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Customizing Employment Arbitration

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ABSTRACT: According to the dispute resolution literature, one advantage of arbitration over litigation is that arbitration enables the parties to customize their dispute-resolution procedures. For example, parties can choose the qualifications of the arbitrator(s), the governing procedural rules, the limitation period, recoverable damages, rules for discovery and the presentation of evidence and witnesses, and the specificity of required arbitrator findings. While some scholars have questioned whether parties to arbitration agreements frequently take advantage of this customization, there is little solid empirical information about the topic.

In this Article, we study the arbitration clauses found in a random sample of 910 Chief Executive Officer ("CEO") employment contracts entered into during the time period from 1995 to 2005 to determine how much customization actually takes place. We find only a small number of instances where fine-grained customization has occurred. Parties pay very little attention to customizing arbitral proceedings in these employment contracts although there is a significant increase in the practice over time. We find this result surprising given that CEO contracts are heavily negotiated documents.

Unexpectedly, we find that about half of the arbitration clauses in our contracts carve out a subset of potential claims or types of relief by reserving a right for the parties to seek such relief or file such claims in court. This phenomenon of customizing the circumstances under which parties will use arbitration has received almost no attention in the academic literature to date. In particular, we find that the types of claims carved out for court resolution are those involving a firm's efforts to protect the value of its

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information, reputation, and innovation. CEOs and companies in the information technology business are not significantly more likely to carve out such claims, and the use of these carveouts is increasing over time, suggesting that such carveouts are increasingly valuable to all firms. Unfortunately, California court regulation of arbitration clauses in employment contracts has significantly dampened the use of carveouts in contracts between CEOs and their firms located in California. Our data suggest that court efforts to protect employees by scrutinizing the specific carveouts we observe is both unnecessary and destructive.

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I. INTRODUCTION

Arbitration has become an increasingly popular form of dispute resolution. Today, it is routine for businesses, consumers, and employees to resort to arbitration rather than courts when they seek redress.¹ This trend has been particularly pronounced in the United States, where the Supreme Court has interpreted the Federal Arbitration Act (“FAA”)² to contain a very strong pro-arbitration policy.³ Parties can agree to arbitrate virtually any claim, including claims arising under the federal securities acts, patent law, antitrust, the Racketeer Influenced and Corrupt Organizations Act (“RICO”), and employment discrimination and other civil rights acts.⁴ According to Supreme Court precedent, the broad respect for agreements to arbitrate applies both when they are negotiated between the parties and when they appear in contracts of adhesion, including consumer⁵ and employment contracts.⁶ Arbitration clauses are even upheld where the clear purpose of arbitration is to circumvent procedural mechanisms like class actions, designed to ensure that such claims will be brought in the first place.⁷ With relatively limited exception, the Court has uniformly struck down state regulations that interfere with arbitration under the FAA.⁸

Arbitration is thought to be popular for many reasons, including that it can be customized to suit the desires of the parties.⁹ Scholars have noted that parties often use arbitration clauses to select a specific arbitration association, a particular location for the proceedings, and an off-the-rack set of governing rules.¹⁰ In addition, parties can specify the number of arbitrators who will decide their case(s),¹¹ qualifications of their

1. See *infra* Part II.B.

2. 9 U.S.C. §§ 1–16 (2006).

3. See *infra* Part II.A.

4. See *infra* notes 78–87 and accompanying text.

5. The Supreme Court has been particularly active this term in ensuring the enforcement of arbitration clauses in consumer contracts. See, e.g., *Marmet Health Care Ctr., Inc. v. Brown*, 132 S. Ct. 1201 (2012) (per curiam) (nursing home care agreements); *Compucredit Corp. v. Greenwood*, 132 S. Ct. 665 (2012) (consumer credit card contracts).

6. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991) (employment discrimination claims).

7. See, e.g., *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011) (holding that California law prohibiting many class waiver clauses in arbitration agreements was preempted by the FAA).

8. See *infra* notes 88–91 and accompanying text.

9. See David Horton, *Arbitration as Delegation*, 86 N.Y.U. L. REV. 437, 444 (2011) (noting that federal arbitration law provides parties with an arbitral option that they can fill with customized procedures).

10. See, e.g., 1 GARY B. BORN, *INTERNATIONAL COMMERCIAL ARBITRATION* 619 (2009) (describing the material terms of an arbitration agreement as “number of, identity of and means of selecting arbitrators, arbitral seat, scope of agreement, institutional rules, [and] choice of law”).

11. *Id.*

arbitrator(s),¹² and the governing procedures for choosing the decision maker(s).¹³ The parties can further specify the mode and conduct of arbitral proceedings, including the relevant rules of discovery¹⁴ and of evidence.¹⁵ Furthermore, the parties can state whether they wish the arbitrator's findings to contain the arbitrator's reasoning,¹⁶ and they can choose a purely private form of law to guide the substantive outcome.¹⁷

While the possibilities for customization seem limitless,¹⁸ there has been little work on understanding whether the parties actually do customize their arbitration clauses in this manner.¹⁹ What types of customization are common for arbitration agreements, and what types are more likely the products of creative but fanciful thinking by law professors?²⁰

In this Article, we explore these questions using a hand-coded, randomly selected sample of 910 CEO employment contracts at S&P 1500 public companies. CEO employment contracts are particularly useful for our

12. Frederick Brown & Catherine A. Rogers, *The Role of Arbitration in Resolving Transnational Disputes: A Survey of Trends in the People's Republic of China*, 15 BERKELEY J. INT'L L. 329, 334 (1997).

13. BORN, *supra* note 10, at 176–77.

14. Anthony J. Diana et al., *Electronic Discovery in Specific Areas of Practice*, in ELECTRONIC DISCOVERY DESKBOOK 2012, at 299, 234 (PLI Litig. & Admin. Practice, Course Handbook Ser. No. 35302, 2012).

15. 1999 IBA Working Party & 2010 IBA Rules of Evidence Review Subcomm., *Commentary on the Revised Text of the 2010 IBA Rules on the Taking of Evidence in International Arbitration*, 5 DISP. RESOL. INT'L 45, 46 (2011).

16. Alan Scott Rau, *On Integrity in Private Judging*, 14 ARB. INT'L 115, 146–50 (1998).

17. See, e.g., Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724 (2001) (explaining how cotton industry uses arbitration where privately drafted contract rules are applied).

18. They are not actually limitless. For example, parties to arbitration agreements governed by the FAA may not contract to alter the applicable standard of review of arbitral awards, at least not in federal courts. See *Hall St. Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008).

19. Existent empirical evidence includes one study of fifty-two arbitration clauses found in a wide variety of consumer contracts, Linda J. Demaine & Deborah R. Hensler, "Volunteering" To Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience, LAW & CONTEMP. PROBS., Winter/Spring 2004, at 55, and one study of twenty standard-form franchise agreements, Christopher R. Drahozal & Peter B. Rutledge, *Contract and Procedure*, 94 MARQ. L. REV. 1103 (2011) (presenting results of former study that indicated an increasing trend toward the use of several customized terms in franchise agreements). In addition, there is at least one study of the use of class waivers in consumer contracts. Theodore Eisenberg et al., *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J.L. REFORM 871 (2008).

20. In some law review articles, the author counsels businesses to pay more attention to their customization options, which suggests a belief that customization is at least suboptimally infrequent. See, e.g., Thomas J. Stipanowich, *Arbitration and Choice: Taking Charge of the "New Litigation,"* 7 DEPAUL BUS. & COM. L.J. 383 (2009); Eileen B. Vernon, *Arbitration in the Energy/Minerals Field: Customizing the Clause*, 56 DISP. RESOL. J. 50 (2001) (advocating updated customization of arbitration clauses used by environmental, energy, and natural-resource companies).

inquiry because they are heavily negotiated documents entered into by sophisticated parties. Consistent with our earlier research, we find that the use of arbitration provisions is increasing over time, but that beyond a few basic decisions about which arbitration associations to use, whether to employ those associations' arbitration rules, and to a much lesser extent, how to divide the costs of the proceeding, these parties and their attorneys rarely focus on customizing arbitration provisions. In other words, despite 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.

We are surprised to find strong evidence of a very different form of customization: carving out certain types of litigable claims from otherwise broad agreements to arbitrate. These litigation carveouts have received scant attention in the arbitration literature.²¹ In fact, most of the arbitration literature assumes that parties face a binary choice between courts and arbitration for the resolution of *all* of their disputes. But in the context of CEO employment agreements, we find it is commonplace for the parties to draft provisions generally requiring arbitration but at the same time reserving a right for the parties to go to court under some defined circumstances. Effectively, these parties are customizing the border between courts and arbitration for specific types of claims. We believe that the carveouts studied in this paper might be common in other types of contracts as well,²² making them an important topic for future research.

More broadly, our study of CEO employment contracts provides a unique opportunity to revisit arguments about some common practices related to arbitration between employers and employees. Employment arbitration is controversial in the United States.²³ Although employment

21. To our knowledge, only Christopher Drahozal has empirically studied carveouts from arbitration, and carveouts typically play only a very minor role in his studies. See, e.g., Christopher R. Drahozal, "Unfair" Arbitration Clauses, 2001 U. ILL. L. REV. 695 [hereinafter Drahozal, *Unfair Arbitration Clauses*]; Christopher R. Drahozal & Quentin R. Wittrock, *Is There a Flight from Arbitration?*, 37 HOFSTRA L. REV. 71 (2008). Drahozal and Stephen Ware have both addressed the topic of carveouts in nonempirical articles. Christopher R. Drahozal, *Nonmutual Agreements To Arbitrate*, 27 J. CORP. L. 537, 552-55 (2002); Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. DISP. RESOL. 89, 98-100.

22. See Erin O'Hara O'Connor, Carveouts and the Choice Between Courts and Arbitration (draft manuscript on file with authors) (studying carveouts in different types of contracts and involving parties from different countries to discern circumstances under which parties affirmatively demand courts).

23. Christopher R. Drahozal, *Busting Arbitration Myths*, 56 U. KAN. L. REV. 663, 665 (2008); Cynthia L. Eslund, *Between Rights and Contract: Arbitration Agreements and Non-compete Covenants as a Hybrid Form of Employment Law*, 155 U. PA. L. REV. 379, 379 (2006); Jyotin Hamid & Emily J. Mathieu, *The Arbitration Fairness Act: Performing Surgery with a Hatchet Instead of a Scalpel?*, 74 ALB. L. REV. 769, 769 (2011); Keith N. Hylton, *Agreements To Waive or To Arbitrate Legal Claims: An Economic Analysis*, 8 SUP. CT. ECON. REV. 209, 248 (2000); David S. Ruder, *Securities Arbitration in the Public Interest: The Role of Punitive Damages*, 92 NW. U. L. REV. 69, 72 n.23 (1997); Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding*

arbitration promises a quicker, cheaper, and less adversary means for employees to resolve their disputes with employers, critics charge that the arbitration agreements are contracts of adhesion, that the employment arbitration system is rigged in favor of employers, and that employers utilize arbitration to effectively deprive employees of their rights.²⁴

Given the concerns about the fairness of employment arbitration, governments and arbitration associations have responded in several different ways.²⁵ Particularly relevant to this Article, many U.S. state courts use the contract law doctrine of unconscionability to scrutinize the terms of arbitration clauses in employment contracts for fundamental fairness. In the context of arbitration carveouts, a number of U.S. courts will strike an arbitration clause as unconscionable if it forces only the employee to arbitrate her claims, while still preserving the employer's right to enforce its rights in court.²⁶ In California, state courts have struck down arbitration clauses that on their face require both parties to bring their claims to arbitration but then carve out from arbitration claims that are likely to be brought by the employer.²⁷ Given that California is often a leader in state efforts to regulate unfair arbitration provisions, its stance on this issue could well spread to other states.

Our CEO employment contracts provide a window into the terms of employment agreements where both parties have significant bargaining power and actively negotiate their agreements with the assistance of counsel.²⁸ These agreements are admittedly very different from the adhesion contracts typically found in employment, but the very fact that our contracts are negotiated can provide some indication of whether sophisticated employees think arbitration disserves their interests. In our contracts, the terms that survive mutual negotiation likely are not the product of employer overreaching, but rather reflect the strong economic desire of one of the parties to obtain a legal right, even if it means that the party must provide extra compensation, or alternate concessions, in order to obtain the right. This suggests that if we find that the parties commonly agree to certain arbitration provisions, these provisions must be the result of an efficient

Arbitration, 74 WASH. U. L.Q. 637, 670 (1996); Adriaan Lanni, Case Note, *Protecting Public Rights in Private Arbitration*, 107 YALE L.J. 1157, 1161 n.25 (1998).

24. See *infra* Part II.C.

25. See *infra* Part II.C.

26. See *infra* notes 129–31 and accompanying text.

27. See *infra* notes 134–37 and accompanying text. As we discuss below, when courts find unconscionable the types of carveouts observed in our contracts, the arbitration clause is struck in its entirety and employers find themselves unable to rely on arbitration for the resolution of any claims.

28. See Stewart J. Schwab & Randall S. Thomas, *An Empirical Analysis of CEO Employment Contracts: What Do Top Executives Bargain For?*, 63 WASH. & LEE L. REV. 231, 236–39 (2006) (describing prevalent contracting behavior among CEOs and their firms' boards).

bargain between them.²⁹ Such findings may have implications for the enforceability of similar provisions in other employment contracts; if even sophisticated employees are comfortable accepting these terms, then perhaps courts should reconsider their hostility to such contract clauses. Along these lines, our first important finding is that about half of the CEO employment agreements provide for the arbitration of disputes, and that the use of arbitration clauses is increasing significantly over time. Our finding suggests that the use of arbitration in the context of employment provides significant perceived legitimate benefit to one or both parties, at least for sophisticated parties.

Our second finding relevant to state regulation of arbitration clauses is that almost half of the contracts with arbitration clauses carve out the very types of disputes that would cause the California courts to strike employment arbitration clauses. These carveouts include disputes pertaining to the confidentiality, noncompete, nonsolicitation, and nondisparagement clauses of the employment agreement. Collectively, these clauses appear to be designed to enable the firm to protect the value of its information, reputation, and innovation. Although we believe that employment arbitration provisions probably should be scrutinized by courts to ensure their fundamental fairness, it appears that these carveouts serve a legitimate economic function for the company and do not simply represent overreaching in a one-sided contract of adhesion. Court scrutiny of these carveouts in employment contracts, especially CEO and top management contracts, therefore seems misplaced.

Our study also provides evidence that the California court decisions have significantly influenced the drafting of arbitration agreements by firms primarily located in California. Using multivariate regression analysis, we find that California firms were significantly more likely than non-California firms to contract for preliminary relief in courts (a carveout permitted by California courts), but significantly less likely to carve out other, more nuanced, claims for resolution by courts (carveouts considered suspect in California courts). For many non-California firms, court resolution of the latter types of claims, such as those involving restrictions on disclosing confidential firm information or soliciting key employees, appears to enable firms to better protect themselves and their shareholders. Those benefits are denied to firms primarily located in California. In the end, California doctrine provides no additional legitimate benefit to employees while inflicting harm on local firms.

We proceed as follows. Part II frames our research questions and provides a review of the existing academic literature and governing law on

29. Specifically, the bargain must be Kaldor-Hicks efficient in that one of the parties is willing to negotiate away other possible advantages in order to include the carveout in the agreement.

arbitration agreements and their contents. In Part III we describe our CEO employment contracts sample and provide a univariate analysis of its contents. Part IV provides a multivariate analysis of the determinants of the use of arbitration provisions, customization, and carveouts. Part V discusses the implications of our study for court treatment of arbitration carveouts and for future scholarship.

II. A BRIEF ARBITRATION PRIMER

To set the stage for our research questions, in Subpart A we briefly describe the growth of arbitration and common factors that can lead contracting parties to opt for arbitration of disputes. Subpart B then discusses the current state of arbitration law as it relates to court regulation of parties' agreements to arbitrate, and it addresses the application of the unconscionability doctrine to arbitration clauses in contracts of adhesion. Subpart C concludes by describing special court concerns regarding employment arbitration.

