An Exploration of the Impact of Modern Arbitration Statutes on the Development of Arbitration in the United States
Author(s): Bruce L. Benson
Source: *Journal of Law, Economics, & Organization*, Vol. 11, No. 2, (Oct., 1995), pp. 479-501
Published by: Oxford University Press
Stable URL: http://www.jstor.org/stable/765007
Accessed: 03/08/2008 16:49

Your use of the JSTOR archive indicates your acceptance of JSTOR's Terms and Conditions of Use, available at http://www.jstor.org/page/info/about/policies/terms.jsp. JSTOR's Terms and Conditions of Use provides, in part, that unless you have obtained prior permission, you may not download an entire issue of a journal or multiple copies of articles, and you may use content in the JSTOR archive only for your personal, non-commercial use.

Please contact the publisher regarding any further use of this work. Publisher contact information may be obtained at http://www.jstor.org/action/showPublisher?publisherCode=oup.

Each copy of any part of a JSTOR transmission must contain the same copyright notice that appears on the screen or printed page of such transmission.

JSTOR is a not-for-profit organization founded in 1995 to build trusted digital archives for scholarship. We work with the scholarly community to preserve their work and the materials they rely upon, and to build a common research platform that promotes the discovery and use of these resources. For more information about JSTOR, please contact support@jstor.org.

http://www.jstor.org

An Exploration of the Impact of Modern Arbitration Statutes on the Development of Arbitration in the United States

Bruce L. Benson
Florida State University

Findings from historical research show that the "evidence" generally cited to support the contention that arbitration is effective primarily *because* of the threat of court-imposed sanctions should actually be characterized as "historical assumptions." Arbitration statutes commanding courts to recognize arbitration settlements and arbitration clauses were not the stimulus for the growth of arbitration that they are often assumed to have been. In fact, arbitration backed by nonlegal sanctions was well established long before the passage of arbitration statutes. Furthermore, political demands for these statutes came primarily from bar associations, which saw arbitration without lawyers as a threat to their livelihood. Refutation of the supporting evidence does not necessarily reject the hypothesis that legal sanctions are prerequisites for some arbitration, but nonlegal sanctions clearly provide sufficient backing under many circumstances.

Over the last seven decades, many have contended that arbitration clauses in contracts are effective and/or that arbitration rulings are accepted primarily *because* of the threat of court-imposed "legal" sanctions [Willoughby, 1929: 56; Lazarus et al., 1965: 31, 125; Landes and Posner, 1979: 247; American Arbitration Association (hereafter AAA), 1981: 34; Domke, 1984: 27; Murray, Rau, and Sherman, 1989: 435]. In sharp contrast, Charny (1990: 409–12) maintains that when a "community of transactors recognizes an authoritative nonlegal decisionmaker" such as an arbitrator, then "nonlegal sanctions" (e.g., reputation effects) will induce the members of the community to accept arbitration and comply with the arbitrator's judgment; thus, arbitration and nonlegal sanctions are "a perfect substitute for legal enforcement."[1] Others likewise

This article is part of a larger project on "The Evolution of Law" supported by an Earhart Research Fellowship. Very helpful comments and suggestions were provided by Randy Holcombe, Kevin Reffett, Jacob Levy, Oliver Williamson, and two anonymous referees.

1. Charny (1990) draws on the large literature suggesting that bond-posting or hostage-taking (e.g., Klein and Leffler, 1981; Williamson, 1983; Kronman, 1985)—including the potential loss of benefits from relation-specific, repeated-game reciprocities (e.g., Axelrod, 1984) and/or of reputation (e.g., Kreps, 1990)—provide powerful sources of credibility. Charny's analysis appears to apply for commitments to arbitrate (also see Ellickson, 1991; and Benson, 1992a).

© 1995 by Oxford University Press. All rights reserved. 8756-6222/95/$5.00

contend that court backing and legal sanctions are not necessary for arbitration to be acceptable (Wooldridge, 1970; Trakman, 1983; Benson, 1990, 1992a). In light of such competing hypotheses, it is appropriate to examine whatever evidence might be available, and considerable "historical evidence" is often cited in support of the contention that legal sanctions are necessary for successful arbitration.[2]

Those who conclude that legal sanctions are a prerequisite for arbitration emphasize some combination of three interrelated pieces of supporting evidence. One element of this support is a claim that "the traditional attitude of judges toward arbitration has been one of considerable hostility" (Murray et al., 1989: 435), and since agreements to arbitrate were not considered binding under common law, hostile judges felt free to overturn arbitration decisions if one of the parties chose to litigate (Lazarus et al., 1965: 18; Horwitz, 1977). Secondly, the argument that there was no effective sanction to induce credible promises to arbitrate in the absence of court backing is then supported by claims that arbitration was virtually nonexistent in the United States before the 1920s, after which time the passage of arbitration statutes commanding the courts to treat executory agreements to arbitrate disputes as irrevocable and fully enforceable provided the stimulus for the growth of commercial arbitration (Willoughby, 1929: 56; Lucas, 1987: 55).[3] The third component of supporting evidence is the contention that passage of these modern arbitration statutes was "prompted by business," in recognition of the need for legal sanctions to make arbitration effective (Florida Bar, 1979: 4).[4]

The primary purpose of the following presentation is to compile evidence from numerous independent historical studies in order to explain that the three legs of "historical evidence" supporting the conclusion that legal sanctions are prerequisites for effective arbitration should actually be characterized as "historical assumptions" or even "historical myths." These assumptions continue

---

2. That nonlegal sanctions are sufficient to support arbitration is also supported by evidence, however. Such evidence includes the fact that throughout most of commercial history, commercial law was "customary law," determined by business practice and contracts *and* enforced by nonlegal sanctions. The medieval "Law Merchant" may be the most widely cited historical example of privately arbitrated commercial law backed by nonlegal sanctions (Mitchell, 1903; Berman, 1983; Trakman, 1983; Benson, 1989, 1990; Milgrom, North, and Weingast, 1990), but similar practices characterized other periods as well. See Leoni (1961) for a discussion of commercial law during the period of Roman dominance, for instance. Additional evidence comes from modern arbitration of international commercial disputes (Trakman, 1983; Berman and Dasser, 1990; Benson, 1990, 1992a). Given the "state of nature" that effectively characterizes many international relationships (Kronman, 1985), international traders often cannot count on legal-sanctions backing of arbitration. Yet, virtually every international trade contract expressly refers all disputes to arbitration, and international commercial disputes are almost always arbitrated (Berman and Dasser, 1990: 33).

3. Note that statutes regarding arbitration were in place in most states prior to 1920. However, since 1920, these statutes have largely been replaced by so-called "modern" arbitration statutes. The key factor distinguishing modern statutes is the one noted in the text: they make executory agreements to arbitrate disputes irrevocable and fully enforceable (e.g., see Macneil, 1992: 15).

4. Also see, for instance, Macneil (1992: 26) and Auerbach (1983) for suggestions that commercial interests were very important sources of demand for modern arbitration statutes.

to be asserted even though they have all been challenged by historical studies indicating that

(i) while common law judges were apparently hostile toward arbitration in the late 1700s and early 1800s, arbitration was, nonetheless, widely practiced;

(ii) judicial attitudes toward arbitration began changing as early as the 1830s in some states, but arbitration was expanding both in states where such attitudes were changing relatively rapidly and in states with courts that were much less supportive of arbitration (indeed, at least some evidence from the period suggests that the development of legal sanctions had little or no impact on the evolution of arbitration);

(iii) strong political impetus for several modern arbitration statutes apparently came from bar associations, while most business groups that were interested in resolving disputes through arbitration played no advocacy role whatsoever.

Sections 1, 2, and 3 below address these three issues in turn. Concluding remarks appear in Section 4.

1. Did Judicial Hostility Prevent the Use of Commercial Arbitration?

A relative lack of litigation regarding arbitration issues appears to be the evidence that many have looked to in contending that arbitration was not in widespread use prior to 1920. It is true that a large increase in litigation over arbitration rulings and procedures followed passage of the first "modern" arbitration statutes by New York (1920), New Jersey (1923), the federal government (1925), Oregon (1925), Massachusetts (1925), Pennsylvania (1927) and California (1927) (see Sturges, 1930), which suggests to many that use of arbitration itself was stimulated by these statutes. Public court records do not provide a clear picture of the historic level of arbitration activity, however, because the vast majority of arbitration decisions are never appealed, and the statutes themselves may have increased the propensity to appeal rather than the propensity to arbitrate (Ashe, 1983; Auerbach, 1983). Moreover, an examination of other sources of information yields a very different picture of the use of arbitration.

