

# Med-Arb and Arb-Med: A Law and Economic Analysis

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*Hybrid mechanisms combining arbitration and mediation have emerged as popular forms of dispute resolution in the last three decades. While contractual parties today often stipulate mediation before arbitration (Med-Arb), another commonly used mechanism reverses that order, putting arbitration before mediation. Arb-Med—the process in which parties attempt mediation following the conclusion of an arbitration with the arbitral award sealed in an envelope—seems profoundly counterintuitive: Why would parties agree to mediate after completing a costly arbitration and pay for both processes? This Article demonstrates that the incentive structures and legal landscape of the two mechanisms are very different, even though Arb-Med merely flips the order of Med-Arb. Parties pursue different dispute resolution mechanisms because Med-Arb, Arb-Med, and standalone arbitration can each help parties achieve optimal economic outcomes under different circumstances. Since each of these mechanisms is desirable, the law should facilitate and treat them equally. However, this is not the case under current U.S. federal law. This Article therefore makes two policy recommendations that would facilitate these desirable hybrid mechanisms: (1) courts should view hybrid mechanisms as sui generis processes, and (2) courts should adopt a broad interpretation of the scope of FAA arbitration.*

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## I. INTRODUCTION

Arbitration agreements are prevalent in today's contracts. Mandatory arbitration clauses are practically boilerplate in consumer and employment agreements. These trends have been encouraged by the combined effects of increasing costs and delays associated with litigation on one hand and four decades of Supreme Court decisions favorable to arbitration on the other.<sup>1</sup> As arbitration has expanded, its costs have increased due to procedural rigidity and delays.<sup>2</sup> In the face of these rising costs, parties are looking to

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1. Since the early 1980s, the Supreme Court has issued a string of decisions in support of a "national policy favoring arbitration." *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984). In *Southland*, the Court held that the Federal Arbitration Act ("FAA") applies to state courts and preempts state law. In *Circuit City Stores, Inc. v. Adams*, 653 U.S. 105, 109 (2001), the Court clarified that the FAA is applicable to most employment contracts containing arbitration agreements in holding that the exemption clause in the FAA must be construed narrowly to exclude only the enumerated categories of workers.

The Court limited the grounds under which parties can avoid arbitration. It held that even if a contract appears void or illegal, "regardless of whether the challenge is brought in federal or state court, a challenge to the validity of the contract as a whole, not specifically to the arbitration clause, must go to the arbitrator." *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 449 (2006). A few years later, the Court held further that an unconscionability challenge to the arbitration clause itself must also go to the arbitrator. *Rent-A-Center West, Inc. v. Jackson*, 561 U.S. 63 (2010).

The Court defeated another unconscionability challenge in *AT&T Mobility v. Concepcion*, holding that the FAA preempts a state's unconscionability doctrine voiding class arbitration waivers because it "interferes with fundamental attributes of arbitration." 563 U.S. 333, 344 (2011). The Court held that state law cannot "stand as an obstacle to the accomplishment of the FAA's objectives." *Id.* at 343.

*Concepcion* is a landmark case that ushered in a series of cases upholding class-arbitration waivers. In *American Express Co. v. Italian Colors Restaurant*, 570 U.S. 228 (2013), the Court examined the challenge that class-arbitration waivers violated federal antitrust laws. The Court upheld the class-action waivers, explaining that federal antitrust laws do not make "mention of class actions" and therefore cannot preclude class-arbitration waivers. *Id.* at 234. The Court also held that the class arbitration waivers are enforceable even if the cost of individual arbitration exceeds the potential recovery. *Id.* at 236. Five years later, in consolidating three employment-contract cases, the Supreme Court again upheld mandatory individual arbitration clauses, holding that the National Labor Relations Act's protection of "concerned activity" by the employees does not override class-arbitration waivers. *Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612, 1637 (2018).

2. Edna Sussman, *Combinations and Permutations of Arbitration and Mediation: Issues and Solutions*, in 2 ADR IN BUSINESS: PRACTICE AND ISSUES ACROSS COUNTRIES AND CULTURES 381, 382 (Arnold Ingen-Housz ed., 2011). The presence of lawyers in arbitration caused arbitration increasingly to resemble adversarial litigation—a phenomenon known as "legalization." See *infra* Section II.A. See generally Thomas J. Stipanowich, *Arbitration: The "New Litigation,"* 2010 U. ILL. L. REV. 1, 11–24 (2010) (explaining how arbitration evolved to resemble litigation).

mediation as a more flexible and less costly alternative.<sup>3</sup> Yet, at the same time, they are hesitant to retreat from the certainty, finality, and enforceability of arbitral awards.<sup>4</sup>

A compromise of these impulses has led to the innovative creation of a variety of hybrid dispute resolution mechanisms blending arbitration and mediation. For example, the American Arbitration Association (“AAA”) now offers structural mediation followed by arbitration. Known as Med-Arb, mediation followed by arbitration is just one among what appears to be an ever-increasing list of hybrid acronyms: Arb-Med, MEDALOA, Co-Med-Arb, Arb-Med-Arb, Med-Arb-Opt-Out, Med Windows in Arb, High-Low Med-Arb, braided Med-Arb, plenary Med-Arb, and so on.<sup>5</sup> All of these hybrid mechanisms are creative attempts to bring the best of both worlds—arbitration’s finality and mediation’s flexibility.

Hybrid mechanisms are becoming increasingly popular in dispute resolution.<sup>6</sup> Frequently used in Asia, hybrid mechanisms are gaining popularity in Canada, the United States, and the European

3. Brian A. Pappas, *Med-Arb and the Legalization of Alternative Dispute Resolution*, 20 HARV. NEGOT. L. REV. 157, 162–63 (2015).

4. Nadja Alexander, Samantha Clare Goh & Ryce Lee, *What’s Happening in International Mediation in 2021*, KLUWER MEDIATION BLOG (Mar. 17, 2021), <http://mediationblog.kluwerarbitration.com/2021/03/17/whats-happening-in-international-mediation-in-2021/> [<https://perma.cc/A9B7-XVQT>] (Documenting the International Dispute Resolution Survey: 2020 Final Report, in which finality and enforceability are ranked as the two least satisfactory factors by mediation users surveyed).

5. See Sussman, *infra* note 46, at 71 (Describing Arb-Med, MEDALOA, Co-Med-Arb, and Arb-Med-Arb); Mark Batson Baril & Donald Dickey, *MED-ARB: The Best of Both Worlds or Just A Limited ADR Option?*, 8, <https://www.mediate.com/pdf/V2%20MED-ARB%20The%20Best%20of%20Both%20Worlds%20or%20Just%20a%20Limited%20ADR%20Option.pdf> [<https://perma.cc/3M88-F98J>] (Describing Co-Med-Arb, Med Windows in Arb, and High-Low Med-Arb); Riddhika Somani, *Different Forms of Med-Arb Procedures*, VIA MEDIATION & ARB. CENT., <https://viamediationcentre.org/readnews/ODc3/DIFFERENT-FORMS-OF-MED-ARB-PROCEDURES> [<https://perma.cc/8T3D-AWJL>] (Describing braided Med-Arb and plenary Med-Arb).

6. The International Arbitration Survey conducted by White & Case in 2018, with 922 questionnaire inputs and 142 in-person/telephone interviews, found that “[c]ompared to the 2015 findings, there has been a significant increase in the overall popularity of arbitration combined with ADR: almost half of respondents expressed their preference for this combination as opposed to only 34% in 2015.” WHITE & CASE, 2018 INTERNATIONAL ARBITRATION SURVEY: THE EVOLUTION OF INTERNATIONAL ARBITRATION 5 (2018), <http://www.arbitration.qmul.ac.uk/media/arbitration/docs/2018-International-Arbitration-Survey-report.pdf> [<https://perma.cc/U8JF-GY7A>]. The recent Global Pound Conferences that the International Mediation Institute organized in major cities in 2016 and 2017 also bear witness to hybrid mechanisms’ growing popularity: About half of the three thousand or so attendees working in dispute resolution ranked hybrid mechanisms as the most effective methods for dispute resolution and perceived their development as one of the key priorities for the future. Thomas J. Stipanowich, *What Have We Learned from the Global Pound Conferences?*, KLUWER

Union.<sup>7</sup> Various international arbitration houses, such as the Singapore International Arbitration Centre (“SIAC”),<sup>8</sup> China International Economic and Trade Arbitration Commission (“CIETAC”),<sup>9</sup> and the Alternative Dispute Resolution (“ADR”) Institute of Canada,<sup>10</sup> have institutionalized these mechanisms with specific provisions in their procedural rules.

Among the various forms of hybrid mechanisms, Med-Arb is the most intuitive<sup>11</sup> and frequently used.<sup>12</sup> By placing mediation before arbitration, Med-Arb encourages parties to look for a voluntary settlement with the help of a mediator before turning to costly arbitration. To be sure, disputants often seek to settle their claims before litigating or arbitrating them. What Med-Arb adds to the usual settlement impetus is a formal process mediated by a third party—a “neutral” in the parlance of dispute resolution professionals. Med-Arb is, in this sense, if not inevitable, a natural response to the desire to preserve the security of arbitration as a backstop while pursuing the more flexible and potentially cost-saving alternative of mediation.

More surprising is Arb-Med, the most common alternative to Med-Arb.<sup>13</sup> In Arb-Med, parties first undergo arbitration, but the arbitrator does not reveal the arbitral award, which is usually issued in

MEDIATION BLOG (Nov. 27, 2017), <http://mediationblog.kluwerarbitration.com/2017/11/27/learned-global-pound-conferences/> [<https://perma.cc/3X93-Q2UX>].

7. Harald Sippel, *Med-Arb: Recent Trends and an Outlook on the Future*, in 6 YEARBOOK OF ARBITRATION: INTERACTION OF ARBITRATION AND COURTS (Alexander J. Belohlavek & Nadezda Rozehnalova eds.), 151, 164–70 (2016).

8. SIAC-SIMC Arb-Med-Arb Protocol, SING. INT’L MEDIATION CENT., <https://simc.com.sg/v2/wp-content/uploads/2019/03/SIAC-SIMC-AMA-Protocol.pdf> [<https://perma.cc/E57V-XJJ8>].

9. China International Economic and Trade Arbitration Commission CIETAC Arbitration Rules art. 47, CHINA INT’L ECON. & TRADE ARB. COMM’N, <http://www.cietac.org/Uploads/201904/5cc129286b1c3.pdf> [<https://perma.cc/5LQR-AEZA>].

10. ADRIC Med-Arb Rules, ADR INST. OF CAN., [https://adric.ca/wp-content/uploads/2020/08/ADRIC\\_Med\\_Arb\\_Rules\\_2020\\_booklet.pdf](https://adric.ca/wp-content/uploads/2020/08/ADRIC_Med_Arb_Rules_2020_booklet.pdf) [<https://perma.cc/HWV6-JHZZ>].

11. See, e.g., Baril & Dickey, *supra* note 5, at 2 (describing Arb-Med as “a natural outgrowth” in a trend that “increasingly linked” litigation with ADR processes).

12. Ellen E. Deason, *Combinations of Mediation and Arbitration with the Same Neutral: A Framework for Judicial Review*, 5 YEARBOOK ON ARBITRATION AND MEDIATION 219, 221 (2013); *Alternative Dispute Resolution In-House: Mediation, Arbitration, or Med-Arb?*, HARV. L. SCH. PROGRAM ON NEGOT. DAILY BLOG (Jan. 25, 2022), <https://www.pon.harvard.edu/daily/dispute-resolution/alternative-dispute-resolution-in-house-mediation-arbitration-or-med-arb/> [<https://perma.cc/878L-4A9E>] (“The three most common alternative dispute resolution techniques are mediation, arbitration, and med-arb.”).

