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A bill currently pending in Congress would render unenforceable mandatory arbitration clauses in all employment contracts. Some perceive these provisions as employer efforts to deprive employees of important legal rights. Company CEOs are firm employees, and, unlike most other firm employees, they can actually negotiate their employment contracts, very often with attorney assistance. Moreover, many CEO employment contracts are publicly available, so they can be examined empirically. In this paper, we ask whether CEOs bargain to include binding arbitration provisions in their employment contracts. After exploring the theoretical arguments for and against including such provisions in these agreements, we use a large sample of CEO employment contracts to test the several different hypotheses for including such provisions. We find that only about one half of CEO employment contracts in our sample include such provisions. What factors might determine whether CEOs agree to arbitrate their employment disputes with their companies? We find that CEOs that receive a higher percentage of long-term incentive pay as a fraction of their total pay, that work in industry sectors that are undergoing greater amounts of change, and that have lower long-term profitability are statistically significantly more likely to have arbitration provisions in their employment contracts. The importance of contextual factors for arbitration clauses in CEO contracts indicates that regulation of arbitration clauses in employment contracts should be more nuanced than that found in pending legislation.

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Arbitration Clauses in CEO Employment Contracts: An Empirical and Theoretical Analysis

*Randall Thomas, Erin O'Hara & Kenneth Martin**

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INTRODUCTION

Both executive compensation[1] and the use of arbitration provisions in employment contracts[2] are hot topics in legal scholarship today. The executive compensation debate revolves around the fight between shareholders and CEOs over how to divide up the firm's profits. Critics of the current regime argue that American CEOs are overpaid because they can dictate the terms of their employment to boards of directors,[3] while defenders of the system see only a few bad apples in the barrel.[4]

In the employment setting, another argument rages over the relative power of employees versus employers to select the forum where they decide their disputes.[5] This issue is currently one of the major concerns in the area of arbitration, where scholars have debated whether employment agreements are contracts of adhesion that include arbitration provisions in order to take away important substantive and procedural rights from employees.[6]

As employees, CEOs actively negotiate their employment contracts, often with the assistance of attorneys. The CEO of the corporation therefore is an important player in both of these disputes: on the one hand, she has an important interest as an employee in how she and the company resolve any potential arguments; on the other hand, wearing her hat as the CEO, she bargains with the board of directors of her firm to try to get what she wants in her own employment arrangements. CEO employment contract provisions thus shed light not only on disputes between employees and employers, but

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1. *See, e.g.*, LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 1 (2004) ("Executive pay has long attracted much attention from investors, financial economists, regulators, the media, and the public at large.").

2. *See, e.g.*, David Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 STAN. L. REV. 1557, 1558 (2005) (stating that the employment arbitration provisions and the Supreme Court's *Gilmer* decision "spawned a debate that resulted in a small Amexandrian library of law review articles, a series of Supreme Court decisions, hundreds of federal and state court opinions, and various state and federal legislative proposals").

3. The best example of this argument is BEBCHUK & FRIED, *supra* note 1, at 80–87.

4. *E.g.*, John E. Core, Wayne R. Guay & Randall S. Thomas, *Is U.S. CEO Compensation Inefficient Pay Without Performance?*, 103 MICH. L. REV. 1142, 1181 (2005) (reviewing BEBCHUK & FRIED, *supra* note 1).

5. *See, e.g.*, 14 Penn Plaza LLC v. Pyett, 129 S. Ct. 1456 (2009) (deciding whether employers can require union members to arbitrate ADEA claims).

6. Sherwyn et al., *supra* note 2, at 1563.

also on the relationship between boards of directors and corporate executives.

In this Article, we seek to explore both relationships by focusing on the presence of arbitration provisions in employment contracts. Critics of such provisions claim that companies prefer arbitration and therefore use contracts of adhesion to force employees to give up their rights to litigate job-related disputes. The strong version of the contracts-of-adhesion theory predicts that arbitration provisions will appear in all employment contracts because arbitration is always a better forum for the company. A weaker claim is that while arbitration is preferable in some circumstances, and litigation in others, many employees lack the bargaining power to seek the right to litigate when it is the optimal choice. The arbitration provisions of CEO employment contracts enable us to look at cases in which employees with bargaining power negotiate meaningfully over where to resolve their disputes. This helps inform us about the overall desirability of arbitration as an alternative to litigation.

CEO employment contracts also cast light on the current executive compensation debate and its two main competing theories—"board capture theory" and "optimal contracting theory." Board capture theory claims that CEOs dictate the terms of their employment in negotiations with weak and pliant boards of directors.[7] In terms of arbitration clauses, board capture theory would predict that CEOs will get what they want from their boards of directors. We would therefore expect that measures of CEO power, such as whether boards are weak or whether CEOs have longstanding relationships with their board, would be important determinants of the presence of arbitration provisions.

Under optimal contracting theory, the terms of CEO employment contracts should be dictated solely by economic variables that reflect the demand for labor, such as firm size, risk, performance, and growth opportunities.[8] If this theory is correct, we would expect these variables to be significant determinants of arbitration provisions in these contracts, and other factors such as board composition or type of CEO to be insignificant.

We use the theories underlying both of these debates to generate a series of testable hypotheses about arbitration provisions in CEO employment contracts. Taking a large sample of actual CEO

7. *See generally* BEBCHUK & FRIED, *supra* note 1.

8. John E. Core, Robert W. Holthausen & David F. Larcker, *Corporate Governance, Chief Executive Officer Compensation, and Firm Performance*, 51 J. FIN. ECON. 371, 375 (1999); Keryn Chalmers, Ping-Sheng Koh & Geof Stapleton, The Determinants of CEO Compensation: Rent Extraction or Labor Demand? 6–7 (Jan. 2006), *available at* http://ssrn.com/abstract=460040.

employment contracts, we then check to see if they do contain such provisions and, if so, try to explain why. Our first important empirical finding is that only about one-half of the contracts in our sample contain arbitration provisions. This contradicts any theory that predicts that employment contracts should always contain, or always not contain, such a provision. On these grounds, we find cause to question the strong version of the contracts of adhesion claim in the employment arbitration context.

Having found that arbitration clauses are not universally used, we next formulate a series of hypotheses about why CEOs might bargain to include, or be willing to include, arbitration provisions in their employment agreements with their firms. We use our sample of CEO employment contracts to test these various hypotheses to determine which ones are supported by the evidence. Using both univariate and multivariate analyses, we find strong and statistically significant results that show CEO employment contracts are more likely to include arbitration provisions in three different situations, all of which reflect economic variables. First, we find that arbitration provisions are more likely when the CEOs receive a larger percentage of their total compensation in long-term incentive-based pay. We posit that in this situation, arbitration enables the parties to select a decisionmaker who is an expert in the compensation area, and who therefore will be better able to calculate the value of a complex pay package and interpret the potentially difficult contractual terms governing it.

Next, we find that CEOs in industries that are experiencing rapid levels of change, such as mergers, acquisitions, bankruptcies, or liquidations, are more likely to seek arbitration provisions in their employment contracts. We argue that CEOs at these firms may prefer arbitration because they perceive it to be a speedier way of resolving disputes. In industries undergoing rapid transformations, a quick resolution of disputes is important because the firm's days of existence as an independent entity may be numbered.

Third, our analysis indicates that CEOs who work at less profitable firms are more likely to include arbitration provisions in their employment contracts. We believe that in these situations the parties are more concerned about the costs of litigation. They perceive that arbitration is less costly, and reducing costs is very important at a poorly performing firm. An alternative hypothesis is that when there are objectively verifiable adverse conditions surrounding the firm, the parties signal their commitment to the relationship by selecting the less adversarial process of arbitration over litigation.

Tying in these results with our earlier discussion of the use of arbitration provisions in employment contracts, our study indicates that the presence of arbitration clauses turns on economic factors. In the context of the contracts-of-adhesion theory, we conclude that while most employees are unable to bargain for arbitration when those nuanced factors indicate that it is desirable, a flat ban on arbitration clauses in all employment contracts may be too blunt a policy tool. Instead, regulatory policy for employment contracts generally might attempt to mimic bargained-for employment arbitration by preserving particular types of employment claims for courts while enabling others to proceed to arbitration.

Turning to the executive compensation debate, we find no evidence that measures of CEO power are correlated with the use or absence of arbitration provisions. Instead, only economic variables that reflect the demand for labor are significant explanatory variables for these provisions. This empirical finding is consistent with optimal contracting theory.

