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PROTECTED RIGHT OR SACRED RITE: THE PARADOX OF FEDERAL ARBITRATION POLICY

Kenneth R. Davis*

INTRODUCTION

A paradox riddles arbitration law. Professing to enforce arbitration agreements, many federal courts disregard the contractual intent of the parties.\(^1\) This ironic result occurs when courts, in the name of federal policy, ignore choice-of-law provisions limiting an arbitrator's authority. Three issues have drawn intense judicial activity. The first issue is whether chosen state law may foreclose arbitral awards of punitive damages.\(^2\) The second is whether such law may vest the courts, rather than the arbitrator, with the authority to decide if a state stat-

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1. See infra note 11 (listing cases where federal courts have upheld punitive awards despite choice-of-law clauses in the parties' arbitration agreements that effectively prohibit such awards).

2. State courts award punitive damages according to various standards ranging from gross negligence to malice. See Richard L. Blatt et al., Punitive Damages § 3.2, at 56 (1994) (discussing standards of conduct that warrant punitive awards).

The principle purposes of punitive damages are retribution and deterrence. See id. § 1.3, at 9 (discussing the social theory supporting punitive damages); David G. Owen, Problems of Assessing Punitive Damages Against Manufacturers of Defective Products, 49 U. Chi. L. REV. 1, 59 (1982) [hereinafter Owen, Assessing Punitive Damages Against Manufacturers] (advocating punitive awards in products liability cases, but challenging the appropriateness and excessiveness of some awards); Alan Howard Scheiner, Judicial Assessment of Punitive Damages, the Seventh Amendment and the Politics of Jury Power, 91 Colum. L. REV. 142, 222 (1991) (arguing that punitive damages serve the interests of retribution and deterrence and that the authority to award such damages should reside in the jury). See generally Linda L. Schlueter & Kenneth R. Redden, 1 Punitive Damages § 2.2(A)(1) (2d ed. 1989) (discussing the public policy arguments in favor of punitive damages).

Proponents of punitive damages argue that such relief fills gaps in criminal law. James D. Ghiardi & John J. Kircher, 1 Punitive Damages Law and Practice, § 2.06 (1994). Opponents criticize punitive damages for injecting a penal, quasi-criminal remedy into civil proceedings which traditionally offer only compensatory relief. These critics stress that since civil defendants are not afforded the scope of due process provided to criminal defendants, punitive awards are inappropriate in civil cases. See Ghiardi & Kircher, supra § 2.06 (noting the courts' use of this policy distinction as a basis for rejecting punitive awards in civil cases); Schlueter & Redden, supra § 2.2(A)(2) (summarizing the argument that civil punitive awards blur the historical distinction between civil and criminal law embedded in American jurisprudence).
ute of limitations bars an arbitration, and the third is whether chosen state law may prevent an arbitrator from awarding attorneys' fees. Misinterpreting federal policy, many courts discern a conflict between the federal policy favoring the enforcement of arbitration agreements and any state law which impinges, even insignificantly, on the scope of an arbitrator's authority. These courts interpose federal policy to preempt state law although the parties expressly chose to follow such law.

The recent Supreme Court decision, Mastrobuono v. Shearson Lehman Hutton, Inc., used preemption, at least in part, to circumvent a state law bar on punitive damages invoked by a choice-of-law clause. Although the Court's confusing analysis left the role of preemption muddled, the Mastrobuono holding clearly sustained the arbitrators' punitive award despite chosen state law prohibiting such relief.

Even before Mastrobuono, most federal circuit courts refused to enforce prohibitions on punitive damage awards arising from choice-of-law clauses. Their view was rooted in a misperceived conflict be-

Critics also challenge the contention that punitive damages deter wrongdoers and others from engaging in future egregious misconduct. See GHIARDI & KIRCHER, supra § 2.07 (expressing doubt whether punitive damages are a significant deterrent); David G. Owen, The Moral Foundations of Punitive Damages, 40 ALA. L. REV. 704, 714 (1989) [hereinafter Owen, Moral Foundations] (questioning whether punitive awards deter misconduct).

3. See infra Part IV.A and accompanying text (discussing cases that address the issue of whether federal arbitration policy contravenes state law authorizing courts to determine if applicable state statutes of limitations bar arbitration).

4. See infra Part IV.B and accompanying text (discussing cases that address the issue of whether federal arbitration policy contravenes state law that disallows an arbitrator from awarding attorney's fees unless the arbitration agreement so provides).


6. See infra note 11 and accompanying text (discussing cases in which federal courts have held that arbitrators possess the authority to award punitive damages despite contrary state law invoked by a choice-of-law clause).


8. Id. at 1219.

9. See id. at 1218 (failing to explain the relative roles of preemption and contract analysis in determining whether an arbitration agreement permits punitive awards).

10. Id.

11. See, e.g., Bonar v. Dean Witter Reynolds, Inc., 835 F.2d 1378, 1387 (11th Cir. 1988) (sustaining a punitive award in light of federal policy favoring arbitration); Willoughby Roofing & Supply Co. v. Kajima Int'l, Inc., 598 F. Supp. 353, 357 (N.D. Ala. 1984), aff'd per curiam, 776 F.2d 269 (11th Cir. 1985) (holding that a panel of arbitrators was empowered, under American Arbitration Association (AAA) rules, to award punitive damages given the "strong federal policy requir[ing] a liberal construction of arbitration agreements"). See also Lee v. Chica, 983 F.2d 883, 887 (8th Cir. 1993) (holding that AAA arbitrators may award punitive damages when a
tween federal arbitration policy, codified in the Federal Arbitration Act (FAA),\(^\text{12}\) and state common law public policy against allowing arbitrators to award punitive damages.\(^\text{13}\) Applying federal policy, these courts held that arbitrators are authorized to grant punitive damages unless the parties' agreement explicitly denies them this power.\(^\text{14}\)

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choice-of-law clause in the parties' agreement incorporates AAA rules); Todd Shipyards Corp. v. Cunard Line Ltd., 943 F.2d 1056, 1062-63 (9th Cir. 1991), cert. denied, 114 S. Ct. 287 (1993) (upholding an arbitration panel's punitive award under federal law despite chosen state law prohibiting such awards); Raytheon Co. v. Automated Business Sys., Inc., 882 F.2d 6, 12 (1st Cir. 1989) (affirming a punitive damages award in a commercial arbitration where a general arbitration clause in the parties' agreement did not explicitly exclude such awards). But see Mas trobuono v. Shearson Lehman Hutton, Inc., 20 F.3d 713, 718 (7th Cir. 1994), rev'd, 115 S. Ct. 1212 (1995) (observing that federal policy supporting arbitration is neutral with respect to remedies); Barbier v. Shearson Lehman Hutton, Inc., 948 F.2d 117, 122 (2d Cir. 1991) (vacating punitive award because the parties elected to abide by New York state law); Fahnestock & Co. v. Waltman, 935 F.2d 512, 517 (2d Cir.), cert. denied, 112 S. Ct. 380 (1991) and cert. denied, 112 S. Ct. 1241 (1992) (finding no conflict between the Federal Arbitration Act (FAA), 9 U.S.C. §§ 1-6 (1994), and Garrity v. Lyle Stuart, Inc., 353 N.E.2d 793 (N.Y. 1976), which prohibits arbitrators from awarding punitive damages, because the FAA is silent on the issue of punitive damages).


14. Arbitral punitive awards may be challenged on the ground that the limited scope of review of such awards does not meet due process requirements. See 9 U.S.C. § 10(a) (1994) (prescribing specific grounds upon which a district court may vacate an arbitration award). Honda Motor Corp. v. Oberg, 114 S. Ct. 2331, 2341 (1994), sparked interest in this issue by holding that due process requires judicial review of jury-awarded punitive damages. Recent cases, addressing the due process issue, have held due process inapplicable to commercial arbitration because arbitration does not involve state action. E.g., Davis v. Prudential Securities, Inc., 59 F.3d 1186, at 1191, 1192 (11th Cir. 1995) (holding that "the state action element of a due process claim is absent in private arbitration cases" and that "the mere confirmation of a private arbitration award by a district court is insufficient state action to trigger the application of the Due Process Clause"); Glennon v. Dean Witter Reynolds, Inc., No. 3-93-0847, 1994 WL 757709, at *15 (M.D. Tenn. Dec. 15, 1994) (holding that an arbitration between a securities firm and its former employee did not constitute state action); see also Brief for Respondent at 41, Glennon v. Dean Witter Reynolds, Inc., No. 3-93-0847, 1994 WL 757709 (M.D. Tenn. Dec. 15, 1994), appeal docketed, No. 95-5257 (6th Cir., 1995) (arguing that, even if due process applies in arbitration, a voluntary submission to arbitration constitutes a waiver of due process).

Most commentators agree with these decisions that arbitration does not constitute state action and, therefore, they conclude that *Oberg* is inapplicable in that forum. See, e.g., Kenneth R. Davis, *Due Process Right to Judicial Review of Arbitral Punitive Damages Awards*, 32 Am. Bus. L.J. 583, 612-13 (1995) (concluding that "the scales tip decidedly against state action in the arbitral forum" because an arbitration agreement is a private matter between the parties and involves the state only inconsequentially); Stephen J. Ware, *Punitive Damages in Arbitration: Contracting out of Government's Role in Punishment and Federal Preemption of State Law*, 63 Fordham L. Rev. 529, 559 (1994) (arguing that *Oberg* is inapplicable to arbitration proceedings because they do not involve state action). But see Edward Brunet, *Arbitration and Constitutional Rights*, 71 N.C. L. Rev. 81, 114-17 (1992) (arguing that the FAA confers due process rights on arbitrating parties).
The New York State Court of Appeals expressed a contrary policy in the seminal New York case *Garrity v. Lyle Stuart, Inc.*,¹⁵ which foreclosed arbitrators from awarding punitive damages.¹⁶ Since several states have adopted the *Garrity* rule,¹⁷ and most brokerage houses, attempting to limit their exposure, require customers to sign arbitration agreements containing New York choice-of-law clauses,¹⁸ the availability of arbitral punitive damages awards has ignited intense debate.¹⁹

The issue has arisen in a number of guises. First and most simply, parties, having agreed to a broad arbitration clause which arguably permits punitive awards, may have simultaneously adopted a choice-

Regardless of whether due process applies to arbitration, the scope of review satisfies due process requirements because an arbitrator who renders an unconstitutional punitive award "exceed[s] his powers," and such award is therefore subject to reversal. See § 9 U.S.C. § 10(a)(4) (1994) (authorizing a district court to vacate an award “[w]here the arbitrators exceed their powers . . .”). See Kenneth R. Davis, *supra*, at 622-23 (discussing the adequacy of judicial review under section 10(a)(4) of the Federal Arbitration Act).

16. *See id.* at 796 (vacating an arbitrator's punitive damages award as violative of public policy, thus allocating the authority to impose punitive damages to the state).

