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Author(s)	MOTOMURA, Hiroshi
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《Material》

## The Relationship Between Arbitration and Court Litigation in the United States<sup>1</sup>

Hiroshi MOTOMURA<sup>2</sup>

### I. Introduction

While court litigation is the usual method of dispute resolution in the United States, delays and costs have prompted increasing use of arbitration as an alternative, especially in recent years. "Arbitration" occurs when a dispute is submitted by private agreement for a binding decision to a person not holding judicial office; it excludes mediation and other nonbinding procedures.<sup>3</sup>

Federal policy favoring use of arbitration as a form of alternative dispute resolution is seen in recent United States Supreme Court cases, which have allowed arbitration of many claims that previously had been reserved for courts. These recent cases are troubling, however, because they focus solely on this question of arbitral "jurisdiction." In fact, defining and understanding the relationship between arbitration and litigation also requires knowing what arbitral awards mean after they are made.

To illustrate, let us take a simple example. An investor claims that a

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- 1) This essay is based on a colloquium presented at the Faculty of Law, Hokkaido University, Sapporo, Japan, on May 27, 1988. A much fuller version of this research is published in the United States in *Arbitration and Collateral Estoppel: Using Preclusion to Shape Procedural Choices*, volume 63, Tulane Law Review, issue 1 (November 1988).
  - 2) Associate Professor of Law, University of Colorado School of Law, Boulder, Colorado, USA.
  - 3) The two major types of arbitration in the United States are commercial and labor arbitration. They are somewhat different but are largely interchangeable for purposes of this analysis.

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securities firm improperly handled his account, but an arbitrator finds the firm's actions were proper because the investor specifically authorized each of the challenged trades. The investor then files a lawsuit, but against the individual broker who handled the account. One issue in the lawsuit is whether the investor specifically authorized each of the challenged trades.

Under the doctrine of collateral estoppel, also known as "issue preclusion," the parties to a suit and their privies are bound by any decision of fact or law fully and fairly litigated in a previous suit and necessary to that judgment. Under the doctrine of res judicata, also known as "claim preclusion," a final judgment on the merits bars further suit by parties or their privies on the same claim.

In our example, the arbitrator's general decision clearly has res judicata effect; the investor, having lost the arbitration, cannot now sue in court on the same claim against the same defendant, the securities firm. The difficult question is this: does the arbitrator's specific finding on authorization issue--that the investor specifically authorized each of the challenged trades--bind the investor when he sues in court against a different defendant, the broker ?

In brief overview, my conclusions are these. Under the dominant approach in the United States, courts accord collateral estoppel to arbitral findings on a case-by-case basis, depending on differences between that arbitration and typical litigation. A case-by-case approach to arbitral collateral estoppel is likely to frustrate the best long-term use of arbitration as an alternative to litigation. Arbitral findings should be admitted into evidence in later litigation, but they generally should not be collateral estoppel.

In some respects, this topic may seem technical and specialized, but in fact, the underlying issues are quite basic. First, what is the proper relationship between arbitration and litigation in a dispute resolution system that includes both? Second, and even more fundamentally, what is "dispute resolution"--in other words, what exactly has been decided when a "dispute" has been "resolved" ?

## II. The arbitral collateral estoppel cases

Many cases do not even recognize that collateral estoppel rules for judicial findings may not be appropriate for arbitration awards. Other cases apply the

same collateral estoppel rules if arbitration uses procedures typical of court litigation, which often they do not.

Another approach recognizes that arbitration and litigation defer in basic perspective. Courts recognize that an arbitrator's view of a dispute is much broader than a judge's in that parties typically intend that it include the entire relationship between them, going beyond just the claim asserted and the strict rules of law that a court would apply.<sup>4</sup> Thus, if an arbitration agreement applies to the claim, judicial review is narrow, and only clearly egregious failure to apply the law will cause an award to be vacated.

However, an arbitrator is allowed to view a dispute with this breadth only within a narrow grant of authority. An arbitrator may only apply the parties' agreement, so an award not based on that agreement may be vacated as exceeding his authority, even if it is consistent with the law or gives weight to other important interests.<sup>5</sup> An arbitrator also may take a narrow view because some of the disputed claims may be nonarbitrable, either by law or by the terms of the arbitration agreement.