The remainder of this Article is structured as follows. Part I provides an overview of the CEO employment contract negotiation process and the parties' possible positions regarding arbitration. Part II examines the scholarship on regulating binding arbitration clauses in employment contracts. It begins by reviewing prior legislation and literature on the subject, then it lays out the theoretical justifications for choosing arbitration (or, alternatively, for preferring litigation) of disputes under these agreements. Part III analyzes CEO employment contracts in light of the ongoing debate over whether CEOs have effectively captured corporate boards of directors or whether boards optimally contract to set their executives' terms of employment. Part IV describes our sample of contracts and some additional variables that we collect to conduct our empirical analysis. Finally, in Part V, we first formulate and then test a number of different hypotheses about when arbitration provisions are most likely to appear in CEO employment contracts. Our tests begin with univariate statistical analyses and then proceed to multivariate logistic regression analysis. We conclude with some brief observations.

I. NEGOTIATING CEO EMPLOYMENT CONTRACTS

Corporate CEOs generally have written employment contracts with their firms.[9] Sometimes these contracts are negotiated when the CEO joins the company; other times they are renewed after the CEO has been employed by the company for several years, or after an executive is promoted internally from a lower-ranking management position. Whenever any of these events occur, the company and the CEO need to negotiate the terms of the employment contract and of the executive's compensation package.

That process often works as follows. One of the parties makes an initial proposal, with the main economic terms of its offer set forth in a term sheet.[10] The term sheet, or its oral equivalent, sets forth the proposed salary, target bonus, equity participation in the company (stock options, restricted stock, and any long-term incentive plans), severance package, change-in-control protections, benefits (health plans, supplemental executive retirement plan, deferred compensation, etc.), and standard perquisites. Any changes to these items are then negotiated between the executive and the company's representatives, usually the chairperson and members of the compensation committee, subject to later approval by the full board of directors.

Once the final term sheet is completed, counsel for the parties negotiate the language and legal terms of the employment contract.[11] When the lawyers sit down to the bargaining table to negotiate the contract's language, they begin the process of filling in the details not covered by the earlier substantive agreement. While details of the economic terms can be very important in these negotiations,[12] our focus here is on the arbitration clause, if one exists, in the contract. Keeping in mind that every negotiation is different, we offer a few generalizations.

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9. This Part draws from prior work by one of the authors. Stewart J. Schwab & Randall S. Thomas, *An Empirical Analysis of CEO Employment Contracts: What Do Top Executives Bargain For?*, 63 WASH. & LEE L. REV. 231, 236–40 (2006).

10. The terms of the initial offer may be determined by the company's human resources department or by the CEO. *Id.* at 236 & n.7.

11. In some cases, a term sheet is not used, and the parties go directly to the contract negotiations as the first written expression of the proposed deal. However, the main economic terms are agreed to orally prior to the drafting, and the remainder of the process is very similar to situations where a term sheet is used. *Id.* at 236–37 & n.8.

12. For example, the principals may agree to a two-year severance package without specifying what compensation payments and benefits are to be continued during that time period. From the executive's perspective, it is important that the contract cover not only salary payments, but also potential bonus payments (and their computation), stock option vesting, benefits, and other potential continuing financial support.

First, incumbent CEOs generally have stronger negotiating positions than incoming CEOs for many reasons, including the fact that they may have already experienced some degree of success in running the company and have an ongoing relationship with the incumbent board of directors. There are two types of incoming CEOs: inside officers who have been promoted, and executives who have been brought in from outside the company. Between these two types of new CEOs, outsiders normally have more leverage in their negotiations than candidates who are promoted from within the company. These differences in negotiating strength significantly affect both the economic terms and the key legal components of the final contract. The final terms depend on both the relative bargaining power of the parties and the importance of the clause.

The presence or absence of an arbitration clause is a significant item that the parties might negotiate. Companies will want to arbitrate disputes to keep things private and avoid adverse publicity over a messy termination. Normally, employees want to preserve their right to a jury trial, calculating that a jury of their peers would be more sympathetic to them than to the company firing them. However, CEOs may have good reason to believe that juries will not empathize with their compensation demands, as the amounts involved may seem excessive to most members of the public. This may lead executives to favor arbitration generally, although they will still carefully negotiate terms such as the selection process for the arbitrators and their right to appeal from an adverse decision.

II. DO FIRMS IMPOSE ARBITRATION ON EMPLOYEES THROUGH CONTRACTS OF ADHESION?

In the employment law literature, there is an ongoing debate about whether companies should be permitted to force employees through contracts of adhesion to arbitrate all disputes that they have with their firms. In this Part, we lay out the arguments that surround this issue and show why they may be less important in the context of CEO employment contracts. We then assume a world of equal bargaining power and ask why workers and companies might nonetheless want to arbitrate disputes, or alternatively, why they might prefer to litigate them. Since this assumption closely approximates the CEO's situation in the firm, our answers show why CEO employment contracts may inform the more general debate about the desirability of arbitration in employment contracts.

A. *Worker Rights and Arbitration Provisions in Employment Contracts*

Congress enacted the basic provisions of what is now the Federal Arbitration Act ("FAA") in 1925. The FAA mandates that both state and federal courts enforce arbitration agreements, with limited exceptions.[13] It further mandates that the courts also confirm and/or enforce arbitration awards at the conclusion of arbitration, again with limited exceptions.[14] For several decades after the enactment of the FAA, however, employment agreements did not contain arbitration clauses. In fact, many assumed that employment contracts were not subject to the FAA because the FAA covered contracts "evidencing a transaction involving commerce,"[15] and "commerce" was defined under the FAA to include all interstate and international commerce except "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce."[16] Employee/employer disputes were often arbitrated pursuant to collective bargaining agreements negotiated between employers and employee unions, but those arbitrations occurred pursuant to the National Labor Relations Act rather than the FAA.[17] Moreover, even if the FAA had been understood to permit arbitration of individual employment disputes, written individual employment contracts were rare until a few decades ago.[18]

During the 1970s, however, courts began to hold that employment contracts fell within the scope of the FAA.[19] Today, arbitration provisions in individual employment contracts are unambiguously within the purview of the FAA, with the exception of the transportation employees listed in the FAA text quoted above. If an employment agreement is silent on dispute resolution, then the parties will be assumed to want their disputes resolved in court. The parties' assumed preference is consistent with some empirical evidence. In contracts of adhesion, which are drafted by one party and imposed on the other, one study indicates that more than 75 percent of

13. Federal Arbitration Act, 9 U.S.C. § 2 (2010) (stating that written agreements to arbitrate "shall be valid, irrevocable, and enforceable save upon such grounds as exist at law or in equity for the revocation of any contract"). The application of the FAA to state courts was judicially imposed some time after the enactment of the FAA. STEPHEN J. WARE, PRINCIPLES OF ALTERNATIVE DISPUTE RESOLUTION §§ 2.6–2.8 (2d ed. 2007).

14. 9 U.S.C. §§ 9–11.

15. *Id.* § 2.

16. *Id.* § 1.

17. Stephen J. Ware, *Employment Arbitration and Voluntary Consent*, 25 HOFSTRA L. REV. 83, 91–94 (1996) (describing legal history of collective bargaining agreement arbitration).

18. *Id.* at 95–96.

19. *Id.* at 98–99.

consumer contracts and 90 percent of general employment contracts contain arbitration provisions.[20] In contrast, a study of contracts filed with the Securities and Exchange Commission found virtually no arbitration clauses in credit commitments, underwriting agreements, pooling and servicing agreements, security agreements, and trust agreements formed between U.S. parties.[21]

Critics of the increasing use of arbitration clauses in employment contracts provide several arguments against the practice. They claim that employment contracts are generally adhesion contracts that cannot be negotiated by the employee.[22] Arbitration can take away many of the procedural and substantive rights available to the employee; for example, the use of arbitration can affect the applicable costs, recoverable damages, statute of limitations, burdens of proof, and availability of evidentiary discovery.[23] Moreover, many employment disputes involve statutory public rights, such as the right against discrimination, and yet arbitration does not provide for public accountability of arbitration decisions or the development of legal precedent for future litigants.[24] In the strong form of the contracts of adhesion claim, employers always want to arbitrate employment disputes with their employees.

Proponents of employment arbitration argue that arbitration tends to be both faster and less expensive for employees.[25] Empirical studies of employment arbitration have not yet resolved the issue of whether employees fare worse in arbitration than they do in litigation.[26] Nevertheless, the controversy has generated legislation

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20. Theodore Eisenberg et al., *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts* 15 (Cornell Law Sch. Legal Studies Research Paper No. 08-017; N.Y. Univ. Law & Econ. Research Paper No. 08-28, 2007), *available at* http://ssrn.com/abstract=1076968.