13. Brian A. Pappas, *Med-Arb: The Best of Both Worlds May be Too Good to Be True: A Response to Weisman*, in 19 DISPUTE RESOLUTION MAGAZINE (Gina Viola Brown ed.), 42, 43 (2013).

a sealed envelope. Without knowing the arbitral outcome, parties then enter mediation in the second stage. Only if they fail to reach an agreement in mediation will the parties open the sealed envelope to reveal the arbitral award. At first glance, Arb-Med appears profoundly counterintuitive: it hardly seems sensible that parties would agree to mediate after completing costly arbitration, thereby paying for both processes.

I solve this puzzle in this Article. Flipping the order of arbitration and mediation leads to drastically different economic and legal consequences. Under different circumstances, Arb-Med, Med-Arb, and standalone arbitration can each help parties reach optimal outcomes in terms of economic efficiency. Since each of these mechanisms is desirable, the law should facilitate and treat them equally. However, this is not the case. Under the Federal Arbitration Act (“FAA”), which governs domestic arbitration and the enforcement of its award in the United States, Arb-Med and Med-Arb face different legal hurdles. This Article makes two recommendations to strengthen the FAA’s applicability to hybrid mechanisms and its enforcement of their outcomes for current law to facilitate Med-Arb and Arb-Med, and to treat them equally.

First, courts should view hybrid mechanisms as unitary, *sui generis* processes, instead of treating them separately as arbitration and mediation. The relevant legal question should not be whether the mediation part of hybrid mechanisms falls under the scope of FAA, but whether Arb-Med and Med-Arb in their entirety are within the scope of FAA.

Second, courts should interpret the scope of FAA arbitration broadly. Since “arbitration” is not defined in the FAA, circuit courts are currently split on the interpretation of the scope of FAA arbitration, with the First, Fifth and Tenth Circuits imposing the strictest requirement that the FAA applies to only classic arbitrations.<sup>14</sup> This Article explains why it is better to adopt a less restrictive scope, such

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14. *Fit Tech, Inc. v. Bally Total Fitness Holding Corp.*, 374 F.3d 1 (1st Cir. 2004); *Gen. Motors Corp. v. Pamela Equities Corp.*, 146 F.3d 242 (5th Cir. 1998); *Salt Lake Trib. Publ’g Co. v. Mgmt. Plan.*, 390 F.3d 684 (10th Cir. 2004). See David J. McLean & Sean-Patrick Wilson, *Compelling Mediation in the Context of Med-Arb Agreements*, 63 DISP. RESOL. J. 28, 30–31 (2008) (discussing the circuit split and arguing that where “the final stage of a step clause is binding arbitration,” the FAA’s remedies should remain available to the parties, including during the mediation process).

as the bright-line rule announced by the Eleventh Circuit, which requires a dispute resolution process to lead to a final outcome for it to be considered within the scope of FAA arbitration.<sup>15</sup>

This Article proceeds as follows. Part II explains the historical and institutional context in which hybrid mechanisms emerged and developed in the last three decades. Part III analyzes the structural differences between Arb-Med and Med-Arb, and answers the initial question: Why do parties choose Arb-Med, Med-Arb, or standalone arbitration<sup>16</sup> in the first place? Part IV presents the legal hurdles that hybrid mechanisms face under current American federal law, and demonstrates that flipping the order of mediation and arbitration can lead to different legal consequences. Part V makes policy recommendations to facilitate these innovative hybrid mechanisms. Part VI concludes.

## II. INSTITUTIONAL BACKGROUND

This Part provides the institutional context for hybrid mechanisms. Section A sets the historical stage by characterizing the reintroduction of mediation as a response to the rising cost of arbitration and explains how mediation soon too suffered from the problem of rising cost. Section B documents the development of hybrid mechanisms combining mediation and arbitration as innovative solutions. Section C discusses the same-neutral problem in these hybrid mechanisms and explains that Arb-Med resolves only some of the issues found in Med-Arb.

### A. *Reintroduction of Mediation as a Response to Rising Cost in Arbitration*

In the second half of the twentieth century, arbitration became the predominant form of commercial dispute resolution in many parts of the world.<sup>17</sup> With its rise in popularity among commercial disputants, arbitration increasingly captured the attention of lawyers

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15. *Advanced Bodycare Sols., LLC v. Thione Int'l, Inc.*, 524 F.3d 1235, 1240 (11th Cir. 2008) (holding that mediation is not within the FAA's scope because "the FAA presumes that the arbitration process itself will produce a resolution independent of the parties' acquiescence—an award which declares the parties' rights and which may be confirmed with the force of a judgment."); see Mclean & Wilson, *supra* note 14, at 29.

16. Standalone arbitration is included in the study as a baseline. The discussion in *infra* Part III thus additionally explains why parties may prefer hybrid mechanisms to standalone arbitration and vice versa due to their structural differences.

17. ALEC STONE SWEET & FLORIAN GRISEL, *THE EVOLUTION OF INTERNATIONAL ARBITRATION: JUDICIALIZATION, GOVERNANCE, LEGITIMACY* 1–3 (2017).

and law firms. A number of prominent, multinational law firms, such as Shearman & Sterling, have since established specialized arbitration divisions through offices in leading commercial centers such as Hong Kong, London, New York, Paris, and Singapore.<sup>18</sup> The ever-growing participation of lawyers in arbitral practice has transformed the field, according to informed observers, causing arbitration to increasingly resemble adversarial litigation. Observers in the ADR community refer to this transformation as the legalization of arbitration. By “legalization” they refer to various formal elements of litigation, such as extended discovery and the incorporation of explicit due process checks. These formal procedures are certainly useful in arbitration, and to some extent perhaps to be expected, but they also add delays and costs to the proceedings, the avoidance of which drew disputants to arbitration in the first place.

Towards the end of the twentieth century, arbitration lost its cost-saving appeal: users of arbitration “appear[ed] to be dissatisfied with a process that, while it still deliver[ed] binding awards which [were] widely enforceable, increasingly [did] so at significant cost to the parties, both in terms of time and money.”<sup>19</sup> As arbitration became more cumbersome and costly, practitioners and arbitral institutions gradually promoted alternatives that encouraged parties to work together through some form of mediation to resolve their disputes in a less adversarial, and by extension, a less costly manner.<sup>20</sup> In fact, in its founding years, the International Chamber of Commerce, the pioneering institution of modern arbitration, encouraged the use of mediation instead of arbitration to resolve disputes.<sup>21</sup> Mediation has traditionally been an informal and conciliatory process, unlike the more formal and adversarial structure of litigation and increasingly arbitration—processes that incentivize parties to act competitively with the goal of winning their cases.

Mediation is structured to encourage parties to work together with their appointed mediators in a less formal and more flexible manner in search of mutually acceptable, win-win solutions. In mediation, disputants hire a third-party mediator to help them negotiate a

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18. See, e.g., GLOB ARB. REV., GAR 100 (14th ed. 2021) (listing more than a hundred audited law firms with serious international arbitration practice including Shearman & Sterling), <https://globalarbitrationreview.com/survey/gar-100/2021> [<https://perma.cc/C6F2-HQSE>].

19. Lucy Greenwood, *A Window of Opportunity? Building a Short Period of Time into Arbitral Rules in Order for Parties to Explore Settlement*, 27 ARB. INT'L 199, 199 (2011).

20. Pappas, *supra* note 3, at 162–63.

21. SWEET & GRISEL, *supra* note 17, at 57.



mutually satisfactory outcome. The hired mediator helps disputants recognize their mutual interests and facilitates communication between them in search of potential settlement options. Like judges and arbitrators, mediators hear arguments from disputants. Unlike judges and arbitrators, however, mediators do not make decisions for the disputants—the parties in mediation must themselves agree to their mediated outcomes. Mediation is therefore a voluntary process and a type of negotiation; its success relies on the *ex post* assent of both parties. Another key characteristic of mediation is caucusing—the practice in which mediators carry out *ex parte* private communications with the disputants. Recognized as an important and advantageous feature of mediation,<sup>22</sup> caucusing is generally forbidden in arbitration and litigation.<sup>23</sup>

The ADR community views mediation as a process that tends to offer disputants a more customizable scope, greater and more direct “control over the process and agreement,” and “more creative, and durable solutions” at better cost, speed, and confidentiality than arbitration.<sup>24</sup> While arbitration ends with a winner and a loser, mediation in theory helps parties discover win-win situations. Mediation’s greater flexibility also gives mediators more options in how they conduct a mediation. There are three major forms of mediation: (i) evaluative mediation, where the mediator suggests his opinion to the parties or predicts court rulings; (ii) facilitative mediation, where the mediator “clarif[ies] and enhance[s] communication” between the parties without offering any opinions and views; and (iii) transformative mediation, where the mediator focuses on party empowerment and puts parties in direct, sole control over both process and outcome.<sup>25</sup>

Facilitative and transformative mediations maintain mediator impartiality and encourage party self-determination, but they do not

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22. See, e.g., Ian Ayres & Jennifer Brown, *Economic Rationales for Mediation*, 80 VA. L. REV. 323 (1994) (demonstrating that caucusing in mediation creates value by mitigating adverse selection and moral hazard).

23. Sippel, *supra* note 7, at 157–58.

24. Pappas, *supra* note 3, at 163–64.

25. *Id.* at 164–65. See also Robert A. Baruch Bush & Sally Ganong Pope, *Changing the Quality of Conflict Interaction: The Principles and Practice of Transformative Mediation*, 3 PEPP. DISP. RESOL. L.J. 67, 83 (2002) (explaining that transformative mediators help parties “make positive interactional shifts by supporting the exercise of their capacities for strength and responsiveness through their deliberation” with the goal of “chang[ing] the quality of their conflict interaction from negative and destructive to positive and constructive, as they explore and discuss the issues and possibilities for resolution.”).

exert as much influence on the mediated outcomes as evaluative mediation. With the growing participation of lawyers in mediation, evaluative mediation became increasingly popular—lawyers tended to want to have a hand in influencing the outcome of their cases.<sup>26</sup> Lawyers often acted as evaluative mediators when appointed by parties, and they also preferred to work with evaluative mediators whom they could persuade to influence mediated outcomes.<sup>27</sup> As lawyers in evaluative mediation sought to persuade mediators to support settlements in their clients' favor, mediation increasingly resembled an adversarial process and faced arbitration's problems of legalization and rising cost.<sup>28</sup> In short, mediation became the "new arbitration" after arbitration became the "new litigation."<sup>29</sup>

### B. *The Rise of Hybrid Mechanisms*

In response to the problem of rising costs in both mediation and arbitration, arbitration and mediation centers developed hybrid mechanisms that combine mediation and arbitration to unite their advantages: "[P]arties struggling to settle in mediation need arbitration's finality, and parties unhappy with arbitration's similarity with trial need to add mediation's flexibility."<sup>30</sup> While informal hybrid mechanisms existed prior to their institutionalization since parties could choose to settle with or without a third-party mediator at any time, the institutions supporting these hybrid mechanisms often have rules and procedures in place to enhance the efficiency and fairness of the process. Such institutional support provides an important advantage over informal hybrid mechanisms.

Two paradigmatic forms of hybrid mechanisms to be examined in this Article are (i) Med-Arb, in which parties go through mediation first and turn to arbitration only if first-stage mediation fails; and (ii) Arb-Med, in which arbitration occurs first, but its result is placed in a sealed envelope; parties then attempt mediation and open the sealed

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26. See Pappas, *supra* note 3, at 165.