Arbitration actually was in widespread use in the United States almost three centuries before modern arbitration statutes were passed in the 1920s; its history traces back to the early colonial period. Aiken (1974: 160) explored records from the Dutch period in New York (1624–1664), for instance, and explains: "Arbitration in New Netherlands in the 17th century ... was frequent, swift, and relatively simple compared to the English common law." Jones (1956: 209) examined newspapers, merchant letters, and the records of the New York Chamber of Commerce, as well as legal records, and found that arbitration was in constant and widespread use in New York throughout both the Dutch colonial period and the British colonial period (1664–1783). Indeed, there is substantial evidence demonstrating that merchants established arbitration arrangements in each of the American colonies (Aiken, 1974; Auerbach, 1983; Jones, 1956; Smith, 1961: 180–88; Odiorne, 1953, 1954).[5] Furthermore, arbitration was also

5. The following presentation focuses relatively heavily on New York, in part because New York's courts were relatively slow to accept arbitration, so arbitration developed in a relatively

used to settle disputes between businessmen from different colonies; arbitration of disputes between New York and Philadelphia merchants developed in the 17th century, for instance, as trade between those communities developed (Aiken, 1974; Jones, 1956).[6]

The most complete record of an arbitration tribunal during the late 18th century is that of the New York Chamber of Commerce. One of the first actions taken by this organization at its first meeting on April 5, 1768, was to make provisions for arbitration, and the Chamber's first arbitration committee was appointed on June 7 of that year (Jones, 1956: 207). There is also evidence of "considerable demand" for arbitration services from the Chamber, as committees were appointed regularly until 1775 when the Chamber temporarily suspended meetings because of the war (Jones, 1956: 207). Four years later, on September 7, 1779, an arbitration committee was again appointed, and arbitration meetings continued throughout the revolutionary period. In fact, during the British occupation of New York, all civil disputes were referred to the Chamber's arbitration committee by the British occupation forces (Jones, 1956: 209).

After the revolution, the New York Chamber of Commerce continued to provide arbitration to its members (Jones, 1956: 211), and there is substantial evidence of arbitration in the other states as well (Auerbach, 1983; Jones, 1956: 219; Smith, 1961: 180–88; Odiorne, 1953, 1954). The fact is that government courts of the period did not apply commercial law in what the merchant community considered to be a just and expeditious fashion: "Not only did courts, according to one New York merchant, dispense 'expensive endless law'; they were slow to develop legal doctrine that facilitated commercial development" (Auerbach, 1983: 33). Beyond these costs associated with litigation, the benefits to arbitration are widely recognized to include: (i) fast, informal, and inexpensive dispute resolution; (ii) privacy; (iii) less "adversarial" dispute resolution than litigation, thus allowing for a higher probability of continuing mutually beneficial business relationships; (iv) arbitrators chosen on the basis of their expertise in matters pertinent to specific disputes, in contrast to public judges who need have no such expertise (implying, among other things, that in order to avoid judicial error contracts themselves are more costly to draft because they must be more explicit and formal if a judge may ultimately consider them); and (v) enforcement of contractual agreements that are inconsistent with common law precedent because an arbitrator looks to the contract (i.e., the transactors' a priori intentions) in resolving a dispute (Mentschikoff, 1961; Lazarus et al., 1965; Williamson, 1979; Trakman, 1983; Berman and Dasser, 1990; Charny, 1990; Benson, 1989, 1990, 1992a). Thus, widespread use of arbitration is not surprising unless it is assumed that legal sanctions are necessary for cred-

hostile environment, and in part because New York arbitration has attracted more historians than that of other states.

6. Nonlegal sanctions were actually the norm in many of the colonies for noncommercial issues as well (Auerbach, 1983; Benson, 1991). For instance, the Puritans of Massachusetts and Quakers of Pennsylvania relied on sanctions imposed through their religious organizations.

ible commitments to arbitrate and to accept arbitration rulings, because such sanctions were not available in the 17th, 18th, and much of the 19th centuries.

The common law pertaining to arbitration in the English colonies and then in the newly formed United States traces to the 1609 *Vynior's Case*, 4 Eng. Rep. 302 (1609), in which Lord Edward Coke pronounced, in reviewing a case previously judged under private arbitration, that "though one may be bound to stand to the arbitrament yet he may countermand the arbitrator ... as a man cannot by his own act make such an authority power or warrant not countermandable which by law and its own proper nature is countermandable." This ruling meant that the decisions of arbitrators could be reversed by the common law courts, because an arbitrator's purpose was, according to Coke, to find a suitable compromise, while a judge's purpose was to rule on the merits of the case. Furthermore, and significantly, contracts to submit to arbitration were declared to be revocable. This precedent was viewed to be binding for the next two to three centuries in both England and the United States. In fact, although this ruling occurred before the common law doctrine of binding contracts was fully formed, as common law courts began enforcing all contracts to which parties intended to bind themselves, arbitration clauses remained revocable. The doctrine was justified and reinforced in England in 1746, for instance, when contracts to arbitrate were declared revocable because they "oust courts of their jurisdiction" [*Kill v. Hollister*, 1 Wilson 129 (1746)]. Thus, the first defenders of the revocability doctrine spoke of the courts' interests, suggesting that the common law judges of England saw arbitration as an undesirable threat to their control of dispute resolution—that is, as a competitor. Concern over jurisdiction probably was motivated at least partially by revenue considerations. Kings obtained revenues through the business of dispensing justice (Benson, 1990, 1992b, 1994; Lyon, 1980: 163, 190), and judges' income came largely from court fees (Landes and Posner, 1979: 258; Baker, 1971: 31), so their incentives were to eliminate competition and absorb all dispute resolution into royal or common law (Benson, 1989).[7]

Common law judges in America were similarly hostile toward arbitration during the 18th and early part of the 19th century (Horwitz, 1977; Levy, 1993), which was revealed in an increasing willingness to overturn arbitrators' decisions for issues relating to either law or fact (Levy, 1993). The use of commercial arbitration developed during the colonial and postrevolutionary periods in spite of this hostility. As Kronman (1985) stresses, no set of sanctions ever creates perfect credibility, and this is true of the business community's nonlegal

7. However, the issue is clearly more complex than the revenue objectives suggested by some. The period during which Coke made his *Vynior's Case* ruling was one of intense political competition between the king with his prerogative courts and the parliament and its ally, the common law courts, with Coke as a key leader. To assert jurisdiction over the domain of the king and his prerogative courts, the common law courts had to claim to be the source of all law, and therefore to have jurisdiction over the commercial courts (arbitrators) of the Law Merchant (Holdsworth, 1924: 210–11, 414; Baker, 1971: 30–47; Ekelund and Tollison, 1980: 584–89). The king had similar incentives, and his prerogative courts, particularly the Court of the Admiralty (Mitchell, 1904: 75–77), also sought jurisdiction over commercial disputes.

sanctions intended to promote arbitration and deter the use of litigation. Thus, as arbitration became more widespread, a small portion of various states' arbitration rulings were challenged in common law courts by losers who found the nonlegal sanctions to be insufficient inducements to live up to their promises. These courts' attitudes toward arbitration can therefore be examined.[8]

The Pennsylvania Supreme Court's 1803 decision in *Gross v. Zorger*, 3 Yeates 521 (1803), may typify the view held by early-19th-century American courts: the court declared that an arbitration award could be reversed for "a clear, plain, evident mistake in law or fact, which affects the justice and honesty of the case."[9] The United States Supreme Court reached a similar decision in 1803 in *Williams v. Paschall*, 4 U.S. 284 (1803). Then, in 1804, the U.S. Supreme Court demonstrated a willingness to overturn arbitration decisions due to procedural matters, even if there was no evidence of fraud [*Maybin v. Coulon*, 4 U.S. 298 (1804)]. State courts displayed a similar attitude. In Massachusetts, for instance, the Supreme Court overturned arbitration decisions for a wide variety of minor procedural issues, despite a state statute presumably protecting arbitration [*Mansfield v. Doughty*, 3 Mass. 398 (1807); *Monoseit v. Post*, 4 Mass. 832 (1808)]. In 1836, the U.S. Supreme Court used the concern over "ousting the jurisdiction of the courts" underlying the English common law doctrine of revocability to rule that an agreement to arbitrate that had not yet been fulfilled could not be used to prevent civil action [*The Hope*, 35 U.S. 138 (1836)]. Thus, an agreement to arbitrate was not binding in the eyes of U.S. courts. In fact, a dispute settled by an arbitrator could be appealed to an American court and essentially be treated as though it had never been investigated before (Horwitz, 1977: 153).