21. Theodore Eisenberg & Geoffrey P. Miller, *The Flight from Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in the Contracts of Publicly Held Companies*, 56 DEPAUL L. REV. 335, 351 (2007); *see also* William W. Park, *Arbitration in Banking and Finance*, 17 ANN. REV. BANKING L. 213, 215–16 (1998) (listing reasons banks historically have preferred courts to arbitration, but detecting a slight recent trend toward experimenting with arbitration).

22. *See* Sherwyn et al., *supra* note 2, at 1563 (describing policy debate).

23. *Id.*

24. *Id.*

25. *Id. See generally* Cynthia Estlund, *Between Rights and Contract: Arbitration Agreements and Non-Compete Covenants as a Hybrid Form of Employment Law* (N.Y. Univ. Law Sch., Pub. Law Research Paper No. 06-20, 2006), *available at* http://ssrn.com/abstract=911284 (explaining why these competing concerns call for conditional waivability in the context of mandatory employment arbitration provisions).

26. *See generally* Sherwyn et al., *supra* note 2 (critically analyzing existing empirical studies). Empirical studies comparing win/loss rates, damages amounts, and/or repeat player effects include Lisa B. Bingham, *Employment Arbitration: The Repeat Player Effect*, 1 EMP. RTS. & EMP. POL'Y J. 189 (1997); Lisa B. Bingham, *Is There a Bias in Arbitration of Nonunion*

pending in Congress that would prohibit the enforcement of mandatory arbitration clauses in all employment contracts.[27]

Whatever the merits of the debate over employment arbitration generally, the concerns of employer overreaching are much weaker for CEO employment contracts, the subject of this Article. CEOs have more bargaining power than do workers on the lower rungs of the corporation, and they are much more likely to be represented by lawyers who help them negotiate the individual employment provisions.[28] There is evidence that this additional bargaining power enables CEOs to avoid mandatory arbitration clauses in at least some cases in which the clauses might be undesirable for them. Although as many as 79 percent of surveyed companies report using employment arbitration,[29] less than 42 percent of studied companies included arbitration clauses in their CEO employment contracts.[30] If these reports are accurate evidence, then CEOs might instead use their enhanced bargaining power to obtain desired benefits from arbitration.

Other empirical studies have focused on CEO employment contracts. For example, at least one study focuses on the extent to which the presence of a lawyer as negotiating agent influences the

Employment Disputes? An Analysis of Actual Cases and Outcomes, 6 INT'L J. CONFLICT MGMT. 369 (1995); Lisa B. Bingham, *On Repeat Players, Adhesive Contracts, and the Use of Statistics in Judicial Review of Employment Arbitration Awards*, 29 MCGEORGE L. REV. 223 (1998); Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RESOL. 559 (2001); Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO ST. J. ON DISP. RESOL. 777 (2003); William M. Howard, *Arbitrating Claims of Employment Discrimination*, DISP. RESOL. J., Oct.–Dec. 1995, at 40; Lewis L. Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29 (1998); Theodore Eisenberg & Elizabeth Hill, *Employment Arbitration and Litigation: An Empirical Comparison* (N.Y. Univ. Law Sch., Pub. Law Research Paper No. 65, 2003), *available at* http://ssrn.com/abstract_id=389780.

27. Arbitration Fairness Act of 2007, S. 1782, 110th Cong. § 4 (2007), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:s1782is.txt.pdf. Note that this Act would still enable parties to decide, after the dispute arises, that they wish to arbitrate their disputes. At that point, the decision is more likely to be fully informed.

28. Indeed, some have claimed that CEOs' interests are far better represented than firms' interests in contract negotiations. For a survey of the literature and an empirical study of differences in contract terms for CEOs represented by "super-lawyer" agents, see generally Shiva Rajgopal et al., Do Professional Negotiators Extract Rents on Behalf of Their Client CEOs? (July 2007) (unpublished manuscript, on file with authors).

29. *Alternative Dispute Resolution: Most Large Employers Prefer ADR as Alternative to Litigation, Survey Says*, 93 Daily Lab. Rep. (BNA) A-4 (May 14, 1997).

30. Schwab & Thomas, *supra* note 9, at 257 (finding that 41.6 percent of contracts opted for arbitration).

substantive terms of the contract.[31] Another study notes that fewer than half of S&P 500 firms have written contracts with their CEOs and, as a result, investigates the factors that influence the likelihood that CEO employment terms will be reduced to writing.[32] Firms with less independent boards, poor recent operating performance, CEOs hired from outside the company, participation in homogenous industries, lower stock market volatility, and/or lower industry-wide survival rates are all more likely to enter into a written employment contract with their CEOs than are other firms.[33]

A third study investigates common substantive provisions found in CEO employment contracts.[34] That study finds that the most common contract durations were three or five years,[35] and the contracts very often limited early termination of the CEO to "just cause" situations, the most common of which were willful misconduct, moral turpitude, failure to perform duties, breach of fiduciary duties, and gross misconduct.[36] About two-thirds of the contracts included noncompetition clauses that restricted the CEO's ability to work for a competitor firm for some period of time after leaving the company.[37] This third study is the only one that even looks for the presence of arbitration clauses,[38] though it explores neither the predictors of their use nor the particular contours of the clauses themselves. To our knowledge, we are the first to undertake such an investigation.

A final set of studies have examined the use of arbitration clauses in commercial disputes. In international commerce, arbitration experts estimate that approximately 90 percent of international commercial contracts contain arbitration clauses.[39] In contrast, a study of contracts filed with the Securities and Exchange Commission found virtually no arbitration clauses in credit commitments, underwriting agreements, pooling and servicing

31. Rajgopal et al., *supra* note 28.

32. Stuart L. Gillan, Jay C. Hartzell & Robert Parrino, *Explicit vs. Implicit Contracts: Evidence from CEO Employment Agreements* 1 (July 4, 2008), *available at* http://ssrn.com /abstract=687152.

33. *Id.* at 23–25.

34. Schwab & Thomas, *supra* note 9.

35 *Id.* at 247.

36 *Id.* at 248–49.

37 *Id.* at 254.

38 *Id.* at 257–58.

39. KLAUS PETER BERGER, INTERNATIONAL ECONOMIC ARBITRATION 8 n.62 (1993); Alessandra Casella, *On Market Integration and the Development of Institutions: The Case of International Commercial Arbitration*, 40 EUR. ECON. REV. 155, 156–57 (1996); *Commentary*, *in* TOWARDS A SCIENCE OF INTERNATIONAL ARBITRATION: COLLECTED EMPIRICAL RESEARCH 57, 59 (Christopher R. Drahozal & Richard W. Naimark eds., 2005) [hereinafter TOWARDS A SCIENCE].

agreements, security agreements, and trust agreements formed between U.S. parties.[40] These studies seem to show that context matters in the selection of arbitration clauses.

B. Why Arbitrate Employment Contract Disputes?

Let us imagine that both parties negotiating a contract have equal bargaining power—as may be the case with CEOs and their employers. When might the parties opt for arbitration? Many of the rationales for arbitration or litigation cannot be studied empirically. But this Section and the next nevertheless provide the reader with a general sense of some of the factors that can influence contracting parties' decisions about how to handle future disputes.

First, parties might opt for arbitration in order to have their disputes resolved by individuals with technical, industry, or (in the case of CEOs) compensation expertise.[41] Courts typically possess expertise in legal doctrine, but they are generalists and thus often know little to nothing about trade usage or other commercial features surrounding the parties' contract. If the parties care more about business expertise than they do about legal expertise, they might opt for arbitration. Parties who place strong emphasis on expertise might also specify that any arbitrator ultimately chosen have a particular background or type of experience.[42] The demand for trade expertise might increase with the frequency and importance of vague or complicated terms.

Second, parties might choose arbitration in order to keep disputes and the information relevant to them secret. Arbitration is more private than litigation because case-relevant evidence is not submitted to juries, court clerks, government officials, the press, or other uninvited third parties, and arbitration usually concludes

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40. Eisenberg & Miller, *supra* note 21; *see also* Park, *supra* note 21, at 232–37 (discussing arbitration in the securities context).

41. *See* PRICEWATERHOUSECOOPERS & SCH. OF INT'L ARBITRATION, QUEEN MARY, UNIV. OF LONDON, INTERNATIONAL ARBITRATION: CORPORATE ATTITUDES AND PRACTICES 2008, at 2 (2008), http://www.pwc.co.uk/pdf/PwC_International_Arbitration_2008.pdf (survey of lawyers involved in transborder transactions listing "depth of expertise of arbitrators" as one of the top reasons for choosing arbitration).

