechanism to resolve disputes); Oliver E. Williamson, *Credible Commitments: Using Hostages to Support Exchange*, 73 AM. ECON. REV. 519, 519–20 (1983) (arguing that hostage taking is “widely used to effect credible commitments”).

<sup>168</sup> See Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724, 1745–54 (2001) [hereinafter, Bernstein, *Private Commercial Law*]; Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code’s Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765, 1771–77 (1996); Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEG. STUD. 115, 119–30 (1992) [hereinafter, Bernstein, *Merchant Law*].

<sup>169</sup> Lisa Bernstein, *Private Commercial Law*, in 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 108 (Peter Newman ed., 1998).

<sup>170</sup> Bernstein, *Merchant Law*, *supra* note 168, at 1777–82; Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724, 1731–34 (2001); Lisa Bernstein, *The NGFA Arbitration System at Work* (Mar. 15, 2007), at 27–28, available at <http://www.ngfa.org/pdfs/NGFAARBITRATIONSTUDY.pdf>.

association.<sup>171</sup> Thus, even if parties occasionally need external enforcement help, they usually avoid the most formal sorts of enforcement in courts.<sup>172</sup>

Because formal legal enforcement is largely irrelevant to contracts in this low-uncertainty, high-scale domain, the risks of litigation opportunism are low or non-existent. To the extent that parties might strategically game post-dispute informal enforcement, customized rules of procedure will not be helpful. When uncertainty begins to creep up, parties might deploy a few coarse, modular customizations of procedure to opt out of courts and into arbitration or to otherwise simplify choice of forum and choice of law issues for the few occasions when courts might be used.

It is worth noting that this prediction may explain, or help to explain, the “procedural dog that hasn’t barked” problem.<sup>173</sup> At a glance, all of the existing studies of procedural contracting suggest that the practice is rare, at least outside of coarse, modular customizations.<sup>174</sup> This finding makes sense if the vast majority of contracts in the world fall within the low-uncertainty, high-scale domain. A random sampling would include a majority of contracts in this domain and thus reveal that procedural customizations are rare and minor. But this conclusion derives from transaction type not contract design. Simply put, in this domain, written contracts are not that important for

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<sup>171</sup> See, e.g., Bernstein, *Merchant Law*, *supra* note 168, at 1777-82 (“In most industries, however, it is rarely necessary for a party to seek judicial enforcement of an award. Merchant tribunals are able to place their own pressures on the parties to comply promptly with their decisions.”); Bernstein, *Private Commercial Law*, *supra* note 168, at 1737-38 (observing that it “is rarely necessary” to seek enforcement of awards in court; instead threat of expulsion is “usually sufficient to induce merchants to promptly comply with arbitration decisions unless they are bankrupt or in severe financial distress”).

<sup>172</sup> See Christopher R. Drahozal, *Private Ordering and International Commercial Arbitration*, 113 PENN. ST. L. REV. 1031, 1032 (2009) (recognizing that private ordering is not dichotomous and hybrid choices between purely formal adjudication in public courts and completely private adjudication in industry trade arbitrations is possible). For instance, Eric A. Feldman has described dispute resolution among Japanese merchants participating in the tuna auction at the Tokyo Central Wholesale Market. See, generally, Eric A. Feldman, *The Tuna Court: Law and Norms in the World’s Premier Fish Market*, 94 CAL. L. REV. 313 (2006). Unlike the merchants studied by Professor Bernstein, the Tokyo tuna merchants resolve disputes in a government-sponsored, albeit highly specialized, court. See *id.*

<sup>173</sup> See *infra* Part II.

<sup>174</sup> See *infra* Part II.

any purpose, so contract design, including procedural customization, is not of paramount significance.

This story would explain Professor Weidemaier's conclusions, for instance. Nearly 56% of the data set in Professor Weidemaier's seminal study involve manufacturing/supply agreements, many or most of which very likely fall within the low-uncertainty, high-scope domain.<sup>175</sup> Another 22% are distribution agreements, at least some of which also likely fall within this domain. Accordingly, his conclusion that few parties customize procedure may be accurate, but this reflects only the reasonable practices of parties in the largest commercial party contracting domain where lawyers and contract design play a minimal role. It does not necessarily reflect the value of procedural contracting in other domains.