Given such precedents, private arbitration in the American colonies and early states clearly did not take its authority from the threat of legal sanctions imposed by the common law courts; indeed, according to the relevant precedent law, arbitration decisions had no standing. They actually did, however: authority arose from nonlegal sanctions such as threats to reciprocal arrangements and to reputation. According to Wooldridge (1970: 100–101), "these penalties were far more fearsome than the cost of the award with which he disagreed. Voluntary and private adjudications were voluntarily and privately adhered to if not out of honor, out of self interest." Thus, even though the courts' attitude toward arbitration might be described as one of increasing hostility throughout the period 1775 to 1835 (Levy, 1993), "there was no time during the period when arbitration was not known and used by a significant number of people"

8. Much of the following discussion of cases draws from Levy (1993).

9. Note that this is in contrast to the way that arbitration awards were treated by English courts as constrained by the Arbitration Act of 1698, which stated that once an arbitration award is made, the common law courts should not overturn the award, either for an error in law or an error of fact. Thus, the English courts were directed to let arbitration awards stand unless they were made under fraudulent or otherwise unfair procedures. The doctrine of revocability was not overturned by the statute, however, and more significantly, the common law courts of postrevolutionary America were not constrained by the Statute.

(Jones, 1956: 213). In fact, new sources of arbitration emerged to supplement or replace other arrangements. For example, in New York, as the economy grew and diversified, the Chamber of Commerce gradually became less important as a provider of arbitration services as more narrowly focused, specialized "commercial groups, whether formally organized or not" developed internal arbitration procedures (Jones, 1956: 212). For instance, the New York Stock Exchange formally provided for arbitration in its 1817 constitution, and "has been working successfully ever since," primarily to rectify disputes between New York Stock Exchange members and their customers (Lazarus et al., 1965: 27).

2. Were Modern Arbitration Statutes Commanding Judges to Enforce Arbitration Necessary to Overcome Judicial Hostility?

The claim that modern arbitration statutes were the stimulus for the growth of arbitration generally relies on an assumption that the statutes were necessary in order to command hostile judges to sanction arbitration rulings. An examination of rulings by appellate courts (including state supreme courts) suggests that, in reality, the trend of increasing hostility by common law courts toward arbitration was reversed beginning as early as the 1830s (Levy, 1993).[10] The first evidence of a changing attitude at the appellate level appeared in Virginia in 1837 (Levy, 1993), where the State Supreme Court ruled that common law precedent allowed courts to overrule arbitrators only when there is an "error of fact or of law *apparent on its face*" [emphasis added], and not whenever a court might be able to discover one [*Doolittle v. Malcolm*, 8 Leigh 608, Virginia (1837)]. The court found a claim that arbitrators in a case had not considered all of the evidence presented and had used personal knowledge of the facts in reaching a decision to be insufficient grounds for setting aside the award, even if the claims were true. Thus, Virginia courts were no longer to treat a previously arbitrated dispute as if it had never been tried before. Over the next several decades, other state appellate courts adopted similar views toward arbitration.[11] As early as 1842, the U.S. Supreme Court also signaled the end of the period of strict judicial scrutiny of and hostility toward arbitration by federal courts. In considering a procedural issue, the Court ruled that courts should construe arbitration contracts according to the intent of the participants, and despite the fact that the participants had not specified the voting rule in the contract for the three-person arbitration tribunal, the arbitration ruling should stand [*Hobson v. McArthur*, 41 U.S. 182 (1842)]. That is, federal courts should not

10. In fact, the actual turning point in court attitude is not clear. Macneil (1992: 35), for instance, finds earlier evidence of judicial support for arbitration than does Levy, citing the New York case of *Underhill v. Cortland*, 2 Johns. Ch. 339, 361 (1817), and contends that the "prevailing spirit" at that time was one of support. However, Macneil does not provide evidence that this support was widespread, particularly at the appellate level, and the cases cited above suggest that it may not have been.

11. For instance, in *Ebert v. Ebert*, 5 Md. 353 (1854), the Maryland Supreme Court stated that "every reasonable intendment is now made in favor of [arbitration] awards ... and that all matters have been decided by them, unless the contrary shall appear on the face of the award."

construe arbitration agreements in the narrow way that they had been, searching for reasons to overturn settlements on procedural grounds. In 1854, the U.S. Supreme Court stated in *Burchell v. Marsh*, 58 U.S. 344 (1854), that

> [a]rbitrators are judges chosen by the parties to decide the matters submitted to them, finally and without appeal. As a method of settling disputes it should receive every encouragement from courts of equity. If the award is within the submission, and contains the honest decisions of the arbitrators, after a full and fair hearing of the parties, a court of equity will not set aside for error, either in law or in fact. A contrary course ... would make the award the commencement, not the end, of litigation.

Williams v. Paschall was not explicitly overturned, but the language of *Burchell v. Marsh* implicitly did so. Thus, the assumption of court hostility toward arbitration prior to passage of modern arbitration statutes in the 1920s is clearly unwarranted for some courts, and perhaps unwarranted for most (Macneil, 1992: 19; Levy, 1993).

The doctrine of revocability of arbitration contracts was also overturned or modified by some common law courts during the same period. Pennsylvania's Supreme Court rejected the doctrine entirely in 1857, concluding that "where parties stipulate that disputes, whether actual or prospective, shall be submitted to the arbitrament of a particular individual or tribunal, they are bound by their contract, and may not seek redress elsewhere" [*Snodgrass v. Gavit*, 28 Pa. 221 (1857)]. The Virginia Court of Appeals reached a similar decision in 1858, holding that

> [t]he ancient principle, that agreements for the final settlement of disputes by arbitration were against the policy of the law and void because tending to oust the courts of their jurisdiction, is against the spirit of modern times, and courts are now very liberally inclined toward submission of matters to arbitration, and place as liberal a construction upon the submission as the intentions of the parties justify. The intention of the parties is the guiding star in construing the submission. [*Condon v. Southside R. R. Company*, 14 Gratt. 320, Virginia (1858)]

Apparently, no other state appellate courts completely rejected revocability during this era (1835–1870), and some, like New York, continued to apply the doctrine into the 20th century. Nonetheless, the general movement in states other than Pennsylvania and Virginia, particularly after 1870, was in the direction of holding contracts to arbitrate *specific* future disputes to be binding, while *general* contracts to arbitrate any disagreement under the contract were held to be revocable (Levy, 1993).[12] Thus, the contention that modern arbitra-

12. English courts began pulling back from the doctrine of revocability in *Scott v. Avery*, 5 H.L. Cas. 811 (1855), holding that contracts to arbitrate specific future disputes were binding but that contracts to arbitrate "any disagreement arising under the terms of the contract" were revocable,

tion statutes were necessary to counter general and widespread judicial hostility clearly is not supported, at least for many states (Levy, 1993; Macneil, 1992).

2.1 Was the Increasing Availability of Legal Sanctions an Important Stimulus for the Continued Growth of Arbitration?

Given the evolving trends in common law, the arbitration statutes themselves may have had little impact, if any, in stimulating court support for arbitration. This is not a particularly startling conclusion by itself. Politically motivated statutes often are endogenous consequences of the same forces they are intended to address rather than exogenous factors that exert significant influences on those forces (Smith, 1982; Shughart and Tollison, 1985; Sass and Leigh, 1991).[13] But perhaps more significantly in the context of this presentation, the fact that courts were increasingly supportive of arbitration before the statutes were enacted might imply that this emerging support was the impetus for the emergence of arbitration, thereby resurrecting the contention that court backing is necessary for arbitration. However, there are at least five reasons to doubt this hypothesis.