Some courts allow punitive damages if the arbitration agreement expressly so provides. *See, e.g.*, Grissom v. Greener & Sumner Contr., Inc., 676 S.W.2d 709, 711 (Tex. Ct. App. 1984) (sustaining an exemplary damages award where the arbitration agreement expressly provided for such relief). Others presume that the parties intended to permit punitive damages unless the agreement expresses the contrary. *See* Starkenstein v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 572 F. Supp. 189, 191-92 (M.D. Fla. 1983) (holding that an investor in a securities arbitration did not waive his punitive damages claim by executing a general agreement that did not mention such relief); Complete Exteriors, Inc. v. Behan, 558 So. 2d 48, 51 (Fla. Dist. Ct. App. 1990) (reversing a punitive award in a contract arbitration on the ground that the parties' agreement did not provide for such relief); Rodgers Builders, Inc. v. McQueen, 331 S.E.2d 726, 734 (N.C. Ct. App. 1985) (finding the language of an arbitration agreement sufficiently broad to authorize punitive awards); Baker v. Sadick, 208 Cal. Rptr. 676, 681 (Ct. App. 1984) (confirming punitive award in a medical malpractice arbitration where the agreement did not mention punitive damages and the language of the relevant state statute was ambiguous).
19. *See infra* notes 67 (discussing commentators' criticisms of the *Garrity* rule) and text accompanying notes 69-81 (examining commentators' beliefs that the FAA preempts the *Garrity* rule).
of-law provision invoking the Garrity rule, which prohibits such awards. The issue has emerged also in more complex situations. For example, most arbitration agreements provide that the parties will submit their disputes to a particular arbitration organization. These organizations, including the American Arbitration Association (AAA) and securities industry self-regulatory organizations (SROs) such as the New York Stock Exchange (NYSE) and the National Association of Securities Dealers (NASD), have elaborate rules that establish procedural guidelines for arbitration. All these organizations have a rule explicitly or implicitly granting arbitrators broad remedial authority which arguably permits them to grant punitive relief.

How these broad remedial provisions interact with choice-of-law clauses invoking the Garrity rule was an unsettled question before

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20. See, e.g., Raytheon Co. v. Automated Business Sys., Inc., 882 F.2d 6, 7 (1st Cir. 1989) (involving a broad arbitration clause which contained a California choice-of-law provision).

21. See, e.g., Mastrobuono v. Shearson Lehman Hutton, Inc., 115 S. Ct. 1212, 1217 (1995) (quoting a typical arbitration clause in which the parties consented to arbitrate "any controversy . . . in accordance with the rules of the National Association of Securities Dealers (NASD) or the Boards of Directors of the New York Stock Exchange (NYSE))."


23. See, e.g., Rule 43 of the AAA's Commercial Arbitration Rules, which provides in part: "The arbitrator may grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement of the parties." Commercial Arbitration R. 43. Until 1989, SROs operated under rules which only arguably permitted punitive damages. For example, the arbitration code of the NASD, the most widely used SRO arbitration forum, provides for the arbitration of "[a]ny dispute, claim or controversy . . . arising in connection with the business of [any member of the NASD]." Code of Arbitration Procedures § 1 (1993); N.Y. Stock Exchange Arbitration R. 600(a), reprinted in 2 N.Y.S.E. Guide (CCH) ¶ 2600 (Aug. 26, 1992) (providing for the arbitration of "[a]ny dispute, claim or controversy"). In 1989, the NASD adopted a rule aimed at insuring the availability of punitive awards in arbitrations conducted at the NASD. The rule provides that "[n]o agreement shall include any condition which limits . . . the ability of the arbitrators to make any award." Rules of Fair Practice Art. III, § 21(f)(4). The NYSE simultaneously adopted an identical rule. N.Y. Stock Exchange Arbitration R. 637(4), reprinted in N.Y.S.E. Guide (CCH) ¶ 2636 (May 10, 1989). Since 1989, SROs have considered adopting rules expressly permitting arbitrators to award punitive damages. See Barbara Franklin, Securities Arbitrations: Rule Would End Novelty of Punitive Damages, N.Y. L.J. June 3, 1993, at 5 (discussing a proposed NASD rule that would expressly provide for punitive damages awards in NASD customer arbitrations). The Securities Industry Association, a trade organization, has proposed a rule change for SROs which would authorize arbitrators to award punitive damages only under circumstances where courts would have the same authority. SIA Responds to NYSE: Symposium Recommendations Draw New Punitive Damage Proposal, Sec. Arb. Commentator (Richard P. Ryder, Maplewood, N.J.), Oct. 1995, at 10. Such awards could not be imposed unconstitutionally. Id. Nor could such awards be imposed in violation of the law of the state in which the claimant resided when the claim arose. Id. The proposed rule would subject the amount of the award to any limits imposed by state law or to two times compensatory damages, whichever is less. This proposal, if adopted, would uphold the Garrity rule by honoring state law limitations on punitive damages.
Some commentators argued that a Supreme Court case which preceded Mastrobuono, Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University, reconciled federal policy with the Garrity rule. Volt held that an arbitration agreement should be interpreted, as should any contract, according to its terms. If the parties adopt a choice-of-law clause, state law will govern unless it conflicts directly with the FAA. Thus, under Volt, it seemed that the Garrity rule was compatible with federal policy, because Garrity merely removes a non-compensatory remedy from arbitration, and thus does not obstruct the enforcement of arbitration agreements. Mastrobuono, however, departed from the fundamental holding of Volt and casts doubt on how other issues involving arbitration will be decided.

The Mastrobuono decision has far-reaching implications. It may forbid the invocation, by a choice-of-law clause, of any state law infringing on an arbitrator’s authority. One such issue is whether the FAA preempts state law that empowers the court, rather than the arbitrator, to rule on statute of limitations defenses. Some decisions, including the recent New York Court of Appeals decision Smith Barney, Harris Upham & Co. v. Luckie, have enforced choice-of-law provisions invoking New York law which empowers the court to rule on such defenses. These decisions arguably conflict with Mastrobuono. Another issue illustrating the tension between Mastrobuono and its implications.

24. See supra note 11 (discussing several pre-Mastrobuono cases in which courts had either upheld or reversed arbitral punitive awards depending on their view of federal preemption and the contractual intent of the parties).
26. See Kenneth R. Davis, A Proposed Framework for Reviewing Punitive Damages Awards of Commercial Arbitrators, 58 ALB. L. REV. 55, 92 (1994) (arguing that the FAA takes no position on the availability of arbitral punitive remedies). But see Ware, supra note 14, at 571 (contending that the FAA provides a “default” rule, which, in the absence of an express or implied limitation, permits arbitral punitive awards).
27. 489 U.S. at 474-75.
28. Id. at 477.
29. See infra Part IV (discussing the Mastrobuono rule and its implications).
31. See, e.g., Chemical Futures & Options, Inc. v. Resolution Trust Corp., 832 F. Supp. 1188, 1195 (N.D. Ill. 1993) ("Because parties may make state arbitration rules applicable by including a state choice-of-law clause in their contract, New York law applies in this instance, and as a result, this Court is compelled to decide the statute of limitations issue presented by plaintiffs.") (citing Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ., 489 U.S. 468 (1989)); Seaboard Surety Co. v. Cates, 604 So.2d 570, 571 (Fla. Dist. Ct. App. 1992) (holding that the trial court determines whether the defendant is barred from arbitration under the applicable state statute of limitations. See infra notes 144-66 and accompanying text (discussing Smith Barney, Harris, Upham & Co. v. Luckie 647 N.E.2d 1308 (N.Y. Ct. App. 1995)).
trobuono and state law is whether the FAA preempts state law restrictions on an arbitrator's authority to award attorney's fees.

Part I.A of this Article discusses federal arbitration law. In Part I.B, this Article explores the Garrity rule and the genesis of the perceived conflict between Garrity and federal policy. Part II analyzes the Mastrobuono decision and Part III criticizes that ruling. In Part IV.A, this Article compares Luckie with federal cases refusing to apply the New York statute of limitations rule and suggests that courts will interpret Luckie as being inconsistent with Mastrobuono. In Part IV.B, this Article examines the impact of Mastrobuono on state law that forbids arbitrators from awarding attorneys' fees unless the arbitration agreement expressly gives them such authority. Finally, this Article concludes in Part V that Mastrobuono, although wrongly decided, may benefit society by curtailting the overreaching of securities brokerage houses.

I. BACKGROUND

A. The FAA and Federal Preemption

Congress passed the FAA in 1925 to counteract pervasive judicial hostility toward arbitration agreements. In Southland Corp. v. Keating, the Court explained that "[t]he need for the [FAA] arises from ... the jealousy of the English courts for their own jurisdiction ... This jealousy survived for so long a period that the principle became firmly embedded in the English common law and was adopted with it by the American courts." To overcome the anti-arbitration sentiment of the courts, Congress enacted section 2 of the FAA, which provides in part that "[a] written provision in ... a contract evidencing a transaction involving commerce to settle by arbitration a contro-
versy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable.” The FAA has succeeded in transforming arbitration into a judicially approved method of dispute resolution. Since passage of the FAA, the Supreme Court has repeatedly reaffirmed “the liberal federal policy favoring arbitration.”

The FAA preempts any state law that interferes with the enforcement of arbitration agreements. Thus, in Southland Corp., the Supreme Court held that the California Franchise Investment Law, which invalidated certain arbitration agreements, was in direct conflict with section 2 of the FAA and violated the Supremacy Clause. The Court explained, “In enacting [Section] 2 of the [FAA], Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.” Although Southland stated unequivocally that state law may not refuse to enforce arbitration agreements, the Court had yet to decide whether federal policy permits state law limitations on arbitration.

The Court first addressed this issue in Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University. Volt entered into a contract with Leland Stanford Junior University to per-

36. See Douglas R. Davis, supra note 32, at 698 (emphasizing the importance of the FAA’s role in expanding the use of arbitration). The FAA has fostered a climate in which arbitration has grown into the most widespread means of alternative dispute resolution. See Domke, supra note 22 § 1:01, at 3 (discussing the broad range of disputes submitted for arbitration); Commercial Arbitration for the 1990s at xv (Richard J. Medalie ed., 1991) (citing numerous industries that commonly use arbitration); 1 Thomas H. Oehmke, Commercial Arbitration § 5:01 (rev. ed. 1995) (labelling arbitration “the preferred mechanism for resolving disputes out of court”); Kenneth R. Davis, supra note 14, at 585-86 (documenting the burgeoning popularity of arbitration over the past thirty years).
37. See, e.g., Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983). See supra note 5 (discussing several Supreme Court cases in which the Court emphasized the FAA’s liberal policy favoring arbitration).
38. See Southland Corp., 465 U.S. at 16 (“In creating a substantive rule applicable in state as well as federal courts, Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements”).
39. See id. at 10 (“‘Any condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law or any rule or order hereunder is void.’”) (quoting Cal. Corp. Code Ann. § 31,512 (West 1977)).
40. Id. Justice O’Connor, joined by Justice Rehnquist, dissented. Id. at 21 (O’Connor, J., dissenting). She argued that Congress intended the FAA to be a procedural statute, applicable only to the federal courts. Id. at 25 (O’Connor, J., dissenting).
41. See id. at 16 (discussing Congress’ attempt to foreclose state legislative action impinging on the enforceability of arbitration agreements).
42. 489 U.S. 468 (1989).
form construction work on the University's campus in California. The contract contained an arbitration clause and a choice-of-law clause providing for the application of "the law of the place where the Project is located." When a dispute arose between the parties, Volt demanded arbitration. The University moved for a stay of arbitration under a California statute on the ground that pending, related litigation might result in an order indemnifying the University. The issue was whether the stay, invoked by the choice-of-law clause, violated federal policy. The Supreme Court found no such conflict and rejected the argument that section 4 of the FAA, which provides an aggrieved party with the right to obtain an order compelling arbitration, preempts the California statute. Rather, the Court observed that the FAA "confers only the right to obtain an order directing that arbitration proceed in the manner provided for [in the parties'] agreement." Thus, the FAA merely requires the enforcement of arbitration agreements as written; it does not impose immutable procedural rules. The FAA "simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms." Since the FAA contains no preemption provision, federal policy nullifies state law only when the two conflict directly. In sum, substantive state law invoked by a choice-of-law clause is preempted only when it conflicts directly with the FAA. Procedural law invoked by a choice-of-law clause, even when contrary to FAA procedures, will not be preempted.