The predominant case law recognizes these differences in procedures and perspective, and it gives collateral estoppel effect to arbitral findings on a case-by-case basis, depending the magnitude of these differences. The most important case is the 1974 United States Supreme Court decision in *Alexander v. Gardner-Denver Co.*<sup>6</sup>

In that case, an employee believed he was fired due to racial discrimination, which was prohibited by both the collective bargaining agreement and federal law. After an arbitrator rejected his claim under the collective bargaining agreement, he sued in court under federal law. The Supreme Court held the arbitral findings were admissible into evidence in court but not binding, because of significant differences between this arbitration and litigation. The arbitration was too narrow because the employee could assert only his collective bargaining agreement claim (not the federal claim) and too broad because it assessed the entire

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4) See *United Paperworkers Int'l Union v. Misco, Inc.*, ---U.S.--, ---S. Ct.--, 56 U. S. L. W. 4011, 4013(Dec. 1. 1987).

5) *United Steelworkers v. Enterprise Wheel & Car Corp.*, 363 U. S. 593, 597 (1960).

6) 415 U. S. 36 (1974).

The Relationship Between Arbitration and Court Litigation in the United States union-company relationship (not just his individual claim). Also, the procedures were far less complete than those in litigation, due to the absence or limited access to a written record, rules of evidence, discovery, compulsory process, cross-examination, sworn testimony, and written decision.

*Alexander* and two later Supreme Court cases,<sup>7</sup> plus many recent lower court cases and section 84 of the Second Restatement of Judgments, attempt to approach arbitral collateral estoppel by way of these differences between arbitration and litigation.

### III. Using jurisdiction and preclusion to control arbitration

The predominant case-by-case approach considers those factors that capture the essential differences between arbitral and judicial decisionmaking, but a more complete analysis undermines its apparent wisdom. To explore this further, we need to examine another, much more visible line of cases that raises the “arbitrability” issue—what claims are beyond arbitral jurisdiction, and are thus reserved for the exclusive jurisdiction of the courts?

Historically, English courts viewed arbitration with hostility, as an infringement on their jurisdiction, and even now, when arbitration agreements are generally enforced, some claims are seen as nonarbitrable. In the seminal modern case, *Wilko v. Swan*,<sup>8</sup> the Supreme Court refused to enforce an arbitration agreement between a securities brokerage firm and its customer, reasoning that securities laws reflect strong investor protection policies that outweighed any general preference for arbitration, especially in view of basic differences between arbitration and litigation. The key antitrust case, *American Safety Equipment Corp. v. J. P. McGuire & Co.*,<sup>9</sup> held unenforceable an arbitration agreement covering antitrust claims, which the court saw as “not merely a private matter,” given “the pervasive public interest in enforcement of the antitrust laws.”

More recent Supreme Court cases have expanded arbitrability, though all

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7) *McDonald v. City of West Branch*, 466 U. S. 284 (1984) ; *Barrentine v. Arkansas-Best Freight System, Inc.*, 450 U. S. 728 (1981).

8) 346 U. S. 427 (1953).

9) 391 F. 2d 821 (2d Cir. 1968).

have been close cases that recognized some arguments for nonarbitrability. In *Scherk v. Alberto-Culver Co.*,<sup>10</sup> the Court held that certain securities law claims (different from those in *Wilko*) that arose in international commerce were arbitrable. In *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*,<sup>11</sup> the Court held that international antitrust claims are arbitrable, but the opinion seemed to go further than just international arbitration: “we are well past the time when judicial suspicion of the desirability of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an alternative means of dispute resolution.” And most recently, in *Shearson/American Express, Inc. v. McMahon*,<sup>12</sup> the Court even further expanded arbitral jurisdiction by rejecting the widely held assumption that claims under the 1934 Securities Exchange Act are nonarbitrable.

The arbitrability cases and the case-by-case arbitral collateral estoppel cases focus on the same differences between arbitration and litigation. This suggests that doubts about arbitration can show up either in jurisdictional decisions or in collateral estoppel decisions. In many cases, we may have enough confidence in arbitration to allow it to settle the claim but not enough to give the award any further effect; if so, we can grant arbitral jurisdiction but limit the effect of that arbitration by denying later collateral estoppel.

A case-by-case approach, under which later collateral estoppel is possible but uncertain, makes courts hesitate to allow arbitration in the first place. In contrast, a general rule denying collateral estoppel encourages arbitration because courts will know that the award will have no further effect.

Cases show this link between collateral estoppel and arbitrability. *Mitsubishi* allowed antitrust arbitration but said that the award could be vacated if it did not apply United States antitrust law, thus evidencing a related principle—that a court can allow arbitral jurisdiction but limit it after the fact, in *Mitsubishi* via stricter judicial review.

More directly to the point, collateral estoppel has been an stated reason for holding some types of claims nonarbitrable, especially (but not only) in cases

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10) 417 U. S. 508 (1974).

11) 473 U. S. 614 (1985).

12) 107 S. Ct. 2332 (1987).