### **3.3.3.2 Low Uncertainty, Low Scale – Slightly More Risk of Litigation Opportunism**

As scale declines but uncertainty stays low, parties are not able to benefit from as many standardized solutions because their contracting needs are somewhat unique. This happens in markets where there are relatively few participants, but the subject matter stays uncomplicated. The low degree of uncertainty allows parties to create state-contingent, bespoke contracts.<sup>176</sup> Effectively, parties provide within the contract their own clarity about the terms of performance, limiting the need for adjudicators to look beyond the four-corners of the document.<sup>177</sup> Because the substantive terms are relatively unambiguous, adjudicators are less likely to make mistakes, which, in turn, reduces the space within which litigation opportunism can fester. As a result, parties are unlikely to invest significant time or energy in procedural customizations.

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<sup>175</sup> Weidemaier, *supra* note 20, at 1907.

<sup>176</sup> Scott, *supra* note 32, at 31.

<sup>177</sup> *Id.*; see also, e.g., Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 YALE L.J. 926, 952-55 (2010).

Depending on the precise degree of uncertainty present, we might anticipate slightly more customization than in the low-uncertainty, high-scale quadrant, however, because at the margins, more formal enforcement may be necessary. Parties cannot depend as comprehensively on relational norms or industry-particular informal enforcement mechanisms, such as trade arbitration tribunals, as they can in higher-scale markets. Although the work of any formal adjudication on the merits should be reasonably uncomplicated, parties might still be able to game litigation based on mechanics of a lawsuit, such as choice of forum or choice of law. Accordingly, we might expect to see more parties to employ a few coarse, modular customizations of procedure aimed at simplifying these basic mechanics.

This prediction seems to map onto the existing evidence. For instance, Professor Scott discusses examples of licenses of patented electronic software as falling within this low-uncertainty, low-scale domain.<sup>178</sup> As he points out, such contracts can provide clear directions to a court of the context within which the specified uses of the licensed intellectual property are to be interpreted.<sup>179</sup> This can happen through some combination of definitional clauses, purpose or “whereas” clauses, and appended examples provisions.<sup>180</sup> Professor Scott does not explicitly look at the dispute resolution provisions in the two contracts he references, but both examples contain modular procedural customization, consistent with what the transactional space would suggest is appropriate.

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<sup>178</sup> See, e.g., Scott, *supra* note 32, at 23 (citing to a Fountain Manufacturing Agreement Between Apple Computer Inc., and SCl Systems, Inc. (May 31, 1996) <http://contracts.onecle.com/apple/scis.mfg.1996.05.31.shtml> [<http://perma.cc/YD36-B6BS>] [hereinafter, Fountain Manufacturing Agreement]; and a Data Management Outsourcing Agreement Between Allstate Insurance Company and Acxiom Corporation, (March 19, 1999), <http://contracts.onecle.com/acxiom/allstate.outsource.1999.03.19.shtml> [<http://perma.cc/NAZ6-LDEA>] [hereinafter, Data Management Outsourcing Agreement]). Technically, Professor Scott labels these as presenting a “moderate” degree of uncertainty, but for purposes of the four-quadrant typology used in this Article, these contracts would fall in the “lower” uncertainty range.

<sup>179</sup> *Id.*

<sup>180</sup> *Id.*

In the 1996 Fountain Manufacturing Agreement Between Apple Computer Inc., and SCI Systems, Inc., the parties simply agreed to a forum – the Northern District of California – and a choice of law – California law.<sup>181</sup> Similarly, in the 1999 Data Management Outsourcing Agreement Between Allstate Insurance Company and Acxiom Corporation, the parties agreed to an intricate series of informal dispute resolution escalation procedures.<sup>182</sup> But these procedures merely aimed at bolstering informal enforcement, providing for resolution of “disputes arising in the ordinary course of the parties performance under this Agreement . . . by those directly involved.”<sup>183</sup> Failing that, the contract provided for a staged escalation, keeping dispute resolution informal and trying to steer it out of courts.<sup>184</sup> In the unlikely event that formal enforcement might be needed, the parties simply selected a forum and choice of law: federal or state court in Cook County Illinois and Illinois law.<sup>185</sup> To effectuate this choice of forum, the parties also waived any personal jurisdiction arguments.<sup>186</sup>

As uncertainty edges even higher, we see some parties segment their potential future disputes, carving out a handful of types of disputes for resolution in courts and other types for resolution in arbitration. For instance, as Part II noted, Professors O’Hara O’Connor and Drahozal studied at least three categories of contracts that would fit squarely within this domain – technology contracts, CEO employment contracts, and franchise contracts.<sup>187</sup> These three categories of contracts address somewhat unique issues for the contracting parties, but those issues largely involve risk, though uncertainty can creep into the calculus for some issues. These

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<sup>181</sup> Fountain Manufacturing Agreement, *supra* note 178, at ¶ 22.12.