43. Id. at 470.
44. Id.
45. Id.
46. Id. at 471.
47. Id. at 475.
48. Id. at 476-77.
50. Id. at 476.
51. Id. at 478.
52. Id. at 477-78.
53. See id. at 477 (stating that the FAA preempts state law "to the extent that it actually conflicts with federal law — that is, to the extent that it stands as an obstacle to the . . . full purposes and objectives of Congress").
54. Id. at 476. In a dissenting opinion, Justice Brennan, joined by Justice Marshall, argued that in choice-of-law clauses parties select the law of a state over the law of other states, not the law of a state over the law of the federal government. Id. at 488 (Brennan, J., dissenting). Justice Brennan believed that the California Court of Appeals had erroneously interpreted the arbitration agreement to exalt California law above federal law. Id. at 488-90 (Brennan, J., dissenting).
B. State Law Bans On Arbitral Punitive Awards

The perceived clash between state and federal law on the issue of the availability of punitive damages in arbitration originated with the landmark case *Garrity v. Lyle Stuart, Inc.* There, an author sued her publisher for breach of contract and intentional torts. Based on an arbitration agreement, the publisher moved successfully to stay the suits and compel arbitration. The issue was whether the arbitrator had authority to award punitive damages. Chief Judge Breitel, writing for a divided court, announced: "An arbitrator has no power to award punitive damages, even if agreed upon by the parties." The court justified this rule on public policy grounds. Punishment is a function of the state. An arbitrator, by awarding punitive damages, encroaches on the state's authority. Private parties, even by design, may not delegate this exclusive state function to a nonjudicial forum. Chief Judge Breitel noted that “[t]he evil of permitting an arbitrator whose selection is often restricted or manipulatable by the party in a superior bargaining position, to award punitive damages is that it displaces the court and the jury, and therefore the State, as the engine for imposing a social sanction.”

The Court relied, too, on a more practical rationale. Unlike court decisions, which are subject to rigorous appellate review, arbitral decisions are substantially immune to reversal. Thus, the court reasoned that “[i]f arbitrators were allowed to impose punitive damages, the usefulness of arbitration would be destroyed. It would become a trap for the unwary given the eminently desirable freedom from judicial overview of law and facts.”

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56. Id. at 794.
57. Id.
58. Id.
59. Id.
60. Id.
61. Id. at 796.
62. Id.
63. Id.
64. Id.
65. Id.
66. Id. Judge Gabrielli dissented, seeing no countervailing policy sufficient to overcome the policy favoring arbitration, which implies the availability of punitive damages. Id. at 799 (Gabrielli, J., dissenting). Nor could he distinguish *Garrity* from federal appellate court precedent that sustained treble liquidated damages, a penal award. Id. at 799-800 (Gabrielli, J., dissenting).
Garrity thus forbids arbitrators from awarding punitive damages, even with the consent of the parties.67 The FAA, on the other hand, favors the liberal interpretation of arbitration agreements,68 a policy which arguably conflicts with Garrity. This potential incompatibility has been the focus of considerable judicial attention.

C. Federal Court Decisions on Punitive Damages

As noted above, even before Mastrobuono, most federal circuit courts held that the FAA preempts the Garrity rule.69 For example, in Raytheon Co. v. Automated Business Systems, Inc.70, Automated Business Systems commenced an arbitration against Raytheon for intentional torts and breach of an exclusive dealership agreement.71 The arbitration clause, which adopted the provisions of the AAA, contained a California choice-of-law clause.72 After a lengthy hearing, Automated Business Systems received a substantial award of punitive damages.73 Raytheon moved in federal court to vacate the punitive award, arguing that California followed the Garrity rule; therefore, the arbitrators had exceeded their authority.74

The Raytheon court not only questioned whether the Garrity rule was California law, but also disapproved of the rule.75 The court

67. Id. at 796. The Garrity rule has elicited vigorous criticism. See Richard P. Hackett, Punitive Damages in Arbitration: The Search For A Workable Rule, 63 CORNELL L. REV. 272, 300 (1978) (criticizing Garrity as unworkable because arbitration awards do not distinguish between compensatory and punitive damages); Thomas J. Stipanowich, Punitive Damages in Arbitration: Garrity v. Lyle Stuart, Inc. Reconsidered, 66 B.U. L. REV. 953, 959 (1986) (lambasting Garrity as "an anomaly, frustrating the goals of fairness and finality that are the essence of arbitration and undermining the valuable role that punitive damages play in deterring fraudulent or malicious conduct").

68. See supra note 5 (citing cases in which courts have interpreted the FAA as embodying a liberal federal policy in favor of arbitration agreements).

69. Many commentators agree with this position. See, e.g., Michael L. Collier, Punitive Damages in Arbitration: The Second Circuit on a Collision Course with the U.S. Supreme Court, 8 OHIO ST. J. ON DISP. RESOL 385, 399 (1993) (contending that federal policy permits arbitral awards of punitive damages unless the parties expressly agree to exclude this remedy); Anthony M. Sabino, Awarding Punitive Damages in Securities Industry Arbitration: Working for a Just Result, 27 U. RICH. L. REV. 33, 63 (1992) (urging that a choice-of-law clause incorporates federal arbitration policy into an agreement, superseding state law exclusions of punitive damages); Ware supra note 14, at 548 (concluding that Garrity conflicts with the FAA). But see Douglas R. Davis, supra note 32, at 710-11 (stating that the parties' intent, which excludes punitive damages absent an express provision to the contrary, should be honored); Kenneth R. Davis, supra note 26, at 94 (arguing that the Garrity rule does not conflict with the FAA because the FAA is silent on the issue of punitive damages).

70. 882 F.2d 6 (1st Cir. 1989).

71. Id. at 7.

72. Id.

73. Id. The court awarded Automated $ 250,000 in punitive damages. Id.

74. Id.

75. Id. at 11.
stated that since the arbitral tribunal substitutes for the courtroom, arbitrators should have powers commensurate with judges.76 Disinclined to enforce the Garrity rule under any circumstances, the court held that, given a broad arbitration clause and an AAA rule which permits the arbitrator to grant "any remedy or relief . . . within the scope of the agreement of the parties," the liberal federal policy tipped the scales in favor of allowing punitive damages.77

Relegating its discussion of Volt to a footnote, the court attempted to distinguish that important case on the ground that Volt dealt with a procedural question, a stay of arbitration, whereas Raytheon dealt with a substantive matter, the availability of punitive damages.78 The court, however, failed to justify its belief that Garrity violates federal policy.79

Some circuit courts have applied the Garrity rule.80 The Seventh Circuit in Mastrobuono, for example, found no tension between Garrity and the FAA.81 The court's analysis, however, did not withstand the review of the Supreme Court.

II. MASTROBUONO v. SHEARSON LEHMAN HUTTON, INC.

A. Facts and Procedural Background

In Mastrobuono v. Shearson Lehman Hutton, Inc.,82 the United States Supreme Court held that an NASD arbitration panel was empowered to award punitive damages, although the parties had agreed to be governed by New York law which, under the Garrity rule, prohibits such awards.83 The Mastrobuonos, who had a securities trading account with Shearson, brought an action against the firm under state and federal law for mishandling the account.84 Based on the client

76. Id. at 12.
77. Id. at 11.
78. Id. at 11-12.
79. Id. at 12. Raytheon has elicited substantial commentary. See Douglas R. Davis, supra note 32, at 705 (suggesting that the court should have directed the arbitrator to determine, prior to the hearing, whether he had authority to award punitive damages); James Hadden, The Authority of Arbitrators to Award Punitive Damages: Raytheon Co. v. Automated Business Systems, 7 J. Disp. Resol. 337, 350 (1992) (arguing that Raytheon is distinguishable from Garrity and favoring the availability of punitive awards in arbitration).
80. For example, the Second Circuit in Barbier v. Shearson Lehman Hutton, Inc. honored a New York choice-of-law clause in an arbitration agreement, thus vacating an arbitral award of punitive damages. 948 F.2d 117, 122 (2d Cir. 1991).
83. Id. at 1218.
84. Id. at 1214.
agreement which contained an arbitration clause, Shearson successfully moved to compel arbitration. In addition to a substantial compensatory award, the arbitration panel awarded the Mastrobuonos $400,000 in punitive damages. Seeking to vacate the punitive award, Shearson argued that the parties' agreement contained a New York choice-of-law clause and, since New York law forbids arbitrators from awarding punitive damages, the arbitrators exceeded their authority.

The district court found this argument persuasive and vacated the punitive award. In affirming the vacatur, the Seventh Circuit held that the intent of the parties determined the availability of punitive damages, and that the choice-of-law clause manifested their intent to foreclose punitive awards. The court rejected Shearson's argument that the FAA, which favors the enforcement of arbitration agreements, preempts any state law limitation of punitive damages. The court stated:

[T]he policy favoring arbitrability applies with less force when there are doubts concerning the availability of punitive remedies — as opposed to the "scope of arbitrable issues" . . . . Just as the FAA does not favor or disfavor arbitration under a given set of procedural rules, neither does it favor or disfavor any particular type of remedy.

Despite this cogent reasoning, the Supreme Court reversed the Seventh Circuit's decision.

B. The Majority Opinion

The Supreme Court began its analysis by remarking that the "FAA's pro-arbitration policy does not operate without regard to the wishes of the contracting parties." This tepid recasting of the Court's vigorous announcement in Volt that the "FAA's primary purpose" is to insure that arbitration agreements "are enforced according to their terms" suggested the Mastrobuono court's desire to distance itself from Volt. The Court acknowledged in Mastrobuono, however,

85. Id. at 1215.
86. Id.
87. Id.
90. Id. at 716-17.
91. Id. at 718 (citations omitted).
93. Id. at 1216.
as it did in Volt, that resolution of the issue hinged on whether the arbitration agreement evidenced the parties’ intent to permit punitive damages.95

Demonstrating uncanny facility, the Court uncovered provisions in the agreement which in its view demonstrated the parties’ intent to permit punitive damages.96 The Court observed that the agreement authorized arbitration under NASD rules.97 Although paragraph 3741(e) of the NASD rules merely directs the arbitrators to summarize the relief granted and does not expressly authorize them to award punitive damages, the Court extracted an implicit grant of authority from this procedural provision.98 The Court relied also on an unofficial manual provided to NASD arbitrators which instructs that “[p]arties to arbitration are informed that arbitrators can consider punitive damages as a remedy.”99 This manual, however, was not incorporated into the arbitration agreement.100 Nevertheless, the Court relied on paragraph 3741(e) and the Manual to conclude, however speciously, that the parties intended to permit punitive awards.101

To defuse the choice-of-law clause, the Court noted that, absent the clause, New York law would presumably have applied if the parties had signed and executed the agreement in New York.102 Since no contractual intent could be gleaned in the absence of such a clause, the Court concluded that no contractual intent could be ascertained

95. Mastrobuono, 115 S. Ct. at 1216.
96. Id. at 1216-17 n.2.
97. Id. at 1218 n.5.
98. Id. at 1218.
99. Id. The Arbitrator’s Manual was developed by the Securities Industry Conference on Arbitration (SICA), a trade association. Katsoris, supra note 18, at 580-81. Established in 1977, SICA has also promulgated a Uniform Code of Arbitration which has served as a model for securities SROs. Id. at 580. The Arbitrator’s Manual instructs:

The issue of punitive damages may arise with great frequency in arbitration. Parties to arbitration are informed that arbitrators can consider punitive damages as a remedy. Generally, in court proceedings, punitive damages consist of compensation in excess of actual damages and are awarded as a form of punishment against the wrongdoer. If punitive damages are awarded, the decision of the arbitrators should clearly specify what portion of the award is intended as punitive damages, and the arbitrators should consider referring to the authority on which they relied.