A. CHOOSING TO ARBITRATE

For many contracting parties, arbitration has become an increasingly popular form of dispute resolution. The typical means of choosing arbitration is for the contracting parties to specify in their agreement that any future disputes will be subject to binding arbitration.³⁰ Survey data³¹ and scholars' claims³² both indicate an increasing use of arbitration clauses in international commerce. Domestically, the past few decades apparently have witnessed an increased use of arbitration clauses in a wide variety of agreements, including securities industry brokerage account contracts,³³ employment contracts,³⁴ consumer contracts,³⁵ and even nursing home care agreements.³⁶

30. Parties can instead contract for nonbinding arbitration, in which case the arbitrator's decision is advisory only. Alternatively, after a dispute arises, the parties can enter into an agreement to resolve the claim through arbitration. This Article ignores such arbitration agreements and focuses almost exclusively on pre-dispute agreements to subject disputes to binding arbitration.

31. See, e.g., BORN, *supra* note 10, at 70; PRICEWATERHOUSECOOPERS, INTERNATIONAL ARBITRATION: CORPORATE ATTITUDES AND PRACTICES 2, 5 (2008), available at http://www.pwc.co.uk/en_UK/uk/assets/pdf/pwc-international-arbitration-2008.pdf.

32. BORN, *supra* note 10, at 70; see also CHRISTOPHER R. DRAHOZAL & RICHARD W. NAIMARK, TOWARDS A SCIENCE OF INTERNATIONAL ARBITRATION: COLLECTED EMPIRICAL RESEARCH 59 (2005) (finding that 88% of sample of international joint venture agreements contained arbitration clauses).

33. See David J. Branson, *American Party-Appointed Arbitrators—Not the Three Monkeys*, 30 U. DAYTON L. REV. 1, 38 (2004) (noting that use of arbitration clauses in securities industry, employment, and consumer contracts is now "standard," and that in general, the use and public acceptance of such clauses is "pervasive").

34. *Id.*; see also Alexander J.S. Colvin, *An Empirical Study of Employment Arbitration: Case Outcomes and Processes*, 8 J. EMPIRICAL LEGAL STUD. 1, 2 (2011) (commenting on dramatic

The popularity of arbitration has also led to a dramatic rise in the reported use of arbitration association services. For example, the International Chamber of Commerce's International Court of Arbitration has had a twenty-fold increase in filed cases between 1956 and 2007.³⁷ Between 1980 and 2007, the number of international arbitrations filed with the American Arbitration Association ("AAA") increased more than six-fold.³⁸ The caseload of eleven arbitral institutions located throughout the world increased from a total of 1392 filings in 1993 to 3235 filings in 2007,³⁹ and to 3685 in 2010.⁴⁰ Between 1997 and 2001, the number of employment arbitrations filed with the AAA rose by 60%;⁴¹ today, an estimated one-third of nonunion employees are subject to arbitration clauses for their employment-related disputes.⁴² Between 2003 and the first quarter of 2012, 61,702 consumer arbitration cases were concluded under the auspices of the AAA.⁴³ And, as noted by Gary Born, "the use of arbitration as a means of resolving new (previously 'un-arbitrated') categories of disputes, including class actions, bilateral investment treaty claims and human rights claims, attests to its enduring and increasing popularity."⁴⁴

Arbitration can provide a number of advantages for contracting parties. In the context of cross-border transactions, for example, arbitration can provide a neutral forum,⁴⁵ and the decisions rendered by arbitrators are more easily enforced across borders than are court judgments.⁴⁶ Moreover,

growth in employment arbitration and citing estimate that for at least one third of nonunion employees, disputes must be resolved in arbitration).

35. Branson, *supra* note 33, at 38; Laura K. Bailey, Note, *The Demise of Arbitration Agreements in Long-Term Care Contracts*, 75 MO. L. REV. 181, 181 (2010).

36. Bailey, *supra* note 35, at 181.

37. BORN, *supra* note 10, at 69.

38. *Id.*

39. *Id.*

40. *Statistics: Case Statistics - 2010*, H.K. INT'L ARB. CTR., <http://www.hkiac.org/index.php/en/hkiac-statistics/case-statistics> (last visited Aug. 16, 2012).

41. Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 DISP. RESOL. J. 44, 44 (2004).

42. Colvin, *supra* note 34, at 2.

43. AM. ARBITRATION ASS'N, CONSUMER ARBITRATION STATISTICS, available at http://www.adr.org/aaa/ShowPDF?doc=ADRSTG_020811 (last visited Aug. 30, 2012).

44. BORN, *supra* note 10, at 70 (footnotes omitted).

45. *See id.* at 2 (stating that international commercial arbitration successfully provides a "fair, neutral, expert and efficient means of resolving difficult and contentious transnational problems").

46. This difference is due to the fact that more than 140 nations are parties 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. Convention on the Recognition and 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* Status of Convention on the Recognition and

arbitration is a much more heterogeneous phenomenon than is court determination, and often the parties are permitted to contract over the particular features of arbitration. This freedom enables the parties to customize the arbitration process to suit their needs.⁴⁷

For example, the parties can ensure that the dispute is heard by decision makers with industry experience who will be familiar with relevant custom and trade usage.⁴⁸ In addition, arbitration can be (although often is not) streamlined to provide relatively cheap and speedy resolution of claims,⁴⁹ and it can enable the parties to avoid juries,⁵⁰ tailor the parties' rights to engage in discovery,⁵¹ eliminate punitive damage awards,⁵² shift fees

Enforcement of Foreign Arbitral Awards, UNITED NATIONS TREATY COLLECTION, http://treaties.un.org/pages/ViewDetails.aspx?src=TREATY&mtmsg_no=XXII-1&chapter=22&lang=en (last visited Aug. 17, 2012) (listing the countries that are participants to the agreement). In contrast, there is no widespread international convention that forces nations to enforce one another's court judgments. A recently concluded Hague Convention on Choice of Court Agreements would require nations to enforce court judgments rendered in a court designated in a contractual choice-of-court clause. Hague Convention on Court of Choice Agreements, June 30, 2005, 44 I.L.M. 1294. However, this Convention has not yet come into force, and some wonder whether it will ever do so. See Stephen B. Burbank, *A Tea Party at the Hague?*, 18 SW. J. INT'L L. 629 (2012).

47. See, e.g., AM. ARBITRATION ASS'N, DRAFTING DISPUTE RESOLUTION CLAUSES: A PRACTICAL GUIDE 5 (2007), available at <http://www.foreclosuremediationfl.adr.org/si.asp?id=4125> ("The parties are free to customize and refine the basic arbitration procedures to meet their particular needs.").

48. ALAN SCOTT RAU ET AL., ARBITRATION 5 (3d ed. 2006).

49. See AM. ARBITRATION ASS'N, *supra* note 47, at 16, 32 (providing sample arbitration clauses designed to help ensure quick dispute resolution). On the question of whether arbitration is in fact faster and cheaper than litigation, see RAU ET AL., *supra* note 48, at 5 (arguing that it is); Peter B. Rutledge, *Whither Arbitration?*, 6 GEO J.L. & PUB. POL'Y 549, 579 (2008) (discussing the cost savings arbitration provides); David S. Schwartz, *Mandatory Arbitration and Fairness*, 84 NOTRE DAME L. REV. 1247, 1268 & n.53 (2009) (assuming, for the purposes of the author's analysis, that "process costs are, on the whole, less in arbitration than litigation," with the caveat that the author suspects that the "cost savings in arbitration are often exaggerated"); Thomas J. Stipanowich, *Rethinking American Arbitration*, 63 IND. L.J. 425, 460 (1988) (lawyer surveys indicate that arbitration tends to be faster and cheaper than litigation). But see W. LAURENCE CRAIG ET AL., INTERNATIONAL CHAMBER OF COMMERCE ARBITRATION 29-36 (3d ed. 2000) (recognizing that some participating in arbitration governed by the International Chamber of Commerce have criticized the process for being too costly); Christian A. Atwood, *Creative Approaches To Financing Company M&A in a Brave New (Unlevered) World*, in DEALING WITH M&A FINANCING AND RISK IN A CHANGING MARKET 25, 33 (2010) (providing that author's personal experience suggests that arbitration is no faster or cheaper than litigation); Christopher R. Drahozal, *Arbitration Costs and Forum Accessibility: Empirical Evidence*, 41 U. MICH. J.L. REFORM 813, 840 (2008) (stating that the empirical evidence is too limited to draw definitive conclusion about relative costs of arbitration and litigation).

50. Randall Thomas, Erin O'Hara & Kenneth Martin, *Arbitration Clauses in CEO Employment Contracts: An Empirical and Theoretical Analysis*, 63 VAND. L. REV. 959, 972 (2010).

51. AM. ARBITRATION ASS'N, *supra* note 47, at 30-31 (providing sample clauses to address document discovery and the taking of depositions).

52. See ERIN A. O'HARA & LARRY E. RIBSTEIN, THE LAW MARKET 94 (2009).

and costs amongst the parties,⁵³ help ensure confidentiality regarding the details of the dispute,⁵⁴ provide a right to appeal awards to an appellate panel,⁵⁵ and provide relative certainty about the governing law of the contract.⁵⁶ In general, arbitrators possess the authority provided to them by the association chosen for arbitration, which typically includes the powers that a judge would possess, but the parties' agreement can further customize the exercise of an arbitrator's authority.⁵⁷

There is little empirical evidence regarding the degree to which contracting parties actually do customize their arbitration clauses. Christopher Drahozal's studies of franchise contracts and (along with Peter B. Rutledge) consumer credit card agreements indicate that companies often carefully address several possible features of arbitration, but they also tend to remain silent regarding several possible issues that could be addressed. Regarding franchise contracts, only about 10% of the arbitration clauses addressed the arbitration award's standard of review, and only about 20% of the contracts addressed the governing rules for discovery, but approximately 96% of the contracts specified the location of the arbitration proceeding.⁵⁸ By 2007, approximately 60% of franchise contract arbitration provisions specified the number of arbitrators, 70% provided time limits for filing claims, 85% restricted the award of punitive damages, 85% also addressed the allocation of the costs of arbitration, and almost 90% addressed the availability of class arbitration.⁵⁹

In contrast, a sample of 293 standard-form credit card agreements indicated that the drafting patterns overlapped with, but were also somewhat distinct from, the franchise agreements. The Rutledge and Drahozal study found that 94% of arbitration clauses addressed the number of arbitrators, but only 42% of issuers addressed the allocation of the costs of arbitration.⁶⁰

53. AM. ARBITRATION ASS'N, *supra* note 47, at 35 (providing sample clauses to address allocation of attorneys' fees). Our CEO employment contracts commonly provide cost-allocation provisions in the arbitration clause. *See infra* Table 4.

54. AM. ARBITRATION ASS'N, *supra* note 47, at 36 (providing sample clauses requiring the parties to maintain confidentiality regarding the details of the dispute).

55. *Id.* at 37 (providing sample language that would create a right of appeal in arbitration).

56. O'HARA & RIBSTEIN, *supra* note 52, at 87-88. Arbitration-association rules typically require the arbitrator to apply the law chosen by the parties, in contrast to courts, which tend to apply a discretionary standard to the enforcement of choice-of-law clauses. *Id.*

57. AM. ARBITRATION ASS'N, *supra* note 47, at 5 ("If the parties agree on a procedure that conflicts with otherwise applicable AAA rules, the AAA will almost always respect the wishes of the parties."); *id.* at 32-33 (providing sample provisions for arbitration agreements specifying or limiting remedies that arbitrators can award); *id.* at 36 (providing sample provisions requiring arbitrators to issue a reasoned award).

58. Drahozal & Wittrock, *supra* note 21, at 102-14.

59. *Id.*

60. Peter B. Rutledge & Christopher R. Drahozal, *Contract and Choice*, *BYU L. REV.* (forthcoming) (manuscript at 31, 33), available at <http://ssrn.com/abstract=2101399>.

Nearly half of these contracts addressed party rights to challenge the award in front of an arbitral appeals panel, but only about 2% stated that the parties had an obligation to keep the details of any dispute confidential, only 2% provided for limits in discovery, and only 4% provided time limits for filing claims. The very small incidence of these latter provisions is likely due to the fact that some arbitration associations will not hear consumer arbitrations unless they satisfy minimum standards of fairness to the consumer,⁶¹ and some courts will strike arbitration clauses in consumer contracts if they appear to be unfairly one-sided.⁶²

Although growing in popularity, arbitration is not well suited for all contracting parties. For example, when at least one party wishes to rely on the certainty of the legal principles that will be applied to the case,⁶³ or forecasts a potential need for assistance to foreclose on property,⁶⁴ courts may be preferred. In addition, because of the very limited ability to obtain judicial review of arbitral awards,⁶⁵ a company concerned about very large judgments relative to the value of the company might prefer the appeals process available in courts.⁶⁶ In their study of material contracts filed with the SEC, Eisenberg and Miller found very low rates of the use of arbitration clauses in several types of high-level business contracts where applicable legal rules are relatively well developed.⁶⁷ They found virtually no use of arbitration clauses in trust agreements, pooling and service agreements, and

61. See AM. ARBITRATION ASS'N, CONSUMER DUE PROCESS PROTOCOL (1998), available at http://www.adr.org/aaa/ShowPDF?doc=ADRSTG_005014.

62. Rutledge & Drahozal, *supra* note 60.

63. See Hylton, *supra* note 23, at 231.

64. See, e.g., R. Wilson Freyermuth, *Foreclosure by Arbitration?*, 37 PEPP. L. REV. 459, 480–82 (2010) (noting lack of arbitration clauses in secured mortgage agreements, but providing no satisfactory explanation for their absence).

65. The grounds for modifying or vacating an arbitral award pursuant to an agreement covered by the FAA are found in section 10 of that statute and include corruption, fraud or undue means, evident partiality, arbitrator misconduct, or excess use of arbitral authority. 9 U.S.C. § 10 (2006); see also *Remmey v. PaineWebber, Inc.*, 32 F.3d 143, 146 (4th Cir. 1994) (“[I]n reviewing arbitral awards, a district or appellate court is limited to determining ‘whether the arbitrators did the job they were told to do—not whether they did it well, or correctly, or reasonably, but simply whether they did it.’” (quoting *Richmond, Fredericksburg & Potomac R.R. Co. v. Transp. Commc’ns Int’l Union*, 973 F.2d 276, 281 (4th Cir. 1992))); *Eljer Mfg., Inc. v. Kowin Dev. Corp.*, 14 F.3d 1250, 1253–54 (7th Cir. 1994) (“Errors in the arbitrator’s interpretation of law or findings of fact do not merit reversal under this standard. Nor does an insufficiency of evidence supporting the decision permit us to disturb the arbitrator’s order.” (internal citations omitted)); *Fine v. Bear, Stearns & Co.*, 765 F. Supp. 824, 827 (S.D.N.Y. 1991) (“It is well-settled that a court’s power to vacate an arbitration award must be extremely limited . . .”).

66. Christopher R. Drahozal, *Contracting Around Hall Street*, 14 LEWIS & CLARK L. REV. 905, 908 (2010).

67. 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, 350 (2007).

bond indentures, and only about 5% use of arbitration clauses in service agreements, about 12% use for securities purchases, and 19% use in merger agreements.⁶⁸

We studied the use of arbitration clauses in the context of CEO employment contracts to determine how commonly these parties choose to have their disputes arbitrated and to glean some indication of whether the use of arbitration clauses in these contracts is growing over time. We were interested in learning about whether the use of arbitration clauses depends on either the industry type or the primary location of the firm. Regarding the specific details of arbitration agreements, we wanted to observe the extent to which arbitration agreements are customized in CEO employment contracts, and we sought a determination of what factors might influence this customization.