First, as explained above, arbitration was developing in the colonies and later in the states even during the period of court hostility, and was firmly in place before court attitudes began to change. Second, arbitration developed in states whose courts were relatively slow to change, such as New York, as well as in states whose courts changed more rapidly. For instance, New York judges maintained the doctrine of revocability until the state's 1920 arbitration statute commanded its demise.[14] Nonetheless, as New York merchants organized into various associations and exchanges, provisions were *always* made for the arbitration of disputes among members (Jones, 1956: 214), despite New York's maintenance of the common law doctrine of revocability. The volume of evidence regarding the widespread and growing use of arbitration by business groups in New York (and elsewhere) is particularly heavy for the last four

the same standard that was becoming the norm in the United States. In Scotland the doctrine was explicitly rejected, however, after being characterized as "irrational" and "absurd" in *Drew v. Drew*, 2 Macqueen's Cases on Appeal (1855).

13. Indeed, it might reasonably be suggested that the arbitration statutes did little more than codify emerging common law. However, such a codification can alter the path of future institutional evolution. For instance, the Sherman Act was essentially a codification of evolving common law, but it significantly altered the evolutionary path of antitrust law, in part by establishing an enforcement bureaucracy (the Antitrust Division of the Department of Justice) with incentives to pursue its own agenda (Greenhut and Benson, 1989).

14. However, it is clear that some New York judges were becoming increasingly less hostile toward arbitration and might have overturned the doctrine had the statute not passed. For instance, in *D & H Canal Co. v. Pa. Coal Co.*, 50 N.Y. 250 (1872), despite upholding the doctrine, the court stated that "it is not easy to assign at this day any good reason why the contract should not stand, and the parties made to abide by it, and the judgement of the tribunal of their choice." Similarly, in *Fudickar v. Guardian Mutual Life Insurance Co.*, 62 N.Y. 392 (1875), when revocability was again upheld, the court still felt that "the jealousy with which, at one time, courts regarded the withdrawal of controversies from their jurisdiction by the agreement of parties, has yielded to a more sensible view, and arbitrations are now encouraged as an easy, expeditious, and inexpensive method of settling disputes, and as tending to prevent litigation."

decades of the 19th century, well in advance of the passage of modern arbitration statutes (Jones, 1956: 214–15; Wooldridge, 1970; Auerbach, 1983; Macneil, 1992).

Indeed, this is the third piece of evidence suggesting that the emergence of legal sanctions supporting arbitration was not the primary impetus for its continued growth: arbitration was being developed and expanded under the auspices of trade associations, mercantile exchanges, and other commercial organizations where nonlegal sanctions apparently were relatively strong,[15] rather than in general forums such as the Chamber of Commerce, where weaker nonlegal sanctions (perhaps due to rising transactions costs of communication in the expanding business community, for instance) might mean that legal sanctions were relatively important.

Further support comes from a fourth fact: as new arbitration arrangements were created by increasingly specialized and therefore more narrowly constituted business groups, some older, less specialized arbitration forums were less in demand *even if* they were backed by legal sanctions. This was true of the New York Chamber of Commerce, and its declining importance as a source of arbitration services is of particular interest in this context (as well as in the context of the following discussion of the political impetus for modern arbitration statutes). As the Chamber lost its dominant position in New York commercial arbitration to more narrowly focused business groups, "it began to seek support from the state in its efforts to provide adjudicatory facilities for its members" (Jones, 1956: 215). The state legislature obliged by amending the Chamber's state charter in 1861 to explicitly provide for an arbitration committee and to provide that awards of the committee could be entered as judgments of courts of record if the parties desired such court enforcement. Despite this legislatively mandated court backing of Chamber arbitration rulings, however, the Chamber continued to lose ground to other arbitration arrangements, which lacked such legal sanctions. Thus, in 1874, a legislative amendment to the charter was obtained which provided for appointment by the state governor of "an arbitrator of the Chamber of Commerce of the State of New York" to be paid by the Chamber; in addition, members could be *summoned* to arbitrate their disputes, although they could escape the Chamber's jurisdiction by filing an objection with the arbitrator (Jones, 1956: 216). An 1874 act further specified that members of the Chamber of Commerce "could be required by requisition to bring their cases before this [the Chamber's arbitration] court whose judge was to be paid by the state" (Jones, 1956: 216).

15. Such groups can provide a formal mechanism to overcome frictions in communication (an issue stressed by Milgrom, North, and Weingast, 1990), ensuring that information about any individual's noncooperative behavior will be transmitted to others in the relevant business community (Rubin, 1994: 24). These groups can also lower the transactions costs of arbitration by establishing their own arbitration arrangements. Furthermore, group membership can include a contractual obligation to boycott anyone who reneges on a promise to arbitrate or accept an arbitration ruling: specifically, any party refusing arbitration will be *automatically* expelled from the organization (Rubin, 1994: 24). Such an automatic penalty makes the reputation threat much more credible (Williamson, 1991: 168).

Nonetheless, while "the Chamber constantly tried to provide arbitration facilities for its members, ... it never devised a completely satisfactory system" (Jones, 1956: 216). Even though a judge was appointed, Chamber members were supposedly required by statute to take their disputes to this judge, and a Chamber arbitration ruling could take on the force of court rulings if the parties agreed, the Chamber attracted virtually no arbitration business after this. Instead, businessmen increasingly turned to their smaller formal and informal groups for arbitration, even though their decisions did not enjoy the same state support or recognition that Chamber arbitration did. Thus, the Chamber's arbitration judge was paid by the state for only two years.[16]

That the business community chose to use arbitration tribunals other than the Chamber's suggests that nonlegal sanctions within evolving business organizations may have been stronger than the evolving legal sanctions backing the Chamber's arbitration during this period. Of course, the choice was not actually between an arbitrator backed by legal sanctions and an arbitrator backed by nonlegal sanctions, *ceteris paribus*. The Chamber's arbitration tribunal was quite different from the alternative arrangements that characterized specialized business associations. Indeed, the Chamber had lost sight of some of the factors that make arbitration attractive. It had a permanently sitting judge rather than allowing parties the ability to choose an arbitrator with particular expertise. Beyond that, this arbitration tribunal began to lose many of the low-cost characteristics of arbitration: as Gwynne (1937: 119) explained, Chamber arbitration decisions were "arrived at with increasing formality and even reached the dignity of a court of justice." At a minimum, it is clear that imposition of legal sanctions could not overcome the additional costs of Chamber arbitration, so the Chamber was the loser in the competition for dispute-resolution business.

This brings us to the fifth reason to suspect that the trend of reduced judicial hostility toward arbitration was not the primary impetus for its continued expansion: the relative cost of litigation itself was also rising. For instance, the late 19th and early 20th centuries witnessed a growing problem of public court congestion and trial delay. Data on court crowding during this period is difficult to obtain and compare. Indeed, no systematic effort to compile such data even existed prior to the mid-1950s, and cross-state comparisons were still not appropriate then because of the lack of standard reporting criteria (Church et al., 1978: 7; Wasby, Marvell, and Aikman, 1979: 12). Nonetheless, it is clear that court delay was substantial in some key states. For example, between 1896 and 1921 the New York Court of Appeals had delays of two years or more (Wasby et al., 1979: 39). As Cheung (1974) and Barzel (1989: 13–27) explain, wealth is dissipated under non-price rationing processes, such as rationing by

16. Some observers have concluded that the decline and ultimate disappearance of Chamber arbitration reflected a general decline and disappearance of all commercial arbitration during the 19th century, with business disputes shifting into the state courts (e.g., Auerbach, 1983). However, as explained above, commercial arbitration was in constant use throughout the century under the auspices of informal business groups, formal trade associations, and organized mercantile exchanges (Jones, 1956).

waiting, and therefore individuals

> seek to minimize the dissipation subject to constraints. This will be done either through seeking alternatives in using or producing the good [or service] ... or through forming alternative contractual arrangements to govern the use or production of the good [or service] with the least rise in transactions costs, or through the least costly combination of the two. (Cheung, 1974: 61)

When litigation is rationed by waiting, even some of disputants who might prefer litigation and legal sanctions over arbitration and nonlegal sanctions in the absence of the time costs will tend to look for substitutes (arbitration). More significantly, there are stronger incentives to establish contractual arrangements to govern the process of dispute resolution and insure against litigation (e.g., arbitration clauses) as well as to overcome the costs of developing an alternative to litigation (e.g., invest in group formation, such as trade associations, to establish arbitration arrangements). Thus, court congestion may have been a more important determinant of arbitration than any development in court support for arbitration.[17]

The cost of using litigation may have been rising in other ways as well. Uncertainty regarding the credibility of public courts' implicit commitment to support business contracts was apparently increasing as "the growth of the regulatory state unsettled advocates of commercial autonomy who turned to arbitration as a shield against government intrusion" (Auerbach, 1983: 101). Thus, as costs rose in terms of both waiting time and uncertainty regarding the way a business dispute might be settled, more and more business people looked to arbitration as a substitute for litigation. By the end of World War I, arbitration had clearly made "the courts secondary recourse in many areas and completely superfluous in others" (Wooldridge, 1970: 101).[18]

3. Did the Business Community Demand Modern Arbitration Statutes?

The common law pertaining to arbitration was not the only relevant law evolving during the 19th century. The discussion of statutes regarding the New York Chamber of Commerce illustrates that arbitration was also the subject of

17. Commercial arbitration also expanded rapidly in England during the 1860s, due at least in part to the public courts' congestion and inability to deal with the rapidly developing complexities in business dealings (Wooldridge, 1970: 99; Willoughby, 1929: 58–64).