SECURITIES INDUSTRY CONFERENCE ON ARBITRATION, THE ARBITRATOR’S MANUAL 26-27 (1992). This document is presented to new NASD arbitrators while attending a mandatory training session which is a pre-requisite to participating as an arbitrator. NASD Training Session administered by Thomas F. Wynn, Assistant Director of Arbitration, NASD (June 28, 1995). As one might expect in the wake of Mastrobuono, the NASD advises its arbitrators that they may, in their discretion, award punitive damages. Id.
100. Id. at 1222 (Thomas, J., dissenting).
101. Id. at 1218.
102. Id. at 1217.
from the inclusion of such a clause.\textsuperscript{103} This circular argument ignores the parties' contractual intent to be bound by New York law, including the \textit{Garrity} rule. Perhaps recognizing the deficiency of its argument, the Court suggested alternatively that the choice-of-law clause might refer only to New York's substantive rights and obligations rather than to decisional law that allocates authority between tribunals.\textsuperscript{104} Such an arbitrary limitation on the effect of the choice-of-law clause contradicts its broad, unqualified language and cannot, as Justice Thomas recognized, be reconciled with \textit{Volt}.\textsuperscript{105} In sum, the Court proposed two reasons for concluding that the choice-of-law clause did not include New York's common law prohibition of punitive damages, neither of which withstands scrutiny.

The Court conceded, however, that the choice-of-law clause may introduce an ambiguity into the arbitration agreement.\textsuperscript{106} To support its refusal to enforce the choice-of-law clause, the Court reverted to a skewed version of federal arbitration policy, deemphasizing party intent and noting that ambiguities in the scope of the agreement must be resolved in favor of arbitrability.\textsuperscript{107}

After justifying its decision on this reformulation of federal arbitration policy, the Court attempted to buttress its position using principles of contract construction and interpretation.\textsuperscript{108} It relied on the common law rule that contractual ambiguity is resolved against the drafting party, reasoning that any ambiguity as to the availability of punitive damages should be construed against Shearson, which required the Mastrobuonos to sign a form client agreement.\textsuperscript{109} The Court concluded its analysis by invoking the principle that a court must interpret a contract to give effect to all its provisions and harmonize them as much as possible.\textsuperscript{110} To achieve harmony in this case, the Court interpreted the choice-of-law clause to apply only to New York substantive law, not to decisional law limiting the authority of arbitrators.\textsuperscript{111} A more resonant harmony would have been sounded by interpreting the choice-of-law clause to prohibit punitive damages, in accordance with express New York decisional law, and interpreting

\textsuperscript{103} \textit{Id.}
\textsuperscript{104} \textit{Id.} at 1219.
\textsuperscript{105} \textit{Id.} at 1221 (Thomas, J., dissenting).
\textsuperscript{106} \textit{Id.} at 1218.
\textsuperscript{107} \textit{Id.}
\textsuperscript{108} \textit{Id.} at 1219.
\textsuperscript{109} \textit{Id.}
\textsuperscript{110} \textit{Id.}
\textsuperscript{111} \textit{Id.}
the vague rules of the NASD, which say nothing about punitive damages,\textsuperscript{112} to authorize awards of compensatory damages only.

\textbf{C. The Dissenting Opinion}

Justice Thomas dissented.\textsuperscript{113} He found \textit{Mastrobuono} indistinguishable from \textit{Volt}, where the Court enforced a statutory stay of arbitration, upholding state law "‘governing the conduct of arbitration.’"\textsuperscript{114} Justice Thomas explained that the \textit{Mastrobuono} majority, without any rationale to distinguish \textit{Volt}, refused to enforce functionally equivalent state law prohibiting punitive damages.\textsuperscript{115} Pointing out that \textit{Volt} makes no distinction between rules that allocate power and rules that achieve other objectives, Justice Thomas observed that the California procedural rule enforced in \textit{Volt} may be characterized as one that allocates power between the courts and the arbitral forum, since it stays arbitration pending judicial resolution.\textsuperscript{116}

Arguing that the parties' intent, as expressed in the arbitration agreement, should be followed, Justice Thomas scrutinized the relevant NASD rules and manual provisions.\textsuperscript{117} He recognized that paragraph 3741(e) of the NASD Code of Arbitration Procedure does not grant or delimit arbitrator authority; "it merely describes the form in which the arbitrators must announce their decision."\textsuperscript{118} Justice Thomas asserted that the NASD never officially adopted the manual on which the majority relied.\textsuperscript{119} Nor did the parties agree to be bound by it.\textsuperscript{120} Justice Thomas argued also that the manual obligates the arbitrator to follow whatever rules the parties designate.\textsuperscript{121} The parties, through the choice-of-law clause, adopted the New York rule, which

\begin{itemize}
\item \textsuperscript{112} See supra notes 98-99 and accompanying text (describing the relevant NASD arbitration rule).
\item \textsuperscript{114} \textit{Id.} at 1220 (Thomas, J., dissenting) (quoting \textit{Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.}, 489 U.S. 468, 476 (1989)). The \textit{Volt} Court said: "Interpreting a choice-of-law clause to make applicable state rules governing the conduct of arbitration — rules which are manifestly designed to encourage resort to the arbitral process — simply does not offend the rule of liberal construction set forth in Moses H. Cone [Memorial Hosp. v. Mercury Constr. Corp.], 460 U.S. 1 (1983)], nor does it offend any other policy embodied in the FAA." 489 U.S. at 476.
\item \textsuperscript{115} \textit{Mastrobuono}, 115 S. Ct. at 1220 (Thomas, J., dissenting).
\item \textsuperscript{116} \textit{Id.} at 1221 (Thomas, J., dissenting).
\item \textsuperscript{117} \textit{Id.} at 1221-23 (Thomas, J., dissenting).
\item \textsuperscript{118} \textit{Id.} at 1221 (Thomas, J., dissenting) (interpreting § 41(e) of the Code of Arbitration Procedures).
\item \textsuperscript{119} \textit{Id.} at 1222 (Thomas, J., dissenting). He noted that SICA published the manual. \textit{Id.}
\item \textsuperscript{120} \textit{Id.} (Thomas, J., dissenting).
\item \textsuperscript{121} \textit{Id.} (Thomas, J., dissenting).
\end{itemize}
prohibits arbitral punitive awards. On the other hand, the NASD rules are silent on the issue of punitive damages. Even if one stretches them to otherwise allow punitive awards, the choice-of-law clause evinces the unmistakable intent to prohibit punitive damages and thus overrides vaguely contrary NASD rules.

III. A Critique of Mastrobuono

The Mastrobuono Court's analysis foundered in two respects. First, the Court misapplied contract principles. Second, federal preemption crept into the Court's rationale, although such reasoning is inimical to the contract analysis that Volt requires. The Court held that "when a court interprets [choice-of-law clauses] in an agreement covered by the FAA, 'due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause itself resolved in favor of arbitration.' " Although this pronouncement may not seem controversial, it has troublesome implications.

A. Faulty Contract Analysis

In ruling that liberal federal arbitration policy must be considered in determining contractual meaning when intent is unclear, the Mastrobuono Court failed to appreciate that contract analysis is as equipped to resolve the ambiguities in arbitration agreements as it is to resolve the ambiguities in other agreements. The legal meaning of nearly all agreements may be ascertained by applying common law rules of interpretation. The principles are well established. In cases of contract ambiguity, the court will adopt the interpretation that most successfully harmonizes the various terms. Specific rather than general terms control; the express overrides the implied. In rare cases

122. Id. at 1220 (Thomas, J., dissenting).
123. Id. at 1222-23 (Thomas, J., dissenting).
124. Id. at 1218 (quoting Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ., 489 U.S. 468, 476 (1989)).
125. Id.
126. See Arthur L. Corbin, Corbin on Contracts § 545-54, at 521 (one vol. ed. 1952) ("Provisions in a contract that appear to be controlling or repugnant can frequently be harmonized by reasonable interpretation."); E. Allan Farnsworth, Contracts § 7.11, at 263-64 (2d ed. 1990) ("[A]n interpretation that gives meaning to the entire agreement is favored over that one that makes some part of it mere surplusage."); Samuel Williston, Williston on Contracts § 619, at 731 (Walter H. E. Jaeger ed., 3d ed. 1961) ("The court will if possible give effect to all parts of the instrument and an interpretation which gives a reasonable meaning to all its provisions will be preferred to one which leaves a portion of the writing useless or inexplicable.").
127. See Goldberg v. Bear Stearns & Co., 912 F.2d 1418, 1421 (11th Cir. 1990) ("When general propositions in a contract are qualified by the specific provisions, the rule of construction is that the specific provisions in the agreement control."); Corbin, supra note 126, §§ 545-54, at 521
where these and other rules fail to resolve ambiguities (*Mastrobuono* is not such a case), the court will hear parol evidence.\textsuperscript{128} Ties do not exist in matters of contract interpretation.

In holding that punitive damages may be awarded, the *Mastrobuono* Court relied substantially on the rule that a contract must be interpreted against the party who drafted it.\textsuperscript{129} However, this principle of construction, known as *contra proferentum*, is applied only when rules of interpretation, which focus on party intent, fail to untangle contractual ambiguity.\textsuperscript{130} The Court should not have resorted to this principle, because, through the choice-of-law clause, the parties demonstrated their intent to be governed by the *Garrity* rule.

A New York choice-of-law clause says: "The agreement shall be governed by the laws of the State of New York." Such a clause incorporates the *Garrity* rule into the agreement. *Garrity* expresses an emphatic rule of public policy prohibiting arbitrators from awarding punitive damages. Contrary contractual intent must be strong and unequivocal to override it. Only an express provision allowing punitive awards supersedes such a choice-of-law clause. Arguably, neither the vague NASD rule nor the arbitrator's manual provision cited by the
Mastrobuono majority even raise an ambiguity regarding the availability of punitive damages.\textsuperscript{131}

Assuming for the sake of argument that the relevant NASD rule and manual provision create an ambiguity in the Mastrobuono arbitration agreement, one may resolve this conflict simply by applying the principle that where a specific contractual provision clashes with a more general one, the specific provision controls. While the Garrity rule expressly repudiates the availability of punitive damages in arbitration, the applicable NASD rule and arbitrator’s manual provision are more general, not expressly authorizing the arbitrator to award punitive damages.\textsuperscript{132} At most, they empower the arbitrator to award punitive damages by vague implication.\textsuperscript{133} The more specific, express rule — the Garrity exclusion of punitive damages — should prevail.