42. *See* Christopher R. Drahozal, *Arbitration Clauses in Franchise Agreements: Common (and Uncommon) Terms*, 22 FRANCHISE L.J. 81, 82 (2002) (finding, in a survey of franchise contracts, that some arbitration provisions required that the arbitrator have experience in franchising law, some required experience in franchise arbitration, and some required experience in either the franchise industry or the particular line of business in which the franchise was engaged).

without a written opinion.[43] Although no legal rule requires individuals to keep knowledge of an arbitrated matter confidential,[44] some arbitration associations impose a duty of confidentiality on the arbitrators.[45] Parties can, and often do, contractually promise to keep arbitration-relevant information confidential. Thus, firms that are more dependent on confidential information (such as research and development or trade secrets) might prefer to maximize their ability to resort to arbitration. Other firms may just prefer not to air their dirty laundry in public.

Third, parties might prefer arbitration as a cheaper and quicker form of dispute resolution. Historically, arbitration involved less discovery, fewer motions, less elaborate trials, and judgments without written opinions. More recently, however, arbitration proceedings have increasingly begun to look more like formal court proceedings. Indeed, a recent survey of contracting parties indicated that arbitration is no longer perceived to be a relatively cheap form of dispute resolution.[46] That said, however, parties can agree to informal and quick arbitration, and they can threaten to fire arbitrators who will not comply with their wishes.[47] Where it matters, then, arbitration can be both cheaper and quicker than litigation. More generally, parties can customize the procedural rules that will apply to their dispute resolution if they opt for arbitration.

Fourth, parties might prefer arbitration as a less adversarial form of dispute resolution. Informal dispute resolution makes it easier for the parties to continue their relationship while their dispute is being resolved.[48] Because arbitration is quicker, it may not entail the intensive involvement of lawyers and may better enable creative compromise solutions. Thus, parties in long-term relationships might prefer to resolve their disputes outside of court.[49]

43. Amy J. Schmitz, *Untangling the Privacy Paradox in Arbitration*, 54 U. KAN. L. REV. 1211, 1215–17 (2006).

44. *Id.* at 1218.

45. *Id.* at 1219 n.48 (listing the JAMS Employment Arbitration Rules and Procedures and the National Arbitration Forum Code of Procedure as examples).

46. *See* Christian Bühring-Uhle, *A Survey on Arbitration and Settlement in International Business Disputes*, *in* TOWARDS A SCIENCE, *supra* note 39, at 25, 33 (51 percent of those surveyed thought that arbitration yields no cost advantage over litigation).

47. ERIN A. O'HARA & LARRY E. RIBSTEIN, THE LAW MARKET 93–94 (2009).

48. *See* DAVID B. LIPSKY & RONALD L. SEEBER, CORNELL/PERC INST. ON CONFLICT RESOLUTION, THE APPROPRIATE RESOLUTION OF CORPORATE DISPUTES: A REPORT ON THE GROWING USE OF ADR BY U.S. CORPORATIONS 17 (1998), *available at* http://digitalcommons.ilr.cornell.edu/icrpubs/4 (stating that 41.3 percent of companies surveyed used arbitration because it "preserves good relationships").

49. More recently, however, arbitration has become more adversarial. THOMAS E. CARBONNEAU, CASES AND MATERIALS ON THE LAW AND PRACTICE OF ARBITRATION 13 (3d ed.

Fifth, some parties prefer to avoid juries. Some fear that their wealth might create an excuse for jurors to rule against them. Others engage in business practices that will make jurors skeptical. And still others anticipate that their disputes might involve complicated scientific or mathematical concepts that are difficult for jurors to fully understand. Juries can be avoided in the courtroom, too, because jury-waiver provisions in contracts are enforceable in almost all the states.[50] But if the parties are worried about having to litigate claims in the few states that will not enforce jury waivers, or if the parties want to avoid juries and obtain other benefits that arbitration can provide, then they are more likely to opt for arbitration.[51]

Sixth, arbitration better enables the parties to customize monetary damage awards.[52] Liquidated damages provisions are more likely to be respected, as are contract clauses that preclude the recovery of punitive damages or otherwise limit recoverable damages.[53] Similarly, the parties might be better able to shift the cost of the prevailing party's attorneys' fees onto the losing party by opting for arbitration.[54]

Seventh, arbitration can better enable contracting parties to choose their own governing laws. To be sure, choice-of-law provisions are commonly enforced in courts too, but court enforcement of choice-of-law clauses is typically limited by a public policy exception that can create costly uncertainty for parties who care that a particular law be applied or avoided.[55] Arbitration also better enables parties to choose private law to resolve their disputes.[56]

2002). As a result, parties who desire less adversarial dispute resolution might have to contract for it, either by selecting an arbitration association committed to less adversarial dispute resolution, or through customized procedures, timing of dispute resolution, etc.

50. Predispute jury waivers are enforceable everywhere in the United States except Georgia and California. Henry S. Noyes, *If You (Re)Build It, They Will Come: Contracts to Remake the Rules of Litigation in Arbitration's Image*, 30 HARV. J.L. & PUB. POL'Y 579, 604 n.107 (2007).

51. Interestingly, some company franchise agreements include an arbitration provision but also provide that the franchisee instead can sue in courts, provided that the franchisee waives any right to a jury trial or to punitive damages. *See* Christopher R. Drahozal & Quentin R. Wittrock, Is There a Flight from Arbitration? 7–8 n.24 (Aug. 11, 2008), *available at* http://ssrn.com/abstract=1147697 (quoting language from Baskin Robbins and Dunkin' Donuts standard franchise agreements).

52. O'HARA & RIBSTEIN, *supra* note 47, at 94.

53. *See, e.g.*, Christopher R. Drahozal, *"Unfair" Arbitration Clauses*, 2001 U. ILL. L. REV. 695, 737–38 (finding, in a study of seventy-five franchise agreements, that about 75 percent of contracts opting for arbitration also precluded relief for punitive damages).

54. *Id.* at 735.

55. *See, e.g.*, O'HARA & RIBSTEIN, *supra* note 47, at 40–41 (describing the lack of predictability of the public policy exception to the enforcement of choice-of-law clauses).

56. *See* Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115, 126 (1992) (stating that Diamond Dealers Club

As mentioned above, the current use of arbitration clauses in CEO employment contracts might represent an equilibrium situation, but it might instead represent a point along the path toward routine use of arbitration. Even in the latter situation, however, the salience of potential disputes could be an indicator of the relative timing of the switch from courts to arbitration. Thus, as an eighth and final predictor of the use of arbitration, parties that anticipate a greater likelihood of disputes may be more likely to opt for arbitration. In the context of CEO employment contracts, a greater likelihood of employment disputes might be associated with such features as (1) a longer contract term, (2) industries with greater merger or turnover activity, (3) firms with poor or erratic performance, (4) firms that have experienced protracted disputes with former CEOs, (5) firms with more independent boards, and (6) contracts with vaguer performance terms.

C. Why Might the Parties Prefer to Litigate?

Alternatively, in our world of equal bargaining power, the contracting parties might prefer litigation to arbitration for at least four reasons. First, parties who anticipate a need for injunctive or preliminary remedies may ultimately need to resort to courts to obtain easily enforceable orders.[57] If so, then the parties might decide simply to stay in court rather than involve both courts and arbitrators in the resolution of their disputes. In particular, parties who need to enforce intellectual property rights, freeze assets, or otherwise act to preserve the availability of witnesses, evidence, or confidentiality might prefer to stick with courts. Thus, we might expect to see litigation carve-outs for these types of issues even in contracts that otherwise provide for arbitration.

Second, parties who seek legal or precedential expertise (as opposed to industry or technical expertise) might prefer courts to arbitration. Lenders and other commercial parties might wish to resolve their disputes in New York courts, corporate officers and

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arbitration "resolves disputes on the basis of trade customs and usages"); Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765, 1772 (1996) (describing the National Grain and Feed Association's substantive rules). Outside of industry-specific arbitration, however, relatively few contracting parties appear to want transnational laws applied to their disputes. *See* Int'l Chamber of Commerce, *International Court of Arbitration Bulletin* 16/1, at 11 (2005) (reporting that only eight of the 561 contracts associated with new arbitration filings in 2004 requested transnational rules).