27. See *id.*

28. *Id.*

29. Donnas Ross, *Med-Arb / Arb-Med: A More Efficient ADR Process or an Invitation to a Potential Ethical Disaster?*, 7 CONTEMP. ISSUES INT'L ARB. & MEDIATION: THE Fordham Papers 352, 353 (2013).

30. Pappas, *supra* note 3, at 200.

envelope only if mediation fails.<sup>31</sup> Under both mechanisms, successful mediation can lead to an ordinary mediated settlement agreement. However, parties often ask the third party to enter their mediated agreement as the final arbitral award for enforcement.<sup>32</sup>

Given that mediation is less costly and more conciliatory, it is intuitive that parties attempt a cheaper, more flexible process before turning to costly and binding arbitration. Arb-Med, on the contrary, begins with a more costly process and requires parties to attempt mediation as well. Arb-Med thus seems profoundly counterintuitive, given that parties must pay for both arbitration and mediation. The next Section reviews one well-documented explanation for Arb-Med in the literature: when these hybrid mechanisms involve the same third-party neutral as both the arbitrator and the mediator, Arb-Med resolves some of the legal issues of Med-Arb.

### C. *Arb-Med Imperfectly Mitigates the Same-Neutral Problem in Med-Arb*

Using the same neutral in hybrid mechanisms reduces delays and costs. It is easier to search for one neutral than to search for two, and the same neutral does not need to relearn the case in different stages of the hybrid mechanism.<sup>33</sup> However, the same neutral serving both as the arbitrator and the mediator also presents legal issues concerning due process, impartiality, and confidentiality.

Consider first Med-Arb. Mediation and arbitration are different processes with contradictory features. Confidentiality is the key for successful mediation, especially because mediation often involves caucusing with the mediator meeting with each party separately.<sup>34</sup> However, caucusing in first-stage mediation contradicts the due process requirement in second-stage arbitration in Med-Arb since

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31. There is no consensus with regard to the terminology used to describe hybrid mechanisms. Arb-Med is sometimes also known as Arb-Med-Arb, since some consider the opening of the envelope following the failure of second-stage mediation as third-stage arbitration. However, Arb-Med-Arb can also refer to Med-Arb, as for instance is the case for the Arb-Med-Arb Model Clause at the Singapore International Mediation Center. *See infra* note 52.

32. *See* Deason, *supra* note 12, at 220.

33. Kristen M. Blankley, *Keeping a Secret from Yourself? Confidentiality When the Same Neutral Serves Both as Mediator and as Arbitrator in the Same Case*, 63 BAYLOR L. REV. 317, 326 (2011).

34. *See, e.g.*, JAY FOLBERG ET AL., RESOLVING DISPUTES: THEORY, PRACTICE, AND LAW 357–75 (4th ed. 2022) (Providing an overview of confidentiality and the sources of rules governing confidentiality in mediation).

caucusing “deprives the opposing party of the right to respond or make clarifications to allegations made by the counterparty.”<sup>35</sup>

Mediation’s confidentiality requirement also conflicts with the neutral’s impartiality in both arbitration and mediation under Med-Arb.<sup>36</sup> There are significant risks that confidential information may flow from mediation to arbitration, resulting in impartiality issues for the neutral acting as an arbitrator in the second stage.<sup>37</sup> Even though neutrals often believe that they can ignore confidential information, research in cognitive psychology demonstrates that even trained professionals such as judges are unable to disregard such information.<sup>38</sup> Moreover, it is also difficult for the neutral to be impartial during first-stage mediation in Med-Arb.<sup>39</sup> During mediation, the neutral’s job is to help parties reach an agreement without imposing a solution. However, parties’ mediation agreement depends on their perceived best alternatives, over which the neutral holds direct control when she becomes the arbitrator following the failure of mediation.<sup>40</sup> Parties therefore may take advantage of the private caucus “to convince the neutral of their case, attempting to ‘spin’ the mediator.”<sup>41</sup>

Disputants’ strategic behavior amplifies these problems. Knowing that confidential information can leak into arbitration, parties

35. Shahla F. Ali, *The Legal Framework for Med-Arb Developments in China: Recent Cases, Institutional Rules and Opportunities*, 10 DISP. RESOL. INT’L 119, 127 (2016).

36. The neutral’s failure to be impartial is a ground for vacatur under the FAA. 9 U.S.C. § 10(a)(2). The Uniform Mediation Act, enacted in 12 states, merely has an optional provision on the impartiality of the mediator. “While few would argue that it is almost always best for mediators to be impartial as a matter of practice, including such a requirement into a uniform law drew considerable controversy. Some mediators, reflecting a deeply and sincerely felt value within the mediation community that a mediator not be predisposed to favor or disfavor parties in dispute, persistently urged the Drafters to enshrine this value in the Act . . . Other mediators, service providers, judges, mediation scholars, however, urged the Drafters not to include the term ‘impartiality’ for a variety of reason.” STEPHEN GOLDBERG ET AL., *DISPUTE RESOLUTION: NEGOTIATION, MEDIATION, ARBITRATION, AND OTHER PROCESSES* 588 (7th ed. 2020). By contrast, some states have enacted mediation laws that allow vacatur of mediated agreements if the mediator is found to be partial. *See, e.g.*, VA. CODE ANN. § 8.01-581.26 (2017); MINN. STAT. ANN. § 572.36 (2021).

37. Pappas, *supra* note 3, at 180.

38. *See* Deason, *supra* note 12, at 228–29 (reviewing relevant literature demonstrating that trained professionals are unable to disregard information).

39. Pappas, *supra* note 3, at 179.

40. *See id.*

41. *Id.*

often selectively disclose information to the neutral during mediation.<sup>42</sup> Moreover, expecting the same neutral to have decision-making power in the second stage of Med-Arb, parties tend to “turn[] away from the issues . . . and focus[] on the neutral” to make the neutral side with them.<sup>43</sup>

Reversing the order by putting arbitration before mediation in the form of Arb-Med does not fix all problems. While Arb-Med avoids the problems of confidentiality and impartiality associated with arbitration since arbitration precedes mediation in Arb-Med, the impartiality problem during mediation remains unresolved. It is still difficult for the second-stage mediator in Arb-Med to be completely impartial, mediating as if she had no knowledge of the sealed arbitration outcome that she has decided.<sup>44</sup>

Moreover, both Arb-Med and Med-Arb face the problem that good arbitrators are not necessarily good mediators, and vice versa.<sup>45</sup> Because arbitration and mediation are two very different processes, they call for different qualities in neutrals. Edna Sussman, Chair of the New York International Arbitration Center (2019–20), explains:

In arbitration the arbitrator is charged with managing the proceeding efficiently, providing a fair opportunity to each side to present its case and analyzing the facts and the law based on the evidence to arrive at the ultimate award. The mediator is charged with working with the parties to craft a process most likely to lead to a resolution, uncover the parties’ interests, understand their relationship and their motivations, explore the strengths and weaknesses of the respective positions, assist in developing workable solutions and help parties overcome psychological barriers to settlement. Bottom line: The mediator’s role requires use of many of the skills of a psychologist, while the arbitrator’s role requires use of many of the skills of a judge.<sup>46</sup>

ADR practitioners point out that these issues concerning confidentiality and strategic withholding of information rarely occurs and that caucusing is highly valuable for effective mediation.<sup>47</sup> Moreover,

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42. *See id.* at 181.

43. *Id.* at 179.

44. *Id.* at 186.

45. Greenwood, *supra* note 19, at 208.

46. Edna Sussman, *Developing an Effective Med-Arb / Arb-Med Process*, 2 N.Y. DISP. RESOL. LAW. 71, 73 (2009) (summarizing recent case law on the enforceability of hybrid mechanisms in the United States).

47. *See* Edna Sussman, *Med-Arb: An Argument for Favoring Ex Parte Communications in the Mediation Phase*, 7 WORLD ARB. & MEDIATION REV. 421, 426 (2013).

it is argued that these problems can be mitigated by choosing a neutral who is trained in both arbitration and mediation,<sup>48</sup> obtaining informed consent from the parties,<sup>49</sup> and designing the process following a careful review of the pertinent law to ensure enforceability.<sup>50</sup> Federal and state courts in the United States have indeed been supportive of the use of hybrid mechanisms under the same neutral so long as they satisfy the conditions of (1) clarity of language and (2) informed consent in terms of the hybrid mechanisms' applicable rules and procedures.<sup>51</sup>

In addition to these measures, institutionalized hybrid mechanisms provide yet another solution to these problems. Arb-Med-Arb ("AMA") at the Singapore International Mediation Center in collaboration with the Singapore International Arbitration Center is one such institutionalized mechanism.<sup>52</sup> Supported by arbitration and mediation institutions, AMA provides model clauses, certifies and standardizes the quality of the mediator-arbitrator, provides institutional procedures to ensure enforceability, and deters strategic delays.<sup>53</sup>

The same-neutral problem has been the focus of previous scholarship on hybrid mechanisms.<sup>54</sup> These issues, however, disappear if parties choose different neutrals. Some arbitration houses, such as the International Chamber of Commerce, strongly discourage parties from using the same neutral in hybrid mechanisms.<sup>55</sup>

While the same-neutral problem is an important issue for hybrid mechanisms, the remainder of this Article departs from existing literature by putting this issue aside to focus on the underexamined structural differences between Arb-Med and Med-Arb.

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48. *See id.* at 429–30.

49. *Id.* at 430–32.

50. *See id.* at 432–33.

51. Sussman, *supra* note 46, at 73.

52. SIAC-SIMC Arb-Med-Arb Protocol, *supra* note 8. The AMA is very similar to the Med-Arb process described in this Article: the first-phase arbitration in AMA is a formality to register the commencement of the Med-Arb process to ensure, among other things, recognition and enforceability of the mediated settlement agreement.

53. *See* Constance Castres Saint Martin, *Arb-Med-Arb Service in Singapore International Mediation Centre: A Hotfix to the Pitfalls of Multi-tiered Clauses*, *ASIAN J. ON MEDIATION*, 35, 45–47 (2015).

54. *See generally* Thomas J. Stipanowich, *Arbitration, Mediation, and Mixed Modes: Seeking Workable Solutions and Common Ground on Med-Arb, Arb-Med, and Settlement-Oriented Activities by Arbitrators*, 26 *HARV. NEGOT. L. REV.* 265 (2021) for a recent discussion of the same-neutral problem.

55. Private communication with Andrija Erac, Deputy Manager, Int'l Chamber of Com. Int'l Ctr. for ADR (July 19, 2019).

### III. WHY DO PARTIES CHOOSE MED-ARB OR ARB-MED?

Since parties do not know the outcome of arbitration during the mediation stage in both Med-Arb and Arb-Med, the two processes may appear, *prima facie*, identical. This is incorrect. Arb-Med and Med-Arb have fundamentally different incentive structures. These structural differences in turn lead to differences in economic and legal outcomes.

Intuitively, Arb-Med and Med-Arb differ in two important ways. First, during first-stage mediation in Med-Arb, parties take into consideration not only their expected outcomes from second-stage arbitration but also the cost of arbitration; by contrast, in Arb-Med, the cost of arbitration is already sunk after parties reach mediation. Second, first-stage arbitration in Arb-Med determines the arbitral outcome, which in turn affects second-stage mediation; by contrast, when parties enter arbitration in Med-Arb, mediation has failed and ended. Flipping the sequence of mediation and arbitration therefore gives rise to different strategic environments.