Even the broad arbitration clause in Mastrobuono does not change this result. The clause made “any controversy” arising out of the transactions between the parties arbitrable.\textsuperscript{134} Although a dispute over whether punitive damages are available can arguably be interpreted as a “controversy” arising out of the transactions between the parties, the arbitration clause is a general provision merely implying that the arbitrators may award punitive damages. Again, the principles of contract interpretation outlined above require that the more specific Garrity rule control.

\textbf{B. The Misinterpretation of Federal Arbitration Policy}

The touchstone of federal arbitration policy is to give effect to the intent of the parties as expressed in the arbitration agreement, even if the intent is to limit the scope of arbitrable issues. Federal policy does not force parties to arbitrate issues against their will. Indeed, the FAA, which promotes the enforceability of arbitration agreements, is satisfied when a dispute reaches the arbitral forum. The House Report on the bill destined to become the FAA stated that the purpose of the bill was to place “[a]n arbitration agreement upon the same

\begin{footnotesize}
\begin{enumerate}
\item[131.] See \textit{supra} notes 118-123 and accompanying text (explaining that the NASD rules are silent on the issue of punitive damages).
\item[132.] Rule 21(f)(4) of the NASD Rules of Fair Practice provides in part that “[n]o agreement shall include any condition which limits . . . the ability of the arbitrators to make any award.” \textit{Rules of Fair Practice Art. III, § 21(f)(4), reprinted in} National Association of Securities Dealers Manual (CCH) ¶ 2171 (Apr. 1992). This rule, which became effective after the Mastrobuono agreement was executed, was therefore inapplicable to the case.
\item[133.] See \textit{supra} note 99 and accompanying text (explaining that the NASD rules do not expressly grant arbitrators the authority to award punitive damages).
\end{enumerate}
\end{footnotesize}
footing as other contracts.” Similarly, Congressman Graham, a proponent of the bill, explained that it “does not involve any new principle of law except to provide a simple method . . . in order to give enforcement.”

Volt correctly interprets the FAA, allowing state procedures to apply to arbitration and allowing state substantive law, consistent with the FAA, to govern arbitration. Garrity’s prohibition of arbitral punitive awards is a rule of substantive law, and, since the FAA does not address the availability of such awards, Garrity is not preempted.

Mastrobuono misapplied federal policy and spawned a murky rule. The Court’s rationale for not enforcing the Garrity rule is unclear. The Court did not hold that the FAA absolutely preempts the Garrity rule. Such a holding would reject Garrity without qualification. Rather, the Court adopted a limited form of preemption which, in essence, transformed federal policy into a rule of contract construction to be considered with the ordinary rules of contract interpretation. Federal policy, held the court, weighs on the side of construing an arbitration agreement broadly. This limited version of federal preemption engenders confusion because the Court did not articulate the force of federal policy as a rule of contract construction. More fundamentally, such a delineation is impossible because every situation presents a unique set of interpretive problems. Thus, rather than ruling that Garrity is not preempted (the correct result) or that Garrity is

135. H.R. REP. No. 96, 68th Cong., 1st Sess. 1 (1924). See supra notes 32-37 and accompanying text (discussing the purpose of the FAA to overcome the hesitancy of state courts to enforce arbitration agreements).

136. 65 CONG. REC. 1931 (1924).


138. See supra text accompanying notes 38-40 (discussing the provisions of the FAA and explaining that they supersede state law) and text accompanying notes 55-68 (discussing the court’s decision in Garrity v. Lyle Stuart, Inc., 353 N.E.2d 793 (N.Y. 1976)).

139. See Mastrobuono v. Shearson Lehman Hutton, Inc., 115 S. Ct. 1212, 1216-17 (1995) (suggesting that the FAA would not preempt the Garrity rule where the parties expressly provide in their written arbitration agreement that punitive damages may not be awarded).

140. Although often used interchangeably, contract interpretation and construction are not synonymous. “Interpretation” refers to the meaning the parties intended to convey by the language used; “construction” refers to the process affixing legal effect to a contract by operation of law, regardless of party intent. CORBIN, supra note 126, § 534, at 492; FARNSWORTH, supra note 126, § 7.7, at 237; WILLISTON, supra note 126, § 602, at 320. As Williston explains:

The word “interpretation” is used with respect to language itself; it is the process of applying the legal standard to expressions found in the agreement in order to determine their meaning. “Construction,” on the other hand, is used to determine, not the sense of words or symbols, but the legal meaning of the entire contract; the word is rightly used wherever the import of the writing is made to depend on a special sense imposed by law.

WILLISTON, supra note 126, § 602, at 320.
preempted (at least a clear result), the court created an ill-defined, "relative" level of preemption, which merely strengthens, to an indeterminable extent, contract provisions broadening the arbitration agreement.

Contract law provides the tools to ascertain the meaning of ambiguous contracts. The Supreme Court's oft-quoted statement that "ambiguities as to the scope of the arbitration clause itself [are] resolved in favor of arbitration,"\(^1\) although impressionistically correct, has bred a preemption rule which does not consider intent as manifested by the agreement. Thus, the statement may point away from the meaning that principles of contract interpretation would cast on an ambiguous agreement. Such a preemption rule may, at times, contradict the central purpose of the FAA — to honor the written agreement.

IV. THE IMPLICATIONS OF MASTROBUONO

By injecting preemption principles into the contract analysis, the Mastrobuono Court undermined the federal policy of enforcing arbitration agreements according to their terms. Swayed by Mastrobuono, courts, in close cases, may defer to the preemption rule of broadly interpreting arbitration agreements, thereby defeating the contractual intent as expressed in the arbitration agreement.

Two issues raise the potential conflict between federal arbitration policy, as expressed in Mastrobuono, and state law. The first is whether federal policy preempts state law that delegates to the court, rather than the arbitrator, questions of time limitations.\(^2\) The second issue is whether federal policy preempts state law disallowing arbitrators from awarding attorneys' fees.\(^3\)

A. Statutes of Limitations

The reflex of many federal judges to rule in favor of arbitrability suggests that when chosen state law in any way limits the powers of arbitrators, the weight of preemption, taken in tandem with other contractual provisions, will be just enough to reject chosen state law. One inevitable victim of Mastrobuono is the New York rule empowering the court to decide arbitral statute of limitations questions.

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142. See infra notes 144-205 (discussing statutes of limitations).
143. See infra notes 206-235 (discussing attorneys' fees).
I. Cases Preceding Mastrobuono

Only two weeks before the Mastrobuono decision, the New York Court of Appeals held in Smith Barney, Harris Upham & Co. v. Luckie144 that the court, rather than the arbitrator, should decide whether a statute of limitations time-bars arbitration.145 In Luckie, Kahn commenced arbitration against Smith Barney, a securities broker-dealer, alleging fraud and account mismanagement.146 The customer agreement provided that "[a]ny controversy" relating to the contract between the parties would be arbitrated.147 The agreement included a New York choice-of-law clause providing that New York law would govern "[t]his agreement and its enforcement."148 Smith Barney moved in New York Supreme Court to stay arbitration, arguing that the claims were time-barred.149

Holding that the arbitration was timely filed, the New York Supreme Court denied the petition.150 The Appellate Division affirmed the denial of the stay on other grounds.151 It noted that the arbitration clause applied to "any controversy" and that a dispute over the timeliness of the arbitration is itself a "controversy" under the agreement.152 Thus, the Appellate Division ruled that, in keeping with the liberal policy of the FAA, the timeliness issue was for the arbitrator, not the court, to decide.153

145. Id. at 1310. In the companion case to Luckie, Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Manhard, 647 N.E.2d 1308 (1995), cert. denied, 64 U.S.L.W. 3239 (U.S. Oct. 3, 1995), Merrill Lynch moved to stay arbitration, arguing that it was barred by Section 15 of the NASD Code of Arbitration Procedure, state and federal statutes of limitations, and New York's borrowing statute. Id. at 1311. Manhard conceded that the NASD rule barred certain of her claims, but argued in her motion that the other timeliness issues were for the arbitrator to decide. Id. at 1311-12. The New York Supreme Court disagreed and decided the motion adversely to Manhard. Id. at 1312. On appeal, the Appellate Division reversed on the ground that the statute of limitations issues were, as a result of federal policy, arbitrable issues. Id.
146. Id. at 1310-11.
147. Id. at 1310.
148. Id. at 1311.
149. Id. C.P.L.R. 7502(b) provides in part:
   If, at the time that a demand for arbitration was made or a notice of intention to arbitrate was served, the claim sought to be arbitrated would have been barred by limitation of time had it been asserted in a court of the state, a party may assert the limitation as a bar to the arbitration on an application to the court as provided in section 7503 or subdivision (b) of section 7511. The failure to assert such bar by such application shall not preclude its assertion before the arbitrators, who may, in their sole discretion, apply or not apply the bar.
150. Id.
151. Id.
152. Id.
153. Id.
On appeal, the New York Court of Appeals began by analyzing the contractual intent of the parties. It noted that, although the parties agreed to submit "any controversy" under the agreement to arbitration, they selected New York law to govern the enforcement of the agreement.\textsuperscript{154} Since statute of limitations issues involve enforcement, such issues must be determined by the forum designated under New York law.\textsuperscript{155} As noted, New York law authorizes the court to decide whether statutes of limitations bar arbitration.\textsuperscript{156}

After ascertaining the intent of the parties, the court explained that it must next determine if the FAA preempts the New York rule, although the parties incorporated this rule into their contract by operation of the choice-of-law clause.\textsuperscript{157} To resolve this issue, the court reviewed \textit{Volt} and concluded that federal law honors the parties' choice of law unless "the chosen law creates a conflict with the terms of, or the policies underlying, the FAA."\textsuperscript{158} Presented with no express provision of the FAA conflicting with the New York rule, the court focused on whether the New York rule undermines the policies of the FAA.\textsuperscript{159} Again citing \textit{Volt}, the court stressed that the state's arbitration law is consistent with the FAA, "even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward."\textsuperscript{160} The court reasoned that by sustaining the parties' choice of law it was advancing the federal policy of "ensur[ing] the enforceability according to their terms, of private agreements to arbitrate."\textsuperscript{161} The court recognized that federal policy and contractual intent are inseparable. Federal policy, above all else, promotes freedom of contract.\textsuperscript{162} To reinforce its holding, the court observed that the FAA was modeled after New York arbitration law.\textsuperscript{163}