57. *See* Drahozal & Wittrock, *supra* note 51, at 8–9 & n.33 (discussing arbitration in franchise agreements).

directors might prefer that some disputes be resolved in Delaware courts, etc. Because arbitrators are not chosen until after the dispute arises and are typically chosen jointly from among many possible options (or assigned by the dispute resolution association), the parties might be more assured of getting the legal expertise they desire by instead opting for a particular court.[58]

Third, if a firm has stronger bargaining power relative to its CEO, it might insist on court resolution of their disputes in cases in which the firm makes a significant contribution to its home state's economy. The smaller the state, and the larger the company, the greater the likelihood that the courts would be expected to exhibit a hometown bias. Put simply, large firms in small states provide a critical employment and tax base to the state, and the judges may be reluctant to decide cases that could have negative effects on those companies. To the extent that the company can dictate the dispute resolution forum, these firms will choose courts. Conversely, where CEOs possess relatively stronger bargaining power, they might be more likely to insist on arbitration at larger firms in smaller states.

Finally, firms might prefer courts to arbitration in those contexts in which potential liabilities are massive. For "bet the company" stakes, arbitration appears to pose more risk because courts are, on the whole, unable to scrutinize an arbitrator's decisions.[59] With court resolution of these very large-scale disputes, more meaningful appeal (and possible overturning of the verdict) is possible. However, "bet the company" litigation is unlikely to occur in the context of CEO employment contracts.

D. What Would Workers Prefer?

Under the strong version of the contracts-of-adhesion theory, we would expect to see companies always select arbitration in order to deprive workers of any right to litigate job-related claims. However, this supposes that no employees have sufficient bargaining power to negotiate for variations of these clauses.

In negotiations where the parties have equal bargaining power, such as those between CEOs and their employers, we would expect arbitration clauses only as an efficient outcome of arms' length negotiations. As we saw in Parts II.B and II.C above, context matters. Sometimes a worker will want to arbitrate a dispute, while other

58. *See* O'HARA & RIBSTEIN, *supra* note 47, at 91–92 (arguing that arbitrators have industry expertise that judges lack).

59. Drahozal & Wittrock, *supra* note 51, at 9.

times she may prefer litigation. Companies face similar choices. This means that to uncover patterns we will need to sort out the underlying choices empirically and see whether the parties follow clear paths in certain situations.

III. SHAREHOLDERS VERSUS CEOS: OPTIMAL CONTRACTING OR BOARD CAPTURE?

The executive compensation literature raises a second set of issues about arbitration provisions. By examining the determinants of arbitration clauses in CEO employment contracts, we can indirectly test the board capture theory's prediction that board composition or CEO background are important determinants of a CEO's contractual relationship with her firm. We also can test the optimal contracting theory's prediction that only economic variables related to the demand for labor will affect the contents of CEO employment contracts. We begin by briefly describing the main features of the two theories and then drawing out some testable hypotheses.

A. Board Capture Theory

Board capture theorists claim that American CEOs largely appoint friends and obedient subordinates as directors. In their view, boards are comprised of compliant "yes-men." Compensation committees are composed of current or former CEOs who bend over backwards to award CEOs whatever amounts of pay they request. The compensation committee's advisors, typically compensation consultants from firms with serious conflicts of interest, collude by ensuring that directors rely upon well-massaged industry surveys of pay levels that lead to benchmarks that favor constantly ratcheting executive pay levels upward.[60]

As American CEO pay levels have risen over the past two decades, this theory has gained many adherents both inside and outside of the academy.[61] Executive compensation has been painted as the symbol of out-of-control greed in corporate America. People want to believe that American CEOs have been playing a one-sided game

60. *See* John M. Bizjak, Michael L. Lemmon & Lalitha Naveen, Does the Use of Peer Groups Contribute to Higher Pay and Less Efficient Compensation? 13–15 (Mar. 2007), *available at* http://ssrn.com/abstract=252544 (finding that competitive benchmarking in setting executive pay increases executive pay levels); *see also* Ronald C. Anderson & John M. Bizjak, *An Empirical Examination of the Role of the CEO and the Compensation Committee in Structuring Executive Pay*, 27 J. BANKING & FIN. 1323, 1332 (2003) (finding that adding independent directors to Compensation Committees does not reduce executive pay levels).

61. BEBCHUK & FRIED, *supra* note 1, 23–44.

and winning without really having to work hard for their pay. Board capture theory provides an argument supporting these claims.

Board capture theory predicts that a CEO's power over her board of directors will have an important effect on the terms of her employment relationship. One measure of CEO power includes whether the board is primarily comprised of independent directors or whether it has a majority of inside directors. Another measure includes whether the CEO is a founder of the company, and therefore has a longstanding relationship with the board. These variables should be important predictors of the contents of the CEO's compensation and employment contract provisions.

B. Optimal Contracting Theory

The competing theory, which has been called optimal contracting theory, posits that CEO contracts are designed to maximize shareholder value net of contracting and transaction costs. An optimal contract "maximizes the net expected economic value to shareholders after transaction costs (e.g., contracting costs) and payments to employees. An equivalent way of saying this is that . . . contracts minimize agency costs."[62] Optimal does not mean perfect; it means the best contract that can be achieved to maximize shareholder value given the contracting costs in a given situation.

Optimal contracting theorists do not claim that U.S. corporate governance is perfect. Rather, they believe that it may be extremely good given the existence of information costs, transaction costs, and the existing U.S. legal and regulatory system. Improved regulation, or other changes to the contracting environment, could lower contracting costs and improve overall governance by, for example, making boards more independent and effective monitors.

For our purposes, optimal contracting theory predicts that "the economic determinants of the level of compensation (such as the size of the organization, contemporaneous firm performance, firm risk, and firm investment opportunity set) should completely describe the cross-sectional variation in the equilibrium level of CEO compensation."[63] Employment contracts are part of the contracting relationship between CEOs and their firms and can be analyzed in the same manner as compensation arrangements under optimal contracting

62. John E. Core, Wayne R. Guay & David F. Larcker, *Executive Equity Compensation and Incentives: A Survey*, ECON. POL'Y REV., Apr. 2003, at 27, *available at* http://www.newyorkfed.org/research/epr/03v09n1/0304core.pdf.

63. Core et al., *supra* note 8, at 375.

theory. In other words, no board structure variables, or other proxies for CEO power, should have any significance in explaining CEO compensation or contract structure under optimal contracting theory. We develop these hypotheses in Part V below.

IV. DESCRIPTION OF THE DATA

Before turning to our discussion of the employment contracts that provide the basis for our empirical analysis, we should note a limitation on our analysis. We can only observe the outcomes of the negotiations that take place between boards and CEOs, and we therefore lack any direct measure of their respective negotiating strengths. What we are able to observe is how much these contracts deviate from the average contract in our database. Coupled with some general information about when CEOs want arbitration and when firms want it, discussed above, this gives us some basis to draw conclusions. Even here, though, we must be cautious, as these negotiations cover all aspects of the employment relationship, and the parties may agree to give up something in one area of the contract in order to obtain concessions on other terms. With this caveat in mind, we turn to our sample construction.

In order to conduct empirical testing, we needed to generate a sample of CEO employment contracts. We began by creating a list of companies that were included in the S&P 1500 from 1995 to 2005. Using this list, we examined each company's mandatory securities law filings under the 1934 Securities Exchange Act in the SEC's EDGAR database. We employed a privately owned version of this database, LiveEdgar, for ease of manual and electronic search techniques.

Using LiveEdgar, we checked each company's Form 10-K (annual report) filings to see if the company had attached copies of its CEO's employment contract as an exhibit. If they exist, these contracts are required disclosures for every registered company. Whenever we found one of the contracts, we downloaded it and coded it using a coding system that we created in order to gather the requisite information. We found a total of 1,970 contracts in this search. Table 1 displays a summary of how we arrived at the final sample used in this Article.

There are several different variations in the type of CEO employment contracts that we found.[64] The three most important

64. We make no attempt to include all of the other various contractual agreements that exist between CEOs and their firms. For example, we do not include change-of-control agreements in our sample, although some of these agreements include arbitration provisions. We recognize that these other forms of agreement may affect the employment relationship between

contract types are initial contracts, contract amendments, and restated contracts. Initial contracts are those that are entered into between the company and its new CEO, or in some cases, by a company and its current CEO where the firm's prior relationship with the CEO was not the subject of a written employment contract. Generally, CEOs and firms enter into initial contracts at the beginning of their employment relationships.

Contract amendments can be initiated at any time for any reason once an employment contract is in place. They are typically quite short and affect only a few terms of the initial (or restated) contract, usually specifying changes in the CEO's compensation arrangement. They rarely alter any noncompensation-related terms of the employment relationship. We did not find a single case where these amendments altered the arrangements, or lack thereof, providing for arbitration of any dispute between the parties. For this reason, we decided to drop these contract amendments from our sample. This decision reduced our sample by 1,052 observations.