The Relationship Between Arbitration and Court Litigation in the United States applying the intertwining doctrine to federal securities claims. If a case involves both arbitrable and nonarbitrable claims that are intertwined, the doctrine allows the trial court to either delay or deny arbitral jurisdiction over the claims that would be arbitrable if asserted alone. These courts feared that these arbitral findings would be collateral estoppel in later litigation of related nonarbitrable claims. These courts believed that this result would be undesirable because it would expand arbitral jurisdiction beyond its original scope, and thus undercut nonarbitrability rules.

In *Dean Witter Reynolds Inc. v. Byrd*,<sup>13</sup> the Supreme Court rejected the intertwining doctrine and required immediate arbitration of arbitrable claims. It reasoned that courts that hear later related lawsuits are free to deny collateral estoppel effect to the arbitral findings. *Byrd* supports a corollary to the intertwining cases—that courts can freely allow arbitration in these situations if they are confident that collateral estoppel can be denied later. No ordinary court, however, can allow arbitration and be confident that collateral estoppel will be denied later, since the case-by-case approach to collateral estoppel is uncertain. If courts hesitate to allow arbitration, parties will also hesitate to use it, resulting in a loss of many of arbitration's advantages in speed, efficiency, and different perspective.

#### IV. The role of collateral estoppel in dispute resolution

Denying arbitral collateral estoppel in order to free courts to send claims to arbitration assumes that arbitration is static, estoppel may change arbitration itself. The case-by-case approach, by creating the possibility of collateral estoppel, pressures arbitration to emulate litigation. This, in turn, undermines arbitration's role as a distinct alternative to litigation.

Indeed, the reaction to limits on collateral estoppel, as in *Alexander*, and to the possibility of broader use of arbitral collateral estoppel, has been to make arbitral procedures and perspective more judicial. More generally, the growing tendency is to think of arbitration as a substitute for litigation, rather than as an alternative to it.

For example, mandatory arbitration statutes penalize the party that asks for a post-arbitration trial if the outcome is not better. Recent proposals would

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13) 470 U. S. 213 (1985).

facilitate consolidation of arbitrations, and allow arbitrators to award punitive damages. These changes would not only make arbitration more cumbersome and change outcomes, but also alter its role in the legal system as a whole.

A few observations about the current role of arbitration in the legal system are appropriate here. One type of difference between arbitration and litigation relates to the procedures and perspectives that apply to “basic dispute resolution”—i. e. , choosing an bare outcome. In addition to basic dispute resolution differences, arbitration and litigation have different commitments to “supplemental lawmaking effects,” which are lawmaking in the broad sense—the outcome’s future influence on persons who are not parties, such as through *stare decisis* and collateral estoppel.

Current forms of arbitration best focus on basic dispute resolution only. In contrast, litigation also supports supplemental lawmaking (including collateral estoppel) because its structure shows a commitment to decisionmaking that accords with, and adds to, a independent body of reasoned principles. For example, typical of litigation but not of arbitration are: publication of decisions, judicial review, and extensive consideration of third parties (especially through impleader, interpleader, and necessary and indispensable parties doctrine). Arbitration derives its speed and efficiency from its heavy emphasis on basic dispute resolution over supplemental effects.

Dispute resolution can strike any balance between basic dispute resolution and supplemental lawmaking, even functioning without collateral estoppel, as many legal systems do. Encouraging arbitration to abandon its primary commitment to basic dispute resolution has implications for other issues, including judicial review, joinder, punitive damages, and *stare decisis*, that go beyond the procedures and perspective that are applied to basic dispute resolution. At stake is a basic change not only in arbitration procedures and perspectives, but also in the role that “dispute resolution” through arbitration plays in our legal system.

#### V. A suggested approach

By way of brief summary, the following points deserve emphasis. The dominant approach grants arbitral collateral estoppel case-by-case, if arbitration closely resembles litigation. The first problem with this approach, assuming that arbitration and litigation remain distinct, is that if courts cannot confidently send

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claims to arbitration for basic dispute resolution only, they will hesitate to send claims to arbitration at all. The second problem is the possible alternative scenario--pressure on arbitration to emulate litigation, eroding distinctions between them and losing the advantages of a dual system.

It would be better never to accord arbitral findings collateral estoppel effect, unless the arbitration agreement clearly and expressly provides for it. Arbitration and litigation may reach inconsistent results, but consistency is just one aspect of respect decisions, and using arbitral findings as evidence may be sufficient. Many observers have criticized litigation and pointed to arbitration as an alternative, but it would be a great irony, as well as a great mistake, to remake arbitration in the image of litigation.