Section A discusses these structural differences in detail. Sections B and C introduce the classic settlement model and adapt it to examine Med-Arb and Arb-Med, respectively. Together, Sections A-C establish the foundational tools for the remainder of this Part. In particular, Section D focuses on the first structural difference: it illustrates that whether the cost of arbitration is sunk leads to different mediation outcomes. Section E focuses on the second difference: it demonstrates that the information flow from arbitration to mediation in Arb-Med can provide parties with valuable information concerning the strength/weakness of their cases and help them discover a settlement range. Sections D and E offer the insight that parties may prefer Arb-Med to Med-Arb even though Arb-Med requires participation in two rounds of dispute resolution: Arb-Med under some circumstances can help parties reach a better mediated settlement than Med-Arb. Section F summarizes.

#### A. *Structural Analysis of Med-Arb and Arb-Med*

Figure 1 is a flow diagram of Med-Arb. Notice that mediation and arbitration in Med-Arb are not entangled: first-stage mediation makes no impact on second-stage arbitration. If mediation is successful, parties do not reach second-stage arbitration. If parties reach second-stage arbitration, mediation has failed and is completely over: Parties enter arbitration as if there had not been a mediation.

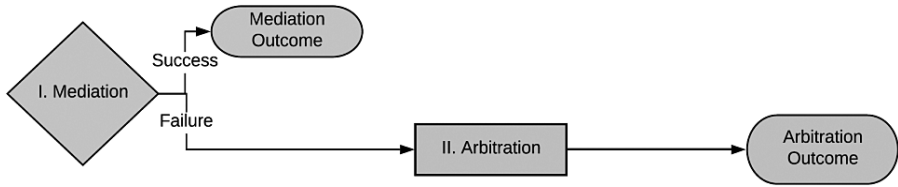


FIGURE 1. FLOW DIAGRAM OF MED-ARB.

Compare this to the flow diagram of Arb-Med in Figure 2 below. During second-stage mediation in Arb-Med, what has transpired during first-stage arbitration remains highly relevant, for parties during second-stage mediation are bargaining in the shadow of the sealed arbitration outcome from the first stage. What happens during first-stage arbitration therefore reaches into second-stage mediation in Arb-Med.

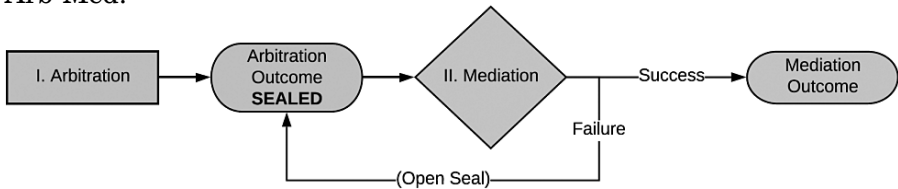


FIGURE 2. FLOW DIAGRAM OF ARB-MED.

B. *Applying the Classic Settlement Model to Med-Arb*

This Section uses the standard settlement model in law and economics as a basis to examine mediation in Med-Arb.<sup>56</sup> The standard settlement model establishes conditions (expressed as inequalities) under which parties can reach a settlement: both parties must prefer the settlement outcome to their expected litigation outcome.

Like settlement, mediation too is a voluntary process—its success requires the assent of both parties. Therefore, the standard settlement model can be adapted directly to examine Med-Arb: Parties will accept a mediated settlement agreement if they prefer the mediated settlement to their expected arbitration outcome.

56. This classic model was first developed in a series of articles. See generally William M. Landes, *An Economic Analysis of the Courts*, 14 J.L. & ECON. 61 (1971); John P. Gould, *The Economics of Legal Conflicts*, 2 J. LEGAL STUD. 279 (1974); Richard A. Posner, *An Economic Approach to Legal Procedure and Judicial Administration*, 2 J. LEGAL STUD. 399 (1973); see also Steven Shavell, *Suit, Settlement, and Trial: A Theoretical Analysis under Alternative Methods for the Allocation of Legal Costs*, 11 J. LEGAL STUD. 55 (1982).



Suppose parties A and B have a dispute concerning the distribution of \$100, which will go to either A or B following an arbitration. For simplicity, I assume A and B are identical in every aspect except that A believes his probability of winning the \$100 in arbitration is  $p_A$  and B thinks A's chance of winning the \$100 is  $p_B$ . Both parties share the same utility function  $U$  and are risk averse. To illustrate, adopt one such utility function:  $U(x) = \sqrt{x}$ . In a companion piece, I present a general model.<sup>57</sup>

Assume that  $c$  is the cost of arbitration for each party, measured in the same unit as utility (dollars for simplicity). It follows that during first-stage mediation, the expected arbitration payoffs are

$$\begin{aligned} \sqrt{100}p_A + \sqrt{0}(1 - p_A) - c &= 10p_A - c \text{ for A; and} \\ \sqrt{0}p_B + \sqrt{100}(1 - p_B) - c &= 10(1 - p_B) - c \text{ for B.} \end{aligned}$$

Party A (B) expects to receive an arbitral award of \$100 with probability  $p_A$  ( $1 - p_B$ ) and \$0 with probability  $1 - p_A$  ( $p_B$ ) in addition to paying arbitration cost  $c$ .

Let  $S$  denote a potential mediated settlement agreement that provides  $S$  dollars to party A and  $\$100 - S$  to party B. It follows that A will accept this settlement if  $\sqrt{S} \geq 10p_A - c$  and B will accept it if  $\sqrt{100 - S} \geq 10(1 - p_B) - c$  is satisfied.<sup>58</sup>

For both parties to assent to the settlement,  $S$  must satisfy both inequalities. Combining the two inequalities and rearranging the result give the Med-Arb settlement condition:

$$(10p_A - c)^2 \leq S \leq 100 - [10(1 - p_B) - c]^2. \quad (1)$$

The settlement model provides the barebones of a model for the mediation stage in Med-Arb, during which the mediator helps A and B look for a potential settlement  $S$  in anticipation of what the parties expect will happen during second-stage arbitration. The model specifies the range of acceptable settlement amount  $S$  for both parties, but does not predict how a settlement offer is selected from the settlement range, which I specify next. As discussed in Part II.A., mediation has become adversarial and increasingly resembles arbitration, so mediation is modelled here as an adversarial process under the assumption that the winning party in mediation will take the highest

57. See generally Yijia Lu, *Economic Analysis of Hybrid Mechanisms: Arb-Med and Med-Arb as Arbitral Innovations* (April 21, 2019) (unpublished manuscript) (on file with author) (analyzing a general model).

58. Parties are assumed to accept the mediated settlement if they are indifferent.

settlement amount subject to the condition that this arrangement is acceptable to both parties.

To be precise, consider any settlement range  $S_{min} \leq S \leq S_{max}$ . During mediation, both parties put in costly efforts to convince an evaluative mediator that they have a winning case. Assume that the larger the settlement range,  $S_{max} - S_{min}$ , the more costly the mediation process will be. Intuitively, a narrower settlement range implies that parties have less at stake and, therefore, will have less incentive to make costly effort to argue their case.<sup>59</sup> It is further assumed that mediation fails with negligibly low cost if no settlement is possible ( $S_{max} < S_{min}$ ).

After the parties put in costly efforts to argue their case, the mediator makes an evaluation of the parties' arguments and suggests a settlement proposal in favor of the party that she thinks is going to win the case at arbitration. If the mediator predicts in favor of A, she will propose the highest settlement offer to party A with  $S = S_{max}$  (that is, the lowest settlement offer that B will accept); otherwise, if the mediator predicts in favor of B, she will propose the lowest settlement offer that A will accept,  $S = S_{min}$ , which maximizes the settlement offer made to B.<sup>60</sup>

### C. *Applying the Classic Settlement Model to Arb-Med*

This Section adapts the settlement model to Arb-Med. Arbitration has already taken place when parties reach the mediation stage in Arb-Med. Therefore, when parties negotiate during second-stage mediation in Arb-Med, they no longer take into consideration the sunk cost of their prior arbitration. It follows that during second-stage mediation, the expected arbitration payoffs are

$$\begin{aligned} \sqrt{100}p_A + \sqrt{0}(1 - p_A) &= 10p_A \text{ for A; and} \\ \sqrt{0}p_B + \sqrt{100}(1 - p_B) &= 10(1 - p_B) \text{ for B.} \end{aligned}$$

Party A (B) expects to receive an arbitral award of \$100 with probability  $p_A$  ( $1 - p_B$ ) and \$0 with probability  $1 - p_A$  ( $p_B$ ). Because the cost of arbitration has already been paid when parties reach second-stage mediation, the expressions found here for Arb-Med do not include the cost term  $c$ , in contrast to the expressions found for Med-

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59. The Appendix outlines a formal model relating settlement range to parties' costly investment to argue their cases.

60. This assumption may be challenged, but the point of this exercise is to provide an illustration to show the key differences among Arb-Med, Med-Arb and arbitration; no model can fully capture reality.

Arb in Section B. Given a settlement offer  $S$ , A will accept it if  $\sqrt{S} \geq 10p_A$  and B will accept it if  $\sqrt{100 - S} \geq 10(1 - p_B)$ .

For both parties to assent to the settlement, both inequalities must be satisfied. Combining the two inequalities and rearranging the result give the Arb-Med settlement condition:

$$100p_A^2 \leq S \leq 100 - [10(1 - p_B)]^2. \quad (2)$$

#### D. Comparison Based on Structural Differences

Relying on the findings in the previous three sections, this Section uses a numerical example to demonstrate that the structural differences of Arb-Med and Med-Arb lead to differences in economic incentives: Each of Arb-Med, Med-Arb and standalone arbitration may be desirable under different circumstances. In particular, despite Arb-Med's counterintuitive cost structure that necessitates the payment of two processes, Arb-Med can help parties achieve more desirable mediated settlements.

Let the cost of arbitration be  $c = 3$ . Let  $p_A = p_B = 0.5$ : parties hold the same belief that each will win and be awarded \$100 with a 50% probability at arbitration. Under this assumption, A and B are identical.<sup>61</sup> Substituting these numbers into the settlement conditions (1) and (2), which characterize the conditions under which parties would accept the mediated outcome under Med-Arb and Arb-Med, yields the following, respectively:

- (i) the Med-Arb settlement condition is  $4 \leq S \leq 96$ ; and
- (ii) the Arb-Med settlement condition is  $25 \leq S \leq 75$ .

For mediation to be successful, (i) under Med-Arb, the offer  $S$  made to party A must be no less than \$4 and no more than \$96, and (ii) under Arb-Med, the mediated offer  $S$  made to party A must be no less than \$25 and no more than \$75. Under the assumption of evaluative mediation, each party under Med-Arb expects to receive a settlement amount of either \$4 or \$96 corresponding to utility levels  $\sqrt{4} = 2$  and  $\sqrt{96} = 9.80$  whereas each under Arb-Med expects to receive either \$25 or \$75 corresponding to utility levels  $\sqrt{25} = 5$  and  $\sqrt{75} = 8.66$ .

Since A and B are identical, a symmetric equilibrium would require them to take the same action, so each party expects to receive the higher settlement with a probability of 50%. It follows that each

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61. The assumption that parties A and B are identical, though highly unrealistic, simplifies the analysis to demonstrate the different economic outcomes stemming from different dispute-resolution mechanisms.

party's expected allocation utility absent cost considerations is  $\frac{1}{2}(2) + \frac{1}{2}(9.80) = 5.90$  for Med-Arb and  $\frac{1}{2}(5) + \frac{1}{2}(8.66) = 6.83$  for Arb-Med.