We also sought to determine the extent to which individually negotiated contracts respond to the desirability of otherwise applicable state laws. For example, one finding of our study is that contracts involving firms primarily located in California are more likely to include an arbitration clause. This increased use might well result from the fact that California courts will not provide a firm with some of the legal protections that it seeks, including enforcement of noncompete provisions in an employment contract.⁶⁹ The increased use of arbitration clauses by California firms is particularly noteworthy given that, as discussed below, California courts are especially hostile to arbitration clauses in employment contracts. This hostility might, in other circumstances, lead firms to use arbitration clauses less rather than more often.

B. COURT REGULATION OF AGREEMENTS TO ARBITRATE

When parties do enter into a written agreement to arbitrate their disputes, a strong federal pro-arbitration policy ensures that their choice will be respected in most cases. In 1925, Congress passed the FAA,⁷⁰ which provides for the enforcement of both arbitration clauses and arbitration awards found in contracts “evidencing a transaction involving commerce.”⁷¹

The FAA instructs courts to stay any pending court proceeding and to issue an order to compel arbitration if one of the parties seeks to enforce an arbitration agreement.⁷² Congress amended the FAA to add Chapter 273 after the United States joined the New York Convention, which requires

68. *Id.* at 351.

69. Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not To Compete*, 74 N.Y.U. L. REV. 575, 607–09 (1999).

70. Federal Arbitration Act, 9 U.S.C. §§ 1–307 (2006).

71. *Id.* § 2.

72. *Id.* §§ 3–4.

73. *Id.* §§ 201–08.

member nations to enforce arbitration agreements and awards.⁷⁴ Chapter 2 provides protections to contracting parties who enter into commercial agreements with a “reasonable relationship” to “one or more foreign states.”⁷⁵ The Supreme Court has held that the FAA binds state as well as federal courts.⁷⁶ And for international commercial relationships, Chapter 2 provides an automatic right to the defendant to remove a case to federal court for enforcement of the arbitration agreement or award.⁷⁷

In order for the arbitration agreement to be enforced, however, the dispute must involve a subject matter that is capable of resolution by arbitration.⁷⁸ It is not uncommon for the governments of other nations to determine that in order to protect certain important public rights or the interests of third parties, some claims are not referable to arbitration.⁷⁹ Elsewhere, common forms of nonarbitrable subject matter include criminal offenses, consumer employment disputes, and claims involving intellectual property and domestic relations.⁸⁰

In the United States, however, the Supreme Court has progressively limited the circumstances under which a court can determine that a dispute is nonarbitrable, in both the international and domestic contexts. For example, the Supreme Court has determined that federal securities act claims can be arbitrated, notwithstanding language in the federal statutes that forbids parties to waive any of their statutory rights.⁸¹ The Court has reasoned that arbitration is merely a venue for dispute resolution and does not necessarily entail a diminution of legal protection.⁸² In addition, antitrust claims,⁸³ RICO claims,⁸⁴ and claims under the Age Discrimination

74. See *supra* note 46.

75. 9 U.S.C. § 202.

76. *Southland Corp. v. Keating*, 465 U.S. 1 (1984).

77. 9 U.S.C. § 205. Suits involving domestic contracts containing arbitration agreements are removable to federal court only if they involve an independent federal question or if the case satisfies the requirements for diversity jurisdiction.

78. See BORN, *supra* note 10, at 767 (“Both international arbitration conventions and national law provide that agreements to arbitrate such ‘non-arbitrable’ matters need not necessarily be given effect and that arbitral awards concerning such matters need not necessarily be recognized.” (footnotes omitted)).

79. *Id.* at 768.

80. *Id.*

81. *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477 (1989); *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220 (1987); *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 514-17 (1974).

82. *Rodriguez de Quijas*, 490 U.S. at 481.

83. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985). The holding in *Mitsubishi* was confined to international agreements, but the lower courts have uniformly held that antitrust claims arising under domestic contracts can also be arbitrated. See BORN, *supra* note 10, at 785 n.1137, 793 n.1170 (citing several cases).

84. *McMahon*, 482 U.S. at 242.

and Employment Act⁸⁵ are all arbitrable. More generally, the Court has stated that “[i]t is by now clear that statutory claims may be the subject of an arbitration agreement.”⁸⁶ In fact, earlier this year in a case involving federal consumer credit card regulations, the Supreme Court suggested that federal law claims should be deemed arbitrable unless Congress specifically provides otherwise.⁸⁷

The Supreme Court has similarly curtailed state power to limit the pro-arbitration policy embedded in the FAA, finding that state laws that deem claims nonarbitrable are preempted.⁸⁸ Furthermore, state procedural laws designed to make sure that parties to adhesion contracts have notice that the agreement is subject to arbitration are preempted under the FAA.⁸⁹ State laws that apply only to arbitration agreements are not permitted.⁹⁰ And state laws that hinder the purposes and objectives of the FAA’s pro-arbitration policy apparently are also preempted, even if they are not directed solely at arbitration.⁹¹

The only situation under which a court can refuse to enforce an arbitration clause in an agreement governed by the FAA is when, under § 2 of the FAA, the court finds “such grounds as exist at law or in equity for the revocation of any contract.”⁹² Grounds for refusing to enforce such arbitration agreements must therefore derive from generally applicable contract doctrines, such as fraud, duress, or unconscionability.⁹³

Unconscionability is a creature of state law, so its contours vary by jurisdiction. As a general matter, however, contract provisions can be struck down in whole or in part if the agreement is infected with elements of both procedural and substantive unconscionability such that it appears to the court that enforcing the contract as written would be fundamentally unfair.⁹⁴

85. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 27, 35 (1991).

86. *Id.* at 26.

87. *CompuCredit Corp. v. Greenwood*, 132 S. Ct. 665, 668–73 (2012).

88. *Marmet Health Care Ctr., Inc. v. Brown*, 132 S. Ct. 1201, 1203–04 (2012) (striking state prohibition on arbitration of wrongful death claims brought against nursing homes); *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 56, 58 (1995) (striking state law that disabled arbitration of claims involving punitive damages); *Perry v. Thomas*, 482 U.S. 483, 491 (1987) (holding that the California Labor Law, which provided that wage collection actions were nonarbitrable, is preempted by the FAA); *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984) (striking law that prohibited arbitration of state financial investment statute claims).

89. *Doctor’s Assocs., Inc. v. Casarotto*, 517 U.S. 681 (1996) (striking Montana statute that required that contracts with arbitration clauses provide conspicuous notice of the clause on the first page of the contract).

90. *Preston v. Ferrer*, 552 U.S. 346, 349–50, 356 (2008) (striking state regulation empowering state commission to decide scope of arbitration); *Casarotto*, 517 U.S. 681.

91. *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011).

92. 9 U.S.C. § 2 (2006).

93. *Casarotto*, 517 U.S. at 687.

94. See generally GEORGE W. KUNEY & ROBERT M. LLOYD, *CONTRACTS: TRANSACTIONS AND LITIGATION* 309–10 (2d ed. 2008).

Procedural unconscionability is present when a party lacks a meaningful choice or there is some defect in the bargaining process that causes a court to question the true assent of the party to the terms of the contract.⁹⁵

Substantive unconscionability is present when the terms of the bargain unreasonably favor one party.⁹⁶ Some courts have determined that contracts of adhesion, offered on a take-it-or-leave-it basis to one of the parties, carry with them some procedural unconscionability and that terms in contracts of adhesion can be struck down if they appear to be oppressive or unfairly one-sided.⁹⁷

Courts have used the unconscionability doctrine in the context of contracts of adhesion, including both consumer and employment contracts, to ensure that the arbitration clause does not effectively deprive the nondrafting party of her ability to vindicate her claims.⁹⁸ For example, arbitration clauses that force a party to an adhesion contract to travel long distances or otherwise incur prohibitively expensive costs in order to arbitrate claims can be struck down as unconscionable.⁹⁹ In addition, arbitration clauses may be deemed unconscionable when coupled with a limitation of the remedies available to consumers.¹⁰⁰ Courts will scrutinize individual arbitration agreements for a determination of whether the process for choosing arbitrators appears to be designed to produce non-neutral decision makers.¹⁰¹ If an arbitration clause provides only one party special procedural advantages in arbitration, the clause can likewise be deemed unconscionable. These last two features were present in the arbitration clause used by Hooters of America, Inc. during the 1990s.¹⁰² Hooters created a list of “acceptable arbitrators” from which the parties would choose, and it could modify that list at any time. Moreover, under the arbitration provision, the employee was required to provide the employer with notice of the claims as well as details of the claims and was thereafter forbidden to raise additional claims later, but these rules did not apply to

95. CHARLES L. KNAPP ET AL., PROBLEMS IN CONTRACT LAW: CASES AND MATERIALS 570 (5th ed. 2003).

96. *Id.* at 568, 570.

97. *See, e.g.*, Alexander v. Anthony Int'l, L.P., 341 F.3d 256, 265 (3d Cir. 2003); Flores v. Transamerica HomeFirst, Inc., 113 Cal. Rptr. 2d 376, 381–82 (Ct. App. 2002).

98. *See, e.g.*, Brower v. Gateway 2000, Inc., 676 N.Y.S.2d 569 (App. Div. 1998) (striking requirement that consumer proceed to arbitration at International Chamber of Commerce (“ICC”) because the expenses associated with filing a claim with the ICC rendered the chosen forum financially prohibitive).

99. *Cf.* Green Tree Fin. Corp.—Ala. v. Randolph, 531 U.S. 79 (2000) (recognizing these grounds for invalidating an arbitration agreement but placing the burden of proof on the party seeking to invalidate the clause).

100. Ting v. AT&T, 182 F. Supp. 2d 902 (N.D. Cal. 2002), *aff'd in part, rev'd in part*, 319 F.3d 1126 (9th Cir. 2003); Powertel, Inc. v. Bexley, 743 So. 2d 570 (Fla. Dist. Ct. App. 1999).

101. Hayes v. County Bank, 713 N.Y.S.2d 267 (Sup. Ct. 2000).

102. Hooters of Am., Inc. v. Phillips, 173 F.3d 933, 939 (4th Cir. 1999).

the employer. In addition, the employee was required to provide the employer with a list of witnesses and a summary of facts known about each, but the employer was subject to no corresponding duty. Finally, the employer—but not the employee—was provided with rights to appeal the arbitrator's decision to a court. Because the arbitration clause had features that increased the likelihood that the employer would prevail, it was struck down as “egregiously unfair.”¹⁰³

C. AGREEMENTS TO ARBITRATE EMPLOYMENT DISPUTES

A number of factors have combined to cause some courts to use whatever tools they may to carefully scrutinize agreements to arbitrate employment disputes. First, states have little ability to enact laws designed to prevent employers from using adhesion contracts to force employees to arbitrate their employment disputes. The Supreme Court has determined that even statutory nondiscrimination suits are subject to arbitration, and state laws directed at preserving particular state employment claims for courts are preempted by the FAA.¹⁰⁴ Second, employment arbitration is on the rise, raising concerns about the employers' motivations for inserting these clauses into employment contracts.¹⁰⁵ For example, some charge that arbitration clauses are drafted to effectively deprive employees of their rights.¹⁰⁶ Along the same lines, some scholars object to the effective privatization of civil rights and other discrimination claims in arbitration.¹⁰⁷ In short, the claim is that employers prefer arbitration because, relative to employees, they fare better in arbitration than in litigation.

The available empirical evidence on case win rates does not provide clear guidance on the matter. Two studies conducted in the 1990s showed higher employee win rates in arbitration than in litigation.¹⁰⁸ In contrast, a recent study comparing outcomes of employment disputes in litigation and arbitration show that employee win rates tend to be higher in litigation.¹⁰⁹ Another study found that results for high-wage employees differ significantly from results for low-wage employees. High-wage employees appear to fare as well in arbitration as in courts. Low-wage employees fare relatively worse than their higher paid counterparts in arbitration, but they seem to be

103. *Id.* at 938.

104. *See supra* Part II.B.

105. *See supra* Part I.

106. David E. Feller, *Fender Bender or Train Wreck?: The Collision Between Statutory Protection of Individual Employee Rights and the Judicial Revision of the Federal Arbitration Act*, 41 ST. LOUIS U. L.J. 561 (1997).

107. Joseph R. Grodin, *Arbitration of Employment Discrimination Claims: Doctrine and Policy in the Wake of Gilmer*, 14 HOFSTRA LAB. L.J. 1 (1996); Lewis L. Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29 (1998).

108. William M. Howard, *Arbitrating Claims of Employment Discrimination*, DISP. RESOL. J. Oct.–Dec. 1995, at 40; Maltby, *supra* note 107.

109. Colvin, *supra* note 34, at 6.

practically shut out of courts due to the fact that their lower-value claims fail to attract counsel.¹¹⁰ Of course, even if we had reliable information on relative employee win rates in arbitration and litigation, the two categories of cases are subject to very different selection pressures, making the comparison not terribly useful.¹¹¹ Nonetheless, concerns about the motivations behind the employer's unilateral choice persist.

When employees win, empirical studies show that overall the amounts that they recover are substantially higher in litigation than in arbitration.¹¹² One study found that although this difference existed for lower wage employees, there was no statistically significant difference in mean or median awards in arbitration and at trial for higher wage employees.¹¹³ Here too, selection effects cause concern over the meaning of any difference.

Still other critics of employment arbitration focus on a potential repeat-player effect. Employers with multiple cases in front of the same arbitration association fare better in arbitration than do employers that do not arbitrate multiple cases.¹¹⁴ Moreover, employers that arbitrate multiple cases with the same arbitrator tend to fare better, on average, than employers that arbitrate multiple cases with different arbitrators.¹¹⁵ The concern is that when employers effectively pick the arbitration association and have greater knowledge about potential arbitrators, they can produce results biased in their favor, especially if arbitrators want to be selected again in the future.¹¹⁶

Defenders of employment arbitration counter that these concerns are overblown and that arbitration can provide a quick, informal, and low-cost means for employees to bring their employment claims.¹¹⁷ Empirical evidence indicates that employment arbitration cases are resolved substantially sooner than are litigated employment cases, regardless of the type of claim alleged.¹¹⁸ Arbitration defenders also argue that arbitration

110. Eisenberg & Hill, *supra* note 41, at 44.

111. See, e.g., Lisa B. Bingham, *Employment Arbitration: The Repeat Player Effect*, 1 EMP. RTS. & EMP. POL'Y J. 189, 199 (1997); Stephen Ware, *The Effects of Gilmer: Empirical and Other Approaches to the Study of Employment Arbitration*, 16 OHIO ST. J. ON DISP. RESOL. 735 (2001).

112. Colvin, *supra* note 34, at 6; Maltby, *supra* note 107, at 48.

113. Eisenberg & Hill, *supra* note 41, at 44.

114. Bingham, *supra* note 111, at 209-10; Colvin, *supra* note 34, at 13.

115. Colvin, *supra* note 34, at 14-15.

116. See, e.g., Bingham, *supra* note 111, at 192-94; Lisa B. Bingham, *On Repeat Players, Adhesive Contracts, and the Use of Statistics in Judicial Review of Employment Arbitration Awards*, 29 MCGEORGE L. REV. 223 (1998); Sarah Rudolph Cole, *Incentives and Arbitration: The Case Against Enforcement of Executory Arbitration Agreements Between Employers and Employees*, 64 UMKC L. REV. 449 (1996).

117. See, e.g., David Sherwyn et al., *In Defense of Mandatory Arbitration of Employment Disputes: Saving the Baby, Tossing Out the Bath Water, and Constructing a New Sink in the Process*, 2 U. PA. J. LAB. & EMP. L. 73, 99 (1999).