<sup>182</sup> Data Management Outsourcing Agreement, *supra* note 178, at ¶ 21.1.

<sup>183</sup> *Id.* at ¶ 21.2.

<sup>184</sup> *Id.* at ¶ 21.3.

<sup>185</sup> *Id.* at ¶ 24.9.

<sup>186</sup> *Id.*

<sup>187</sup> *See infra* 156.

contracts tend to provide for generic arbitration for most fights, with little customization of arbitration procedures. This makes sense for the low-uncertainty issues at stake. But these contracts also carefully select carve-outs for certain categories of disputes, particularly disputes about information or intellectual property rights, where marginally greater degrees of uncertainty might be present.<sup>188</sup> Professors O'Hara O'Connor and Drahozal suggest that these carve-outs exist for a number of reasons, including that these subcategories of disputes may have stakes that are sufficiently high to increase the harm of litigation opportunism, even if the probability of its occurrence remains low, and justify additional procedural customization.<sup>189</sup>

In short, in contexts of low uncertainty and low scale, parties can usually address the risk of litigation opportunism through the use of state-contingent contracts. Although parties might need to turn to formal enforcement occasionally, they can supply courts or general arbitration tribunals with sufficiently specified substantive terms to make adjudication of the substantive terms straightforward. To the extent that some residual risk of litigation opportunism exists, it tends to relate to mechanics of lawsuits – such as concerns over where the lawsuits will be filed or what law will be applied – so we can observe parties making modular customizations focusing on who will decide the dispute and what law will be used. As uncertainty edges slightly higher, some parties address increasing the hazard of litigation opportunism by making more granular, but still modular, carve-outs for differing categories of disputes.

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<sup>188</sup> See O'Hara O'Connor & Drahozal, *supra* note 129, at 2182.

<sup>189</sup> *Id.* (“The high stakes in at least some of the cases (such as trademark disputes for franchisors) also are important. Parties often prefer to have courts resolve ‘bet-the-company’ cases because the availability of appellate review reduces the risk of aberrational decisions.”).

### 3.3.3.3 High Uncertainty, High Scale – Moderate Risk of Litigation Opportunism

In contexts of high uncertainty but high scale, parties are more likely to encounter unanticipated contingencies than those conducted in a stable environment.<sup>190</sup> And parties struggle to identify obligations for each of those contingencies. Accordingly, the primary substantive tool that designers turn to in this environment is the increasing use of standards that take advantage of a decision maker's hindsight and thus allow for more flexibility in the specification of rights and obligations.<sup>191</sup> This drafting technique necessarily injects the possibility of ambiguity about what counts as performance and breach and thus increases the potential for harmful litigation opportunism.

But in high scale contexts, the parties can ameliorate that risk by looking to established industry norms, which help resolve that ambiguity *ex post*. Because many contracting parties face the same or similar challenges, they can pool resources to come up with collective understandings. Even if these understandings would be difficult for general courts or adjudicators to verify, in high-scale contexts, parties can turn to decision makers with an industry-rich understanding sufficient to convert observable phenomena into enforceable outcomes.<sup>192</sup> These decision makers may be part of specialized arbitration tribunals or specialized courts. For instance, Professor Scott has argued that parties can turn to courts that see a sufficiently large number of similar disputes to allow them to develop experience and expertise.<sup>193</sup> Examples of such courts are Delaware Chancery courts for corporate matters or the Santa Clara County Superior Court for industrial disputes arising in Silicon Valley.<sup>194</sup>

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<sup>190</sup> See Michael J. Leiblein, *The Choice of Organizational Governance Form and Performance: Predictions from Transaction Cost, Resource-Based, and Real Options Theories*, 29 J. MANAG. 937–961 (2003).

<sup>191</sup> See, e.g., Gilson, Sabel & Scott, *supra* note 22.

<sup>192</sup> See, e.g., Scott, *supra* note 32, at 32.

<sup>193</sup> Scott, *supra* note 32, at 33-34.