18. Indeed, the rising cost of litigation apparently created incentives for the New York Chamber of Commerce's efforts to supply arbitration arrangements to reemerge around the turn of the century, and the Chamber apparently enjoyed an increasing role as a supplier of arbitration services for the next few years (Auerbach, 1983). Not all business firms were members of associations and exchanges with their own arbitration arrangements, so as the use of the public courts became more costly, they faced a choice: bear the cost of organizing such a group in order to strengthen nonlegal sanctions, use the increasingly costly public courts, or use the Chamber with its legislatively mandated backing and potential for some nonlegal sanctions as well. Some apparently found the relative price of Chamber arbitration to be the lowest.

repeated legislative attention long before 1920. Indeed, as Macneil (1992: 15–19) explains, "contrary to modern folklore . . . , the premodern statutory law of arbitration was largely supportive of that institution, as was the common law." Some states, like Virginia and Pennsylvania, had established something very much like "modern" treatment of arbitration through precedent, while others, like Illinois, passed arbitration statutes that were in many ways similar to the modern statutes passed beginning in the 1920s (Macneil, 1992: 17–18). But if arbitration was developing without statutory law mandates of court backing, why were such statutes passed? Perhaps the increased demand for arbitration services as a substitute for congested courts led businessmen to demand arbitration statutes that would provide sanctions to back commitments to arbitrate (e.g., see Auerbach, 1983). However, the foregoing discussion of statutes regarding Chamber arbitration illustrates a possible alternative hypothesis: perhaps competition for commercial dispute-resolution "business" was an important factor in shaping statute law, as groups who wished to provide or be involved in arbitration attempted to either lower the transactions costs of using their forum or raise the transactions costs of using an alternative. Let us consider the evidence regarding the political impetus for modern arbitration statutes in light of these two alternative hypotheses.

During the second decade of the 20th century, political pressure began to build for some state legislatures to pass arbitration statutes that would officially sanction arbitration clauses and judgments. However, according to Auerbach (1983: 103), "Preliminary support for the principle of arbitration came from an unexpected source: the legal profession." This may seem surprising, since lawyers had virtually no role in arbitration. Indeed, arbitration, as it was developing, not only avoided the use of lawyers but was hostile toward the legal profession. The feelings that many trade associations had regarding lawyer involvement in their arbitration processes is effectively represented by an officer of the Silk Association who suggested that businessmen can settle their disputes better than lawyers because a lawyer "is going to dominate the situation and bind the thing up with technicalities and precedents" rather than yield to business expertise and an "ordinary understanding of what is right and what is wrong" (Auerbach, 1983: 108). Why would lawyers support statutes that are generally claimed to have been intended to make arbitration more efficient by backing it with a legal sanction, when arbitration was so hostile to lawyers?

One answer is suggested by the fact that many lawyers' incomes clearly depend, to a great degree, on their involvement in dispute resolution. Trial lawyers dominated litigation, and arbitration was clearly an increasingly important "lawyerless" alternative to litigation for contract disputes. Many lawyers clearly recognized that they would benefit if the incentives to use arbitration were somehow reduced—for instance, if commercial disputes were shifted back to the public courts—just as English kings and judges had benefited centuries earlier. As evidence of the fact that lawyers recognized arbitration as a competitive threat, note that the 1919 meeting of the New York Bar Association involved a vigorous debate over general arbitration clauses in contracts providing that all disputes arising under the contracts be settled by arbitration, with

many lawyers arguing that such clauses should be illegal, supposedly because they required businessmen to sign away their right to a fair trial. The real fear—that arbitration clauses significantly reduced lawyers' business—was explicitly stated by many Association members, however, and "echoed throughout the arbitration debate" (Auerbach, 1983: 105–6).[19]

While many lawyers may have preferred to squelch the competitive threat posed by arbitration, others apparently recognized that its rapid development and widespread use suggested that its elimination was not possible (in addition, reasons for general bar association support of the development of an alternative to public courts are discussed below). Moreover, if lawyers could establish a lucrative role for themselves in arbitration, ther absorption by the public courts was not necessary, as it had been for kings and common law judges in the 17th century. Therefore, if an alternative forum to the public courts was to be used, trial lawyers wanted a forum that they might be able to influence and perhaps even dominate. Arbitration had already developed as an alternative forum. An obvious hypothesis follows: lawyers hoped to initiate arbitration statutes written in a way that would lead to a role for lawyers in the arbitration process, and they sought such statutes by lobbying through their bar association.

This hypothesis might be questioned because many, perhaps most, lawyers may not have recognized a direct stake in the arbitration issue. Lawyers who specialized in business disputes in the public courts, or who wished to develop such a specialization, were threatened by arbitration, but they constituted only a small minority of bar association membership. However, the fact that many lawyers are never involved in litigation does not mean that arbitration did not pose at least an indirect threat to many of them. For instance, consider commercial and corporate lawyers who specialize in writing agreements in an effort to avoid disputes. Demand for the services of contract-drafting lawyers is, in theory, a function of the cost of disputes: carefully drafted contracts and dispute-resolution procedures are substitutable, at least to a degree. If the cross-elasticity is of any consequence, commercial lawyers who draft contracts might perceive arbitration as a threat, just as trial lawyers specializing in business disputes would. After all, as noted above, trade associations demonstrated considerable animosity toward lawyers (Mentschikoff, 1961: 857), and the availability of their own internal arbitration arrangements may have allowed association members to avoid some expenses for contract-drafting lawyers as well as for trial lawyers.[20] In fact, as Charny (1990: 388, 403–5) explains, when

19. Conflicts within the American Bar Association over the issue of general arbitration clauses were far from over. In 1925, for instance, the Commission on Uniform Laws, which functioned under the auspices of the American Bar Association, drafted a proposed uniform arbitration law, including a provision that arbitration laws should apply only to disputes as they arise and not to general arbitration clauses. The American Bar Association adopted this position and endorsed the proposed legislation (Willoughby, 1929: 70). Some states adopted the proposed statute (see note 24 below). Many lawyers continued to be strongly opposed to general arbitration clauses at least into the 1960s (Lazarus et al., 1965).

20. Furthermore, while this discussion focuses on the more tangible aspects of arbitrated commercial law (arbitration as a substitute for litigation, and perhaps for careful contract drafting), the

legal sanctions are available, the demands placed on formal contract writing are increased. When nonlegal sanctions alone apply, particularly within narrowly focused commercial organizations, less formality in contracting is required, because the parties are intimately familiar with business practice and custom in their particular area of transactions; they understand what a general statement in a contract means, *and* they can choose an arbitrator who has similar intimate understanding. However, a judge is much less likely to have such an understanding, so a contract that may face judicial scrutiny will have to be much more specific and formal in order to counterbalance a high probability of judicial error (Charny, 1990: 385, 404). Thus, the growth of arbitration was probably a threat to contract-writing lawyers as well as trial lawyers. Creating a potential legal sanction for arbitration agreements might increase the requirements for formal, specific contracts, which required the expertise of contract-writing lawyers.

Whether all lawyers recognized self-interest concerns about the threat posed by nonlegally sanctioned arbitration, or whether a vocal minority within various bar associations were responsible for their associations' lobbying efforts cannot be determined from the records of the period. However, it is clear that some bar association members were very concerned about arbitration and that, following their urging, the bar associations took the lead in advocating statutory changes. Indeed, it apparently was not difficult to secure a fairly general consensus among (or at least acquiescence by) bar association members to support arbitration statutes, *despite* their general dislike for arbitration,[21] because virtually all lawyers recognized that respect for the legal profession, including the judiciary, and the courts in general was on the decline during the early 20th century.