118. Eisenberg & Hill, *supra* note 41, at 51 (finding that mean and median times in arbitration ranged from seven to thirteen months while mean and median times in both state and federal courts exceeded twenty months).

better enables the parties to resolve disputes while preserving a positive working relationship and that employer cost savings can be rechanneled into more generous employee compensation and benefits.¹¹⁹ But even defenders of employment arbitration acknowledge that some contractual provisions and practices could prove harmful to employees.¹²⁰

Persistent concerns about employment arbitration have caused some countries to refuse to enforce arbitration clauses in employment contracts.¹²¹ During the past few years, Congress has regularly considered but not passed an Arbitration Fairness Act that would also preclude courts from enforcing such clauses.¹²² As a matter of current governing federal law in the U.S.,¹²³ however, state and federal courts must enforce arbitration clauses in employment contracts to the same extent as any other arbitration clause.¹²⁴

In response to the controversy surrounding employment arbitration, some arbitration associations have made efforts to self-regulate. To better protect employee interests, and to help preserve the validity of employment arbitration, the major U.S. arbitration associations have drafted protocols that each employer must satisfy as a prerequisite to the association handling its employment disputes. For example, JAMS provides Employment Arbitration Minimum Standards that require, among other things, that (1) all remedies available under applicable law remain available to the employee; (2) the employee is provided with at least minimally adequate discovery rights; (3) fees and costs incurred by the employee are reasonable and not so large as to preclude employee claim prosecution; and (4) the

119. See, e.g., Ware, *supra* note 111, at 754 & n.92 (noting that fans of the *Gilmer* case argue that employment arbitration benefits everyone).

120. See, e.g., Samuel Estreicher, *Predispute Agreements To Arbitrate Statutory Employment Claims*, 72 N.Y.U. L. REV. 1344 (1997); Sherwyn et al., *supra* note 117, at 147 (acknowledging that mandatory arbitration is not perfect). For models of employment arbitration producing both efficiencies and inefficiencies, see Matthew T. Bodie, *Questions About the Efficiency of Employment Arbitration Agreements*, 39 GA. L. REV. 1 (2004), and Hylton, *supra* note 23.

121. Jean R. Sternlight, *Is the U.S. Out on a Limb? Comparing the U.S. Approach to Mandatory Consumer and Employment Arbitration to That of the Rest of the World*, 56 U. MIAMI L. REV. 831 (2002). One author suggests that the high union density in other countries makes labor courts cost-effective and attractive, resulting in less demand for labor arbitration. See Samuel Estreicher, *Arbitration of Employment Disputes Without Unions*, 66 CHI-KENT L. REV. 753, 793 (1990).

122. For current text, see Arbitration Fairness Act of 2011, S. 987, 112th Cong. (2011).

123. Section 1 of the FAA contains language that could have been interpreted to exclude employment arbitration from its coverage. In defining the scope of applicability of the FAA, Congress provided "but nothing herein contained shall apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce." 9 U.S.C. § 1 (2006). The Supreme Court has interpreted this provision to exclude only interstate transportation workers. *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001).

124. See *supra* Part II.B.

arbitrator provides a written award containing reasons for her decision.¹²⁵ The AAA Employment Due Process Protocol provides employees with similar rights to discovery, reasonable fees, and costs and remedies available under applicable law in their disputes involving statutory rights.¹²⁶

Some state courts use the unconscionability doctrine to independently police problematic terms in employment arbitration agreements, including those that provide for potentially biased arbitrator selection, impose prohibitively expensive costs to arbitrate, or so limit the employee's rights in arbitration that effective claim prosecution or effective remedies are precluded. Other provisions that unilaterally restrict an employee's right in arbitration are also heavily scrutinized. For example, a unilateral provision precluding the award of punitive damages to the employee only was similarly struck down as substantively unconscionable.¹²⁷ And, in response to concerns about the repeat-player problem, California courts have refused to enforce arbitration clauses when the arbitral forum chosen by the employer is so small that the employer can at least implicitly exert pressure on the arbitrators to render decisions in its favor.¹²⁸

In addition to these measures, some courts also require mutuality in the parties' agreement to arbitrate. In fact, at least one court has described mutuality as "the paramount consideration in assessing conscionability."¹²⁹ If an arbitration clause requires only the employee but not the employer to take claims to arbitration, then these courts will strike the arbitration clause.¹³⁰ Mutuality helps to ensure fairness: "If the arbitration system

125. JAMS, JAMS EMPLOYMENT ARBITRATION RULES & PROCEDURES (2009), available at http://www.jamsadr.com/files/Uploads/Documents/JAMS-Rules/JAMS_employment_arbitration_rules-2009.pdf. These minimum standards do not apply to individually negotiated agreements. *Id.* at 4.

126. AM. ARBITRATION ASS'N, EMPLOYMENT DUE PROCESS PROTOCOL (2011), available at http://www.adr.org/aaa/ShowPDF?url=/cs/groups/lee/documents/document/mdaw/mdaw/~edisp/adrstg_004368.pdf.

127. See *Zuver v. Airtouch Commc'ns, Inc.*, 103 P.3d 753, 766-67 (Wash. 2004).

128. See *Mercuro v. Superior Court*, 116 Cal. Rptr. 2d 671, 678-79 (Ct. App. 2002) (noting that employer's choice of arbitral forum resulted in only eight available arbitrators in the relevant district and finding that the potential for the repeat-player effect to influence the decision was one factor in its decision to strike the arbitration clause).

129. *Abramson v. Juniper Networks, Inc.*, 9 Cal. Rptr. 3d 422, 436 (Ct. App. 2004).

130. See, e.g., *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165 (9th Cir. 2003); *Circuit City Stores, Inc. v. Adams*, 279 F.3d 889 (9th Cir. 2002); *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669 (Cal. 2000); *Frye v. Speedway Chevrolet Cadillac*, 321 S.W.3d 429, 441-42 & n.21 (Mo. Ct. App. 2010) (questioning but not deciding whether arbitration clause is sufficiently mutual when employer does not obligate itself to submit its disputes to arbitration); *cf. Iberia Credit Bureau, Inc. v. Cingular Wireless LLC*, 379 F.3d 159 (5th Cir. 2004) (striking an arbitration agreement in consumer contract obligating only the consumer to arbitrate); *Simpson v. Grimes*, 2002-0869 (La. App. 3 Cir. 5/21/03); 849 So. 2d 740, *abrogated by* *Aguillard v. Auction Mgmt. Corp.*, 2004-2804, 2004-2857 (La. 6/29/05); 908 So. 2d 1. *But see* *Harris v. Green Tree Fin. Corp.*, 183 F.3d 173, 181 (3d Cir. 1999); *Doctor's Assocs., Inc. v. Distajo*, 66 F.3d 438, 453 (2d Cir. 1995) (upholding one-sided obligation to arbitrate);

established by the employer is indeed fair, then the employer as well as the employee should be willing to submit claims to arbitration.”¹³¹ Even when the arbitration clause appears to obligate both parties to participate in binding arbitration, courts can strike it as unconscionable when the employer reserves for itself an unfettered right to modify or to terminate the arbitration plan without prior notice to the employee.¹³² In these cases, it appears that the mutual obligation to arbitrate is illusory.¹³³ When the arbitration provision is found to lack mutuality, the employee is permitted to proceed with litigation notwithstanding the presence of an arbitration agreement.

Even if the parties appear to mutually commit to arbitrate disputes, courts will sometimes strike an arbitration clause if the drafter carves out a right to bring claims to court and the claims carved out appear to represent the entirety of the drafter’s claims. Consider, for example, the arbitration clause at issue in *Sutton’s Steel and Supply, Inc. v. BellSouth Mobility, Inc.*¹³⁴ BellSouth’s standard-form contract included an arbitration clause that obligated both it and the customer to resolve disputes in arbitration, but in a separate clause, the company reserved the right to bring court actions against the customer to collect debts owed.¹³⁵ The court found that this carveout compromised the mutuality of the parties’ agreement to arbitrate, especially because it seemed implausible that BellSouth would ever have claims against its customers other than claims for the collection of moneys owed.¹³⁶ In effect, the carveout took back the company’s promise to arbitrate claims. Similar reasoning is sometimes used in the context of arbitration clauses in employment contracts,¹³⁷ although it is less clear at what point an employer has carved out all conceivable claims against an employee.

Martindale v. Sandvik, Inc., 800 A.2d 872 (N.J. 2002) (upholding potentially unilateral arbitration clause); Motsinger v. Lithia Rose-FT, Inc., 156 P.3d 156 (Or. Ct. App. 2007) (holding that it is not unconscionable to require only employee to arbitrate where the terms of the arbitration appear fair to the employee).

131. *Armendariz*, 6 P.3d at 692.

132. *Dumais v. Am. Golf Corp.*, 299 F.3d 1216, 1219 (10th Cir. 2002); *Floss v. Ryan’s Family Steak Houses, Inc.*, 211 F.3d 306, 315–16 (6th Cir. 2000); *Gibson v. Neighborhood Health Clinics, Inc.*, 121 F.3d 1126 (7th Cir. 1997); *Snow v. BE & K Constr. Co.*, 126 F. Supp. 2d 5, 14–15 (D. Me. 2001); *Gibson v. Nye Frontier Ford, Inc.*, 205 P.3d 1091 (Alaska 2009); *Frye*, 321 S.W.3d at 442 & n.21; *Redmond v. Big Sandy Furniture, Inc.*, No. 08CA12, 2008 WL 4966549 (Ohio Ct. App. Nov. 19, 2008); *Salazar v. Citadel Commc’ns Corp.*, 2004-NMSC-013, 135 N.M. 447, 90 P.3d 466; *J.M. Davidson, Inc. v. Webster*, 128 S.W.3d 223 (Tex. 2003).

133. *See, e.g., Dumais*, 299 F.3d at 1219; *Salazar*, 2004-NMSC-013, 91 12; *Webster*, 128 S.W.3d at 232.

134. *Sutton’s Steel & Supply, Inc. v. BellSouth Mobility, Inc.*, 00-511, 00-898 (La. App. 3 Cir. 12/13/00); 776 So. 2d 589, *abrogated by* *Aguillard v. Auction Mgmt. Corp.*, 2004-2804, 2004-2857 (La. 6/29/05); 908 So. 2d 1

135. *Id.* at p. 9–11, 776 So. 2d 596–97.

136. *Id.* at p. 10–11, 766 So. 2d 597.

137. *Mercurio v. Superior Court*, 116 Cal. Rptr. 2d 671, 676–77 (Ct. App. 2002).

In truth, courts do not agree on the doctrinal foundation for mutuality. Some place the issue within unconscionability, reasoning that it is fundamentally unfair for an employer to force employees to submit claims to arbitration without itself agreeing to submit its claims to arbitration.¹³⁸ Other courts treat the issue as one of consideration,¹³⁹ reasoning that the arbitration agreement is a separate agreement from the remainder of the employment agreement and that therefore something other than the terms of the employment contract must support the employee's promise to arbitrate. The consideration doctrine is a blunter regulatory tool than is unconscionability. Courts using the consideration doctrine must either enforce or refuse to enforce the arbitration agreement,¹⁴⁰ whereas those using unconscionability have the authority to enforce part of the arbitration clause, while striking the portion perceived to be unfair.¹⁴¹ More importantly for present purposes, under consideration analysis, courts typically do not inquire into adequacy or fairness; anything given by the employer, whether a return promise or a small bonus, would be sufficient.¹⁴² For courts using the consideration doctrine, then, the employee's promise to arbitrate claims can be supported by a promise on the part of the employer to submit any claims to arbitration.¹⁴³ But for courts using the unconscionability doctrine to scrutinize the agreement, more obligation on the part of the employer may be necessary to establish fundamental fairness.

In particular, courts using the unconscionability doctrine are more likely to look past the agreement's bilateral arbitration obligations to inquire into whether the drafter has used carveout provisions to reserve a greater (albeit qualified) right to resort to courts. California courts, in particular, express concern that when the employer carves out a right to bring even a small number of its claims to court, it is preserving for itself a procedural advantage not realistically offered to employees. In several cases, the California courts have refused to order an employee to arbitrate her claims

138. See *supra* note 130.

139. See *supra* note 130; see also *Showmethemoney Check Cashers, Inc. v. Williams*, 27 S.W.3d 361 (Ark. 2000) (consumer loan agreement).

140. Cf. RESTATEMENT (SECOND) OF CONTRACTS § 17(1) (1981) (listing consideration as requirement of contract).

141. See U.C.C. § 2-302(1) (2012) ("If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result."); RESTATEMENT (SECOND) OF CONTRACTS § 208 ("If a contract or term thereof is unconscionable at the time the contract is made a court may refuse to enforce the contract, or may enforce the remainder of the contract without the unconscionable term, or may so limit the application of any unconscionable term as to avoid any unconscionable result.").

142. See *KNAPP ET AL.*, *supra* note 95, at 62 (discussing adequacy of consideration requirement).

143. *Harris v. Green Tree Fin. Corp.*, 183 F.3d 173, 181 (3d Cir. 1999).

on grounds that the employer has tainted the arbitration clause by including such carveouts. Almost always, the carveouts are for the very types of claims that we commonly observe in CEO employment contracts. Specifically, carveouts rendering the arbitration clause substantively unconscionable have included rights to bring the following types of claims to court: noncompetence claims;¹⁴⁴ claims involving intellectual-property rights;¹⁴⁵ and confidentiality clause or other proprietary-information claims.¹⁴⁶ On the other hand, carveouts for preliminary relief that mirror the rights to such relief already afforded to arbitrated disputes under state law are permitted.¹⁴⁷

On the surface, California has not rendered these unilateral carveouts categorically impermissible. California courts have consistently stated that carveouts and other forms of nonmutuality will not render an arbitration clause unconscionable if the employer can justify the carveouts with evidence of a legitimate business need.¹⁴⁸ However, we are not aware of a single case where a California court has found the employer's business justification to be sufficient to preserve the arbitration clause.¹⁴⁹

In *Mercuro v. Superior Court*,¹⁵⁰ for example, the arbitration clause included carveouts for injunctive or other equitable relief for unfair competition, unauthorized disclosure of trade secrets, or violation of

144. See, e.g., *Fitz v. NCR Corp.*, 13 Cal. Rptr. 3d 88 (Ct. App. 2004); *Stirlen v. Supercuts, Inc.*, 60 Cal. Rptr. 2d 138 (Ct. App. 1997); see also *Martinez v. Master Prot. Corp.*, 12 Cal. Rptr. 3d 663 (Ct. App. 2004) (unfair competition claims); *Mercuro v. Superior Court*, 116 Cal. Rptr. 2d 671 (Ct. App. 2002) (fee sharing).

145. See, e.g., *Kalmbach v. Sportsmobile W., Inc.*, No. F054648, 2008 WL 4988663 (Cal. Ct. App. Nov. 25, 2008); *Fitz*, 13 Cal. Rptr. 3d 88 (intellectual property); *Martinez*, 12 Cal. Rptr. 3d 663 (trade secrets); *Abramson v. Juniper Networks, Inc.*, 9 Cal. Rptr. 3d 422 (Ct. App. 2004) (trade secrets); *O'Hare v. Mun. Res. Consultants*, 132 Cal. Rptr. 2d 116 (Ct. App. 2003) (trade secrets); *Mercuro*, 116 Cal. Rptr. 2d 671 (intellectual-property violations and trade secrets); *Stirlen*, 60 Cal. Rptr. 2d 138 (patent infringement).

146. See, e.g., *Fitz*, 13 Cal. Rptr. 3d 88 (confidentiality-clause claims); *Martinez*, 12 Cal. Rptr. 3d 663 (misuse or disclosure of confidential information); *Abramson*, 9 Cal. Rptr. 3d 88 (confidential and proprietary information); *O'Hare*, 132 Cal. Rptr. 2d 116 (confidentiality-clause claims); *Mercuro*, 116 Cal. Rptr. 2d 671 (confidential information); *Stirlen*, 60 Cal. Rptr. 2d 138 (improper use of confidential information).