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\textsuperscript{154} \textit{Id.} at 1313.
\textsuperscript{155} \textit{Id.}
\textsuperscript{156} \textit{Id.} (citing Rockland v. Primiano Constr. Co., 409 N.E.2d 951, 954 (1980)); see N.Y. Civ. Prac. L. & R. 7502(b) (McKinney 1980) (stating a party may assert a time limitation as a bar to the arbitration upon application to the court).
\textsuperscript{157} \textit{Id.}
\textsuperscript{158} \textit{Id.} at 1312 (quoting \textit{Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.}, 489 U.S. 468, 476 (1989)).
\textsuperscript{159} \textit{Id.} at 1313-14.
\textsuperscript{160} \textit{Id.} at 1315 (quoting \textit{Volt}, 489 U.S. at 479).
\textsuperscript{161} \textit{Id.} at 1316 (quoting \textit{Volt}, 489 U.S. at 476).
\textsuperscript{162} \textit{Id.} Chief Justice Kaye concurred. \textit{Id.} (Kaye, J., concurring). Although agreeing with the court's reading of \textit{Volt}, she questioned the wisdom of imposing of New York law on Florida and Virginia residents, who, despite having agreed to arbitrate, never reached the arbitral forum. \textit{Id.} (Kaye, J., concurring).
\textsuperscript{163} \textit{Id.} at 1315 (citing Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 405 n.13 (1967)).
\end{flushright}
of federal arbitration law are therefore consistent with New York arbitration policy.\textsuperscript{164}

Smith Barney sought to distinguish \textit{Volt} on the ground that \textit{Volt} involved a temporary stay of arbitration, whereas \textit{Luckie} potentially involved a permanent stay.\textsuperscript{165} The court rejected this argument because the holding in \textit{Volt} expressed no such qualification.\textsuperscript{166}

Several cases, contrary to \textit{Luckie}, instruct that the FAA preempts the New York statute of limitations rule.\textsuperscript{167} Such a holding was implicit in \textit{Shearson Lehman Hutton, Inc. v. Wagoner},\textsuperscript{168} where the Second Circuit ruled that the arbitrator decides statute of limitations questions.\textsuperscript{169} In \textit{Wagoner}, the parties arbitrated a churning claim under an agreement "to refer all disputes arising out of a contract to arbitration," while selecting New York law to govern disputes.\textsuperscript{170} The court concluded that "any limitations defense — whether stemming from the arbitration agreement, arbitration association rule,\textsuperscript{171} or state

\begin{footnotesize}
\textsuperscript{165} Id.
\textsuperscript{166} Id.
\textsuperscript{167} E.g., Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Shaddock, 822 F. Supp. 125, 136 (S.D.N.Y. 1993) (refusing to find that the choice-of-law provision at issue required application of New York law in place of federal arbitration law); Victor v. Dean Witter Reynolds, Inc., 606 So. 2d 681, 685 (Fla. Dist. Ct. App. 1992) (holding that the FAA preempts the application of New York law granting the court the authority to decide statute of limitations issues); see Shearson Lehman Hutton, Inc. v. Wagoner, 944 F.2d 114, 121 (2d Cir. 1991) (reversing a district court decision holding that an arbitration was time-barred because, "when the contract contains a 'broad' arbitration clause . . . that purports to refer all disputes arising out of a contract to arbitration," the strong presumption in favor of arbitrability applies with even greater force").
\textsuperscript{168} 944 F.2d 114 (2d Cir. 1991).
\textsuperscript{169} Id. at 120-22.
\textsuperscript{170} Id. at 121.
\textsuperscript{171} The \textit{Wagoner} court was referring to arbitration association rules limiting the time in which a party may commence arbitration. E.g., NASD Code of Procedures § 15; NYSE Rule 603 (both requiring arbitration to be commenced within six years of the event giving rise to the dispute). Some courts have interpreted New York law to authorize New York courts to decide whether an association rule time-bars an arbitration. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. DeChaine, 600 N.Y.S. 2d 459, 460 (Sup. Ct. App. Div. 1993), appeal denied, 624 N.E.2d 694 (N.Y. 1993) (holding that NYSE Rule 603 time-bars an arbitration); Prudential Bach Securities v. Archard, 579 N.Y.S.2d 890, 891 (Sup. Ct. App. Div. 1992), appeal denied, 600 N.E.2d 633 (N.Y. 1992) (holding that NASD code § 15 time-bars an arbitration). The issue then arises whether the FAA preempts the New York rule and empowers arbitrators to decide if an association rule time-bars an arbitration. Most federal courts hold that the FAA does preempt the New York rule, although these courts are split over whether the federal courts or the arbitrators should decide if the arbitration is time-barred. \textit{Compare} Merrill Lynch, Pierce, Fenner & Smith v. Masland, 878 F. Supp. 710, 712 (M.D. Pa. 1995) (holding that the FAA preempts New York law, which presumably authorizes the state court to resolve the issue, and that, since NASD Code § 15 is an "eligibility" requirement and therefore jurisdictional, the federal court decides whether that section time-bars arbitration) \textit{with} Painewebber, Inc. v. Landay, No. 94-10957 WL 598205, at *5 (D. Mass. Sept. 21, 1995) (holding that the FAA preempts New York law and that
\end{footnotesize}
statute — is an issue to be addressed by the arbitrators.”\textsuperscript{172} Though not expressly invoking federal preemption, the court relied on the broad arbitration clause and “the strong presumption in favor of arbitrability” arising from federal policy.\textsuperscript{173} Curiously, \textit{Volt} eluded the court’s analysis.

In \textit{Merrill Lynch, Pierce, Fenner \& Smith v. Shaddock},\textsuperscript{174} the court, citing \textit{Wagoner}, decided the preemption issue directly.\textsuperscript{175} It stated that “at the time the parties entered into the agreement, New York courts considered choice-of-law provisions in arbitration agreements to designate only the substantive law to be applied by the arbitrators and not to displace application of federal arbitration law.”\textsuperscript{176} Thus, the court, dismissing the effect of the choice-of-law clause, reasoned that the parties did not intend New York arbitration law to apply.\textsuperscript{177} The court also managed to discount \textit{Volt}. It found that \textit{Volt} merely affirmed the California court’s ruling that the parties intended California law to govern.\textsuperscript{178} The court then observed that the New York courts, unlike the California court in \textit{Volt}, do not exalt chosen state law above federal policy.\textsuperscript{179}

The \textit{Shaddock} court’s analysis obscures two salient points: (1) \textit{Volt} limited the scope of federal preemption to state law conflicting di-

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\textsuperscript{172} Shearson Lehman Hutton, Inc., 944 F.2d at 121.

\textsuperscript{173} Id. The trustee in bankruptcy, who advanced the claim against Shearson, argued unsuccessfully that the arbitration agreement did not include tort as opposed to contract claims. \textit{Id.} at 121-22.


\textsuperscript{175} Id. at 136.

\textsuperscript{176} Id. Petitioners argued that, since subject matter jurisdiction was based on diversity, the case was governed by New York law rather than federal law. \textit{Id.} at 132. The court rejected this argument, noting that the FAA applies to any case, regardless of the source of subject matter jurisdiction, if the contract containing the arbitration clause concerns transactions in interstate commerce. \textit{Id.}

\textsuperscript{177} Id. at 134-35.

\textsuperscript{178} Id.

\textsuperscript{179} Id. at 133-34.
rectly with federal arbitration law,\textsuperscript{180} and (2) generally prevailing state common law principles of contract interpretation support the applicability of chosen state law barring punitive awards.\textsuperscript{181} The court’s skewed reading of the choice-of-law clause was even more extreme than the gloss the United States Supreme Court put on the choice-of-law clause in \textit{Mastrobuono}. Unlike \textit{Mastrobuono} where the High Court truncated the choice-of-law clause so that it did not encompass decisional law allocating power between tribunals,\textsuperscript{182} the \textit{Shaddock} court carved out all arbitration law from the ambit of the choice-of-law clause.\textsuperscript{183} The evisceration of the broad choice-of-law clause, which said that the agreement and its enforcement would be governed by New York law, showed the court’s determination to refer the statute of limitations issue to the arbitrators, regardless of the terms of the agreement.\textsuperscript{184}

2. \textit{The Rule After Mastrobuono}

It is arguable that \textit{Mastrobuono} may be limited to its facts and therefore does not answer the statute of limitations issue. The Court said that the issue posed was one of contract interpretation.\textsuperscript{185} It rationalized its ruling, in part, on paragraph 3741(e) of the NASD Code of Arbitration Procedure, which, the majority concluded, empowered the arbitrator to award "damages and other relief," including punitive damages.\textsuperscript{186} The court relied also on the NASD arbitrator’s manual which refers to punitive damages.\textsuperscript{187} These provisions have no relevance to statute of limitations issues.

As Justice Thomas optimistically observed in his dissent:

This case amounts to nothing more than a federal court applying New York and Illinois contract law to an agreement between parties in Illinois. Much like a federal court applying a rule of decision to a case when sitting in diversity, the majority’s interpretation of the contract represents only the understanding of a single federal court regarding the requirements imposed by state law.\textsuperscript{188}

\begin{footnotes}
\item[181] See supra notes 126-30 and accompanying text (discussing the common law principles of contract interpretation).
\item[184] \textit{Id.} at 132.
\item[185] \textit{Mastrobuono}, 115 S. Ct. at 1216.
\item[186] \textit{Id.} at 1218.
\item[187] \textit{Id.}
\end{footnotes}
Justice Thomas' point is that, should an authoritative New York state court interpret the contract at issue to bar punitive damages, the Supreme Court and all other courts would presumably be bound by that interpretation. Theoretically, *Mastrobuono* is not binding on any court because the question of contract interpretation that it addressed is one of state common law, not federal law. This view strips *Mastrobuono* of any meaningful precedential effect. It is unlikely, however, to take hold in federal courts.

If *Mastrobuono* is narrowly interpreted, *Volt* may govern the statute of limitations issue. *Volt* explained that the FAA does not prevent "the enforcement of agreements to arbitrate under different rules than [sic] those set forth in the Act itself." Both the issue decided in *Volt* and the statute of limitations issue involve procedure rather than substance. By determining that the parties could agree to procedural rules different from those set forth in the FAA, *Volt* suggests that chosen state law may govern the statute of limitations issue. Thus, the heightened sensitivity to preemption shown in *Mastrobuono* may not apply in statute of limitations cases.