This numerical example illustrates that Arb-Med can induce a better allocation outcome for the parties than Med-Arb ( $6.83 > 5.90$ ) even though Arb-Med necessarily involves costs for both arbitration and mediation. Moreover, since the mediation settlement range is larger under Med-Arb than under Arb-Med, parties put in more costly effort during the mediation stage in Med-Arb than in Arb-Med. Therefore, despite its counterintuitive cost disadvantage that necessarily requires the payment of two processes, Arb-Med can lead to a better allocation outcome at a lower mediation cost than Med-Arb. Whether Arb-Med outperforms Med-Arb depends on whether the gain in utility owing to Arb-Med's better allocation outcome and lower mediation cost is sufficient to offset the unavoidable cost of its first-stage arbitration.

Table 1 documents these findings in the first three columns. Standalone arbitration is included in the fourth column for comparison. Standalone arbitration provides the worst allocation outcome: parties either receive \$0 or \$100 corresponding to utility levels 0 and 10, respectively. Each party's expected allocation utility is therefore  $\frac{1}{2}(0) + \frac{1}{2}(10) = 5$ . Under the assumption that the cost of arbitration is higher than the cost of mediation,<sup>62</sup> standalone arbitration is less efficient than Med-Arb. However, if mediation cost is sufficiently high, standalone arbitration too can emerge as the most efficient outcome. In fact, any of the six rankings of the three mechanisms in terms of their overall economic efficiency is possible.<sup>63</sup>

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62. This assumption may not always be true, especially if mediation turns adversarial.

63. See Lu, *supra* note 57, at 55–59 (using a parametric example to demonstrate all six possible efficiency rankings).

TABLE 1. COMPARISON OF ARB-MED, MED-ARB AND STANDALONE ARBITRATION. DURING MEDIATION, THE COST OF ARBITRATION IS SUNK IN ARB-MED, BUT NOT IN MED-ARB.

	<b>Arb-Med</b>	<b>Med-Arb</b>	<b>Arbitration</b>
<b>Arbitration Cost</b>	Yes	-	Yes
<b>Mediation Cost</b>	Yes (lower)	Yes (higher)	-
<b>Allocation Outcome</b>	Best	Intermediate	Worst

Intuitively, mediation is more likely to help parties reach a better joint outcome than arbitration because mediation takes into consideration the consent of both parties. Moreover, parties are more likely to reach a better agreement under Arb-Med than Med-Arb because the cost of arbitration is not a part of the bargaining during mediation under Arb-Med. However, the optimal allocation advantage of Arb-Med is offset by its cost disadvantage because Arb-Med involves inevitably the costs of both arbitration and mediation. Which of Arb-Med, Med-Arb and standalone arbitration is the optimal mechanism depends on how much parties value improvements to their dispute-resolution outcome relative to the increase in cost.

*E. Information Flow From Arbitration to Mediation in Arb-Med*

First-stage arbitration in Arb-Med involves a full discovery process and dynamically influences second-stage mediation, during which parties bargain in the shadow of the sealed arbitral award from the first stage. One particular way that first-stage arbitration makes its impact on second-stage mediation is through information flow: parties learn about the relative strength of their cases through first-stage arbitration and bargain for a better outcome during second-stage mediation. This Section illustrates through another numerical example how information flow in Arb-Med can help parties reach a settlement outcome, may be unattainable under Med-Arb.<sup>64</sup>

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64. Although the model assumes no information flow during mediation, in reality parties do learn valuable information during mediation, but the extent of learning is much more limited under mediation than arbitration because: (i) arbitration involves a full discovery process while mediation often does not, and (ii) mediation is usually limited in time and scope to save time and cost.

Imagine that parties A and B have different expectations over the probability that A will win at arbitration. Party A is over-confident: he thinks that he will surely win at arbitration with  $p_A = 1$ . Party B, however, *correctly* believes that A will win only half of the time with  $p_B = 0.5$ . Since cost is not a key issue here,  $c$  is set to 0 for simplicity.

Putting these variables into the settlement inequality for Med-Arb shows that no settlement is possible during first-stage mediation since the settlement inequality requires  $\$100 \leq S \leq \$75$ . Mediation will therefore fail in Med-Arb. Parties will proceed to second-stage arbitration, with each gaining an average allocation payoff of  $\frac{1}{2}U(100) + \frac{1}{2}U(0) = 5$ .

Consider next Arb-Med. Parties undergo arbitration first. Suppose through first-stage arbitration, A observes that B has made some good arguments against his position. He no longer feels as confident and updates his belief to  $p_A = 0.8$ . Substituting  $p_A = 0.8$ ,  $p_B = 0.5$ , and  $c = 0$  into the settlement inequalities (2) for Arb-Med leads to

$$64 \leq S \leq 75.$$

A settlement possibility has thus emerged for the parties during second-stage mediation in Arb-Med. Notice that in this settlement range, the least that A will receive is \$64, corresponding to a utility level of  $U(64) = \sqrt{64} = 8$  for A and a utility level of  $U(100 - 64) = \sqrt{36} = 6$  for B; and the least that B will receive is  $\$100 - \$75 = \$25$ , corresponding to a utility level of  $\sqrt{25} = 5$  for B and a utility level of  $U(100 - 25) = \sqrt{75} = 8.66$  for A. Therefore, both parties are guaranteed a level of utility no worse than 5, the expected outcome of Med-Arb.

In conclusion, this numerical example illustrates that information flow in Arb-Med can help parties reach a better allocation outcome by mitigating the problem of overconfidence, which prevents them from reaching a mediated settlement in Med-Arb. Whether Arb-Med outperforms Med-Arb again depends on whether the utility gain owing to Arb-Med's better settlement outcome is sufficient to offset its higher cost.

## F. Summary

This Part began with a structural analysis of Arb-Med and Med-Arb to identify their differences. It then constructed numerical examples to illustrate how these structural differences can, in turn, lead to different economic outcomes. Arb-Med may seem counterintuitive in

requiring parties to participate in both costly arbitration and mediation, but it can lead to more desirable allocation outcomes.

Two insights explain this result. First, during mediation in Med-Arb, parties negotiate a mediated settlement that depends not only on their expectation of the second-stage arbitration outcome, but also on the cost of arbitration. The cost of arbitration, which first-stage mediation in Med-Arb attempts to avoid, widens the settlement gap against the interest of the parties. This cost consideration is, however, absent during second-stage mediation in Arb-Med since the cost of arbitration is already sunk. Second, the two stages of arbitration and mediation are entangled in Arb-Med: what happens during first-stage arbitration makes its impact on second-stage mediation. Learning and information updating during first-stage arbitration in Arb-Med can help parties identify a settlement range when they mediate in the second stage.

#### IV. LEGAL ISSUES OF HYBRID MECHANISMS UNDER THE FEDERAL ARBITRATION ACT

The previous Part has demonstrated that flipping the order of arbitration and mediation alters the economic structures of Med-Arb and Arb-Med. Hybrid mechanisms are already gaining strong support from arbitral centers across North America.<sup>65</sup> Because both Med-Arb and Arb-Med are desirable mechanisms under different circumstances, it is important to examine whether current American law supports these mechanisms and treats them equally. This is because institutional support facilitates the efficient execution of these hybrid mechanisms as they are designed.

Current American law does not support hybrid mechanisms in the same way: flipping the order of arbitration and mediation alters the legal issues that Med-Arb and Arb-Med confront under the Federal Arbitration Act (“FAA”), which regulates domestic arbitration in the United States.<sup>66</sup> Section A in this Part explains why the FAA matters, highlighting the FAA’s power to specifically compel arbitration, enforce arbitral awards, and preempt mandatory state laws in the United States. The FAA, however, does not define the term arbitration, and courts have not reached a consensus. Section B reviews the circuit split on the scope of arbitration under the FAA. Section C

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65. For example, the ADR Institute of Canada launched new rules, designation, and a course for Med-Arb in November 2019. *The ADRI Med-Arb Rules are now available!*, ADR INST. OF CAN., <https://adric.ca/rules-codes/adric-med-arb-rules/> [<https://perma.cc/M5UJ-QFJG>].

66. United States Arbitration Act, 9 U.S.C. §§ 1–16 (2018).

then examines the applicability of the FAA to Arb-Med and Med-Arb. Section D turns to the problem of enforcement of arbitral awards and mediated settlement agreements stemming from hybrid mechanisms. Section E discusses enforcement issues that may arise as parties go through hybrid mechanisms. Finally, Section F discusses the very narrow grounds under which arbitral awards and mediated settlement agreements can be vacated and modified under the FAA.

A. *Importance of the Federal Arbitration Act*

1. *The FAA Specifically Compels Dispute Resolution and Enforces its Outcome*

Chapter 1 of the FAA governs domestic arbitration and its enforcement across the United States.<sup>67</sup> The FAA is a powerful tool that allows parties to petition courts to specifically compel arbitration and enforce its award. Thus, whether the FAA applies to Med-Arb and Arb-Med in their entirety or only to the arbitration part of these mechanisms is a critical issue.

Section 3 of the FAA requires “any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration” to “stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement” upon the petitioning of one of the parties.<sup>68</sup> Section 4 of the FAA allows parties with a written arbitration agreement to petition “any United States district court” for “an order directing that such arbitration proceed in the manner provided for in such agreement.”<sup>69</sup> Section 9 specifies the rules under which the parties can petition courts for the confirmation of arbitral awards.<sup>70</sup>

The power of the FAA lies in its ability to (1) stay litigation and compel arbitration, and (2) expediently enforce arbitral awards under “one of the narrowest standards of judicial review in all of American Jurisprudence.”<sup>71</sup> If a dispute resolution mechanism is not considered arbitration under the FAA, then it becomes unclear if courts can specifically compel the mechanism under other laws such as state

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67. *Id.* § 2.

68. *Id.* § 3.

69. *Id.* § 4.

70. *Id.* § 9.

71. *Lattimer-Stevens Co. v. United Steelworkers*, 913 F.2d 1166, 1169 (6th Cir. 1990); *accord Nationwide Mut. Ins. Co. v. Home Ins. Co.*, 278 F.3d 621, 625 (6th Cir. 2002).



contract law and mediation law. Moreover, the enforcement of its outcome can be difficult in some jurisdictions, and parties almost always face higher standards of review.

## 2. *The FAA Preempts State Law*

Over the last fifty years, the U.S. Supreme Court has expanded the scope of the FAA under a “national policy favoring arbitration.”<sup>72</sup> Under current case law, arbitration under the FAA can bypass mandatory state law with a choice of law clause.<sup>73</sup>

Imagine that an employer and an employee in Oklahoma enter into an employment contract with a noncompete clause.<sup>74</sup> Oklahoma state law makes “void and unenforceable” any such noncompete clauses.<sup>75</sup> However, the same employment contract also includes an arbitration agreement and a choice of law clause specifying Louisiana law, which permits noncompete clauses.<sup>76</sup> While Oklahoma state courts would certainly void these noncompete clauses, an arbitrator applying Louisiana law may issue an arbitral award upholding the noncompete clause. Under the FAA and current U.S. Supreme Court jurisprudence, Oklahoma courts would have no choice but to enforce the arbitral award in contradiction to its mandatory state law.<sup>77</sup>

Whether the FAA applies to parts or all of hybrid mechanisms can likewise result in very different legal consequences. Consider a similar employment contract including a noncompete clause and a Med-Arb agreement. A dispute arises and the parties go for Med-Arb. Suppose mediation is successful, resulting in a mediated settlement agreement upholding the noncompete clause, but the employee later starts to work for a competing employer in Oklahoma. The previous employer would have great difficulty petitioning Oklahoma courts to

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72. *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984). See *supra* note 1 for an overview of the development of caselaw following *Southland Corp.* that illustrates the Court’s policy favoring arbitration over the last four decades. See generally Sarath Sanga, *A New Strategy for Regulating Arbitration*, 113 Nw. U. L. REV. 1121, 1129–34 (2019), which demonstrates that the “national policy favoring arbitration” has dubious support in Supreme Court precedents.