Restated contracts (sometimes called "amended and restated contracts") are contracts that are entered into subsequent to the initial contract, usually after one or more amendments have been made to the initial contract. A restated contract incorporates all of the changes made in the various amendments, and it also frequently adds new terms. This new, integrated document reflects all of the terms of the employment contract between the CEO and the firm. We included these agreements in our sample for two reasons. First, in some instances, the initial contracts are unavailable.[65] Second, restated contracts could result in changes to the arbitration arrangements to the parties' agreement.

Next, to test the hypotheses formulated later in the Article, we needed to obtain some additional information about the CEOs and their companies. We used the ExecuComp database to collect information about each CEO's total compensation, including the amount of her incentive-based pay, the percentage of independent directors on each firm's board, and the type of CEO at the firm (i.e., insider, outsider, or founder). Total compensation is comprised of the following items: salary, bonus, other annual compensation, total value of restricted stock granted, total value of stock options (using the

the firm and its managers, but have decided to leave them for a later day in order to maintain our focus on employment contracts.

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

Black-Scholes option-pricing formula), long-term incentive payouts, and all other compensation paid by the company. We then adjusted total compensation from nominal to real terms (year-2000 dollars) using the Consumer Price Index. We defined incentive-based pay as all compensation other than salary and bonus. We were forced to drop an additional 266 contracts from our sample because we could not match them with the ExecuComp database coverage and therefore could not obtain complete compensation data for these CEOs for our analysis.

Finally, we used the Compustat database to collect information about firm performance and to determine in which state each firm's headquarters were located. The firm performance variables consist of sales and return on capital, which is defined as net income divided by capital. Capital consists of the book value of debt and equity as reported on the firm's balance sheet. Return on capital is then averaged over the five-year period prior to the start date of the CEO's compensation contract. Finally, to compute sales per capita, we used each state's population as taken from the 2000 Census. We dropped an additional 101 contracts from our sample because complete information on these terms was not available.

For each employment contract in our sample, we coded the presence or absence of an arbitration clause. We also coded a wide variety of additional information about the contents of the arbitration provision,[66] such as whether certain types of disputes were "carved out" for resolution by litigation. For the purposes of this Article, though, we are solely concerned with the presence or absence of an arbitration provision.

As Table 1 shows, we obtained a final sample of 551 contracts for which we have complete information about firm characteristics, executive compensation, and other variables that are important for our analysis. About half of these contracts contain arbitration provisions—a proportion that is consistent with the results of an earlier study by one of the authors of this Article.[67]

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66. We also coded those contracts with arbitration provisions for whether the parties chose an arbitration association, whether they specified the rules of procedure that arbitration would follow, whether they chose a specific number of arbitrators to resolve disputes, where they chose to arbitrate, whether the parties contractually allocated the costs of arbitration, whether they provided a limitations period for filing for arbitration, whether they addressed rules of discovery or rules of evidence, whether the arbitrator was contractually prohibited from awarding punitive damages, whether the parties were bound to keep the contents of arbitration proceedings confidential, whether the arbitrator was obligated to issue a written opinion justifying her decision, and whether the parties reserved the right to appeal the arbitrator's decision to the courts.

67. Schwab & Thomas, *supra* note 9, at 257–58.

TABLE 1: DESCRIPTION OF CEO CONTRACTS SAMPLE

Description	*Number of Contracts*
Initial sample of CEO contracts	1,970
Less contracts that are not regular employment contracts or reinstatements	(1,052)
Less contracts missing variables on ExecuComp database (total compensation, founder, board independence, outside CEO)	(266)
Less contracts missing data on Compustat (firm performance or headquarters data)	(101)
Net usable contracts	551

The contracts in our sample were executed during the time period between 1995 and 2005, as illustrated in Table 2A. Initially, fewer contracts exist in the sample for the years 1995 and 1996, perhaps because EDGAR filings did not become mandatory until May 1996 or because companies may have taken some time to become accustomed to having to disclose publicly the intimate details of their CEOs' financial and legal arrangements. It is also possible, according to some press reports, that it has become more common for CEOs to have employment contracts with their firms.[68] Such a trend may result because these disclosure requirements have caused CEOs and firms to become more aware that other firms are employing such contracts.[69] Or perhaps CEO job tenure has been declining over this time period.[70]

68. Rachel Emma Silverman, *Your Career Matters: The Jungle*, WALL ST. J., Mar. 7, 2000, at B16 (reporting trend toward increased usage of employment contracts for CEOs).

69. Randall S. Thomas & Kenneth J. Martin, *The Effect of Shareholder Proposals on Executive Compensation*, 67 U. CIN. L. REV. 1021, 1041–42 (1999) (arguing that CEOs feel social pressure to keep up with their peers in compensation); *see also* James Ang et al., Is There a Social Circle Premium in CEO Compensation? 20–21 (June 25, 2009), *available at* http://www.fma.org/Prague/Papers/Is_there_a_Social_Circle_Premium_in_CEO_Compensation.pdf ("[T]he intensity of pay comparisons increases with the amount of available information on peer pay.").

70. Robert Weisman, *Being a CEO Has Its Perks, But Tenure Isn't One of Them*, BOSTON GLOBE, May 11, 2008, at G1 (reporting that average CEO job tenure dropped from 9.7 years in 1999 to 8.3 years in 2006, while median job tenure in 2006 was only 5.5 years).

TABLE 2A: TIME SERIES OF CEO CONTRACTS: 1995–2005

Year	*Total*	*Initiation of contracts containing arbitration provisions*	*Renewal of contracts containing arbitration provisions*	*Percent of contracts containing arbitration provisions*	*Contracts with no arbitration provisions*
1995	10	3	2	50.0%	5
1996	21	7	1	38.1%	13
1997	39	11	3	35.9%	25
1998	45	18	4	48.9%	23
1999	53	22	2	45.3%	29
2000	58	22	5	46.6%	31
2001	79	36	5	51.9%	38
2002	67	25	11	53.7%	31
2003	67	26	11	55.2%	30
2004	64	32	3	54.7%	29
2005	48	21	8	60.4%	19
Total	**551**	**223**	**55**	**50.5%**	**273**

The next-to-last column of Table 2A shows the percentage of contracts containing arbitration provisions. Whereas a total of 50.5 percent of the contracts in our sample include an arbitration provision, this overall average masks an upward trend in the use of arbitration over time—from a low of 35.9 percent of contracts in 1997 to a high of 60.4 percent of contracts in 2005. A simple linear regression of the percentage of contracts containing arbitration provisions each year against time indicates a statistically significant upward slope.[71] This trend indicates a possible transition toward a new equilibrium situation where arbitration is more commonly employed than in the past.

71. The t-statistic on the slope is 3.84.

TABLE 2B: NUMBER OF OBSERVATIONS WHERE FIRM HAD AN ARBITRATION CONTRACT IN A PRIOR CEO'S AGREEMENT

		Arbitration in prior year contract		
		Yes	*No*	**Total**
Arbitration in sample contract	*Yes*	113	165	**278**
	No	18	255	**273**
	Total	**131**	**420**	**551**

In Table 2B, we examine whether prior employment contracts between the company and its previous CEO contained arbitration provisions. We do so to determine if the presence of an arbitration provision in the contract of the prior CEO is more likely to result in an arbitration provision in the contract of the CEO in our sample. This might occur, for example, when the employer uses the prior contract as a model for the current CEO's contract, and that clause is simply carried over to the next CEO. This example is consistent with what practitioners in the area tell us is common practice.

To test the significance of these differences, we calculated a chi-square statistic to test the null hypothesis of independence between the two classifications (i.e., the existence of an arbitration provision in a contract and the existence of an arbitration contract in a prior CEO's contract at the same firm). The result was highly statistically significant.[72] This finding supports the hypothesis that the inclusion of an arbitration provision in a prior CEO's contract is likely to increase the probability that such a clause will exist in the next CEO's contract. We therefore need to control for this variable in our multivariate analysis later in the Article.

One obvious implication of these descriptive results is that the parties do not always choose either arbitration or litigation. Companies are unable to unilaterally impose arbitration provisions on CEOs, contrary to the claims of proponents of the strong form of the contracts of adhesion argument. We conclude that our evidence does not support this strong form argument. Given the wide dispersion of outcomes, we turn next to formulating and testing hypotheses about why firms and CEOs agree to include arbitration provisions in their executive employment agreements.