<sup>194</sup> See *id.*

In terms of procedural customization, this means that parties in high uncertainty but high scale environments are usually able to combat litigation opportunism effectively through simple modular customizations of procedure that opt into these specialized tribunals. Parties are unlikely to need or want much additional customization, since a primary advantage of these specialized decision makers is their ability to leverage hindsight to achieve more accurate outcomes. Parties would run the risk, with complex procedural customization, of hamstringing these specialized adjudicators and undercutting their ability to extract value from vague standards included in the substantive terms of the contract.

Alternatively, if sufficient interdependencies exist, parties in high-scale contexts may be able to forego most formal enforcement altogether. For example, Professor Lisa Bernstein has explored the ways that mid-western original equipment manufacturers (“OEMs”) and their suppliers use long and detailed contracts to establish space for extra-legal modes of enforcement.<sup>195</sup> Effectively, these contracts are “artfully designed to create a framework for growing relational social capital and leveraging network governance.”<sup>196</sup>

In one sense, OEM contracts are relatively predictable, as they often involve the supply of discrete and already-existing goods.<sup>197</sup> But the long-term nature of these contracts, the fact that buyers expect strict compliance regarding quality, the need for on time delivery, and a host of logistics-related requirements, including the interdependency of buyers on multiple suppliers, creates high degrees of uncertainty.<sup>198</sup> Professor Bernstein concludes that transacting parties have been able

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<sup>195</sup> See Bernstein, *supra* note 53, at 562.

<sup>196</sup> *Id.* at 564-65.

<sup>197</sup> Professor Bernstein notes that many OEM relationships, in the modern world, also involve elements of innovation. In fact, “tapping supplier innovation . . . is the second-highest [procurement] priority, and includes actively attracting and developing the most innovative suppliers to help generate new ideas.” *Id.* at 610 n.155 (quotation omitted). To the extent that OEM relationships spin into contracts for innovation, they may more aptly be considered collaborative innovation contracts and fall within the high-uncertainty, low-scale domain discussed in the following section.

<sup>198</sup> See *id.* at 578.

to confront this uncertainty with only minimal reliance on the legal system, in large part because the network in which they function serves as a contract governance mechanism.<sup>199</sup> Effectively, parties can learn the pattern of past alliances and connections in the deal-relevant network, and this results in “opportunism [being] mitigated by a counterparty’s reputation among [and position in relation to] potential future contracting partners, not just through its reputation with preexisting partners.”<sup>200</sup> As a result, although there are high levels of uncertainty, parties are able to avoid most litigation or dispute opportunism through informal enforcement processes. They, therefore, do not need to turn to much procedural customization.<sup>201</sup>

In short, in high-uncertainty, high-scale environments, parties can primarily rely on industry-provided solutions, including specialized decision makers or network governance that enhances informal enforcement mechanisms, to confront litigation opportunism. The procedural customization that exists tends to direct disputes to specialized decision makers through choice of forum clauses, including arbitration clauses. In circumstances where there might be various categories of disputes that could benefit from differential treatment, parties might use more atomistic carve-outs to modify their dispute resolution processes. Finally, in arbitration, we might expect to see parties provide some tailoring, especially around qualifications or expertise for decision makers.

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<sup>199</sup> See *id.* at 563.

<sup>200</sup> David T. Robinson & Toby E. Stuart, *Network Effects in the Governance of Strategic Alliances*, 23 J. L. ECON. ORG. 242, 244 (2006).

<sup>201</sup> For instance, in the Harley-Davidson Master Supply Agreement (2015), Purchase Order Terms and Conditions Module (one of the contracts that Professor Bernstein evaluates in some detail), Harley-Davidson does minimal procedural customization, and all of it is modular in nature. Harley-Davidson selects Wisconsin law (and opts out of the Convention on the International Sale of Goods), see ¶ 21(b), and selects Milwaukee County Circuit Court for the State of Wisconsin or the United States District Court for the Eastern District of Wisconsin as the forum, see ¶ 21(d). The only other customizations bolster the choice of forum. For instance, Harley-Davidson includes a waiver of objections to personal jurisdiction. *Id.*

### 3.3.3.4 High Uncertainty, Low Scale – High Risks of Litigation Opportunism

Parties are most likely to benefit from, and thus most likely to seek, bespoke procedural systems in innovation-oriented contracts, where uncertainty is high and scale is low.<sup>202</sup> These environments include co- or join-development contracts, research and development collaborations, OEM contracts that include going improvement and development provisions, or new services innovations.<sup>203</sup> In such environments, parties cannot hope to specify all or even a meaningful set of the future states of the world in which the contract will have to be performed and the actions to be taken in each of those states. Moreover, the changes caused by persistent innovation, and the limited number of market actors, undermine the capacity for any market or industry to settle on shared understandings. As a result, frequent, and sometimes even good-faith, disagreements occur about what constitutes proper performance or an appropriate response to conditions that arise *ex post*.