Furthermore, they recognized that court congestion was becoming a relatively significant problem and contributing to the general decline in respect for their profession (Willoughby, 1929: 7–26; Lazarus et al., 1965: 128; Auerbach, 1983: 103). Thus, trial lawyers and judges in particular, but to some extent, members of the legal professional in general, were on the defensive (Auerbach, 1983: 103). Indeed, this may be a secondary but complementary reason for the bar associations' support for arbitration statutes. Of course, as noted above, the most vocal supporters of the arbitration statutes probably were less concerned with the public image of lawyers and the courts and more concerned with losing clients (Auerbach, 1983: 104), so they wanted arbitration statutes that would also establish a significant role for themselves in the arbitration process. In 1914, for example, a St. Louis attorney argued before the meeting of the Missouri Bar Association that some private disputes should be diverted to arbitration, where a *lawyer* chosen by the disputants would serve

---

use of arbitration also reflects the potential for greater reliance on customary law in commerce as apposed to statute, public court precedent, and administrative law, which provides all lawyers with their legal frame of reference—that is, arbitration may also be a substitute for legislation (Benson, 1989, 1990, 1992a; Wooldridge, 1970: 101).

21. Lazarus et al. (1965: 98–124) conducted a survey of 170 law firms and found a "somewhat negative attitude toward arbitration" among the lawyers surveyed, concluding: "Lawyers *generally* ... are strongly opposed to the so-called general arbitration clause" (118, emphasis added).

as the arbitrator (Werner, 1915: 146). To make his proposal attractive to the membership, he also emphasized that it would increase respect for the judiciary because court delay should diminish, and given that only *attorneys* with "character and learning" would serve as arbitrators, "suspicion and reproach" of the bar would also recede. Therefore, by publicly supporting arbitration by lawyers as an alternative to the courts, the bar could claim that it was actively pursuing the "public interest."

3.1 New Yorks's Arbitration Statutes

The first modern arbitration statute was passed in New York in 1920. Prior to this, in 1914, the New York State Bar Association had established a Committee on the Prevention of Unnecessary Litigation (Cohen, 1921: 147). In 1916, that committee adopted a set of "Rules for the Prevention of Unnecessary Litigation," which included the following:

> Where differences cannot be adjusted between the parties or their attorneys and the intervention of a third party becomes necessary, there are several forms which arbitration may take. The arbitration may be (1) informal, (2) under the Code, (3) under the auspices of a commercial body, or (4) under the auspices of a bar association. (Cohen, 1921: 148)

The second and fourth points stand out here, since neither was relevant as arbitration had developed up to this time (the 1918 national Conference of Bar Association Delegates adopted a similar resolution encouraging the use of arbitration). In 1920, the New York Bar Association *initiated* a lobbying effort to establish statutory backing of commercial arbitration decisions (Kellor, 1948: 10; MacCrate, 1988: 15). Three committees of the association combined with the Committee on Arbitration of the New York Chamber of Commerce to draft the statute that became the Arbitration Law of the State of New York (Cohen, 1921: 148). This statute made arbitration agreements binding under New York law and enforceable in New York courts.

Although the New York Bar Association initiated the effort and won the support of the Chamber of Commerce, some writers view the active involvement of the Chamber of Commerce as evidence that the primary demand for this statute came from "commercial interests using arbitration" (Macneil, 1992: 26; Florida Bar, 1979: 4; Auerbach, 1983). Many members of the Bar apparently wanted Chamber support because they wanted to appear to be championing a beneficial alternative to the public courts, and the Chamber apparently was the only "business" group interested enough to actively support such legislation.[22] When it came to arbitration issues, however, the Chamber clearly did not rep-

22. Charles Bernheimer, a spokesman for the Chamber of Commerce and strong advocate for Chamber involvement in arbitration, was invited to address a conference of New York Bar Association delegates. He suggested that a united effort by the Chamber and the Bar to reduce litigation and court crowding through arbitration could restore respect for the legal profession (Auerbach, 1983: 106), and argued for recognition of general arbitration clauses.

resent most business interests, as explained above. Like many lawyers, the Chamber may well have been trying to expand its own potential arbitration role, just as it had attempted to do several decades early when it turned to the legislature. Furthermore, there does not appear to be any evidence that other business groups such as trade associations and commercial exchanges, which had been relying on their own arbitration arrangements for decades, took any active part in lobbying for this arbitration statute. Such groups were already organized and many were active in the political arena on other issues, so a lack of active support for the statute by these groups probably reflects their recognition that mandated legal sanctions were not needed as backing for their arbitration arrangements, rather than reflecting any collective-action problems. Perhaps businesses that did not belong to organizations with their own arbitration tribunals wanted such statutes, of course, and collective-action problems prevented them from lobbying (conceivably, they were even free riding on the Chamber and Bar Association efforts).

3.2 Arbitration Statutes Outside of New York

Significant amounts of arbitration occurred outside of New York, so the American Bar Association "took the lead" in securing enactment of the Federal Arbitration Act of 1925, which was drafted by the Association (Willoughby, 1929: 66, 70; MacCrate, 1988: 15). "The Association had this bill introduced in Congress, and, through the presentation of testimony and submission of briefs and memoranda at hearings on the bill, it brought to bear the necessary pressure to secure favorable consideration" (Willoughby, 1929: 66). In addition, in 1922, a number of the leaders of the New York and National Bar Associations formed the Arbitration Society of America (ASA). The ASA's active leader, Moses H. Grossman, expressed a strong concern over court delay and an eagerness to encourage arbitration, but he considered dispute resolution without lawyer involvement to be "absolutely ridiculous" (Auerbach, 1983: 106–7). The ASA quickly became active in seeking arbitration statutes in other states, and also pursued the establishment of a *single*, integrated, organized, structured, national system of arbitration with standardized rules and procedures (Kellor, 1948: 22–28). They hoped that this single, centralized system dominated by lawyers would replace all the dispute-resolution arrangements established by various independent business groups. The ASA also lobbied for passage of the Federal Arbitration Act, and additional lobbying support came from the Chamber of Commerce of the United States. This law was patterned after the New York statutes but applied to disputes arising in interstate commerce. Lobbying efforts instigated by bar associations, the ASA, and the Chamber in New Jersey, Oregon, and Massachusetts also led to passage of similar laws in those states in 1923, 1925, and 1925, respectively (Willoughby, 1929: 65–66; Florida Bar, 1979: 4; Macneil, 1992: 42–46).

To counter the political power of the ASA, the American Arbitration Foundation (AF) was formed in 1925. The AF was apparently dominated by the Chamber of Commerce. Whether or not other business groups were involved is not clear in the literature (e.g., Auerbach, 1983; Kellor, 1948; MacCrate,

1988), since many writers explicitly or implicitly see the Chamber of Commerce as a representative of the entire heterogeneous business community. The AF represented a view of arbitration that differed in important ways from the lawyer-dominated view of the ASA (e.g., the AF's membership apparently was more supportive of statutory recognition of general arbitration clauses). Nonetheless, both the AF and ASA soon recognized that neither would get its way if open political conflict persisted, so after a year of negotiation they reached a merger agreement, and the American Arbitration Association (AAA) was formed, a development that was "applauded" by the American Bar Association (MacCrate, 1988: 15). This is not surprising if, as Auerbach contends, "consolidation was an indisputable victory for the bench and the bar" (1983: 108). In support of Auerbach's contention, it clearly is the case that judges and lawyers have had a significant presence in the AAA as members of the board of directors and of various committees. Furthermore, they joined the organization in strength and have had a substantial influence over AAA policies and procedures (Kellor, 1948: 18). Not surprisingly, the AAA "openly encourages lawyer participation at all steps of the arbitration procedure, from the drafting of arbitration clauses in contracts to the hearing itself" (Lazarus et al., 1965: 92), contending that lawyers are essential to the process (AAA, 1964: 6–7). Thus, the AAA "opened to lawyers a general practice that is lucrative to them" (Kellor, 1948: 69), and one result was the increasing level of lawyer representation before AAA arbitration tribunals, which rose from 36 percent in 1927 to 70 percent in 1938, 84 percent in 1942, and 91 percent in 1947 (Auerbach, 1983: 111; Kellor, 1948: 26).[23]