One might also distinguish *Luckie* from *Mastrobuono* on the language of the arbitration clauses those cases interpreted. The arbitration clause in *Luckie* provided that New York law would govern "the agreement and its enforcement." Under New York law, the issue of whether a statute of limitations has expired is a threshold question of arbitrability. A threshold question is by definition an "enforce-

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189. See Eric Rieder, *High Court Decisions Leave Questions Unanswered*, N.Y.L.J., Mar. 30, 1995, at 5 (noting that the New York Court of Appeals might, even now, decide the issues presented in *Mastrobuono* contrary to the decision of the Supreme Court).
190. Since the *Mastrobuono* decision, the federal courts have unanimously sustained the arbitrability of punitive awards. *E.g.*, Gateway Technologies, Inc. v. MCI Telecommunications Corp., 64 F.3d 993, (5th Cir. 1995) (interpreting *Mastrobuono* to hold that an arbitrator may award punitive damages unless the arbitration agreement contains an express prohibition); Davis v. Prudential Securities, Inc., 59 F.3d 1186, 1189 (11th Cir. 1995) (relying on *Mastrobuono* to sustain punitive award where parties arbitrated under both AAA rules and New York law); Kelley v. Michaels, 59 F.3d 1050, 1055 (10th Cir. 1995) (upholding punitive award on the authority of *Mastrobuono*); Smith Barney Inc. v. Schell, 53 F.3d 807, 809 (7th Cir. 1995) (reversing district court's vacatur of arbitral punitive award on authority of *Mastrobuono*); Painewebber, Inc. v. Landay, No. 94-10957, 1995 WL 598205, at *11 (D. Mass. Sept. 21, 1995) (granting motion to compel arbitration including the issue of punitive damages); Shearson Lehman Brothers, Inc. v. Neurological Assoc. of Indiana, P.C., 896 F. Supp. 844, (S.D. I(nd. 1995) (following *Mastrobuono* where the arbitration agreement incorporated NASD rules and contained a New York choice-of-law clause); Painewebber, Inc. v. Richardson, 1995 U.S. Dist. LEXIS 5317, at *9-10 (S.D.N.Y. Apr. 20, 1995) (confirming punitive award on authority of *Mastrobuono*).
193. See *id.* (referring to the statute of limitations issue as a "threshold" question).
ment” matter, which the parties expressly agreed would be governed by New York law. In contrast to the arbitration clause in Luckie, the arbitration clause in Mastrobuono provided that the agreement “shall be governed by the laws of the State of New York.”194 That clause made no reference to “enforcement.” Even if one interprets Mastrobuono broadly to hold that the FAA rendered that choice-of-law clause ineffective as to all state law limitations on arbitrator authority, inclusion of the word “enforcement” in the choice-of-law clause in Luckie may distinguish it from Mastrobuono.195

It seems, however, that the Mastrobuono Court intended to go far beyond a ruling limited to the facts of the case. The Court likened a choice-of-law clause, to a conflict-of-laws rule, ignoring that a choice-of-law clause reflects contractual intent.196 The Court’s flimsy basis for reversing the Seventh Circuit suggests that it shares the predisposition, predominant among federal courts, to rule against state law incursions into the authority of arbitrators. The federal judiciary will undoubtedly seize upon Mastrobuono to reject the reasoning in Luckie.197 A justification for repudiating a state law rule delegating statute of limitations issues to the courts is easily at hand when the parties adopt a broad arbitration clause submitting “any controversy” to arbitration. A statute of limitations issue may readily be characterized as a “controversy” under the agreement.198 Such a rationale fits neatly under Mastrobuono, which relied on even less persuasive contract arguments.


196. Mastrobuono, 115 S. Ct. at 1217.


198. See Shearson Lehman Hutton, Inc. v. Wagoner, 944 F.2d 114, 121 (2d Cir. 1991) (holding that the issue whether an arbitration is time-barred is a “dispute” under a broad arbitration clause).
Inc., holding that a contested timeliness defense presented a "dispute" within the meaning of a broad arbitration clause. Although the court found that a choice-of-law clause created an ambiguity as to whether the parties intended the arbitrators or the court to decide the timeliness issue, it ruled the issue arbitrable in light of federal policy. The court reached this decision without even considering rules of contract interpretation. Seduced by the presumption of arbitrability, the court abandoned dispositive contract principles and obscured the intent of the parties. This case illustrates the mischief inherent in Mastrobuono. Waving the magic wand of federal policy excuses a careful analysis of what the parties intended.

Chosen state law that allocates power from the arbitral forum to the courtroom may be defunct after Mastrobuono. The "allocation of power" rule, broadly applied, would swallow virtually any state law infringement on an arbitrator's authority. Like Garrity, the New York statute of limitations rule allocates power to the courts. Sustaining a statute of limitations defense terminates an arbitration, resulting in a permanent stay rather than the temporary stay upheld in Volt. Courts may, therefore, be more inclined, in statute of limitations cases, to apply the Mastrobuono rationale than the Volt holding. Even the California procedure sustained in Volt might not survive Mastrobuono's "allocation of power" analysis.

Mastrobuono arguably reshapes federal arbitration policy. Applying a distorted view of the FAA, the Mastrobuono court constricts the reach of Volt and elevates the federal policy resolving "ambiguities as to the scope of the arbitration clause . . . in favor of arbitration" above the policy that should be preeminent: honoring the terms of the agreement. Although the Court sought to protect the freedom

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200. Id. at *8-9. The arbitration clause provided that "all claims, disputes and other matters in question between the [parties] arising out of, or relating to, the contract ... shall be decided by arbitration. . . ." Id. See also Merrill Lynch, Pierce, Fenner & Smith v. Shaddock, 822 F. Supp. 125, 136 (S.D.N.Y. 1993) (construing a clause requiring the arbitration of "any controversy" arising from the parties' securities brokerage agreement to encompass a dispute over compliance with a statute of limitations).

201. Id. at *10-11 (citing Moses H. Cohen Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25 (1983)).

202. Ironically, the court cited Mastrobuono for the proposition that "the intention of the parties as expressed in their contract determines whether the arbitrators or the court should resolve the timeliness issue." Id. at *8.


to enter into arbitration agreements, it limited that freedom by discounting a choice-of-law provision.

B. Attorneys' Fees

New York law prohibits arbitrators from awarding attorneys' fees unless the agreement expressly grants this authority to the arbitrator. If the parties agree to arbitrate subject to New York law, application of the New York rule would, in most instances, preclude such relief. On the other hand, liberal federal arbitration policy arguably permits arbitral awards of attorneys' fees. The issue is whether federal policy, in conjunction with a broad arbitration clause, preempts a state law restriction on such awards. Before Mastrobuono, there was authority for and against this preemption argument.

205. CPLR 7513 provides in pertinent part: "Unless otherwise provided in the agreement to arbitrate, the arbitrator's expenses and fees, together with other expenses, not including attorneys' fees, incurred in the conduct of the arbitration, shall be paid as provided in the award. N.Y. CIV. PRAC. L. & R. 7513 (McKinney 1980). Although the New York Court of Appeals has never ruled on this issue, the Appellate Divisions that have confronted the issue are in accord that arbitrators may award attorneys' fees only if the agreement so provides. E.g., MKC Development Corp. v. Weiss, 612 N.Y.S.2d 946, 946-47 (1994) (vacating an arbitral award of attorneys' fees on the ground that the arbitrators exceeded their powers by making such an award); Merrill, Lynch, Pierce, Fenner & Smith, Inc. v. McConachie, N.Y.L.J. (1st Dept. Dec. 22, 1993) at 22 (staying a demand to arbitrate attorneys' fees because the agreement did not confer this power on the arbitrators). Other jurisdictions similarly restrict arbitrators from awarding attorneys' fees. E.g., ALASKA STAT. § 09.43.100 (1995); FLA. STAT. ANN. § 682.11 (West 1989); MASS. GEN. LAWS ANN. ch. 251. § 10 (West 1992); N.C. GEN. STAT. § 1-567.11 (1983).

206. See Todd Shipyards Corp. v. Cunard Line, Inc., 943 F.2d 1056, 1064 (9th Cir. 1991) (articulating the liberal federal policy supporting arbitral awards of attorney's fees); Delaware Dept. of Social Servs. v. Department of Educ., 772 F.2d 1123, 1139 (3d Cir. 1985) (suggesting that the FAA empowers arbitrators to award attorneys' fees). But see Raytheon Co. v. Computer Distribrs., Inc., 632 F. Supp. 553, 560 (D. Mass. 1986) (confirming arbitrators' refusal to consider awarding attorneys' fees under Massachusetts law because the FAA does not contemplate such awards); Sammi Line Co. v. Altamar Navegacion S.A., 605 F. Supp. 72, 74 (S.D.N.Y 1985) (vacating an arbitral award of attorneys' fees because arbitrators do not ordinarily have authority to grant such relief).


1. Cases Preceding Mastrobuono

In *Todd's Shipyards Corp. v. Cunard Line Ltd.*, the court sustained an arbitral award of attorneys' fees against Cunard, despite a New York choice-of-law clause. Although the arbitration panel did not articulate why it had awarded Todd Shipyards attorneys' fees, the court surmised that the reason was Cunard's bad faith conduct at the arbitration. The panel, the court conjectured further, may have imposed the award against Cunard for violating a novel variant of federal arbitration policy — the punishment of bad faith arbitration tactics. Though unarticulated by the panel, that rationale was sufficient, in the court's view, to preempt the New York rule. On appeal, the Ninth Circuit affirmed, noting merely that a finding of bad faith is within the purview of a panel. It failed to comment on federal preemption.

The district court's analysis, endorsed implicitly on appeal, ignored the source of the panel's powers, the arbitration agreement. Contract analysis would not have revealed the intent to vest the arbitrators with the authority to award attorneys' fees. A misapprehension of federal policy again displaced the intent of the parties.

Unlike the *Todd Shipyards* court, the district court in *Raytheon Co. v. Computer Distributors, Inc.* discerned no conflict between federal arbitration policy and state law restrictions on arbitral awards of attorneys' fees. Refusing to vacate the arbitrators' determination that they lacked authority, under chosen Massachusetts law, to award legal costs, the court found no grant of such authority in the FAA. Rather, the court suggested that eliminating the complex issue of attorneys' fees served federal policy by facilitating efficiency in arbitration.

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210. *Id.* at 1468.
211. *Id.*
212. *Id.*
213. *Id.*
215. *Id.* at 1064.
217. *Id.* at 560.
218. *Id.*
219. *Id.* The court also noted that the parties' choice of Massachusetts law, which precludes arbitral awards of attorneys' fees, overrode any contrary federal policy. *Id.* at 559.
2. The Rule After Mastrobuono

Although Mastrobuono points toward the argument for preemption, some courts, even after Mastrobuono, have resisted adopting that position. In Painewebber v. Richardson, the court applied the New York attorneys' fees rule to an arbitration, because it found no conflict between the rule and Mastrobuono. Rather than focusing on federal arbitration policy, the court stressed Mastrobuono's reliance on the principle that an ambiguous contract should be construed against the drafting party. The court noted that the Supreme Court sustained the punitive award in Mastrobuono because customers, in signing standard brokerage account agreements, could not foresee relinquishing the "important substantive right" to receive punitive damages. Luckie, the district court reasoned, is consistent with Mastrobuono, because no deprivation of an important substantive right occurs when the court, rather than the arbitrator, decides a statute of limitations issue. The district court concluded that enforcing the New York attorneys' fees rule does not unforeseeably result in the waiver of an important substantive right. To distinguish Richardson from Mastrobuono, the court noted that, whereas litigants are entitled under appropriate circumstances to punitive damages, they are not ordinarily entitled to attorneys' fees. Thus, arbitrating parties, who might reasonably seek punitive damages, would not expect attorneys' fees to be an available remedy. Second, the court observed that a brokerage customer, if defeated in arbi-

220. See infra notes 221-231 and accompanying text (discussing cases that reject preemption).
221. 94 Civ. 3104, 1995 Dist. LEXIS 5317 (Apr. 20, 1995).
222. Id. at *12.
225. Id. at *13.
226. Id.
227. Id. See Pennsylvania v. Delaware Valley Citizens Council for Clean Air, 478 U.S. 546, 561 (1985) ("It is well established, under the 'American Rule,' 'the prevailing litigant is ordinarily not entitled to collect a reasonable attorneys' fee from the loser.' ") (quoting Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240, 247 (1975)); Todd Shipyards Corp. v. Cunard Line, Ltd., 943 F.2d 1056, 1064 (9th Cir. 1991) (articulating the rule that parties should bear their own attorneys' fees). Courts will sustain the award of counsel fees, however, when the parties' contract or an applicable statute authorizes such relief. E.g., Eljer Manu Co. v. Kowin Dev. Corp., 14 F.3d 1250, 1257 (7th Cir. 1994) (confirming an arbitral award of attorneys' fees because statute authorized such relief); Delaware Dept. of Health and Social Servs. v. Department of Educ., 772 F.2d 1123, 1139 (3d Cir. 1985) (commenting that the American Rule generally prevents the recovery of attorneys' fees absent contractual or statutory authorization).
tration, would not expect to be saddled with his adversary’s attorneys’ fees, a possible outcome if the New York rule were not applied.\footnote{229 Id. at *13-14.}

This decision analyzes \textit{Mastrobuono} through a myopic lens. Regardless of whether \textit{Mastrobuono} was correct, federal preemption was central to its rationale. Yet, in discussing \textit{Mastrobuono}, the \textit{Richardson} court relegated federal preemption to invisibility. The principle of \textit{contra proferentum}, generally applied only after rules of contract interpretation fail to resolve an ambiguity,\footnote{230 See supra note 130 and accompanying text (discussing Professor Corbin’s characterization of \textit{contra proferentum}).} emerged, in the district court’s view, as the dispositive rule of \textit{Mastrobuono}. No other rules of contract law even warranted mention.