This pervasive uncertainty means that parties often contract to provide a framework for their collaboration rather than to guarantee a particular outcome. In these contracts for innovation, formal enforcement plays an important, but focused role. For instance, Professors Hadfield and Bozovic describe formal enforcement mechanisms as “scaffolding” for informal enforcement norms.<sup>204</sup> Professors Gilson, Sabel, and Scott argue for the imposition of “low-powered” sanctions in the event of a breach of the formal aspects of a collaborative contract.<sup>205</sup> Low-powered enforcement imposes formal remedies for “red-faced” violations of the agreement to provide a

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<sup>202</sup> A distinction should be made between contracts for innovation and contracts about innovation. Some contracts, in other words, provide the framework within which innovation takes place, while other contracts are more conventional and address the protection, transfer, licensing, or other use of extra-contractual innovations.

<sup>203</sup> See Hadfield & Bozovic, *supra* note 24, at 992-95.

<sup>204</sup> *Id.*

<sup>205</sup> See, e.g., Gilson, Sabel & Scott, *Braiding*, *supra* note 36, at 1427.

prioritized opportunity, but does not impose sanctions for a failure to reach particular outcomes.<sup>206</sup>

Both approaches view trust as emerging endogenously from the parties' relationship, with formal enforcement provisions playing a limited but critical role by requiring certain information sharing. Professor Bozovic and Hadfield postulate that trust grows as the parties proceed with the relationship and as they continually refer back to the constituting documents of that relationship in order to evaluate one another's performance. Professors Gilson, Sabel, and Scott contend that informal constraints become effective as the collaboration progresses and relevant metrics of performance become more observable. Additionally, the continuing revelation of information and ongoing relationship increases switching costs, making it more likely that the parties will informally solve problems in order to maintain the collaboration.

The critical point is that in collaborative contracts, legal enforcement should, or does, take a back seat, but it remains foundational to the functioning of the alliance. Default procedural rules are frequently an ill fit for the parties' objectives, given the unique needs of both sanctioning some specific behavior but also encouraging the development of informal norms. Because of the limited number of parties with similar needs, generalist courts struggle to supply accurate *ex post* specification of substantive terms, and open-ended public procedural rules, which give tremendous discretion to judges, magnify this shortcoming.<sup>207</sup> Procedure, in other words, amplifies worries that formal enforcement will crowd out the development of essential informal norms. It makes sense, then, that parties confronting the dilemmas of contracting in environments of high

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<sup>206</sup> See *id.* at 1417.

<sup>207</sup> See, e.g., See Blair, *supra* note 16, at 800 (“[T]he reformers opted to entrust judges with broad discretion to put the rules of procedure into action in individual cases.”); Amalia D. Kessler, *Our Inquisitorial Tradition: Equity Procedure, Due Process, and the Search for an Alternative to the Adversarial*, 90 CORNELL L. REV. 1181 (2005) (noting how the Rules retrieved equity as a source of procedural discretion); Thomas O. Main, *Traditional Equity and Contemporary Procedure*, 78 WASH. L. REV. 429 (2003) (arguing for broad use of equitable discretion).

uncertainty and low scale would turn to bespoke procedural regimes to help them resolve their disputes reliably and at an acceptable cost.<sup>208</sup>

This, in fact, is precisely what we see in practice. As Part II(C) observes, parties to alliance agreements regularly create intricate procedural regimes. These multi-tiered and complex dispute resolution regimes are highly-customized to augment and reinforce other substantive governance mechanisms without crowding out the growth of informal norms.<sup>209</sup>