147. See, e.g., *Clarus Sys., Inc. v. Variphy, Inc.*, No. A115360, 2007 WL 576149, at *1 (Cal. Ct. App. Feb. 26, 2007); *Inter@ctive, Inc. v. Cubic Transp. Sys., Inc.*, No. D047096, 2007 WL 178429, at *1 (Cal. Ct. App. Jan. 25, 2007); cf. *Htay Htay Chin v. Advanced Fresh Concepts Franchise Corp.*, 123 Cal. Rptr. 3d 547 (Ct. App. 2011) (franchise contract).

148. See, e.g., *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669, 692 (Cal. 2000) (inference of unconscionability can be overcome if employer has reasonable justification for the nonmutuality); *Fitz*, 13 Cal. Rptr. 3d at 103 (upholding nonmutual arbitration agreement only if the stronger party can show, through the contract or other facts, that "business realities" create a special need for the advantage); cf. *Mercuro*, 116 Cal. Rptr. 2d at 677-78 (rejecting employer's proffered evidence of business justification as insufficient).

149. See, e.g., *Fitz*, 13 Cal. Rptr. 3d 88; *O'Hare*, 132 Cal. Rptr. 2d 116; *Mercuro*, 116 Cal. Rptr. 2d 671; *Stirlen*, 60 Cal. Rptr. 2d 138.

150. *Mercuro*, 116 Cal. Rptr. 2d 671.

intellectual-property rights. The employer attempted unsuccessfully to justify the carveouts on the ground that monetary damages for misappropriation of its intellectual-property assets would be difficult to calculate and that in any event money damages would not protect it from further misappropriation.¹⁵¹ The court rejected the employer's argument in part by stating that it had no evidence to support its business justification.¹⁵² This and other questionable provisions in the arbitration clause resulted in the clause being struck in its entirety.¹⁵³

Consider also *Fitz v. NCR Corp.*¹⁵⁴ The arbitration clause at issue carved out disputes involving the parties' confidentiality or noncompete agreements and those involving its intellectual-property rights.¹⁵⁵ In addition, the clause carved out some employee claims like worker's compensation and unemployment insurance proceedings, as well as agency proceedings for discrimination or other civil rights violations.¹⁵⁶ The court concluded that the employer could not justify its carveouts by a need for provisional relief in courts because California law already gives parties some limited ability to obtain provisional relief.¹⁵⁷ The company had cited to some cases where employees rather than employers have brought noncompete and intellectual-property-rights claims to court, but the court nevertheless found it problematic that most such claims are brought by employers.¹⁵⁸ The employer argued that it had only carved out a fraction of its possible claims and had obligated itself to arbitrate others, including theft and embezzlement claims, but the court thought these claims were unlikely.¹⁵⁹ Finally, the company argued that it had also agreed to carve out some employee claims, but the court cited *Mercurio* to conclude that those claims would be separately maintained by an administrative agency in any event.¹⁶⁰ Here too the court struck the entire arbitration clause from the employment contract.¹⁶¹

In striking arbitration clauses with carveouts, the California courts have not confined their role to the protection of low-level employees. The same scrutiny has been applied to carveouts in the arbitration clause of a franchise contract,¹⁶² and to employment disputes brought by the employer's vice

151. *Id.* at 677-78.

152. *Id.* at 678.

153. *Id.* at 684.

154. *Fitz*, 13 Cal. Rptr. 3d 88.

155. *Id.* at 92.

156. *Id.*

157. *Id.* at 105.

158. *Id.* at 104.

159. *Id.* at 104-05.

160. *Id.* at 92, 104.

161. *Id.* at 106-07.

162. *See Nagrampa v. Mailcoups, Inc.*, 469 F.3d 1257 (9th Cir. 2006).

president of operations,¹⁶³ vice president and chief financial officer,¹⁶⁴ and president and CEO.¹⁶⁵ This extension is remarkable, given that procedural unconscionability is much less likely in the employment contracts of company executives.¹⁶⁶

To our knowledge no other courts have subjected carveouts to arbitration agreements in employment contracts to the same exacting scrutiny as have the California courts. One non-California court struck an arbitration clause with carveouts similar to those found in the California cases, but the court interpreted the carveout provision as completely eliminating any obligation on the part of the employer to arbitrate its claims.¹⁶⁷ In addition, the JAMS Employment Arbitration Minimum Standards¹⁶⁸ impose a mutuality requirement on arbitration clauses in employment contracts, but its requirement is less stringent than California's. The Minimum Standards provide that "[b]oth the employer and the employee must have the same obligation (either to arbitrate or go to court) with respect to the same kinds of claims."¹⁶⁹ Presumably nothing in this standard prevents an employer from carving out particular types of claims, so long as both employer and employee are by the terms of the clause permitted to bring such claims in court (as was true in *Fitz*). California courts often take the lead in scrutinizing arbitration clauses, so California's scrutiny of carveouts from employment-contract arbitration agreements could well spread to other courts.

In this Article we seek a better understanding of the use of carveouts in the arbitration clauses contained in CEO employment contracts. How common are carveouts? What types of claims are carved out? Does the frequency of the use of carveouts depend on the type of firm? Are firms based in California less likely to carve out claims, given the precedent in California? And, given that our contracts are heavily negotiated employment contracts, does their content shed light on the soundness of the California courts' reasoning regarding the mutuality of party obligations to arbitrate? We now turn to our research questions.

163. See *Kalmbach v. Sportsmobile W., Inc.*, No. F054648, 2008 WL 4988663, at *1 (Cal. Ct. App. Nov. 25, 2008).

164. See *Stirlen v. Supercuts, Inc.*, 60 Cal. Rptr. 2d 138, 140 (Ct. App. 1997).

165. See *Trivedi v. Curexo Tech. Corp.*, 116 Cal. Rptr. 3d 804 (Ct. App. 2010).

166. Cf. *Guiliano v. Inland Empire Pers., Inc.*, 58 Cal. Rptr. 3d 5, 14-16 (Ct. App. 2007) (holding that protections of *Armendariz* do not apply in case brought by company executive vice president and chief financial officer, at least when his dispute involves a right to a multimillion-dollar bonus rather than an unwaivable statutory claim).

167. See *Hull v. Norcrom, Inc.*, 750 F.2d 1547 (11th Cir. 1985).

168. See JAMS, JAMS POLICY ON EMPLOYMENT ARBITRATION MINIMUM STANDARDS OF PROCEDURAL FAIRNESS (2009), available at http://www.jamsadr.com/files/uploads/Documents/JAMS-Rules/JAMS_Employment_Min_Stds-2009.pdf.

169. *Id.* at 4.

III. UNIVARIATE ANALYSIS

We begin our empirical analysis with a description of our data-collection procedure and an overview of the prevalence of arbitration clauses in our sample. We then present some univariate statistics concerning the use of arbitration clauses, followed by a discussion of the more refined forms of customization of these clauses. We conclude this section with an analysis of the use of litigation carveouts in these agreements and the “California” effect on these provisions.

A. *THE CONTRACTS SAMPLE AND THE PREVALENCE OF ARBITRATION CLAUSES*

We generated a sample of CEO employment contracts by creating a list of all of the companies included in the S&P 1500 from 1995 to 2005. Using this list, we examined each of these companies’ mandatory securities-law filings under the 1934 Securities Exchange Act in the SEC’s EDGAR database. We employed a privately owned version of this database, Live Edgar, for ease of manual and electronic search techniques.

Using Live Edgar, we checked each company’s Form 10-K (annual report) filings to see if the company mentioned that its CEO had an employment contract. If so, we searched for these employment contracts, which are attached as an exhibit to one of the firm’s securities filings. If they exist, these contracts are required disclosures for every registered company. Whenever we found one of the contracts, we downloaded it and coded it using a coding system that we created in order to gather the requisite information. We found a total of 1970 contracts in this search.

We found several different variations in CEO employment contract types.¹⁷⁰ For our purposes, the three most important contract types are initial contracts, contract amendments, and restated contracts. Initial contracts are those that are entered into between the company and its new CEO, or in some cases, by a company and its current CEO when the firm’s prior relationship with the CEO was not the subject of a written employment contract. Generally, CEOs and firms enter into initial contracts at the beginning of their employment relationships.

Contract amendments can be initiated at any time for any reason once an employment contract is in place. They are typically quite short and affect only a few terms of the initial (or restated) contract, usually specifying changes in the CEO’s compensation arrangement. They rarely alter any noncompensation-related terms of the employment relationship. We did not

170. We made no attempt to include all of the other various contractual agreements that exist between CEOs and their firms. For example, we did not include change-of-control agreements in our sample, although some of these agreements include arbitration provisions. We recognized that these other forms of agreement may affect the employment relationship between the firm and its managers, but we decided to leave them for a later day in order to maintain our focus on employment contracts.

find a single case where these amendments altered the arrangements, or lack thereof, providing for arbitration of any dispute between the parties. For this reason, we decided to drop these contract amendments from our sample. This decision reduced our sample by 1052 observations.

Restated contracts (sometimes called “amended and restated contracts”) are contracts that are entered into subsequent to the initial contract, usually after one or more amendments have been made to the initial contract. A restated contract incorporates all of the changes made in the various amendments, and it also frequently adds new terms. This new, integrated document reflects all of the terms of the employment contract between the CEO and the firm. We included these agreements in our sample for three reasons. First, in some instances, the initial contracts are unavailable.¹⁷¹ Second, restated contracts can result in changes to the arbitration arrangements in the parties’ agreement. Finally, they provide us with some insight into the “stickiness” of arbitration provisions, that is, whether their presence in an earlier CEO contract is likely to persist in later ones.

Next, for some of the variables included in our multivariate analysis, we needed additional information about the CEOs and their companies. For this information, we used the Compustat database maintained by Standard and Poor’s. It contains company-specific descriptive and financial-statement data for the past twenty years on an annual basis for companies that have actively traded securities at any point during that time period. The Compustat database enabled us to collect information about firm performance, the company’s principal business line, firm size, and the state of the headquarters for the firms where our CEOs worked. The firm performance variables are sales and return on capital. Return on capital is defined as net income divided by capital. Capital is the book value of debt and equity as reported on the firm’s balance sheet. Return on capital is then averaged over the five-year period prior to the start date of the CEO’s compensation contract. After eliminating contracts for which this information was unavailable, we ended up with 910 contracts in our sample.¹⁷²

For each employment contract in our sample, we coded the presence or absence of an arbitration clause. For each of the employment contracts containing an arbitration clause, we coded a wide variety of additional information about the contents of the arbitration provision, including

171. This could happen if the initial contracts were entered into prior to May 6, 1996, when the SEC mandated that all companies file electronically on the EDGAR database, or if the company failed to disclose an earlier contract. We searched diligently to find all prior contracts to confirm wherever possible if they contained an arbitration clause.

172. We could have included all of the CEO employment contracts in our analysis; however, the absence of the additional data on certain variables would have made it difficult to test different explanations for the presence or absence of arbitration provisions.

whether the parties: (1) chose an arbitration association (and if so, which one); (2) specified the rules of procedure that arbitration would follow; (3) chose a specific number of arbitrators to resolve disputes; (4) chose a location for arbitration (and if so, where); (5) contractually allocated the costs of arbitration; (6) provided a limitations period for filing for arbitration; (7) addressed rules of discovery or rules of evidence; (8) contractually prohibited the arbitrator from awarding punitive damages; (9) were bound to keep the contents of arbitration proceedings confidential; (10) obligated the arbitrator to issue a written opinion justifying her decision; and (11) reserved the right to appeal the arbitrator's decision to an arbitration-appeal panel or to the courts. In addition, we coded the contracts for whether the parties carved out a right to have courts grant preliminary relief and whether the parties carved out particular types of claims for court resolution, including claims involving the confidentiality,¹⁷³ noncompete,¹⁷⁴ nonsolicitation,¹⁷⁵ and nondisparagement¹⁷⁶ provisions of the agreement.

Turning to the presence or absence of arbitration provisions, we see in Table 1 that of the 910 contracts studied, 469 (52%) provided for arbitration of at least some of the parties' disputes, and their arbitration provisions typically required both parties to proceed to mandatory, binding arbitration.¹⁷⁷ This proportion is consistent with the results of two earlier studies by one or more of the authors of this Article.¹⁷⁸

In an earlier study by the authors of this Article, we noted that the overall average of about half masks an upward trend in the use of arbitration over time—from an observed low of 36% of the contracts in 1997 to a high of 60% of contracts in 2005.¹⁷⁹ A simple linear regression of the percentage of contracts containing arbitration provisions each year against time indicated a statistically significant upward slope.¹⁸⁰ This trend indicates a

173. Confidentiality provisions state that the executive promises not to disclose certain information about the firm and its activities.

174. Noncompete provisions bar executives from competing with the company for a period of time after the termination of their employment position with the company. *See* Schwab & Thomas, *supra* note 28 at 254–57.

175. Nonsolicitation provisions stop departing executives from soliciting employees and clients of their employer to change their allegiances and move to the new firm where the executive will be working.

176. Nondisparagement clauses are designed to ensure that departing executives do not make negative comments or statements about their former employer.

177. Arbitration clauses can alternatively provide for optional arbitration or for nonbinding arbitration, where an arbitrator provides a recommended settlement. None of our contracts provided for nonbinding arbitration, and only a handful provided for optional arbitration.

178. Schwab & Thomas, *supra* note 28; Thomas, O'Hara & Martin, *supra* note 50, at 981.

179. Thomas, O'Hara & Martin, *supra* note 50, at 981.

180. The t-statistic on the slope was 3.84. *Id.* at 981 n.71.

possible transition toward a new equilibrium situation where arbitration is more commonly employed than in the past.

TABLE 1

PRESENCE OF ARBITRATION CLAUSE IN CONTRACT BY LOCATION AND FIRM TYPE

| | All Sample Firms | California Firms | Firms Located Outside California | IT Firms | Non-IT Firms |
|--------------------------------------|------------------|------------------|----------------------------------|----------------|-------------------|
| Contracts with Arbitration Clause | 469 (51.5%) | 75 (67.0%) | 394 (49.4%) | 115 (61.5%) | 354 (49.0%) |
| Contracts with No Arbitration Clause | 441 (48.5%) | 37 (33.0%) | 404 (50.6%) | 72 (38.5%) | 369 (51.0%) |
| Total | 910 | 112 | 798 | 187 | 723 |
| | | | California Effect *** | | IT Firm Effect*** |

As discussed in Part II, we had good reasons to believe that firms located in California might be more likely to insert arbitration provisions into contracts with their employees. To determine whether California law is influencing contracting parties, we separated firms based on the designated primary location of the firm in Compustat. Primary location is likely a rough, albeit imperfect, proxy for the location of employment of the CEO. However, even if it does not capture the actual headquarters of a firm, a firm primarily located in California should be concerned about the possible application of California law to the agreement.¹⁸¹ In our sample, 112 contracts were for firms that had their primary location in California, while the remaining 798 were for firms located primarily in other states. Of the 469 contracts that contained an arbitration clause, 75 of those contracts involved firms primarily located in California (“California firms”), and 394 involved firms primarily located outside of California (“non-California firms”).

We tested a null hypothesis that the incorporation of an arbitration clause into an agreement did not depend on whether the firm was primarily located in California. As Table 1 shows, 67% of contracts entered into by California firms contained an arbitration clause, compared to 49% of non-

181. See, e.g., *In re* Consol. Capital Equities Corp., 143 B.R. 80, 85 (Bankr. N.D. Tex. 1992) (applying California law to a corporation based on its principal place of business and location of a majority of its assets); *DiTondo v. Meagher*, 883 N.Y.S.2d 690, 695 (Sup. Ct. 2009) (noting that it is “well-settled” that for choice-of-law purposes a corporation is domiciled at its principal place of business).

California firms. Using a chi-squared test for statistical significance, we reject the null hypothesis of no difference.¹⁸² This suggests that California firms are more wary of courts in general than are non-California firms.