73. Sanga, *supra* note 72, at 1124–25.

74. The hypothetical comes from *Howard v. Nitro-Lift Techs., L.L.C.*, 273 P.3d 20, 24–25 (Okla. 2011). See *id.* at 1123–25 (discussing and analyzing *Nitro-Lift* in detail).

75. OKLA. STAT. ANN. TIT. 15, § 219A (West 2018).

76. LA. STAT. ANN. § 23:921(C) (2020) (permitting certain noncompete agreements that last up to two years from termination of employment).

77. See Sanga, *supra* note 72, at 1125–49 (reviewing federal law and Supreme Court precedents to show that “there is virtually no circumstance under which a state or federal court may refuse to enforce an arbitration agreement or arbitral award”).

uphold the noncompete clause if the FAA does not apply to the mediated settlement agreement.

### B. *Circuit Split on the Scope of FAA Arbitration*

For the FAA to be applicable, a dispute resolution mechanism must fall within its scope. The FAA, however, does not define the term “arbitration.” Section 2 of the FAA offers a rather general description of its applicability:

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.<sup>78</sup>

Circuit courts are split on the scope of FAA arbitration. In *Advanced Bodycare Solutions, LLC v. Thione International, Inc.*, the Eleventh Circuit held that the FAA does not apply to mediation.<sup>79</sup> The *Thione* court announced a *bright-line rule* to decide whether a dispute resolution mechanism is “arbitration” under the FAA:

The FAA clearly presumes that arbitration *will result* in an ‘award’ declaring the rights and duties of the parties . . . If a dispute resolution procedure does not produce some type of award that can be meaningfully confirmed, modified, or vacated by a court upon proper motion, it is not arbitration within the scope of the FAA.<sup>80</sup>

The bright-line rule thus requires that a dispute resolution mechanism must yield a final or binding decision for it be considered “arbitration” under the FAA. The Second Circuit endorses a similar bright-line rule focusing on the finality of the process, citing approvingly two cases wherein (1) “contractual language . . . ‘constitute[s] an enforceable arbitration clause’ . . . because ‘the language clearly manifests an intention by the parties to submit certain disputes to a specified third party for *binding* resolution;”<sup>81</sup> and (2) “‘an adversary proceeding, submission of evidence, witnesses and cross-examination

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78. 9 U.S.C. § 2.

79. 524 F.3d 1235, 1240–41 (11th Cir. 2008).

80. *Id.* at 1239 (emphasis added).

81. *Bakoss v. Certain Underwriters at Lloyds of London Issuing Certificate No. 0510135*, 707 F.3d 140, 143 (2d Cir. 2009) (quoting *McDonnell Douglas Fin. Corp. v. Pa. Power & Light Co.*, 858 F.2d 825, 830 (2d Cir. 1988) (emphasis added)).

are not essential elements of an arbitration' . . . '[i]f the parties have agreed to submit to a dispute for a decision by a third party, they have agreed to arbitration.'"<sup>82</sup>

In deemphasizing the procedural requirements of "an adversary proceeding," the Second Circuit disapproved of the more stringent requirement of a "classic arbitration" imposed by some circuit courts. The First Circuit, for example, requires "an independent adjudicator, substantive standards . . . and an opportunity for each side to present its case" in addition to finality.<sup>83</sup> The Fifth and Tenth Circuit Courts also follow the same *classic arbitration rule*.<sup>84</sup> In addition to the bright-line rule's final or binding award element, the classic arbitration rule requires three additional procedural elements: "(a) a process to settle disputes between parties; (b) a neutral third party; [and] (c) an opportunity for the parties to be heard."<sup>85</sup>

On the other end of the spectrum, the Fourth, Eighth and Ninth Circuit Courts adopted the least restrictive requirement for a dispute resolution mechanism to fall within the scope of the FAA, ruling that arbitration does not need to be binding for the FAA to be applicable.<sup>86</sup> The *nonbinding rule* merely states that FAA arbitration can be non-binding; it does not, however, imply that *any* nonbinding dispute resolution mechanism is FAA arbitration. Notably, these circuit courts did not decide whether mediation is FAA arbitration.

The nonbinding rule focuses on whether the dispute-resolution process can be *completed* to resolve issues prior to the pursuit of litigation. The Fourth Circuit endorsed the Ninth Circuit's citation to a Third Circuit case that emphasized completeness: "Some courts have chosen to focus on whether the arbitration process is likely to resolve

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82. *Id.* at 143 (alteration in original) (quoting *AMF Inc. v. Brunswick Corp.*, 621 F. Supp. 456, 460 (E.D.N.Y. 1985)).

83. *Fit Tech, Inc. v. Bally Total Fitness Holding Corp.*, 374 F.3d 1, 7 (1st Cir. 2004) (internal citations omitted).

84. *Gen. Motors Corp. v. Pamela Equities Corp.*, 146 F.3d 242, 246 (5th Cir. 1998) (defining arbitration as "the reference of a particular dispute to an impartial third person chosen by the parties to a dispute who agree, in advance, to abide by the arbitrator's award issued after a hearing at which both parties have an opportunity to be heard." (internal citations omitted)); *Salt Lake Tribune v. Mgmt. Plan.*, 390 F.3d 684, 689 (10th Cir. 2004) (citing approvingly to the classic arbitration requirement in *Fit Tech*, 374 F.3d at 1, and highlighting finality as a central element).

85. FOLBERG ET AL., *supra* note 34, at 516.

86. *See, e.g., Dow Corning Corp. v. Safety Nat'l Cas. Corp.*, 335 F.3d 742, 747–48 (8th Cir. 2003); *United States v. Bankers Ins. Co.*, 245 F.3d 315, 321–23 (4th Cir. 2001); *Wolsey, Ltd. v. Foodmaker, Inc.*, 144 F.3d 1205, 1208–09 (9th Cir. 1998).

the issues, and whether the parties ‘agree not to pursue litigation until the process is *completed*.’”<sup>87</sup> Completion is a weaker requirement than finality: Any final process must be complete, but not all complete processes are final.

The three approaches regarding whether a dispute resolution mechanism falls within the scope of FAA “arbitration” are summarized in the table below in increasing order of strictness.

TABLE 2. SUMMARY OF THE THREE-WAY CIRCUIT SPLIT OVER THE SCOPE OF ARBITRATION UNDER THE FEDERAL ARBITRATION ACT

	Required Elements	Circuit Courts
<b>Nonbinding Rule</b>	completion—a process does not need to be binding to be considered FAA arbitration	First, Fifth, Tenth
<b>Bright-Line Rule</b>	finality	Second, Eleventh
<b>Classic Arbitration Rule</b>	(i) finality, (ii) substantive standards for process to settle disputes, (iii) independence of neutral, and (iv) opportunity to be heard	Fourth, Eighth, Ninth

### C. Availability of the FAA to Compel Hybrid Mechanisms

Having (1) established that the applicability of the FAA to hybrid mechanisms is an important issue in Section A and (2) outlined the circuit split on the scope of FAA in Section B, this Section will examine whether the FAA applies to Med-Arb and Arb-Med. Assume that the arbitration part in hybrid mechanisms is a classic arbitration that satisfies each of the three rules announced by different circuit courts. This Section shows that flipping the order of arbitration and mediation leads to different legal consequences regarding the compelling of arbitration and mediation under the FAA.

Since the first stage in Arb-Med is a classic arbitration, the FAA can compel the start of Arb-Med. By contrast, whether the FAA can compel the start of Med-Arb is unclear. If courts view mediation as an essential part of the second-stage arbitration in Med-Arb—in other words, if courts view Med-Arb as a unitary, inseparable, *sui generis*

87. *Bankers Ins. Co.*, 245 F.3d at 322 (emphasis added) (internal quotation marks omitted) (quoting *Wolsey*, 144 F.3d at 1208–09).

process of dispute resolution (henceforth, the “unitary view”)—then the FAA is likely applicable under the bright-line rule because Med-Arb always ends with a final decision (an arbitral award or a mediated settlement agreement). However, under the classic arbitration rule, whether Med-Arb can be considered FAA arbitration is less clear. On the one hand, Med-Arb involves independent adjudicators (mediators and arbitrators) and leads to final awards. On the other hand, Med-Arb may terminate in the first stage with successful mediation, which may not fully satisfy the conditions of “substantive standards” and “an opportunity for each side to present its case.”<sup>88</sup> Finally, under the nonbinding rule, courts are likely to find the FAA applicable to compel the start of Med-Arb since it is a complete mechanism.

If courts view mediation and arbitration as two separate processes in hybrid mechanisms (henceforth, the “separable view”), it is even more difficult to argue that the FAA can compel the start of Med-Arb. One district court recently adopted this separable view, holding that the FAA applies to the arbitration part but not the mediation part of Med-Arb.<sup>89</sup> Since mediation by itself does not satisfy the bright-line rule and the more demanding classic arbitration rule due to its lack of finality, the only remaining possibility to compel first-stage mediation in Med-Arb under the FAA is to argue that mediation satisfies the nonbinding rule—a difficult hurdle to overcome.

The table below summarizes these conclusions concerning the applicability of the FAA to compel the start of Arb-Med and Med-Arb under the unitary view and the separable view.

TABLE 3. APPLICABILITY OF THE FAA TO COMPEL THE START OF ARB-MED AND MED-ARB.

	Arb-Med	Med-Arb
<b>Unitary View</b>	Yes	- Yes (bright-line rule & nonbinding rule) - Maybe (classic arbitration rule)
<b>Separable View</b>	Yes	- No (bright-line rule & classic arbitration rule) - Unlikely (nonbinding rule).

88. *Fit Tech*, 374 F.3d at 7.

89. *See Trujillo v. Gomez*, No. 14cv2483 BTM (BGS), 2015 WL 1757870, at \*8–9 (S.D. Cal. Apr. 17, 2015).

D. *Enforcement of Mediated Settlement Agreements Under the FAA*

If mediation fails in Med-Arb or Arb-Med, the mechanism will end with a binding arbitral award, which can be readily enforced under the FAA.<sup>90</sup> But what if parties succeed in mediation—is the mediated settlement agreement enforceable under the FAA?

Parties sometimes ask arbitrators to enter mediated settlements as arbitral awards. But this does not change the fact that the process leading to the arbitral awards is mediation.<sup>91</sup> The enforceability of mediated settlement agreements under the FAA is therefore also a relevant issue for mediated settlement agreements that are entered as arbitral awards.

If courts adopt the separable view, mediation cannot satisfy the bright-line rule and the classic arbitration rule due to its lack of finality. Moreover, it is unlikely for mediation to satisfy the least stringent nonbinding rule. Thus, the FAA does not apply to the mediation part of hybrid mechanisms since it cannot enforce mediated settlement agreements.

Now suppose courts adopt the unitary view. The next two subsections analyze the possible use of the FAA to enforce mediated settlement agreements under the unitary view for Med-Arb and Arb-Med, respectively.