72. The chi-square test value is 88.14, which is significant with a p-value less than 0.0001.

V. HYPOTHESIS FORMULATION AND TESTING

The analysis above can help us to formulate and test some hypotheses regarding the inclusion of arbitration clauses in CEO contracts. Recall that when a contract does not contain a binding arbitration clause, the parties have retained their rights to have future disputes resolved in courts. The presence of an arbitration clause, by contrast, represents an affirmative choice by the parties to have some or all of their disputes resolved by arbitrators rather than by courts. Given the above factors, then, when might we predict CEO employment contracts to include arbitration clauses? In the following section, we develop our hypotheses and conduct some univariate tests on them. Part V.B then incorporates these results into a multivariate model.

A. Univariate Tests

1. Arbitration and CEO Pay Levels and Composition

Our first hypothesis is that, all else equal, CEOs receiving higher pay are more likely to prefer arbitration than their lower-paid counterparts if they think that their high compensation would cause jurors to be unsympathetic to their claims. Companies might also prefer arbitration of this question if they are concerned about keeping otherwise private information about CEO compensation from entering the public domain. While many elements of CEO compensation are publicly disclosed, there may be documents related to its determination (or other aspects of pay that are highly correlated with total amount, such as the size of supplemental retirement plans) that are not publicly known. For these reasons, both parties to the contract may prefer arbitration, which leads us to our first hypothesis.

H1: More highly compensated CEOs are more likely to have contracts that include an arbitration provision.

Table 3 displays the mean and median total CEO compensation for CEOs who have contracts with arbitration clauses (about $5 million annually) and for those who do not have contracts with arbitration clauses (just under $4.2 million per year). Although the difference in means test is marginally significant at conventional levels of significance,[73] the test of the difference in medians is statistically significant at the 5 percent level. This result is consistent with our first hypothesis.

73. The p-value is 0.07.

TABLE 3: ARBITRATION AND AVERAGE TOTAL CEO COMPENSATION[74]

Description	*Sample with arbitration provision*	*Sample with no arbitration provision*
Sample size	278	273
Mean (median) total CEO compensation (000s)	\$5,001.5 (\$3,215.2)	\$4,178.7 (\$2,601.6)
t-statistic (p-value)	1.79 (0.07)	
z-statistic (p-value)	2.20 (0.03)	

A related claim is that CEOs who receive a larger percentage of their total compensation in the form of incentive-based pay will be more likely to seek arbitration. Here the motivation for seeking arbitration might be to have a compensation expert who understands the intricacies of incentive-based pay plans resolve any contested issues between the company and its top executives. One might expect that both parties to the contract would have an interest in ensuring that this was done properly and therefore would agree that an arbitration clause should be included in the contract.

In a related vein, all else equal, parties that have drafted more complicated or vaguer payment provisions may be more likely to seek expert arbitrators to resolve their disputes than parties that have used less complicated payment provisions. Complicated provisions can result from the use of complex formulas. Vague provisions can take the form of judgments regarding the CEO's performance—that is, "exceptional" or "adequate" performance expectations. As stated earlier, these are situations where arbitrator expertise will be preferred over generalist judges. Presumably this preference is mutual. In CEO employment contracts, incentive-based pay is more likely to be complicated than non-incentive-based pay. This leads to our second hypothesis.

> H2: CEOs who receive a greater percentage of their compensation in the form of incentive pay are more likely to have an employment contract with an arbitration clause.

In our analysis, incentive pay is defined as all compensation other than the CEO's annual salary and bonus. Although this may be

74. In each table, we show the number of observations in each sample, the mean value of each variable with the median value in parentheses directly below the mean, the t-statistic for a test of the difference in means with the p-value based on a 2-tailed test of the null hypothesis of no difference in means, and finally a z-statistic for a Wilcoxon two-sample test of the difference in medians with the p-value in parentheses. All tests are run using SAS 9.1 for Windows. The tests are described in 2 SAS/STAT USER'S GUIDE, VERSION 6 (4th ed. 1990).

a noisy measure, it is likely that compensation from restricted stock grants, stock option grants, and long-term incentive pay portions of the pay package will be substantially higher than other forms of pay that are neither salary nor bonus. Table 4 shows that the results are much stronger for Hypothesis 2 than for Hypothesis 1—both the t-statistic and the z-statistic are significant at the 1 percent level. This result implies that arbitration clauses are more common when CEOs receive a greater proportion of their pay in incentives.

TABLE 4: AVERAGE PERCENT OF TOTAL CEO COMPENSATION IN THE FORM OF INCENTIVE PAY

Description	*Sample with arbitration provision*	*Sample with no arbitration provision*
Sample size	278	273
Mean (median) percent of incentive pay in CEO's total compensation	55.3% (60.1%)	49.3% (53.3%)
t-statistic (p-value)	2.66 (0.01)	
z-statistic (p-value)	2.74 (0.01)	

To summarize, for both total compensation and the average percentage of compensation in the form of incentive pay, the evidence is consistent with Hypotheses 1 and 2. This suggests that more highly paid CEOs—and CEOs who receive a greater part of their pay in the form of stock options or other incentive-based pay—are more likely to seek arbitration clauses in their employment contracts. As to total compensation, highly paid CEOs might believe that an arbitrator will be more sympathetic to their claims than a jury, which might find their pay excessive. From the companies' perspective, they may prefer to keep nonpublic information about high pay levels private for proprietary reasons. Turning to incentive pay, these results are consistent with the claim that an experienced arbitrator is better able to understand the complexities of determining the appropriate amount of incentive-based pay. As a result, both parties have an interest in using an expert arbitrator.

2. Arbitration and Firm Characteristics

A second set of important variables that may affect the presence of arbitration provisions are the characteristics of the firm employing the executive. For instance, all else equal, a firm that is a large employer in its home state may be more likely to prefer court to arbitral resolution of its disputes, based on the theory that local judges and juries will be more inclined to favor large local businesses. Conversely, the CEO of such a company might be reluctant to agree to go to court in her home state and, if she has sufficient bargaining power, might demand arbitration. For that reason, we make no prediction about the direction for this hypothesis.

We confronted two methodological issues in formulating this hypothesis. First, what is the home state of the firm? Second, how should we measure the firm's importance to that state? To determine the home state, we decided to use the state where the firm's executive headquarters are located,[75] rather than its state of incorporation. We made this decision primarily because most public corporations are incorporated in Delaware but do not maintain significant operations there. Determining the state where the firm has the largest presence is also a question of judgment. For example, we could measure employer importance by using firm assets, firm sales, or number of employees, divided by state population. We chose the second measure—firm sales per capita—as our measure of a firm's importance within the state because it is a convenient and widely reported measure. Our third hypothesis is therefore as follows:

> H3: Firms that have higher sales per capita in their home state are less likely to have arbitration clauses in their CEO's employment contract.

Table 5 shows the results of a two-sample t-test and nonparametric z-test of this hypothesis.[76] The results are mixed. The t-test does not support our hypothesis, but the z-statistic, which tests the difference in the medians, does support it. In this case, we are more inclined to believe the test of medians because the mean of the sample with arbitration provisions appears to be driven by two extreme observations.[77]

75. By this, we mean the state in which the firm's executive headquarters are located and where it is most likely to employ its largest number of workers and executives.

76. Three observations have missing sales on Compustat.

77. One, Fannie Mae, which is headquartered in Washington, D.C., has sales per capita of $48.56, while the other is the large grocery chain Albertson's, which is headquartered in Idaho and has sales per capita of $28.41.

TABLE 5: AVERAGE SALES PER CAPITA IN HEADQUARTERS STATE AND THE EXISTENCE OF ARBITRATION PROVISION IN CEO CONTRACT

Description	*Sample with arbitration provision*	*Sample with no arbitration provision*
Sample size	277	271
Mean (median) sales per capita (000,000s)	\$0.7075 (\$0.1152)	\$0.5466 (\$0.1680)
t-statistic (p-value)	0.74 (0.46)	
z-statistic (p-value)	-2.70 (0.01)	

We interpret these results to be consistent with the hypothesis that very important local firms will prefer to litigate employment contract disputes with their CEO, although CEOs will resist doing so. The fact that the results are significant suggests that the corporations' preferences on the question prevail.

We next focus on the effects of industry change on CEO employment contract arbitration clauses. CEOs at firms in industries that are experiencing rapid changes may prefer to select arbitration as the dispute resolution mechanism in their contracts because they believe that it is a quicker method of resolving any problems that arise. Speed is important to CEOs in rapidly changing industries because the firm may not continue to exist as an independent entity. If new owners are put in place, a new board might also be appointed. The CEO would then face an entirely different adversary with different motivations, making the outcome of a dispute highly uncertain.