We also wanted to know whether information technology firms (“IT firms”) are more likely to want to arbitrate disputes than other types of firms (“non-IT firms”). We had no clear hypothesis regarding the question, however. On the one hand, if IT firms can garner more value from noncompete clauses that are reliably enforced across state borders, then we would expect IT firms to choose arbitration more often than non-IT firms, given that some courts will heavily scrutinize noncompete clauses in employment contracts and California courts refuse to enforce them altogether.¹⁸³ On the other hand, a cursory glance at our collected data indicated that companies commonly carve out noncompete clauses and other information-protecting clauses for court resolution. If IT firms disproportionately rely on such provisions to protect firm value, they might be inclined to forgo arbitration altogether in order to ensure court protection of the rights they most value. To test whether there might be a difference in the use of arbitration clauses for IT firms, our null hypothesis was that there is no difference. To test this claim, we coded the firms into IT firms and non-IT firms. The firms were categorized according to whether they were classified as being in the information technology economic sector using the Global Industry Classification Standard (“GICS”) as reported in Compustat. Of the CEO contracts having arbitration clauses, there were 115 CEO contracts for IT firms and 354 CEO contracts for non-IT firms. Table 1 shows that 62% of IT firms had arbitration clauses in their contracts, whereas only 49% of non-IT firms did. The difference is statistically significant, indicating that the IT firms have a definite preference for arbitration.¹⁸⁴

B. ARBITRATION PROCEDURE AND COST FINDINGS

We turn next to the contents of the arbitration provisions. We began by examining whether or not the parties chose a specific arbitration association. In our sample, when the parties chose arbitration, they almost always specified an arbitration association that would handle their disputes, and they also virtually always chose a governing set of procedural rules for arbitral proceedings. As shown in Table 2, in 435 out of 469 (93%) of the contracts with arbitration clauses, the parties chose an arbitration association, and in another 6 contracts specifically selected a method for arbitration without choosing a specific association (for a total of 441 contracts). Only 28, or about 6%, of the arbitration clauses in our sample

182. The difference is statistically significant at the 1% level.

183. Gilson, *supra* note 69, at 607–09.

184. These differences are statistically significant at the 1% level.

remained silent on the method of arbitration. Similarly, Table 3 shows that 96% (all but 18) specified a set of governing rules to apply in arbitration.

While the parties almost always chose an arbitration association and a set of governing rules, there was remarkably strong convergence on one of two arbitration associations but considerable variation across the choice of arbitration rules. Table 2 shows that the overwhelming majority of contracts choosing an arbitration association chose either the AAA (399 out of 441, or 90%) or JAMS/Endispute (30 out of 441, or 7%). Seven other arbitration associations were chosen, although only in one or two contracts each in our sample.

TABLE 2
PARTY CHOICE OF ARBITRATION ASSOCIATION

| Arbitration Association | Count |
|---|-------|
| Association Unspecified | 28 |
| Parties Specified Own Method for Proceeding Without the Use of an Arbitration Association | 6 |
| American Arbitration Association (AAA) | 399 |
| JAMS* | 29 |
| Endispute* | 1 |
| California Mediation and Conciliation Services | 2 |
| CPR Institute for Dispute Resolution | 1 |
| Judicate | 1 |
| Arbitration Services of Portland | 1 |
| American Health Lawyers Dispute Resolution Services | 1 |
| Complainant Can Choose Between JAMS and CPR Institute | 1 |
| Total | 469 |

* JAMS and Endispute merged into JAMS/Endispute in 1994, so these choices are actually identical.

Turning to Table 3, we show the parties' choice of governing arbitration rules. Overall, some version of the AAA rules of procedure were chosen in 306 of the 451 contracts (68%) specifying rules for the arbitration. Although substantial, the percentage of parties choosing AAA rules is a much smaller percentage than the percentage of contracts choosing AAA as a forum for dispute resolution.¹⁸⁵ This disparity suggests that many contracting parties chose arbitration associations for reasons

185. Note that this disparity holds even if all 18 (less than 4%) of the contracts that failed to specify rules are contracts choosing the AAA as a forum and that the failure to choose governing procedural rules is a silent choice in favor of the application of AAA rules.

other than the desirability of their rules of procedure. In all, seventeen different types of arbitration rules were chosen. Given the apparent textured choices made, it appears that the parties gave this feature more attention than they afforded to the choice of arbitration association. Future empirical studies should focus on the overlap between arbitration associations and arbitration rules.

TABLE 3
PARTY CHOICE OF ARBITRATION RULES

| Arbitration Rules | Count |
|---|-------|
| No Rules Specified | 18 |
| AAA Commercial Arbitration Rules | 105 |
| National Rules for the Resolution of Employment Disputes | 103 |
| JAMS | 25 |
| AAA Expedited Commercial Rules | 3 |
| CPR Rules for Non-Administered Arbitration | 1 |
| Endispute | 4 |
| AAA Employment Arbitration Rules | 16 |
| AAA Rules—but Specific Rules Unspecified | 179 |
| AAA Voluntary Arbitration Rules | 1 |
| AAA Labor Arbitration Rules | 2 |
| CPR Rules for Non-Administered Arbitration of Business Disputes | 4 |
| Arbitration Rules of California Code of Procedure | 1 |
| JAMS, but Specific JAMS Rules Excluded | 3 |
| Judicate Rules | 1 |
| Rules of Arbitration Services of Portland | 1 |
| American Health Lawyers Association Arbitration Rules | 1 |
| Governing Rules Depended on Source/Type of Dispute | 1 |
| Total | 469 |

Table 4 shows that the parties also commonly addressed the allocation of arbitration costs. Overall, 355 out of the total of 469 contracts with arbitration clauses, or 76%, state how the parties intended to allocate costs, although 114, or 24%, remained silent on the issue. These numbers are somewhat misleading because the choices do not all contribute to the degree of customization. For example, 47 of the contracts left the allocation of costs to be determined by the arbitrator, a provision that is no more informative than silence. Another 52 of the contract provisions stated either that each party will bear its own costs, or that the costs will be split evenly

between the parties, which are the two most likely outcomes when cost allocations are determined by the arbitrator.¹⁸⁶ Even so, 252 out of 469, or 54%, of the arbitration clauses clearly customized the allocation of arbitration costs in that they displaced the applicable legal default rule. These latter provisions typically specified either that the employer would pay a majority of the costs of arbitration (90 contracts, or 19% of all arbitration clauses), or that the costs would be allocated based on the resolution of the dispute (162 contracts, or 35% of all arbitration clauses), a type of prevailing-party provision.

TABLE 4
PARTY CHOICE OF ALLOCATION OF ARBITRATION COSTS

| Allocation of Arbitration Costs | Count |
|---|-------|
| No Cost Allocation Provided in the Agreement | 114 |
| Costs To Be Split Evenly or Each Party Bears Own Costs | 52 |
| Company Agrees To Pay More than Half/Own Share of Costs | 90 |
| Costs Left to Arbitrator To Allocate | 47 |
| Costs Allocated According to How the Dispute Is Resolved | 162 |
| Costs Allocated According to When a Dispute Arises or Is Resolved | 2 |
| Costs Allocated According to Type of Claim | 2 |
| Total | 469 |

Our contracts provide useful insight into a relative preference for the English rule relative to the American rule for awarding attorney fees. In a recent study, Ted Eisenberg and Geoff Miller examine a broad variety of contracts filed with the SEC to glean a relative preference for each rule for the allocation of attorney fees among sophisticated parties.¹⁸⁷ Under the American rule, each party bears its own attorney fees, but under the English rule, the loser pays the attorney fees of the prevailing party.¹⁸⁸ Eisenberg and Miller categorize a silent contract as one that chooses the American rule, even though silence could simply mean that the parties have not considered

186. See CHARTERED INST. OF ARBITRATORS, PRACTICE GUIDELINE 9: GUIDELINE FOR ARBITRATORS MAKING ORDERS RELATING TO THE COSTS OF ARBITRATION § 3.5 (remarking that it is unusual in the U.S. for an arbitrator to award attorney fees), available at <http://www.ciarb.org/information-and-resources/PracticeGuideline9.pdf>; John Yukio Gotanda, *Awarding Costs and Attorneys' Fees in International Commercial Arbitrations*, 21 MICH. J. INT'L L. 1, 10 (1999) (same).

187. Theodore Eisenberg & Geoffrey P. Miller, *The English vs. the American Rule on Attorneys Fees: An Empirical Study of Attorney Fee Clauses in Publicly-Held Companies' Contracts*, (N.Y.U. Ctr. for Law & Econ., Working Paper No. 10-52, 2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1706054.

188. *Id.* at 3.

the issue. Moreover, many of their contracts contain arbitration clauses,¹⁸⁹ and silence in an arbitration clause does not necessarily indicate that the American rule would apply by default. Given that the allocation of attorney fees is most often left to the arbitrator to decide, silence in the context of a contract with an arbitration clause is much more likely to indicate no preference regarding the split of attorney fees.¹⁹⁰ With silent contracts categorized as a preference for the American rule, Eisenberg and Miller find no preference between the American rule and the English rule: 39% of contracts fall in the former group and 35% of contracts fall in the latter group.¹⁹¹ Because we have good reason to believe that our silent contracts most likely indicate no preference, we can directly compare the number of contracts choosing the American rule, at most 52, with those choosing the English rule, 162. In our contracts, where parties expressed a clear preference, they were more than three times as likely to choose the English rule than the American rule. These contrary results are particularly striking, given that Eisenberg and Miller hypothesize that relational contracts (including employment contracts) should be more likely to choose the American rule.¹⁹²

C. OTHER FEATURES OF ARBITRATION CUSTOMIZATION

Beyond these three factors—arbitration association, governing rules, and cost allocation—relatively few contracts customized the features of future arbitrations. This is clearly illustrated by the data presented in Table 5. In our contracts, 57, or 12%, of the arbitration clauses included a provision that required the parties to keep confidential the details of a dispute. Only 47, or 10%, of the arbitration provisions stated that the arbitrator was required to provide a written statement of her findings. Roughly the same number of clauses prohibited the arbitrator from awarding punitive damages. In 30, or 6%, of the arbitration clauses, the parties agreed to permit discovery and specified how it would be conducted. We also find that in 21, or 4%, of the clauses, the parties limited the period of time after a claim arose in which parties could file an arbitration request. Even more rarely, in 8, or 2%, of the clauses, the parties agreed about what was permitted testimony in the arbitration hearing. And finally, in only 3, or 0.6%, of the clauses, there were provisions addressing the parties' right to appeal an arbitration decision to courts.

189. *Id.* at 4–5.

190. We say “much more likely” rather than “certainly” in the text because it is possible that some arbitration associations impose rules on arbitrators for how to allocate costs in the face of a silent contract, in which case silence could indicate a choice in favor of the association’s rule. However, many associations do not so constrain the arbitrator.

191. Eisenberg & Miller, *supra* note 187, at 25.

192. *Id.*

TABLE 5
CUSTOMIZATION OF CONTRACTS BY FEATURE

| Customized Feature | Count |
|---------------------------------------|-------|
| Confidentiality | 57 |
| Written Statement of Findings | 47 |
| No Award of Punitive Damages Possible | 46 |
| Types of Discovery Permitted | 30 |
| Limitations Period | 21 |
| Types of Testimony Permitted | 8 |
| Right To Appeal Arbitrators' Decision | 3 |

We find this lack of customization to be surprising given the amount of academic attention that has been devoted to the issue. It suggests that, at least in the heavily negotiated documents that we are examining, customization is not widespread and has been oversold in the literature.

D. CARVEOUTS: CUSTOMIZING THE CHOICE BETWEEN LITIGATION AND ARBITRATION

In contrast to the relatively low rates of customizing the specific features of arbitration, the parties more frequently specified types of claims and relief that can or must be sought in courts. Put differently, the parties often limited the scope of their chosen arbitration by carving out particular types of disputes or particular types of relief (i.e., preliminary, injunctive, or other equitable relief) for resolution by courts.

Turning to Table 6, we found that of the 469 contracts containing arbitration clauses, nearly half (219, or 47%) permitted the parties to bring at least one matter to a court for resolution. The contracts were coded for the presence of specific types of carveout provisions, including those carving out disputes involving the contract's noncompete, confidentiality, employee solicitation, client solicitation, and nondisparagement clauses, as well as provisions providing the parties with a right to seek preliminary relief (including injunctions or specific performance) in courts.

Confidentiality carveouts permit the parties to bring to court disputes involving any provision of the contract addressed to confidentiality, the nondisclosure of information, or the protection of trade secrets. Overall, 37% of the contracts with arbitration clauses and 79% of contracts that had at least one carveout specified that disputes involving the confidentiality clauses would or could be resolved in courts.

Noncompetition carveouts allow the parties to remove from arbitration disputes that involve the noncompete clause (or covenant not to compete) contained in the employment contract. In all, 32% of the contracts with arbitration clauses and 69% of contracts containing at least one carveout

specified that disputes involving these noncompete clauses would or could be resolved in courts.

Employee-solicitation carveouts allow disputes involving a contract provision that forbids the executive to entice an employee to leave the firm for employment elsewhere to be litigated in court. We found this carveout in 30% of the contracts with arbitration clauses and 64% of contracts containing at least one carveout. Less common carveouts we found were: client-solicitation carveouts¹⁹³ (22% of all contracts with an arbitration clause); disparagement carveouts¹⁹⁴ (7% of contracts with an arbitration clause); and preliminary relief carveouts¹⁹⁵ (12% of contracts containing arbitration clauses).

TABLE 6

NUMBER OF CONTRACTS WITH ARBITRATION CLAUSES CONTAINING CARVEOUTS
BY TYPE OF CLAIM CARVED OUT

| Type of Carveout | Percentage of Total Contracts with This Carveout (N = 469) | Percentage of Contracts at Information Technology Firms (N = 115) | Percentage of Contracts at Non-Information Technology Firms (N = 354) | Percentage of Contracts at California Firms (N = 75) | Percentage of Contracts at Non-California Firms (N = 394) |
|--------------------------------|--|---|---|--|---|
| Any Carveout | 46.7% | 52.2% | 44.9% | 44.0% | 47.2% |
| Noncompetition Carveout | 32.4% | 27.0% | 34.2% | 5.3% | 37.7% |
| Confidentiality Carveout | 36.9% | 36.5% | 37.0% | 24.0% | 39.3% |
| Client Solicitation Carveout | 21.8% | 13.9% | 24.3% | 4.0% | 25.1% |
| Employee Solicitation Carveout | 30.1% | 20.0% | 33.3% | 6.7% | 34.5% |
| Disparagement Carveout | 6.6% | 4.3% | 7.3% | 0.0% | 7.9% |
| Preliminary Relief Carveout | 12.4% | 15.7% | 11.3% | 24.0% | 10.2% |

193. This captures the carving out of disputes involving a provision that forbids the CEO to solicit clients or customers of the firm to take their business elsewhere.

194. These clauses carve out disputes involving a provision in the contract that forbids the executive to publicly disparage the company.

195. This carveout permits the parties to seek preliminary injunctive relief in court in certain circumstances.

Although these findings indicate that the parties often carved out particular types of disputes for court resolution, they underestimate the extent to which parties actually carved out the particular disputes—for many of the carveouts we do not know how often the contract clause on which the carveout was based actually appeared in a contract.¹⁹⁶ To get an idea of how important this effect is, we coded for the presence of two very common (and therefore anticipated) types of contract provisions: confidentiality clauses and nonsolicitation provisions. In the case of confidentiality clauses, we coded contracts for the presence of any provisions requiring the CEO to keep information about the firm confidential or providing that the CEO could not disclose certain types of information. We found that 418 of the 469 contracts containing arbitration clauses also contained confidentiality provisions. Of the 418 contracts with confidentiality provisions, 172, or 41%, of them carved out these disputes for court resolution. This is somewhat greater than the 37% (with confidentiality carveouts) of all the contracts with arbitration clauses (shown in Table 6).