1. *Med-Arb*

Consider a Med-Arb process that ends with a mediated settlement agreement. If courts view Med-Arb as a unitary process, then the bright-line rule and the nonbinding rule must accept Med-Arb as arbitration under the FAA.<sup>92</sup> Likewise, the bright-line rule and the nonbinding rule must also support the enforcement of the mediated settlement agreement under the FAA since the mediated settlement agreement is final and complete.

However, even if courts applying the classic arbitration rule accept Med-Arb as FAA arbitration, it does not necessarily follow that they will enforce the mediated settlement agreement, since Med-Arb

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90. This statement is true if different neutrals serve as the arbitrator and the mediator in hybrid mechanisms. When the same neutral serves as both the arbitrator and the mediator, enforcement of arbitral awards can be problematic. *See generally* Deason, *supra* note 12, at 238–49 (reviewing enforcement issues arising from the same-neutral problem under the FAA).

91. *Id.* at 233 (arguing that the FAA should not be applicable to mediated settlement agreements from hybrid mechanisms on policy grounds).

92. *See supra* Section IV.C.

with a successful mediation no longer resembles a classic arbitration. Professor Ellen Deason makes a similar point:

Arguments have been made that the FAA requires courts to enforce parties’ agreement to use med-arb. If the med-arb process is regarded as a unified whole rather than a combination of two separate processes, this position can be supported. Functionally, the process the parties selected does include an opportunity to have a neutral third party apply substantive standards to make a final and binding decision based on a hearing in which each side can present their arguments. But when the process terminates in an agreement without proceeding to arbitration, the functions subject to review bear no resemblance to arbitration. Nor is there any indication that Congress intended to extend review under the FAA to mediated agreements.<sup>93</sup>

Therefore, under the classic arbitration rule, it is possible that Med-Arb is accepted as FAA arbitration but nonetheless lacks FAA support to enforce its mediated settlement agreements. This awkward possibility stems from the inherent structure of Med-Arb: once parties reach second-stage arbitration, mediation is dead; once mediation is successful, arbitration is dead.

2. *Arb-Med*

A mediated settlement agreement stemming from Arb-Med, by contrast, suffers less from this defect, since arbitration has taken place in Arb-Med. Under the unitary view, the mediated settlement agreement is Arb-Med’s final outcome and is more likely to be considered enforceable under the FAA, as it (1) certainly satisfies the bright-line rule requiring finality and the nonbinding rule requiring completeness; and (2) likely satisfies the requirements of a classic arbitration, which has taken place.

The table below summarizes this Section’s key conclusions.

TABLE 4. ENFORCEABILITY OF MEDIATED SETTLEMENT AGREEMENTS UNDER THE FAA.

	Arb-Med	Med-Arb
<b>Unitary View</b>	Yes	- Yes (bright-line rule & nonbinding rule)
		- Maybe (classic arbitration rule, even if the FAA is applicable to Med-Arb)
<b>Separable View</b>		- No (bright-line rule & classic arbitration rule)
		- Unlikely (nonbinding rule)

93. Deason, *supra* note 12, at 236 (internal citations omitted).

### E. *Interim Problems*

Another distinction between Arb-Med and Med-Arb concerns the FAA's applicability to specifically compel the continuation of the mechanism and enforce its interim outcome—after the conclusion of the first-stage process but before the start of the second-stage process.

#### 1. *Two Interim Problems for Arb-Med*

In the interim of Arb-Med, a sealed arbitral award is issued, and mediation has not yet begun. If the arbitral award by itself satisfies the requirements of the FAA for enforcement, two interim problems may nevertheless arise because the arbitral award is sealed. First, if a party believes that the sealed arbitral award is not in her favor, can she petition courts to vacate it under Section 10(a)(4) of the FAA by claiming that the award is not “mutual, final, and definite”<sup>94</sup> because it is sealed? Second, can one of the parties at the end of first-stage arbitration abandon mediation and petition courts to enforce the sealed arbitral award under Section 9 of the FAA?<sup>95</sup>

Facilitating Arb-Med implies that both questions *should* be answered in the negative: parties should not be permitted to terminate the process in the interim by vacating the sealed arbitral award or enforcing it without proceeding to mediation.

The goal of facilitating Arb-Med is achieved if courts view Arb-Med as a unitary process. Courts can vacate or enforce an award under the FAA only if the dispute resolution process within the scope of the FAA is complete; otherwise, courts must first specifically compel the dispute resolution process to its completion. Under the unitary view, the issuance of a sealed arbitral award from first-stage arbitration is not the completion of Arb-Med since second-stage mediation has not yet taken place. It follows that the answers to the two interim questions are both “no” under the unitary view because Arb-Med remains incomplete in the interim.

In contrast, the separable view considers arbitration in Arb-Med as an individual process. The answer to the first interim question concerning vacatur depends on whether courts consider the issuance of the sealed award as the completion of arbitration.

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94. 9 U.S.C. § 10(a)(4). Section 10(a)(4) provides the following ground for vacatur: “where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.” *Id.*

95. *Id.* § 9.



If courts consider the issuance of the sealed award as incomplete arbitration, then parties can petition courts to compel the completion of arbitration under the FAA, and the only missing step is the unsealing of the sealed award.<sup>96</sup> The award, once unsealed, would then satisfy the requirement of “mutual, final, and definite”<sup>97</sup> and thus cannot be vacated under Section 10(a)(4).

By contrast, if courts consider the issuance of the sealed arbitral award as complete arbitration, parties cannot use the FAA to compel the unsealing of the award in the interim. The answer to the first interim question concerning vacatur may seem uncertain in this case because it depends on whether courts view the sealed arbitral award as “mutual, final, and definite,” but parties themselves may be able to unseal the awards.

Under the separable view, the answer to the second interim question concerning the immediate enforcement of the seal arbitral award is likely “yes” especially if courts find that only first-stage arbitration in Arb-Med falls within the scope of the FAA. And this is the case even if courts consider the issuance of the sealed arbitral award as incomplete arbitration because the party requesting enforcement can first petition courts to compel the completion of arbitration through the unsealing of the arbitral award.

The analysis thus demonstrates that viewing Arb-Med as a unitary process avoids the two interim problems arising from the fact that the interim arbitral award is sealed.

## 2. *A Different Interim Problem for Med-Arb*

The interim problem for Med-Arb, however, is not the same as those for Arb-Med. If parties have failed to reach a mediated settlement agreement during mediation in Med-Arb, they can readily petition courts to use the FAA to compel second-stage (classic) arbitration. Alternatively, if parties have reached a mediated settlement agreement, they have little incentive to turn towards arbitration since successful mediation implies mutual assent.

The relevant interim problem for Med-Arb arises when one of the parties later changes his mind because circumstances have changed. Can that party petition courts to compel second-stage arbitration?

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96. Just because the award is sealed, it does not mean parties have not agreed to be legally bound by it. See Randy E. Barnett, *Consenting to Form Contracts*, 71 FORDHAM L. REV. 627, 636 (2002) (discussing the sealed envelope hypothetical in contract law).

97. 9 U.S.C. § 10(a)(4).

The answer is almost definitely no if the settlement agreement contains a proper clause releasing parties from arbitration.

This same problem manifests in Arb-Med following the conclusion of a successful mediation: Can parties later petition courts to enforce the sealed arbitral award, if circumstances have changed? As in Med-Arb, a properly drafted mediated settlement agreement in Arb-Med too can circumvent this problem.

Finally, Section 9 of the FAA provides an additional protection by requiring parties to petition courts “*within one year* after the award is made . . . for an order confirming the award.”<sup>98</sup> This relatively short period of one year decreases the probability that this problem will arise: the shorter the limitation period, the less likely it is for parties to face significant changes in their circumstances.

#### F. *Vacatur and Modification of Arbitral Awards Under the FAA*

Due process, impartiality, and confidentiality are key issues pertaining to the vacatur and modification of arbitral awards under the FAA. Many of these issues are relevant to Med-Arb and Arb-Med, only if the same neutral serves as both the arbitrator and the mediator.<sup>99</sup>

If parties use different neutrals who perform their respective roles in good faith, it is very difficult to use Section 10<sup>100</sup> to vacate or Section 11<sup>101</sup> to modify arbitral awards under the FAA. Nevertheless, a discussion of remaining issues is included here for completeness.

Section 10(a)(1) of the FAA requires courts to vacate arbitral awards “procured by corruption, fraud, or undue means.”<sup>102</sup> One may argue that the term “undue means” refers to the negation of due process requirements. Since mediation in hybrid mechanisms involves *ex parte* communication, the role played by the mediator may not follow the strict due process standards of arbitration and litigation.

Such a view is mistaken. Under the statutory interpretation principle of *ejusdem generis*, the scope of the term “undue means” is narrowed by its antecedents: “corruption, fraud.” This suggests that “undue means” here refers to malicious acts. In *Hall St. Associates, L.L.C. v. Mattel, Inc.*, the Supreme Court applied the same principle

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98. *Id.* § 9 (emphasis added).

99. *See supra* Section II.C.

100. 9 U.S.C. § 10.

101. *Id.* § 11.

102. *Id.* § 10.

to rule that Sections 10 and 11 of the FAA “address *egregious* departures from the parties’ agreed-upon arbitration.”<sup>103</sup> It is difficult to construe alternative dispute resolution mechanisms that do not adhere to strict due process standards as “*egregious departures*.”

The second and third grounds for vacatur under the FAA are: “(2) where there was evident partiality or corruption in the arbitrators, or either of them;” and “(3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.”<sup>104</sup> These two grounds concerning neutral misconduct do not apply specifically to hybrid mechanisms so long as the neutrals perform their roles in good faith. Finally, the fourth ground for vacatur under Section 10(a)(4) cannot be used to vacate sealed arbitral awards as already discussed.<sup>105</sup>

If parties fail to vacate their arbitral award, Section 11 of the FAA enumerates the following three grounds under which they can petition courts to “modify and correct the award, so as to effect the intent thereof and promote justice between the parties.”<sup>106</sup>

(a) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award.

(b) Where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted.

(c) Where the award is imperfect in matter of form not affecting the merits of the controversy.<sup>107</sup>

Of these three grounds, (b) is the only pertinent one for hybrid mechanisms. Suppose that the mediated settlement agreement includes bargaining outcomes on a matter not submitted to the arbitrators in Arb-Med or Med-Arb. Suppose further that the parties have asked the arbitrators to enter the mediated settlement as an arbitral award. If the courts adopt the separable view that the FAA only applies to the classic arbitration part of hybrid mechanisms, it seems that parties can later petition courts to modify the award under Section 11(b), arguing that the arbitrator has “awarded upon a matter not submitted to them.” This argument, however, is rather weak for

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103. 552 U.S. 576, 586 (2008) (emphasis added).

104. 9 U.S.C. § 10.

105. See *supra* Section IV.E.

106. 9 U.S.C. § 11.

107. *Id.*

two reasons. First, these additional bargaining outcomes may not be “affecting the merits of the decision upon the matter submitted,” as required in Section 11(b).<sup>108</sup> Second, the purpose for granting modification is “to effect the intent thereof and promote justice between the parties,” as stated at the beginning of Section 11.<sup>109</sup> It can thus be argued that Section 11(b) is not applicable, because these additional terms in the original settlement agreement, though not submitted to the arbitrators, have been entered into the award based on the parties’ mutual assent.

In conclusion, little ground exists under Sections 10 and 11 of the FAA for parties to vacate and modify arbitral awards stemming from Arb-Med and Med-Arb when employing different neutrals.