The AAA also quickly became an important participant in the political process. For instance, in 1927, both Pennsylvania and California adopted arbitration statutes that followed the "Draft State Arbitration Act" written and recommended by the AAA (AAA, 1928: 117, 182). The bar associations and Chambers of Commerce were also lobbying forces instrumental in the passage of these statutes (Willoughby, 1929: 66). In no case does it appear that business groups other than the Chamber took any active lobbying role in obtaining passage or influencing the content of these statutes. Other states followed over the next several decades.[24]

---

23. However, Auerbach—as well as Ashe (1983) and others—may overemphasize the success lawyers have had in influencing the AAA, taking it as evidence of what he believes has been a virtually complete "legalization" of commercial arbitration in general. There is no doubt that the AAA is an important source of commercial arbitration, but it is not the only source. In fact, in the mid-1950s, the AAA provided only 27 percent of all commercial arbitration, with trade associations providing most of the rest. Moreover, about 40 percent of the nation's trade associations explicitly forbade attorney representation, while attorney involvement in the other roughly 60 percent was reported to be "highly unlikely," according to Mentschikoff (1961: 857). Similarly, Lazarus et al. surveyed 1,673 trade associations in 1965, and all respondents indicated that legal representation was "not encouraged" (1965: 92).

24. During the 1920s, modern statutes were passed in 5 of the 10 states with the largest numbers of lawyers (U.S. Department of Commerce, 1923: Table 15). Other determinants of passage may have included the substantial court delays in these states (Wasby et al., 1979: 39).

None of this discussion proves that business in general did not at least passively support the passage of arbitration statutes, although it does cast considerable doubt on the claim that the statutes were "prompted by business" in recognition of the need for legal sanctions to make arbitration effective, as has often been claimed.[25] Apparently, for many businesses interested in arbitration as an alternative to litigation, nonlegal sanctions were already providing sufficient sources of credibility, but some businesses that did not belong to trade associations or organized exchanges might have benefited from the addition of this legal sanction, as explained below. They were not actively organized to "prompt" passage of the statutes, however, perhaps because of disinterest, a lack of relevant knowledge, and/or collective-action problems.

4. Conclusions

The claim that arbitration clauses in contracts are effective and/or that arbitration rulings are accepted primarily *because* arbitration statutes force the public courts to enforce such contracts and rulings, suggests that the threat of legal sanctions is a necessary complement to arbitration. The "historical evidence" typically cited in support of this claim is refuted above, however. An exploration of the history of commercial arbitration in the United States illustrates that so-called modern arbitration statutes, which command courts to recognize arbitration settlements and arbitration clauses in contracts, were not the major stimulus for the growth of commercial arbitration that they are often assumed to have been. Arbitration was well established and growing rapidly long before the statutes were passed, as nonlegal sanctions induced many members of the business community to live up to their commitments to arbitrate and to accept arbitration rulings. Furthermore, an examination of the political demands for the enactment of these statutes reveals that their passage was due more to the efforts of bar associations—which saw arbitration without lawyers, as it was evolving, to be a threat to their livelihood—than to business-community efforts to establish legal sanctions in support of arbitration.

Rejection of the hypothesis that legal sanctions are necessary for successful arbitration does not definitely follow from this refutation of the evidence typically supporting it. Indeed, a middle ground is also possible, which may well be consistent with all of the evidence. Rubin (1994: 4), for example, suggests that

> in many cases, law itself will be unnecessary. Private Parties can use many available mechanisms to make agreements self-enforcing ... [but] the law can facilitate the use of these mechanisms ... [by enforcing] arbitration clauses in contracts if parties insert such clauses.

Perhaps nonlegal sanctions are strong enough to support arbitration for some

25. Among those making this claim, Macneil (1992: 26) and Auerbach (1983) both also recognize the role of the Bar Association, but they see the Chamber of Commerce's efforts as evidence of general business support; they cite no evidence of additional business support.

(many?) transactions, but other transactions may have to rely on legal sanctions, and therefore statutes mandating court backing are, on net, beneficial. However, when nonlegal sanctions provide sufficient sources of credibility for transactors, the potential for turning to legal sanctions may raise transactions costs (Ashe, 1983; Auerbach, 1983; Trakman, 1983; Benson, 1989, 1990; Charny, 1990: 426–29). This suggests that there may be significant trade-offs, because the application of legal sanctions to back arbitration benefits some parties, those for whom nonlegal sanctions are weak threats, while harming others, those for whom nonlegal sanctions are strong enough to induce compliance with arbitration rulings. For instance, shortly after the passage of the New York Arbitration Act in 1920, Cohen observed that this statute

> establishes legal machinery for protecting, safeguarding and *supervising* commercial arbitration. Instead of narrowing the jurisdiction of the Supreme Court it broadens it.... Instead of being ousted of jurisdiction over arbitration, the courts are given jurisdiction over them, and ... the party aggrieved has his ready recourse to the courts. (1921: 150; emphasis added)

Upon passage of the act, the state essentially asserted that it was the source of authority and sanctions for arbitration agreements, implying that rulings from arbitrated commercial disputes were less decisive than they had been (Benson, 1989; Ashe, 1983: 42) and weakening incentives to abide by arbitrated settlements when they are explicitly subject to potential appeal. Indeed, an enormous number of court cases were filed as businessmen tried to determine what characteristics of arbitration would be considered "legal" by the public courts (see Sturges, 1930).[26] In addition, as Charny (1990: 428) explains, the existence of such legal sanctions may stifle the development of trust relation-

---

26. Perhaps the wave of litigation following the passage of the earliest modern statutes was simply a response that often follows new legislation as individuals attempt to define the new legal margins. If this were true, the level of litigation should have diminished over time, *ceteris paribus*, as precedent was established. However, the early 1980s were still witnessing a "growing number of court challenges to arbitration awards" (Ashe, 1983: 42). Apparently the *ceteris paribus* does not hold. Ashe suggests that the increase in appeals reflects the increasing use of lawyers in arbitration, arguing that a losing attorney has a stronger tendency to circumvent the arbitrator's decision than does the losing party, who tends to have greater "allegiance to the system of arbitration itself" when lawyers' "advice" is not involved (1983: 42). Businesses, forced to pay attention to the prospect of judicial review, have had to make their arbitration processes compatible with statute and precedent law, including public court procedure. To do so, they have had to consult lawyers and involve lawyers in arbitration. A Harvard professor of business law, who observed the period immediately following passage of the 1920s statutes, wrote:

> There is irony in the fate of one who takes precautions to avoid litigation by submitting to arbitration, and who, as a reward for his pain, finds himself in court fighting not on the merits of his case but on the merits of arbitration ... [This] monumental tragicomedy ... [demonstrates the success of the common law legal process at] thwarting legitimate efforts to escape its tortuous procedure. (Isaacs, 1930: 149–51)

ships from which nonlegal sanctioning mechanisms often spring, because the honoring of any commitment may often be perceived to arise primarily because of the deterrent effect of legal sanctions.[27] Thus, it does not follow that the level of arbitration would be dramatically less in the absence of modern arbitration statutes than it is today.

References

Aiken, John R. 1974. "New Netherlands Arbitration in the 17th Century," 29 *Arbitration Journal* 145–60.

American Arbitration Association (AAA). 1928. *The Practice of Commercial Arbitration*. New York: Oxford University Press.

——— 1964. *The Lawyer and Arbitration* (AAA pamphlet). New York: AAA.

——— 1981. *Lawyers' Arbitration Letters, 1970–1979*. New York: Free Press.

Ashe, Bernard F. 1983. "Arbitration Finality: Myth or Reality?" 38 *Arbitration Journal* 42–51.

Auerbach, Jerold S. 1983. *Justice Without Law?* New York: Oxford University Press.

Axelrod, Robert. 1984. *The Evolution of Cooperation*. New York: Basic Books.

Baker, J. H. 1971. *An Introduction to English Legal History*. London: Buttersworth.

Barzel, Yoram. 1989. *Economic Analysis of Property Rights*. Cambridge: Cambridge University Press.

Benson, Bruce L. 1989. "The Spontaneous Evolution of Commercial Law," 55 *Southern Economic Journal* 644–61.

——— 1990. *The Enterprise of Law: Justice Without the State*. San Francisco: Pacific Research Institute.