In the case of nonsolicitation clauses, we coded contracts for the presence of any clause prohibiting the executive from soliciting clients, customers, suppliers, or employees. We also coded contracts for the presence of any nonsolicitation carveouts, and found that 345, or 74%, of these contracts with arbitration clauses contained a nonsolicitation provision. Breaking this down further, we determined that 145, or 42%, of these contracts with arbitration provisions carved out disputes involving one or more of the nonsolicitation provisions. By comparison, Table 6 shows that employee nonsolicitation carveout clauses were found in 30%, and client nonsolicitation carveouts were in 22% of all contracts with arbitration clauses. Here too, the frequency with which disputes involving these clauses were carved out is actually significantly higher than our initial numbers indicated.

Based on our analysis in Part II, we wanted to know whether there was a difference in the likelihood that IT and non-IT firms would carve out disputes from arbitration. We hypothesized that IT firms would be more likely to include these carveouts because, relative to non-IT firms, a higher fraction of the IT firms' value should turn on its ability to protect information and innovation. Table 6 shows our findings. Comparing these two columns of percentages, there are several apparent differences between the firm types. As we predicted, the presence of at least one carveout is greater for IT-firm than non-IT-firm contracts (52% vs. 45%), but this

196. For example, while only 7% of the contracts with arbitration clauses carve out disputes involving the nondisparagement clause of the contract, it is likely that many, and perhaps most, of these contracts do not contain a nondisparagement provision. What we really need to know is how many contracts actually include nondisparagement clauses in order to determine how frequently such claims are carved out for court resolution. Unfortunately, we did not code for the frequency of nondisparagement clauses.

difference is present only for one specific category—preliminary injunctive relief (16% vs. 11%). For all other categories, non-IT-firm contracts are more likely to include litigation carveouts than are IT-firm contracts. These results surprised us initially. However, if IT firms are disproportionately located in California, the “California effect” for carveouts could be driving our IT-firm results. Our multivariate analysis in the next Part indicates that this is precisely what is happening.

Turning to the possible “California effect,” the location of the firm’s business may also have an effect on carveouts. If California law influenced the contracting parties, then we should see a difference in the use of carveouts between contracts involving CEOs to be employed at firms primarily located in California and contracts for CEOs employed at firms located elsewhere. We hypothesized that contracts involving California firms would have fewer claim carveouts because the presence of these carveouts, particularly the presence of multiple such carveouts, can cause the California courts to strike the arbitration clause altogether. Table 6 presents the data for California and non-California firms. We first tested a null hypothesis that there was no difference in the incidence of the use of the coded carveouts based on whether the firm was primarily located in California or not. The data show that when comparing the likelihood of using any carveout in an arbitration provision, non-California firms were slightly more likely to incorporate any carveout into the provisions (44% of the California firm contracts compared with 47% of the non-California firm contracts), but that difference was not statistically significant.

Regarding specific types of carveouts, however, Table 6 shows that non-California firms were much more likely to incorporate most of the types of carveouts studied. For example, 25% of non-California firm arbitration clauses carved out disputes involving the client nonsolicitation clause of the contract, as compared with only 4% of the California firm provisions.¹⁹⁷ Similarly, 35% of the provisions in non-California firm contracts carved out disputes related to the employee nonsolicitation clause, as compared with just under 7% of the California firm provisions.¹⁹⁸ Non-California firms were also more likely to carve out disputes involving the confidentiality and nondisparagement clauses of the agreement, and those differences were each statistically significant at the 5% confidence level.

Disputes involving the noncompetition clause of the agreement were carved out in 38% of non-California firms compared with 5% of California firms.¹⁹⁹ This difference could have multiple causes, however. Given that California courts will not enforce employee noncompete provisions, firms located in California might be more likely to steer clear of asking courts to

197. This difference is statistically significant at the 1% confidence level.

198. We find that this difference is statistically significant at the 1% confidence level.

199. Again, this difference is statistically significant at the 1% confidence level.

enforce these provisions even without the unconscionable-employee-arbitration-clause wrinkle.

In contrast to these carveout provisions, Table 6 shows that California firms were more likely than non-California firms to incorporate a carveout for preliminary relief. We found that 24% of the California firms' arbitration clauses, compared with only 10% of the non-California firms' provisions, reserved a right to seek preliminary relief in court, a difference that is statistically significant at the 1% confidence level.

These results suggest that California firms are responding to the California court precedents. The fact that California firms are just as likely to incorporate any carveouts, yet much less likely to incorporate a provision carving out any specific claim, suggests that the parties are cognizant of the California courts' concern that multiple carveouts of firm claims creates unconscionable non-mutuality. It appears that California firms are forced to carve out fewer claims than they might otherwise carve out in order to preserve enforcement of the arbitration clause, a clause that California firms are more likely to seek in the first place.

The fact that California firms are much more likely to carve out a right to seek preliminary relief in court also suggests that they are responding to the California courts because, as mentioned earlier, the courts have made clear that simple preliminary relief carveouts do not jeopardize arbitration clause enforcement.²⁰⁰ Although the preliminary relief carveouts enable California firms to freeze assets and stop infringing behavior so that arbitrators can resolve the parties' dispute, separation of the dispute in this manner deprives the California courts of possible efficiency gains due to the courts having jurisdiction over the entire matter.²⁰¹

E. THE CALIFORNIA EFFECT: IT FIRMS VERSUS NON-IT FIRMS

Given the surprising differences between IT firms and non-IT firms, and the differences between California and non-California firms, we investigated the possibility that there were interactive effects at work. To get a better sense of this possibility, in Table 7, we broke out the California firm contracts to compare IT-firm and non-IT-firm contracts. We found that 57% of California IT firms used carveouts, as compared with 31% of non-IT firms, a difference that is statistically significant at the 5% level. The difference initially seemed to indicate that although California firms avoid using carveouts, IT firms primarily located in California seem relatively more

200. See *supra* note 147 and accompanying text.

201. Gary Born counsels against the carving out of claims on the ground that it invites bifurcated dispute resolution and therefore parallel proceedings. BORN, *supra* note 10, at 1127-28. Note that carving out a right to proceed to court for preliminary relief but not resolution of the claims guarantees bifurcated dispute resolution. Parties outside of California may be carving out these claims for court resolution to *minimize* bifurcated proceedings notwithstanding the potential risks that Born identifies.

willing to risk enforcement of the arbitration clause in order to gain more effective protection of the firm's information and innovation. However, when we broke down the categories and examined the differences more closely, we observed that although the IT firms were more likely than non-IT firms to utilize most forms of carveouts, few of the differences were statistically significant, and in many cases too few contracts were observed to render the results reliable. We now turn to our multivariate analysis, which provides us with a better indication of the interaction between our California effect and our results based on firm type as well as a better way to distinguish preliminary relief from claim carveouts.

TABLE 7

USE OF ANY CARVEOUT IN CALIFORNIA FIRM CONTRACTS

| | IT Firms | Non-IT Firms | Total |
|--|---------------|---------------|---------------|
| Contracts with Any Carveout | 20 (57.1%) | 12 (30.8%) | 32 (43.2%) |
| Contracts with No Carveout | 15 (42.9%) | 27 (69.2%) | 42 (56.8%) |
| Total | 35 | 39 | 74 |
| Chi-Squared Statistic (<i>p</i> -value) | 5.23 | (0.022)** | |

** indicates statistical significance at the .05 level

IV. MULTIVARIATE ANALYSIS

While the univariate tests utilized in Part III are very suggestive of several important underlying relationships, we need to use multivariate regression analysis to ensure that we are controlling for the potential effects of other variables. For example, we would like to know more about how multiple factors influence the parties' decision to place an arbitration clause into the employment contract, including the size, profitability, type, and location of the firm, and the use of an arbitration clause in prior contracts between this firm and its CEOs. In Table 8, we present the results of a multivariate logistic regression analysis using the presence or absence of an arbitration clause as our dependent variable. This form of estimation allows us to determine if the presence of any one of the independent (right hand side) variables increases or decreases the probability of an arbitration clause being included in a CEO's employment contract. For independent variables, we include firm size, firm type (IT, non-IT), firm location (inside or outside California), an interaction term ("Cal x IT"), the presence of an arbitration clause in a prior CEO contract at this firm, and the five-year average return

on capital at the firm. These variables are defined as stated in the heading of the Table.

We are particularly interested in the California and IT variables, and the interaction between the two, in order to determine if the univariate results that we found in the earlier tables hold up. We estimate two different versions of the model. We include the variables on average return on capital, arbitration clause in prior contract, and a control variable for time, because our earlier research found that they are important influences on the presence of an arbitration clause.²⁰² In Table 8, Model 1, we omit the interactive variable CA x IT, which is 1 when a firm is both California based and an information technology firm. Model 2 includes this variable.

TABLE 8

LOGISTIC REGRESSION RESULTS

DEPENDENT VARIABLE: ARB = 1 IF CONTRACT INCLUDES ARBITRATION CLAUSE, 0 IF NOT
(*p*-VALUES IN PARENTHESES)

CALIFORNIA is a dummy variable equal to 1 if the firm's primary location according to Compustat is in California, 0 if not. IT is a dummy variable equal to 1 if the firm is categorized by Compustat in the GICS information technology sector. CA x IT is an interaction variable computed as CALIFORNIA times IT. FIRM_SIZE is the ln (company sales) in the start year of the CEO's contract. INDUSTRY_CHANGE is measured by the percentage of companies in a firm's GICS economic sector deleted from COMPUSTAT due to acquisition, merger, bankruptcy, or liquidation in the year in which the CEO employment contract started. 5-YEAR_AVG_ROC is the five-year average return on capital beginning with the year prior to the start year of the CEO's contract. ARB_IN_PRIOR_CONTRACT is a dummy variable equal to 1 if a previous CEO contract at the company included an arbitration clause, 0 if not. YEAR is equal to the beginning calendar year of the contract.

| Independent Variables | (1) | (2) |
|-----------------------|-----------------------|-----------------------|
| Intercept | -191.60*** (0.007) | -191.70*** (0.007) |
| CALIFORNIA | 0.66*** (0.003) | 0.59** (0.03) |
| INFOTECH | 0.31* (0.099) | 0.28 (0.17) |
| CA x IT | | 0.18 (0.70) |
| FIRM_SIZE | 0.03 (0.47) | 0.03 (0.48) |
| INDUSTRY_CHANGE | 3.14 (0.15) | 3.13 (0.15) |

202. Thomas, O'Hara & Martin, *supra* note 50, at 997.

| Independent Variables | (1) | (2) |
|------------------------------|--------------------|--------------------|
| 5-YEAR_AVG_ROC | -0.009* (0.07) | -0.009* (0.08) |
| ARB_IN_PRIOR_CONTRACT | 0.27* (0.07) | 0.28* (0.07) |
| YEAR | 0.10*** (0.007) | 0.10*** (0.007) |
| N | 910 | 910 |
| Likelihood ratio Chi-Squared | 38.21*** | 38.36*** |
| (<i>p</i> -value) | (0.00) | (0.00) |

***, **, * indicate statistical significance at the .01, .05, or .10 level, respectively

The results show that there is a strong, consistent California effect on the presence of an arbitration clause in CEO contracts. IT firms are more likely to put arbitration clauses in their CEO contracts as well, although this effect becomes statistically insignificant when we control for the interactive effect of a California location and an IT firm. This suggests that IT and non-IT firms may be equally likely to wish to protect their information, reputation, and innovation more efficiently with the use of arbitration carveouts. In addition, the five-year average return on capital, the presence of an arbitration clause in prior CEO contracts, and a time trend are all statistically significant and have the same signs, as we found in our earlier work.²⁰³

In results not tabulated, we further analyzed the degree of customization in arbitration provisions in CEO contracts. Using the same variables shown in Table 8, we ran a variety of different regressions for the presence and degree of customization (number of customized provisions contained in a single arbitration clause). We found that there was a strong, significant positive time trend in both the presence of customization and its degree. This indicates that more contracts are being customized over time and to a greater degree. However, none of the other explanatory variables were statistically significant.

Can carveouts be predicted using the same variables? This is a way of testing the persistence of the univariate effects we found in Tables 6 and 7. Table 9 displays six different models: versions 1 and 2 examine the presence or absence of carveouts in arbitration clauses, 3 and 4 try to determine the causes for the number of carveouts in these clauses, and 5 and 6 use a dependent variable that includes only those provisions that carve out actual claims, excluding preliminary injunction carveouts. We use the same

203. Thomas et al., *supra* note 50.

independent variables as in Table 8, and their definitions are given at the top of the table.

The results show a consistent, significant positive time trend for all six models. Carveouts are becoming increasingly common in our contracts, and more carveouts are appearing in each contract. In Models 3, 4, 5, and 6, we find a strong, statistically significant, and negative relationship between firms primarily located in California and the number of carveouts contained in their contracts. California firms clearly use fewer carveouts than firms located outside of California.

Model 2, which examines the presence of any carveout, offers some intriguing results as well. There is a weakly significant, negative effect on the presence of carveouts for California based firms, but this is offset for IT firms located in the state. California IT firms are significantly more likely than California non-IT firms to have at least one court carveout in their CEO's employment contract. This is consistent with the univariate results shown in Table 7. Models 3 and 4 were included to determine whether California IT firms were more likely to include a larger number of carveouts from arbitration. The results indicate that the California IT firms are as reluctant to include multiple carveouts as are the California non-IT firms. Models 5 and 6 were included to determine whether California IT firms were more or less likely to use preliminary relief carveouts, which are upheld by California courts, rather than claim carveouts, which are more heavily scrutinized by those courts. We see no change in the main results reported above, indicating no significant differences across the different types of California firms.

TABLE 9

REGRESSION RESULTS
(*p*-VALUES IN PARENTHESES)

CARVEDUM = 1 if contract includes at least one carveout, 0 if there are no carveouts. PCTCARVE = number of carveouts divided by 6 (the maximum number of carveouts). CARVEDUM ex-Prelim is 1 if contract includes at least one carveout that is not for Preliminary Relief, 0 otherwise. CALIFORNIA is a dummy variable equal to 1 if the firm's primary location according to Compustat is in California, 0 if not. IT is a dummy variable equal to 1 if the firm is categorized by Compustat in the GICS information technology sector. CA x IT is an interaction variable computed as CALIFORNIA times IT. FIRM_SIZE is the ln (company sales) in the start year of the CEO's contract. INDUSTRY_CHANGE is measured by the percentage of companies in a firm's GICS economic sector deleted from COMPUSTAT due to acquisition, merger, bankruptcy, or liquidation in the year in which the CEO employment contract started. 5-YEAR_AVG_ROC is the five-year average return on capital beginning with the year prior to the start year of the CEO's contract. ARB_IN_PRIOR_CONTRACT is a dummy variable equal to 1 if a previous CEO contract at the company included an arbitration clause, 0 if not. YEAR is equal to the beginning calendar year of the contract.

| Dependent Variable | CARVEDUM | CARVEDUM | PCTCARVE | PCTCARVE | Ex-Prelim | Ex-Prelim |
|-----------------------|---------------------|---------------------|----------------------|----------------------|---------------------|--------------------|
| Independent Variables | (1) | (2) | (3) | (4) | (5) | (6) |
| Intercept | -254.30** (0.02) | -250.20** (0.02) | -47.89*** (0.001) | -47.43*** (0.001) | -208.70* (0.06) | -205.60* (0.06) |
| CALIFORNIA | -0.18 (0.49) | -0.61* (0.10) | -0.14*** (0.0003) | -0.17*** (0.0004) | -0.84*** (0.005) | -1.08** |
| INFOTECH | 0.26 (0.29) | 0.04 (0.88) | -0.03 (0.38) | -0.05 (0.18) | 0.15 (0.56) | 0.06 (0.83) |
| CA x IT | | 0.96* (0.09) | | 0.09 (0.23) | | 0.50 (0.43) |
| FIRM_SIZE | 0.01 (0.88) | -0.005 (0.94) | 0.01 (0.27) | 0.009 (0.35) | 0.06 (0.34) | 0.06 (0.40) |
| INDUSTRY_CHANGE | -1.38 (0.67) | -1.46 (0.65) | 0.005 (0.99) | 0.0003 (0.99) | -0.69 (0.84) | -0.74 (0.83) |
| 5-YEAR_AVG_ROC | -0.007 (0.36) | -0.006 (0.43) | -0.0008 (0.43) | -0.0008 (0.47) | -0.007 (0.36) | -0.007 (0.39) |
| ARB_IN_PRIOR_CONTRACT | -0.27 (0.21) | -0.25 (0.24) | -0.04 (0.15) | -0.04 (0.16) | -0.08 (0.69) | -0.08 (0.72) |
| YEAR | 0.13** (0.02) | 0.13** (0.02) | 0.02*** (0.001) | 0.02*** (0.001) | 0.10* (0.06) | 0.10* (0.06) |
| N | 469 | 469 | 469 | 469 | 469 | 469 |

| Dependent Variable | CARVEDUM | CARVEDUM | PCTCARVE | PCTCARVE | Ex-Prelim | Ex-Prelim |
|------------------------------|----------|----------|-----------|-----------|-----------|-----------|
| Likelihood ratio Chi-Squared | 18.67** | 21.69*** | | | 21.17*** | 21.82*** |
| (p-value) | (0.01) | (0.01) | | | (0.003) | (0.005) |
| F-value | | | 6.00*** | 5.43 | | |
| (p-value) | | | (<0.0001) | (<0.0001) | | |
| Adjusted R ² | | | 0.0696 | 0.0705 | | |

***, **, * indicate statistical significance at the .01, .05, or .10 level, respectively

V. IMPLICATIONS AND CONCLUSIONS

Our findings have significant implications for the arbitrability of employment claims generally and for the advisability of a mutuality doctrine that heavily scrutinizes carveouts designed to protect the value of a company's information, reputation, and innovation. Our findings also highlight the potential importance of arbitration carveouts for better understanding circumstances under which parties affirmatively demand courts. Subpart A discusses the implications of our study for understanding carveouts more generally, and Subpart B concludes by highlighting the policy implications that can be gleaned from CEO employment contracts.