For instance, in a recent alliance agreement between Frequency Therapeutics, Inc. and Astellas Pharma, Inc., the parties established a framework for the development, manufacture, and commercialization of a new regenerative therapy for hearing loss.<sup>210</sup> Their dispute resolution system distributes different conflicts to different parties and decision makers. Most common disputes regarding details of the collaboration are first sent to a Joint Steering Committee (“JSC”).<sup>211</sup> If a routine disagreement cannot be solved by the JSC, it gets escalated to the executive officers who attempt to resolve it informally.<sup>212</sup> Failing such informal resolution, a standard dispute gets sent to binding arbitration using a simplified baseball procedure with very constrained opportunities for evidence gathering and production.<sup>213</sup> In contrast, more serious disputes about alleged material breaches, failures of payments, or the validity of the agreement do not go through the JSC at all. The executive officers may attempt to resolve such disputes informally, but failing that, these disputes get sent to conventional arbitration before a three-

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<sup>208</sup> See generally Gilson, Sabel & Scott, *Contracting for Innovation*, *supra* note 36 (advancing a similar argument with respect to the design of substantive terms).

<sup>209</sup> Jennejohn, *supra* note 17, at 362 (2016) (“Establishing a constellation of enforcement institutions appears to be a common strategy among collaborations.”).

<sup>210</sup> See License and Collaboration Agreement By and Between Frequency Therapeutics, Inc. and Astellas Pharma, Inc. (2019) [hereinafter, License and Collaboration Agreement], Preamble, ¶1.95; see also, e.g., *Astellas Pharma and Frequency Therapeutics collaborate on hearing loss therapy*, Comment, July 29, 2019, Medical Device Network, <https://www.medicaldevice-network.com/comment/322-hearing-loss-therapy/>.

<sup>211</sup> See License and Collaboration Agreement, *supra* note 210, at ¶3.02(f).

<sup>212</sup> *Id.* ¶ 3.10.

<sup>213</sup> *Id.* ¶ 16.01(d).

arbitrator tribunal under the rules and auspices of the International Chamber of Commerce.<sup>214</sup> If these more serious disputes involve scientific or technical matters, the arbitrators need to have industry expertise.<sup>215</sup> Disputes involving intellectual property rights do not go through the JSC. Executive Officers presumably may attempt to resolve such disputes, but failing that, these disputes get sent to a court or patent office of a country where the patent was issued or a patent application was filed.<sup>216</sup> Finally, either party may go to a U.S. court to seek injunctive relief in order to protect other intellectual property rights.<sup>217</sup>

In short, the Frequency Therapeutics, Inc. and Astellas Pharma, Inc. alliance agreement provides for an intricate system of informal and formal dispute resolution that sorts potential fights into different categories and then filters them through individuated layers of dispute resolution. The system encourages the resolution of routine disagreements informally, providing multiple opportunities for such a resolution. This fosters trust by focusing on communication and information sharing, reinforcing the substantive goals of the collaboration. In the somewhat unlikely event that such routine disputes are not informally resolved, the simplified baseball arbitration procedure helps assure that the cooperative venture is not derailed by costly and time-consuming post-dispute opportunism related to minor disagreements. The agreement also recognizes, however, that there could be other more serious disputes, so it creates a different pathway for their resolution, directing them to decision makers who have relative expertise or injunctive powers.

A similar example can be seen in a collaboration agreement between Vir Biotechnology, Inc. and Alnylam Pharmaceuticals, Inc. for the therapeutic for the treatment of chronic hepatitis

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<sup>214</sup> *Id.* ¶ 16.01(c).

<sup>215</sup> *Id.*

<sup>216</sup> *Id.* ¶ 16.01(e).

<sup>217</sup> *Id.* ¶ 16.01(c).

B.<sup>218</sup> The Vir Biotechnology, Inc./Anylam Pharmaceuticals, Inc. collaboration agreement similarly distributes common disputes through a JSC, to executive officers. The agreement then trifurcates where disputes next go for resolution. It sends a few common categories of disputes to expedited baseball arbitration.<sup>219</sup> Notably, this expedited process does not allow for discovery and relies on the parties to appoint representative experts, who, in turn, select a neutral expert to serve as the arbitrator. The parties have no direct contact with the neutral expert but the neutral may consult with the party appointed experts.<sup>220</sup> It then allows parties to choose between litigating in a court of competent jurisdiction or arbitrating other more serious disputes.<sup>221</sup>

Like the Frequency Therapeutics alliance agreement, then, the Vir Biotechnology agreement sorts potential disputes into different categories. This has the particular benefit, in the case of the Vir Biotechnology agreement, of sending most minor disputes through an expedited baseball arbitration. By removing most discovery and presentation of evidence and streamlining the adjudication, the parties to the Vir Biotechnology agreement have cabined most post-dispute litigation opportunism while still allowing for the streamlined resolution of nettlesome disagreements.