\textit{Richardson}, despite its shortcomings, has inspired support.\footnote{231 Merrill Lynch & Co. v. Mathes, No. 0126054, 1995 WL 534247, at *9 (Conn. Super. Ct. Sept. 1, 1995) (adopting expressly the reasoning of \textit{Richardson}).} Subsequent decisions on the availability of attorneys’ fees should consider federal arbitration law and conclude that state law limitations on arbitral awards of attorneys’ fees do not offend federal policy. As cogently as one may argue that the FAA takes no position on awards of punitive damages, one may contend, with even greater assurance, that the FAA takes no position on awards of attorneys’ fees.\footnote{232 The limitation on attorneys' fees is less restrictive than the \textit{Garrity} rule. Whereas the \textit{Garrity} rule bars punitive damages even when the parties expressly agree to confer on the arbitrators the authority to grant such relief, \textit{Garrity} v. Lyle Stuart, Inc., 353 N.E.2d 793, 796 (N.Y. 1976), CPLR 7513 honors an express agreement to confer on the arbitrators the authority to grant counsel fees. \textit{Civ. Prac. L. & R.} 7513 (McKinney 1980). The argument that the FAA preempts CPLR 7513 is therefore even weaker than the argument that the FAA preempts \textit{Garrity}. See supra text accompanying notes 135-41 (arguing that the FAA does not preempt \textit{Garrity}).} \textit{Richardson’s} analysis of contractual intent, though inaptly tied to its over-emphasis of \textit{contra proferentum}, reveals the flaw in the preemption argument. Federal arbitration policy instructs courts to interpret arbitration agreements in accordance with the intent of the parties. Parties would presumably not intend to confer on arbitrators authority to award counsel fees when judges do not ordinarily grant such relief.\footnote{233 This argument does not always apply. For example, in Raytheon Co. v. Computer Distributors, Inc., 632 F. Supp. 553, 558 (D. Mass. 1986), Massachusetts law would have authorized a court to award attorneys' fees, had the parties litigated the dispute. Massachusetts law, however, did not grant commensurate authority to arbitrators hearing the identical claim.} Similarly, the drafters of the FAA did not intend to invest arbitrators with power to grant remedies beyond the scope of judicial authority. No such express statutory authority appears in the FAA, and only the most zealous advocates of arbitration would infer such extraordinary power based on the policy favoring arbitration.
Even *Mastrobuono* seems to permit state law restrictions on arbitral awards of attorneys' fees. *Mastrobuono* interpreted a choice-of-law clause to embrace state substantive law excluding special rules allocating authority from arbitration to the court.\(^{234}\) When state law precludes courts and arbitrators alike from granting such relief, it is not allocating power. Rather, such a rule is general substantive law, which, according to *Mastrobuono*, is incorporated into an arbitration agreement by a choice-of-law clause.

**Conclusion**

Federal law preempts state law that refuses to honor arbitration agreements.\(^{235}\) However, the state law chosen by arbitrating parties may, without offending federal law, displace FAA procedures.\(^{236}\) In areas where the FAA is silent, state law may even impose substantive limitations on arbitration, such as a ban on punitive damages and attorneys fees. The Supreme Court recognized in *Volt* that the thrust of federal arbitration policy, as embodied in the FAA, is to enforce arbitration agreements as written, not to compel parties to arbitrate issues against their will.\(^{237}\) *Mastrobuono* has converted the benign Supreme Court dictum that the FAA creates a "liberal federal policy favoring arbitration"\(^{238}\) into a creed that exalts arbitration as if it were a sacred rite. The drafters of the FAA had no such intent.\(^{239}\) They were combatting the judiciary's institutional hostility toward arbitration.\(^{240}\) Their objective was to make arbitration into an acceptable means of dispute resolution. Federal policy, under *Mastrobuono*, has distorted that goal. The pro-arbitration trend in the courts, particularly the federal judiciary, will flourish and the reasoning of *Luckie* will be discredited.

There is, however, a more favorable vantage point from which to assess *Mastrobuono*. Although legally insupportable, the *Mas-

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\(^{237}\) See id. at 475-76 (stating that federal arbitration policy requires enforcing private agreements to arbitrate according to their own terms).


\(^{239}\) See *supra* notes 135-36 and accompanying text (reviewing the legislative history of the FAA which indicates that the purpose of the FAA is to accord arbitration agreements the same status as other agreements).

\(^{240}\) See *supra* note 32 and accompanying text (noting the courts historical opposition to arbitration).
trobuono decision serves societal interests. First, by increasing the scope of arbitrable issues, Mastrobuono tends to lighten the judiciary's burden. Former Chief Justice Warren Burger has encouraged arbitration to ease the demands placed on the courts by the "mass neurosis that leads many people to think courts were created to solve all the problems of mankind." If court-imposed federal policy, though contrary to Congressional intent, succeeds in unclogging crowded courtrooms, benefits to a beleaguered judiciary may justify legally suspect court rulings.

It seems, too, that the courts, viewing arbitration as a substitute for litigation, have labored to avail injured arbitrating parties the same relief that a court might grant. This predilection to provide the full panoply of remedies is strongest in the area of securities arbitration, where broker-dealers notoriously contrive to limit their exposure by planting self-serving clauses in account agreements. Since the Supreme Court announced that securities claims are arbitrable, virtually all large securities firms require customers to sign account agreements containing arbitration clauses. Pro-arbitration policy has doomed most efforts to persuade courts to condemn such arbitration clauses as unconscionable or unenforceable contracts of adhesion. By adding a New York choice-of-law clause to account agreements, securities firms seek to deny customers punitive reme-

241. Warren E. Burger, Using Arbitration to Achieve Justice, 40 AR. J. 3, 5 (Dec. 1985). See MACNEIL ET AL., supra note 32, § 3.2.5, 3:15 ("Widespread arbitration takes a great deal of pressure off court dockets. The judicial trend is to encourage more rather than less arbitration in more diversified contexts.").

242. See Marilyn B. Cane, Punitive Damages in Securities Arbitration: The Interplay of State and Federal Law (or a Smaller Bite of the Big Apple), 1993 J. DISP. RESOL. 153, 170 (1993) ("To conclude that a person has the right to punitive damages in a court setting, but not in an arbitral setting, would undermine the concept that arbitration is an appropriate alternative forum.").

243. Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987). In McMahon, the Supreme Court also held federal RICO claims arbitrable. Id. at 242.

244. See Cane, supra note 242, at 158 (noting the significance of the widespread use of brokerage firms' customer arbitration agreements); Katsoris, supra note 18, at 578 n.25 (detailing the typical industry-wide customer agreement containing a pre-dispute arbitration clause). See also Franklin D. Ormsten, Punitive Damages in Securities Arbitrations, N.Y.L.J., Jan. 21, 1993 at 1, 31 (stating that "many agreements to arbitrate securities disputes feature a New York choice-of-law provision (that is to say any issues or disputes will be governed by New York law")

245. See generally William A. Gregory & William J. Schneider, Securities Arbitration: A Need for Continued Reform, 17 NOVA L. REV. 1223, 1236-38 (1993) (stating that to establish that an agreement is unconscionable or an unenforceable contract of adhesion, a party must prove that it wielded little or no bargaining power and that, as a result of this disadvantage, the other party exacted unfair terms); Theodore Krebsbach, New York Stock Exchange Symposium on Arbitration in the Securities Industry, 63 FORDHAM L. REV. 1505, 1513 (1995) (explaining that arbitration clauses in customer account agreements are contracts of adhesion, but that courts nevertheless enforce such arbitration clauses because of the federal policy favoring arbitration).
Chief Judge Breitel cautioned in Garrity that the powerful might coerce their weaker adversaries into arbitration raising the specter of excessive punitive awards.247 His warning that arbitration should not be a “trap for the unwary”248 was prophetic, but not as he envisioned it. Securities firms foist mandatory arbitration clauses and choice-of-law provisions on their customers, not to exact punitive awards but to prevent them.

The Mastrobuonos, however, did not raise issues of adhesion or unconscionability. These arguments would most certainly have failed.249 Rather, they argued that federal arbitration policy supports the broad construction of arbitration agreements and prevaild by application of a curious mixture of preemption and contract analysis. Though the Court’s reasoning is flawed, the result may be sound. In the arena of securities arbitration, Mastrobuono may indeed safeguard freedom of contract.250 Limiting the abuses of securities firms is a laudable goal which gives solace to those who question the faulty conceptual basis of Mastrobuono.

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246. See Cane, supra note 242, at 173 (asserting that securities firm customers are unaware that they contractually waive the right to punitive relief); Theodore Epstein, Securities Arbitration: A Need for Continued Reform, 17 NOVA L. REV. 1223, (1993) (rebuking brokerage houses for scheming in account agreements to “eradicate” customer rights, including the right to receive punitive damages that might otherwise be recoverable); Katsoris, supra note 18, at 591-96 (accusing brokerage houses of manipulating unsuspecting customers into surrendering the right to punitive awards).


248. Id.

249. See, e.g., Adams v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 888 F.2d 696, 700 (10th Cir. 1989) (finding that the arbitration clauses were neither unconscionable, nor contracts of adhesion); Cohen v. Wedbush, Noble, Cooke, Inc., 841 F.2d 282, 286 (9th Cir. 1988) (holding that federal pro-arbitration policy defeats the argument that securities account arbitration clauses are contracts of adhesion); Pierson v. Dean Witter Reynolds, Inc., 742 F.2d 334, 339 (7th Cir. 1984) (declining to hold an arbitration provision unconscionable). But see Woodward v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 640 F. Supp. 760 (S.D. Tex. 1986) (sustaining unconscionability claim of inexperienced investor). See generally Gregory & Schneider, supra note 245, at 236-39 (summarizing federal cases where parties attacked securities account arbitration clauses as unconscionable and concluding that most courts have been unfriendly to such arguments); Katsoris, supra note 18, at 595-96 (observing that unconscionability claims in securities arbitration cases have not fared well in federal court and urging courts to re-appraise their view so that punitive damages will be available).

250. See Cane, supra note 242, at 171 (“It is implausible that brokerage customers realize that by signing a customer agreement with a New York governing choice-of-law clause they may have abandoned any claim they may have to punitive damages.”).