A. INFORMATION, REPUTATION, INNOVATION, AND THE NEED FOR FURTHER CARVEOUT STUDIES

Carveouts should receive more attention in academic literature. The phenomenon has so far received little systematic study. Only Christopher Drahozal has thought it worthwhile to observe contracting party use of carveouts, although carveouts are but a small piece of his empirical projects.²⁰⁴ Our study contributes to an understanding of carveouts and their function because we observe many of the same types of carveouts in CEO employment contracts that were observed in franchise agreements. The similarities in carveout use are potentially instructive in that they provide information about the perceived advantages of courts relative to arbitration. However, the available empirical evidence raises many more questions than it answers.

Like the CEO employment contracts, approximately 45% of Drahozal's franchise contracts include arbitration clauses.²⁰⁵ One might therefore conclude that contracting parties in both contexts perceive the relative

204. See *supra* note 21.

205. Drahozal, *Unfair Arbitration Clauses*, *supra* note 21, at 726-27.

advantages of arbitration and litigation to be about equal. Far more franchise contracts provide carveouts from arbitration than do the CEO employment contracts, however. Only about half of the CEO employment contracts with arbitration clauses contain carveouts, but virtually all of the franchise agreements contain them.²⁰⁶ Why are there fewer carveouts in the CEO employment contracts? One explanation is that a higher fraction of franchise contracts are not negotiated; thus, the franchise contracts could more closely represent the preferences of the franchisor, which are muted in the CEO contracts by the ability of CEOs to have their preferences observed. This possibility is strengthened by the fact that the franchise contracts studied are the company's standard-form contract, so even if individual franchisees can bargain to change the agreement, those changes would not appear in the empirical results. Another explanation, explored below, is that legal restrictions force the parties in the CEO employment contract negotiations to incorporate fewer carveouts in their agreements than appear in franchise contracts. And finally, because guidelines for standard-form contracts are publicly available,²⁰⁷ franchise contracts might have achieved a greater degree of industry standardization than have CEO employment contracts. Obviously, more study of these carveouts is needed.

Other questions beg for the further study of carveouts from arbitration. Are carveouts equally present in other types of arbitration clauses? There is evidence that consumer contracts often carve out consumers' small claims,²⁰⁸ probably because the major arbitration associations²⁰⁹ (and some courts)²¹⁰ require that consumers be granted these protections.

Is the frequency of the use of carveouts positively or negatively correlated with the use of arbitration clauses in the first place? Put differently, do carveouts make parties more comfortable with arbitration, increasing the use of arbitration clauses, or do carveouts signal problems with arbitration such that a high incidence of carveouts may serve as a proxy for a relatively low demand for arbitration? As an initial matter, in the regression, the presence of an arbitration clause in a prior contract did not significantly affect the likelihood of the presence of a carveout, suggesting that parties long comfortable with arbitration seemed to use carveouts just as often (or as rarely) as other parties. We can glean relatively little from this observation, however. Some carveouts might be positively correlated and some negatively correlated with the use of arbitration clauses. For example, it is likely that some carveouts aid or facilitate arbitration, and we would expect those to be positively correlated with the use of arbitration clauses.

206. *Id.* at 739-40.

207. *See, e.g., 2008 Franchise Registration and Disclosure Guidelines*, N. AM. SEC. ADM'RS ASS'N, INC., http://mn.gov/commerce/images/NASAA_guidelines.pdf (last visited Aug. 27, 2012).

208. Rutledge & Drahozal, *supra* note 60, at 5, 15.

209. *See* AM. ARBITRATION ASS'N, *supra* note 61.

210. Rutledge & Drahozal, *supra* note 60, at 2.

Preliminary relief carveouts might serve this function. Others, especially carveouts for the resolution of claims rather than remedies, might signal general disadvantages to arbitration. Here, a negative correlation is more likely. A comparison of California and non-California firm contracts, presented below, shows this basic pattern, but again, much more study is needed.

Are carveouts equally common for contracting parties outside the U.S.²¹¹ Are they perhaps less common in cross-border contracts, where concerns about a neutral litigation forum might arise?²¹² Are different types of carveouts present in contracts drafted by parties outside of the U.S.? To the extent that carveouts reflect the relative advantages of courts and arbitration, a country with a weaker or stronger judiciary and/or weaker or stronger arbitral forums might generate very different carveout behaviors.²¹³

Despite a large number of unanswered questions, the carveouts studied in the CEO employment contracts are instructive and can be used to reach tentative conclusions. For one, the carveouts present in these contracts, as well as in the franchise contracts, seem primarily focused on using courts to protect the value of the firm's information, reputation, and innovation. These carveouts suggest that although arbitration may provide a cost-effective and otherwise efficient mechanism for parties to enforce standard contractual rights and for recovering standard legal remedies, courts are needed to provide property-type protections, including the provision of equitable relief. Property-type protections can provide relief swiftly,²¹⁴ they can help prevent future violations,²¹⁵ and they can help parties protect against loss to third parties.²¹⁶ These features are especially important in cases where money damages are likely hard to prove and are, therefore, often unrecoverable.²¹⁷

Of course these insights could be sharpened with further study. For example, when parties carve out disputes for courts, which courts do they

211. One of us is in the process of studying carveouts in technology firm business contracts. For example, in contracts involving two Chinese firms, no carveouts were found. O'Connor, *supra* note 22.

212. *See id.* (finding that carveouts are also popular for cross-border contracts, but the sample is small, and almost all contracts include one U.S. contracting party).

213. *Id.* (comparing contracts between U.S. companies with contracts between Chinese companies).

214. *Cf.* Alisha Kay Taylor, *What Does Forum Shopping in the Eastern District of Texas Mean for Patent Reform?*, 6 J. MARSHALL REV. INTELL. PROP. L. 570, 577 (2007) (noting that in intellectual-property litigation, quick injunctive relief is sought "because time is of the essence").

215. This was a business justification offered in *Mercuro v. Superior Court*, 116 Cal. Rptr. 2d 671, 677-78 (Ct. App. 2002).

216. *Cf.* Eileen M. Kane, *Patent-Mediated Standards in Genetic Testing*, 2008 UTAH L. REV. 835, 864 (2008) (discussing use of injunctions to prevent third-party violations of patent rights as a property protection).

217. *See Mercuro*, 116 Cal. Rptr. 2d at 677-78.

choose? Are the parties seeking the advantages of particular courts, or do they wish to preserve the right to obtain relief in any court where the contract rights are likely to be violated (rights to information, reputation, and innovations are intangibles)? To the extent that parties contract for particular courts at least some of the time, those choices can provide lessons to other courts about how to better protect and promote these interests. Future studies should also identify any links between the use of carveouts and the parties' choice of arbitral forum. Some arbitral forums may better provide quick relief to the parties prior to the start of formal arbitral proceedings, or they might provide for expedited arbitration in certain circumstances.²¹⁸ Do contracts choosing these arbitral forums contain fewer carveouts? If so, the results could provide guidance to other arbitration associations regarding their services.

B. CARVEOUTS AND UNCONSCIONABILITY

The arbitration clauses in CEO employment contracts have important policy implications for the regulation of employment arbitration clauses more generally. For most employment contracts, the employer unilaterally drafts the agreement with the vast majority of terms offered to the employee on a take-it-or-leave-it basis. Recently, attention has focused on arbitration clauses in employment contracts. Although arbitration can provide cheap and quick dispute resolution that carries the promise of preserving the employment relationship, it can also be used to disadvantage employees in unfair ways. First, in some cases the costs of arbitration are so high that, if forced to pay them, the employee can be effectively prevented from vindicating some or all of her claims.²¹⁹ Cost concerns have been addressed by employers, who have in many cases agreed to pay some or all of the arbitration costs,²²⁰ and by arbitration associations, which now offer low-cost arbitration of employment disputes.²²¹

218. See, e.g., IP LAW 360, ALTERNATIVE DISPUTE RESOLUTION FOR COPYRIGHT AND TRADEMARK MATTERS 4 (2006), available at <http://www.foreclosuremediationfl.adr.org/si.asp?id=4328>; Peter J.W. Sherwin & Douglas C. Rennie, *Interim Relief Under International Arbitration Rules and Guidelines: A Comparative Analysis*, 20 AM. REV. INT'L ARB. 317, 322-29 (2009).

219. See generally Michael H. LeRoy & Peter Feuille, *When Is Cost an Unlawful Barrier to Alternative Dispute Resolution? The Ever Green Tree of Mandatory Employment Arbitration*, 50 UCLA L. REV. 143 (2002) (surveying federal court cases addressing concerns regarding the employee's arbitration costs).

220. See Christopher R. Drahozal, *Arbitration Costs and Forum Accessibility: Empirical Evidence*, 41 U. MICH. J.L. REFORM 813, 823-25 (2008) (discussing studies demonstrating an employer's willingness to pay for an employee's arbitration costs).

221. See, e.g., AM. ARBITRATION ASS'N, EMPLOYMENT ARBITRATION RULES AND MEDIATION PROCEDURES 40-42 (2010), available at http://www.adr.org/aaa/ShowProperty?nodeId=/UCM/ADRSTG_004362&revision=latestreleased (documenting the costs of an arbitration "For Disputes Arising Out of Employer-Promulgated Plans").

Second, arbitration agreements can have the effect of circumventing procedural and other statutory safeguards provided to employees.²²² Here too some of the arbitration associations have provided for the protection of employees with Due Process Protocols,²²³ and a review of the case law indicates that employers have responded to judicial and private pressures by incorporating fairer provisions into their arbitration clauses. The difficulties, however, have not been fully resolved, due in part to weaker discovery rules, fee-shifting provisions, and other procedural devices put in place to provide cheaper employment arbitration.²²⁴

Third, even with ostensibly fair cost and procedural provisions, some express concern that arbitration is inevitably biased toward the employer. Specifically, the concern is that some arbitrators feel beholden to the employer, as a repeat player and the party responsible for the arbitration bill; and moreover, the employer, knowing more about how arbitrators are likely to resolve disputes, is able to make a self-interested choice.²²⁵ In response to this concern, at least one California court has determined that it is suspect for a large employer to designate an arbitral forum and district with a small number of available arbitrators.²²⁶ Note that the larger firms' contracts in our sample were more likely to choose the larger AAA dispute resolution. Perhaps this is a result of active bargaining on the part of the CEOs.

As mentioned earlier, members of Congress have responded to these and other concerns by introducing a bill entitled the Arbitration Fairness Act that would prohibit the enforcement of predispute mandatory binding arbitration clauses in employment and consumer contracts.²²⁷ In an earlier article we argued that the CEO contracts provided evidence that a blanket prohibition on the enforcement of employment arbitration clauses would be overly broad.²²⁸ After all, the CEO contracts were jointly negotiated by sophisticated parties who were often represented by attorneys, and half of these contracts called for employment arbitration typically specifying the same arbitration forums and rules that are chosen for other employment contracts. The CEO contracts provide a glimpse of what employment contracts would look like if employees had roughly equal bargaining power

222. See Martin H. Malin, *Ethical Concerns in Drafting Employment Arbitration Agreements After Circuit City and Green Tree*, 41 BRANDEIS L.J. 779, 786 (2003) (discussing such possibility).

223. See, e.g., AM. ARBITRATION ASS'N, *supra* note 61 (including the Due Process Protocol).

224. See, e.g., *Trivedi v. Curexo Tech. Corp.*, 116 Cal. Rptr. 3d 804 (Ct. App. 2010) (finding unacceptable a provision entitling the prevailing party to recover attorney fees because it has the effect of circumventing state antidiscrimination law protections for employees); *Fitz v. NCR Corp.*, 13 Cal. Rptr. 3d 88 (Ct. App. 2004) (striking arbitration clause for multiple problems, including curtailment of an employee's discovery rights).

225. See *supra* note 114-16 and accompanying text.

226. See *supra* note 128.

227. See *supra* note 122 and accompanying text.

228. See Thomas, O'Hara & Martin, *supra* note 50, at 999-1000.

with their employers, and they therefore indicate that arbitration likely is often in the interests of employees. To be sure, the unilaterally imposed contracts should be scrutinized to ensure that individual arbitration provisions are fair to employees, but a blanket prohibition on the enforcement of arbitration clauses seemed unwarranted.

Our analysis also indicates that the California court condemnation of the types of carveouts that we observed is misplaced. Recall that the California courts will strike the arbitration clause from an employment contract when the employer has carved out some of its claims for court resolution. Although California state law purports to permit these carveouts if the employer proves that they serve a legitimate business justification, to date it appears that no California appellate court has deemed an offered justification to be sufficient. And yet, the justifications offered by employers—a need for quick relief in order to effectively protect information and intellectual property, a need to protect against future violations, and a need to establish intellectual-property rights as against third parties—do seem to be legitimate justifications for the carveouts. The CEO contracts lend credence to these justifications, especially since these carveouts seem to be valuable enough to firms to commonly appear in heavily negotiated agreements. In fact, taken as a whole our CEO contract analysis provides substantial evidence that the types of carveouts we observe with some frequency should be considered *per se* justified by legitimate business purposes. Court protection of overreaching by employers in the context of employment arbitration provisions might well make sense, but this particular form of paternalism is not necessary.²²⁹

Indeed, our study suggests that California court paternalism is more than simply unnecessary; it has the effect of denying firms a tool they apparently find valuable for protecting the value of the firm's information, reputation, and innovation. Specifically, as our study indicates, firms primarily located in California are significantly less likely to carve out claims for resolution by courts than are firms located elsewhere. Given that firms located elsewhere seem to derive value from the carveouts, the California doctrine has the effect of destroying economic value and should not be adopted by other courts.

229. Note that California courts might well be trying to keep employees from having to arbitrate whenever possible, but that this systemic hostility to arbitration is not permitted under the FAA. See *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011) (striking down California's unconscionability rule that had the effect of nullifying class arbitration waivers).