## V. POLICY RECOMMENDATIONS

Part III demonstrated that Arb-Med, requiring parties to go through both arbitration and mediation, sometimes leads to better allocation outcomes that justify its higher costs. Since Med-Arb and Arb-Med are desirable under different circumstances, the legal system should facilitate these innovative dispute resolution mechanisms and treat them equally.

This is not the case under current federal law, as shown in Part IV. Flipping the order of arbitration and mediation in Arb-Med and Med-Arb creates different legal hurdles. Courts have not agreed upon the scope of arbitration under the Federal Arbitration Act. The narrowest scope admits only “classic arbitrations” whereas the broadest scope may even admit other forms of alternative-dispute resolution such as mediation. Moreover, instead of viewing hybrid mechanisms as unitary processes, courts tend to partition them into separate processes, adapting existing rules and standards governing standalone arbitration and standalone mediation to their combination.

Observing Tables 3 and 4 leads to the following recommendations to facilitate these desirable hybrid mechanisms. First, courts should view hybrid mechanisms as unitary, *sui generis* processes, instead of partitioning them into separate arbitration and mediation. Moreover, courts should interpret FAA arbitration broadly under the bright-line rule or the nonbinding rule.

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108. *Id.*

109. *Id.*

Adopting these two recommendations will make the FAA applicable to hybrid mechanisms in their entirety and facilitate the enforcement of their outcomes. Arb-Med's interim problems too disappear under the unitary view.

Although this Article does not deal with the same-neutral problem that prior literature has carefully analyzed,<sup>110</sup> the two recommendations must not exacerbate this problem. The recommendations do not alter existing due process, confidentiality, and impartiality requirements under the FAA. However, one unavoidable consequence of placing hybrid mechanisms entirely under the umbrella of the FAA is that the standards of review of these hybrid mechanisms will become extremely narrow. Users of hybrid mechanisms may want to opt for more permissible standards of review to protect their legal rights. However, opting for more expansive review standards under the FAA is not permitted under current case law: the Supreme Court ruled in *Hall St. Associates, L.L.C. v. Mattel, Inc.* that parties may not broaden the grounds for review under the FAA.<sup>111</sup>

In recommending judicial support for hybrid mechanisms, the focus is primarily on resolving disputes in business-to-business transactions where parties have similar bargaining power. Whether these innovative hybrid mechanisms could also improve dispute resolution in other areas is an open question. There have been growing concerns that employment and consumer contracts more and more frequently include mandatory arbitration clauses that bar employees and consumers, who typically have less bargaining power, from using the court system.<sup>112</sup> The #MeToo movement raised further concerns, as sexual harassment cases are often resolved by mandatory arbitration behind closed doors that conceal the identities of perpetrators.<sup>113</sup> Whether combining mediation with arbitration can be helpful in such

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110. See, e.g., Deason, *supra* note 12, at 238–49 (reviewing enforcement issues arising from the same-neutral problem under the FAA).

111. 552 U.S. 576, 578 (2008).

112. See, e.g., Jessica Silver-Greenberg & Robert Gebeloff, *Arbitration Everywhere, Stacking the Deck of Justice*, N.Y. TIMES, Nov. 1, 2015, at A1; See also Alexander J.S. Colvin, *The Metastasization of Mandatory Arbitration*, 94 CHI.-KENT L. REV. 3, 9 (2019) (finding that more than 50% private-sector nonunion workers have signed mandatory arbitration agreements).

113. Note that arguments against arbitration associated with the #MeToo movement focus on the disadvantage of arbitration's confidentiality. While the public have an interest in disclosing the perpetrators' identities, victims in these cases often tend to prefer confidentiality and express the desire to move on, according to plaintiffs' lawyers who spoke at the NYU Center for Labor and Employment Law and the American Arbitration Association Symposium on Addressing Challenges to Employment Arbitration held on October 25, 2019.

cases is beyond the scope of this Article, although mediation is often the first step after an employee files a sexual harassment claim.

## VI. CONCLUSION

Disputes can be resolved publicly in courts or privately through a myriad of tools such as arbitration, mediation, and their various combinations. A thorough analysis of dispute resolution mechanisms requires not only a clear understanding of the key elements and incentive structures that induce people to choose them, but also a broad appreciation of the underlying institutional and legal framework that may support or impede these desirable mechanisms.

This Article applied one such analysis to examine a puzzle in dispute resolution. Arb-Med, which flips the order of arbitration and mediation in Med-Arb, seems profoundly counterintuitive: Why would parties take the trouble to go through an arbitration and commit to go through another round of mediation?

A careful analysis of the structural differences between Med-Arb and Arb-Med uncovers parties' economic incentives to use Med-Arb, Arb-Med, and standalone arbitration. Under different circumstances, each mechanism may emerge as the most desirable.

After showing that both Med-Arb and Arb-Med are desirable hybrid mechanisms, this Article proceeded to examine the underlying legal framework in the United States. The analysis found that current U.S. federal law does not facilitate dispute resolution by these hybrid mechanisms. Med-Arb and Arb-Med face different legal hurdles when parties petition courts to specifically compel these hybrid dispute resolution processes or to enforce their outcomes under the FAA. This Article concluded by proposing two recommendations to strengthen the legal support for Med-Arb and Arb-Med.

This Article focused on Med-Arb and Arb-Med, since they are the two most frequently used hybrid mechanisms. The analysis in this Article can readily be extended and adapted to study a much broader class of dispute resolution mechanisms. For example, Med-Arb and Arb-Med mirror current trends in public dispute resolution. Med-Arb is similar to pretrial mediation, which American courts encourage and sometimes even mandate. Arb-Med is similar to appellate mediation in which parties settle after the trial court has ruled.

A careful analysis of dispute resolution mechanisms also piques the interest of imaginative institutional designers, who may ask: What can we do to further improve existing mechanisms? The analysis of Arb-Med, for example, points to ways to cut costs and improve

efficiency. During Arb-Med, parties put in costly efforts to argue their cases in first-stage arbitration even though they anticipate settling their dispute during second-stage mediation. Since such efforts are deadweight losses, institutional designers and parties themselves can improve the efficiency of Arb-Med by limiting wasteful investment in efforts during first-stage arbitration in Arb-Med. For example, arbitration centers or parties themselves can set a deadline to limit the maximum effort level during first-stage arbitration.

Taking this suggestion further, and notwithstanding potential due process concerns, Arb-Med with limits placed on first-stage arbitration can allow parties to quickly terminate a costly, adversarial process with finality so that they can focus on mediation. In other words, Arb-Med provides disputants with an opportunity to burn the bridge to an otherwise extremely costly dispute resolution process with finality so that they can commit themselves to search for better outcomes through mediation. By efficiently and carefully structuring their first-stage arbitration in Arb-Med, parties may be able to jointly choose outside options that will incentivize them to negotiate towards a mutually beneficial mediated settlement.<sup>114</sup>

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114. This is similar to a standalone mediation with outside options that parties themselves carefully choose. The first-stage arbitration provides a means for parties to make these outside options final and binding (assuming courts are willing to confirm and enforce such arbitral agreements under the principles of party autonomy and self-determination).

## APPENDIX: TOURNAMENT MODEL FOR ARBITRATION/MEDIATION

This appendix summarizes the adaptation of the rank-order tournament approach of Professors Edward P. Lazear and Sherwin Rosen to model adversarial arbitration and mediation.<sup>115</sup>

In the original tournament model, employees are paid according to their ordinal rank instead of their marginal outputs, with the winning employee taking a higher wage  $W$  and the losing one taking a lower wage  $w < W$ ; employees simultaneously put in costly efforts to increase their probability of winning the wage tournament.

By analogy, in the setting of adversarial dispute resolution, disputants put in costly efforts to win the case. Two further assumptions are in order: (1) when A wins, A's winning prize is  $W_A$  and B's losing prize is  $w_B = 100 - W_A$ ; (2) when B wins, B's winning prize is  $W_B$  and A's losing prize is  $w_A = 100 - W_B$ .

Party  $i = A$  or  $B$  chooses effort level  $\mu_i$  at cost  $C(\mu_i)$ . This function  $C(\cdot)$  will take on different forms, representing different cost functions for arbitration and mediation. However, these cost functions are assumed to satisfy the following conditions:  $C' > 0$  and  $C'' > 0$ . These two conditions state that cost rises with the effort level at an increasing rate.

The chosen effort levels interact to determine the winning probabilities in the following way. Let  $q_A$  be a measure of the quality of A's argument, where

$$q_A = \mu_A - (1/2)\varepsilon,$$

and similarly let  $q_B$  be a measure of the quality of party B's argument with

$$q_B = \mu_B + (1/2)\varepsilon,$$

where  $\varepsilon$  is a random variable centered at 0 and distributed according to a well-defined, smooth cumulative distribution function  $G(\varepsilon)$  such that  $G(0) = 1/2$  with probability density function  $g(\varepsilon) = dG(\varepsilon)/d\varepsilon > 0$ . For any given effort levels  $\mu_A$  and  $\mu_B$ , the random variable  $\varepsilon$ , centered around 0, puts A in a more favorable light when  $\varepsilon < 0$  and puts B in a more favorable light when  $\varepsilon > 0$ .

Party A wins whenever  $q_A > q_B$ ; B wins whenever  $q_A < q_B$ ; and a winner is chosen randomly whenever  $q_A = q_B$ .<sup>116</sup>

115. Edward P. Lazear & Sherwin Rosen, *Rank-Order Tournaments as Optimum Labor Contracts*, 89 J. POL. ECON. 841 (1981).

116. As  $\varepsilon$  is a random variable drawn from a smooth distribution, the probability of drawing the  $\varepsilon$  that leads to exactly  $q_A = q_B$  is almost surely 0.



After the two parties have simultaneously chosen their effort levels  $\mu_A$  and  $\mu_B$ , nature reveals the random variable  $\varepsilon$ , and the probability that A wins is

$$\begin{aligned} Pr(A \text{ wins}) &= Pr(q_A > q_B) = Pr(\mu_A - (1/2)\varepsilon > \mu_B + (1/2)\varepsilon) \\ &= Pr(\varepsilon < \mu_A - \mu_B) = G(\mu_A - \mu_B). \end{aligned}$$

Given this, party A chooses effort level  $\mu_A^*$  to solve the following problem:

$$\begin{aligned} &\max_{\mu_A} U(W_A)Pr(A \text{ wins}) + U(w_A)(1 - Pr(A \text{ wins})) - C(\mu_A) \\ &= \max_{\mu_A} U(W_A)G(\mu_A - \mu_B) + U(w_A)(1 - G(\mu_A - \mu_B)) - C(\mu_A). \end{aligned}$$

Taking the first-order condition with respect to  $\mu_A$ , the equilibrium choice  $\mu_A^*$  must satisfy:<sup>117</sup>

$$[U(W_A) - U(w_A)]g(\mu_A^* - \mu_B) = C'(\mu_A^*).$$

Similarly, party B chooses equilibrium effort level  $\mu_B^*$  that satisfies:

$$[U(W_B) - U(w_B)]g(\mu_A - \mu_B^*) = C'(\mu_B^*).$$

The two equations above jointly determine  $\mu_A^*$  and  $\mu_B^*$ . The equilibrium effort levels correspond to equilibrium costs  $C_A = C(\mu_A^*)$  and  $C_B = C(\mu_B^*)$  for party A and party B, respectively.

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117. Following Lazear & Rosen, *supra* note 115, the distribution function  $g(\varepsilon)$  is assumed to be well-behaved to guarantee the existence of interior solutions to maximization problems throughout the analysis.