——— 1991. "Reciprocal Exchange as the Basis for Recognition of Law: Examples from American History," 10 *Journal of Libertarian Studies* 53–82.

——— 1992a. "Customary Law as a Social Contract: International Commercial Law," 2 *Constitutional Political Economy* 1–27.

——— 1992b. "The Development of Criminal Law and Its Enforcement: Public Interest or Political Transfers," 3 *Journal des Economistes et des Etudes Humaines* 79–108.

——— 1994. "Are Public Goods Really Common Pools? Considerations of the Evolution of Policing and Highways in England," 32 *Economic Inquiry* 249–71.

Berman, Harold J. 1983. *Law and Revolution: The Formation of Western Legal Tradition*. Cambridge, Mass.: Harvard University Press.

———, and Felix J. Dasser. 1990. "The "New" Law Merchant and the "Old": Sources, Content, and Legitimacy," in T. E. Carbonneau, ed. *Lex Mercatoria and Arbitration: A Discussion of the New Law Merchant*. Dobbs Ferry, N.Y.: Transnational Juris Publications.

Charny, David. 1990. "Nonlegal Sanctions in Commercial Relationships," 104 *Harvard Law Review* 373–467.

Cheung, Steven N. S. 1974. "A Theory of Price Control," 17 *Journal of Law and Economics* 53–72.

Church, Thomas W., Jr., Jo-Lynne Q. Lee, Teresa Tan, Alan Carlson, and Virginia McConnell. 1978. *Pre-trial Delay: A Review and Bibliography*. Williamsburg, Va.: National Center for State Courts.

Cohen, Julius H. 1921. "The Law of Commercial Arbitration and the New York Statute," 31 *Yale Law Journal* 147–60.

Domke, Martin. 1984. *Domke on Commercial Arbitration*. Rev. ed., by Gabriel M. Wiker. Willmette, Ill.: Gallaghen & Co.

27. Whether the net effects of legal sanctions are negative is not clear, but there is little basis for a general claim that arbitration is made "more efficient by giving it legislative sanction" (Domke, 1984: 27).

Ekelund, Robert B., and Robert D. Tollison. 1980. "Economic Regulation in Mercantile England: Heckshер Revisited," 18 *Economic Inquiry* 565–72.

Ellickson, Robert C. 1991. *Order Without Law: How Neighbors Settle Disputes*. Cambridge, Mass.: Harvard University Press.

Florida Bar. 1979. *Arbitration in Florida*. Tallahassee: Florida Bar Continuing Legal Education Publications.

Greenhut, M. L., and Bruce L. Benson. 1989. *American Antitrust Law in Theory and in Practice*. Aldershot, Eng.: Avebury.

Gwynne, G. 1937. "The Oldest American Tribunal," 1 *Arbitration Journal* 117–25.

Holdsworth, Sir William. 1924. *A History of English Law*. Vol. 1. London: Meteun.

Horwitz, Morton. 1977. *The Transformation of American Law, 1780–1860*. Cambridge, Mass.: Harvard University Press.

Isaacs, Nathan. 1930. "Review of Wesley Sturges, *Treatise on Commercial Arbitration and Awards*," 40 *Yale Law Journal* 149–51.

Jones, William C. 1956. "Three Centuries of Commercial Arbitration in New York: A Brief Survey," 1956 *Washington University Law Quarterly* 193–221.

Kellor, Frances. 1948. *American Arbitration: Its History, Functions and Achievements*. Port Washington, N.Y.: Kennikat Press.

Klein, Benjamin, and Keith Leffler. 1981. "The Role of Market Forces in Assuring Contractual Performance," 89 *Journal of Political Economy* 615–41.

Kreps, David. 1990. "Corporate Culture and Economic Theory," in J. Alt and K. Shepsle, eds., *Perspectives on Positive Political Economy*. New York: Cambridge University Press.

Kronman, Anthony T. 1985. "Contract Law and the State of Nature," 1 *Journal of Law, Economics, & Organization* 5–32.

Landes, William M., and Richard A. Posner. 1979. "Adjudication as a Private Good," 8 *Journal of Legal Studies* 235–84.

Lazarus, Steven, John J. Bray Jr., Larry L. Carter, Kent H. Collins, Bruce A. Giedt, Robert V. Holton Jr., Phillip D. Matthews, and Gordon C. Willard. 1965. *Resolving Business Disputes: The Potential for Commercial Arbitration*. New York: American Management Association.

Levy, Jacob T. 1993. "The Transformation of Arbitration Law, 1835–1870: The Lessening of Judicial Hostility Towards Private Dispute Resolution," mimeo, Brown University.

Leoni, Bruno. 1961. *Freedom and the Law*. Los Angeles: Nash.

Lyon, Bruce. 1980. *A Constitutional and Legal History of Medieval England*. 2nd ed. New York: W. W. Norton.

Lucas, Malcolm M. 1987. "The Future of Arbitration," 42 *Arbitration Journal* 55–59.

MacCrate, Robert. 1988. "The Legal Community's Responsibilities for Dispute Resolution," 43 *Arbitration Journal* 15–18.

Macneil, Ian R. 1992. *American Arbitration Law*. New York: Oxford University Press.

Mentschikoff, Soia. 1961. "Commercial Arbitration," 61 *Columbia Law Review* 846–69.

Milgrom, Paul R., Douglas C. North, and Barry R. Weingast. 1990. "The Role of Institutions in the Revival of Trade: The Law Merchant, Private Judges, and the Champagne Fairs," 2 *Economics and Politics* 1–23.

Mitchell, W. 1904. *Essay on the Early History of the Law Merchant*. New York: Burt Franklin.

Murray, John S., Alan Scott Rau, and Edward F. Sherman. 1989. *Processes of Dispute Resolution: The Role of Lawyers*. Westbury, N.Y.: The Foundation Press.

Odiorne, George S. 1953. "Arbitration Under Early New Jersey Law," 8 *Arbitration Journal* 117–25.

———. 1954. "Arbitration and Mediation Among the Early Quakers," 9 *Arbitration Journal* 161–69.

Rubin, Paul H. 1994. "Growing a Legal System in the Post-Communist Economies," 27 *Cornell International Law Journal* 1–47.

Sass, Tim R., and J. Paul Leigh. 1991. "The Market for Safety Regulation and the Effects of Regulation on Fatalities: The Case of Motorcycle Helmet Laws," 73 *Review of Economics and Statistics* 167–72.

Shughart, William F., II, and Robert D. Tollison. 1985. "Corporate Chartering: An Exploration in the Economics of Legal Change," 23 *Economic Inquiry* 585–99.

Smith, Janet K. 1982. "An Analysis of State Regulations Governing Liquor Store Licensees," 25 *Journal of Law and Economics* 301–19.

Smith, Joseph H. 1961. *Colonial Justice in Western Massachusetts*. Cambridge, Mass.: Harvard University Press.

Sturges, Wesley A. 1930. *A Treatise on Commercial Arbitrations and Awards*. Kansas City, Mo.: Vernon Law Book Co.

Trakman, Leon E. 1983. *The Law Merchant: The Evolution of Commercial Law*. Littleton, Colo.: Fred B. Rothman.

U.S. Department of Commerce, Bureau of the Census. 1923. *Fourteenth Census of the United States in the Year 1920, Vol. 4: Population 1920, Occupations*. Washington, D.C.: U.S. Government Printing Office.

Wasby, Stephen L., Thomas B. Marvell, and Alexander B. Aikman. 1979. *Volume and Delay in State Appellate Courts: Problems and Responses*. Williamsburg, Va.: National Center for State Courts.

Werner, Percy. 1915. "Voluntary Tribunals," 32 *Missouri Bar Association Proceedings* 142–146.

Williamson, Oliver E. 1979. "Transaction-Cost Economics: The Governance of Contractual Relations," 22 *Journal of Law and Economics* 233–61.

——— 1983. "Credible Commitments: Using Hostages to Support Exchange," 83 *American Economic Review* 519–40.

——— 1991. "Economic Institutions: Spontaneous and Intentional Governance," 7 *Journal of Law, Economics, & Organization* 159–87.

Willoughby, William F. 1929. *Principles of Judicial Administration*. Washington, D.C.: Brookings Institute.

Wooldridge, William C. 1970. *Uncle Sam, The Monopoly Man*. New Rochelle, N.Y.: Arlington House.