In short, in contexts of high uncertainty but low scale, parties already invest more in drafting complicated substantive contracts that are designed to foster and develop trust over time. Careful and thoughtful procedural customizations are used to make sure that enforcement mechanisms

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<sup>218</sup> See Collaboration and License Agreement By and Among Vir Biotechnology, Inc. and Anylam Pharmaceuticals, Inc. (2019); *Vir Biotechnology and Anylam Pharmaceuticals Initiate Phase 1/2 Study of VIR-2218*, <http://investors.anylam.com/news-releases/news-release-details/vir-biotechnology-and-anylam-pharmaceuticals-initiate-phase-12> (last visited August 28, 2019).

<sup>219</sup> See *id.* ¶13.03.

<sup>220</sup> See *id.*

<sup>221</sup> See *id.* ¶¶ 13.01, 13.02.

support the substantive goals of the parties without crowding out the development of informal, relational norms.<sup>222</sup>

### 3.4 Conclusion

Despite a vast contract theory literature, we are only just scratching the surface of understanding how parties design their contracts in the real world.<sup>223</sup> This is particularly true of procedural customizations. Contrary to some early commentator's estimates, parties sometimes engage in a diverse range of procedural customization. The challenge has been identifying and explaining the patterns of *ex ante* procedural contracting.

This Article has argued that the first step towards understanding the ways that transactional designers harness the potential of procedural autonomy is to recognize that procedural customization functions best to offset litigation opportunism. By systematically considering the way that various forms of procedural customization function to limit or eliminate litigation opportunism, this Article provides an important advance in helping identify the circumstances when customizations of procedure can be valuable as additional governance tools.

This Article then advances a typology of procedural innovation by considering underlying key attributes of a transaction, namely the degree of environmental and behavioral uncertainty present and the frequency with which other similar parties contract in the same domain.

In environments of low uncertainty but high scale, parties have little need for formal, detailed contracts, structuring their relationships instead through relational norms. Because written contracts do modest work and parties place little reliance on formal enforcement, contract designers need not invest much in procedural customizations. At most, designers in this domain might make a few coarse, modular customizations aimed at simplifying choice of forum and law

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<sup>222</sup> Need citation

<sup>223</sup> Scott, *supra* note 32.

decisions, in the rare event business solutions break down and the parties turn to courts or arbitrators. As scale drops, parties in low uncertainty environments can no longer rely on standardized solutions, but they can draft substantively state-contingent contracts at reasonably low costs. This keeps the risk of litigation opportunism in check. Accordingly, there is still little need for precise procedural tailoring. Parties can, instead, mostly rely on the default rules of procedure. To the extent that any customization makes cost-effective sense, that customization tends to be coarse and simple, aimed at streamlining adjudication and curbing extreme litigation abuses.

When uncertainty increases, parties in a high-scale market tend to be able to address future contingencies and their inherent risks by choosing decision makers with specialized expertise or relying network governance – an interconnected web of relationships with similarly situated parties. In these high-uncertainty but high-scale environments, parties rely on more detailed and transactionally-particularized contracts but engage in relatively limited procedural customization. To the extent that such customization exists, it tends to be modular, often opting out of courts and into arbitration, at least for some categories of disputes. Given the importance of decision-maker expertise, however, parties more frequently tweak the details of the arbitral process, including arbitrator expertise, in order to assure that a decision-maker has relevant industry expertise and sensitivity to the parties' circumstances. Parties also sometimes make more atomistic carve-outs for certain categories of disputes.

In contrast, as uncertainty rises but scale declines – as the business environment becomes more innovative – parties cannot confront increasing exchange hazards through common industry norms, but they also struggle to specify obligations and rights *ex ante*. Parties rely more heavily on lawyers and contracts to supply substantive obligations, but those obligations are often framed vaguely, opening the door to litigation opportunism. To confront that opportunism, parties invest

greater tailoring of the procedural mechanisms that reinforce, maintain, and decide the integrity of those obligations. The degree of that tailoring roughly correlates to the degree of uncertainty and scale at issue.

While rough, conclusions predicted by this four-quadrant typology seem to correspond with most of the empirical data we have about procedural contracting. That said, perhaps the most significant advance this Article makes is in providing a roadmap for future, more particularized, empirical work to test the key hypothesis that procedural innovation will vary in relation to the mix of uncertainty and market scale of a given commercial transaction.