From the corporation's perspective, it may be willing to accommodate the CEO's understandable desire for greater certainty about who will decide her fate because its board may not wish to have any significant outstanding litigation issues in the event it becomes a target for merger and acquisition activity. Moreover, if the firm is in financial distress or in a declining industry where the likelihood of financial distress is elevated, the firm may be attracted to the perceived lower cost of arbitration. For these reasons, we formulate the first version of our fourth hypothesis as follows:

> H4: CEO contracts at firms in industries that are experiencing rapid levels of change, including mergers, acquisitions, bankruptcies, and liquidations, are more likely to include arbitration clauses.

In Table 6, we show the results of a two-sample t-test and nonparametric Z-test of the hypothesis that CEO employment contracts at firms that are in industries experiencing dramatic changes are more likely to include arbitration provisions. As a proxy for industry change, we used the number of companies deleted from the "active" Compustat set divided by the total number of companies listed in the company's respective two-digit SIC code from 1988 to 2007. This variable gives us a measure of the likelihood of a firm within the industry being acquired by another firm, merging with another firm, experiencing bankruptcy, or undergoing liquidation.

TABLE 6: ARBITRATION AND AVERAGE PERCENT OF COMPANIES WITHIN AN INDUSTRY SUBJECT TO AN ACQUISITION, MERGER, BANKRUPTCY, OR LIQUIDATION

Description	*Sample with arbitration provision*	*Sample with no arbitration provision*
Sample size	278	273
Average (median) percent of companies deleted	38.08% (38.28%)	36.39% (36.67%)
t-statistic (p-value)	2.78 (0.01)	
z-statistic (p-value)	2.60 (0.01)	

The results are strongly consistent with the hypothesis. Both the t-statistic and z-statistic on the difference between the two groups is significant at the 1 percent level.

An alternative measure of firm-level uncertainty is the amount of variation in the annual sales of its industry. Firms in industries with higher levels of variation are at greater risk of experiencing changes to their structure and existence. For the same reasons given in Hypothesis 4, this increased risk should lead both CEOs and firms to add arbitration provisions to their employment contracts.

H5: CEO contracts at firms that have higher levels of industry variation in their sales are more likely to contain arbitration clauses.

Table 7 presents the results from testing Hypothesis 5. It shows the results of a two-sample t-test and nonparametric z-test of this hypothesis. Industry uncertainty is measured as the standard deviation of annual percentage change in industry sales from 1989 to 2006. These results do not support the hypothesis, and the median results are not in the predicted direction.

TABLE 7: AVERAGE OF STANDARD DEVIATION OF INDUSTRY SALES

Description	*Sample with arbitration provision*	*Sample with no arbitration provision*
Sample size	278	273
Mean (median) of standard deviation of industry sales	10.91% (7.48%)	9.98% (7.59%)
t-statistic (p-value)	1.42 (0.16)	
z-statistic (p-value)	0.06 (0.95)	

Overall, the results in Tables 6 and 7 suggest that both CEOs and corporations prefer to arbitrate their mutual employment disputes when the firm is in an industry experiencing rapid economic change. The fact that both parties to the contract have similar incentives, though perhaps for different reasons, is the most likely explanation for these patterns. The second set of tests, however, does not support Hypothesis 5.

Next, CEOs asked to lead firms in industries characterized by low profitability may be more likely to prefer arbitration. One argument is that they are more likely to prefer arbitration because low firm profitability makes the parties more concerned about the high costs of litigation. Arbitration is perceived to be less expensive, and every dollar counts at low-profit firms. Alternatively, we would argue that when external conditions surrounding the firm are verifiably adverse, such as poor profits or rapidly changing industry conditions, the parties anticipate a greater likelihood of disputes arising out of the employment relationship that are not the fault of either party. To address this risk, the parties signal their commitment to performance by negotiating an arbitration clause in an effort to try to resolve disputes amicably.[78] Given the long lead times between contract execution and potential disputes, we expect that sustained profitability should have a stronger effect, so we use a measure of long-term profits at the time of the contract.

H6: Contracts with arbitration clauses are characterized by firms with lower profitability.

The results in Table 8 support this hypothesis. We see a strong relationship between the use of arbitration clauses and lower five-year

78. This rationale would also apply to Hypothesis 3 above. We thank Professor Geoffrey Miller for this insight.

average return on capital.[79] This finding supports our belief that CEOs at weaker companies seek to include arbitration clauses in their contracts for two potential reasons. First, arbitration clauses may facilitate a cheaper resolution of any disputes, which should be important at firms where cost containment is of primary importance. Second, arbitration clauses send a positive signal that the contracting parties will agree to arbitration in a situation where adverse external factors are ex ante the most likely cause of their disagreement. An examination of the data shows that the results do not appear to be driven by extreme outliers.

TABLE 8: FIRM PROFITABILITY AND ARBITRATION PROVISIONS

Description	*Sample with arbitration provision*	*Sample with no arbitration provision*
Sample size	276	269
Mean (median) five-year average return on capital	6.38% (7.45%)	9.33% (8.13%)
t-statistic (p-value)	2.45 (0.01)	
z-statistic (p-value)	1.63 (0.10)	

3. Contract Length and Arbitration

We might also think that certain contract provisions would affect the likelihood that the parties will include an arbitration provision. For instance, all else held constant, parties contemplating a longer relationship may be more likely to want to resolve their disputes through arbitration than those contemplating a shorter relationship. This hypothesis stems from the suggestion made earlier that the informal nature of arbitration better enables parties to preserve their working relationship notwithstanding the dispute. Presumably a desire to preserve the working relationship is shared by the parties. This leads to our seventh hypothesis.

H7: Contracts with longer durations are more likely to include arbitration clauses.

Table 9 provides information on Hypothesis 7.[80] We also show the results of a two-sample t-test and z-statistic of the hypothesis.

79. We did a sensitivity analysis with several different measures of long-term profitability to see if this result was robust. We found similar results using three-year average return on capital and also using return on assets.

80. Note that contract lengths were unavailable for 134 of our observations.

TABLE 9: ARBITRATION AND TERM OF CEO CONTRACT

Description	*Sample with arbitration provision*	*Sample with no arbitration provision*
Sample size	223	195
Mean (median) length of CEO contract (in years)	3.32 (3.00)	3.34 (3.00)
t-statistic (p-value)	-0.18 (0.86)	
z-statistic (p-value)	0.03 (0.98)	

We find no support for Hypothesis 7. We find this quite surprising, as we anticipated that parties entering into long-term agreements would want to resolve disputes informally to preserve their working relationship. However, there does not appear to be a strong desire by either party to do so. We offer two possible explanations for why our hypothesis lacks support. First, it is likely that contract length is less important than the length of severance payments, in terms of the actual economic significance of the CEO's contract to the firm. The firm is always able to terminate a CEO without cause, no matter how long the contract, as long as it is willing to pay the full amount of the CEO's severance pay. Second, most disputes between CEOs and their firms are likely over termination payments to the CEO once the employment relationship ends, perhaps minimizing any interest the parties have in maintaining an amicable long-term relationship.

4. Arbitration and CEO Power

Board capture theory predicts that a CEO with greater control over her board of directors will have more control over the contents of her employment contract. This would lead us to expect that CEOs who have insider-dominated boards will be able to decide whether to include arbitration provisions in their employment contracts. If boards that are dominated by CEOs are less likely to have legal disputes with those CEOs, then we would expect greater harmony between the parties and could predict that they will be more inclined to contract for arbitration. Our testable hypothesis is:

H8: Greater board independence affects the likelihood that an arbitration clause will appear in its CEO employment contract.

Table 10 provides information on Hypothesis 8. We also show the results of a two-sample t-test and z-statistic of the hypothesis.

TABLE 10: ARBITRATION AND BOARD INDEPENDENCE

Description	*Sample with arbitration provision*	*Sample with no arbitration provision*
Sample size	278	273
Average (median) percent of board deemed independent	68.2% (70.0%)	68.9% (71.4%)
t-statistic (p-value)	-0.52 (0.60)	
z-statistic (p-value)	-0.59 (0.56)	

For Hypothesis 8, we see that there is no support for board capture theory's prediction that board structure will affect the contents of the CEO's employment contract. However, any effect may be obscured by other economic variables, so that we will need to examine potential relationships through multiple regression analysis.

An alternative method of examining the effects of CEO power is to analyze the relationship between the background of the CEO and the contract structure. Some commentators claim that founding CEOs have greater power over their boards of directors because of their long-term relationships with directors.[81] Board capture theory predicts that this power should give these founders greater ability to obtain what they want in their employment contracts. When CEOs are founders of the firm, they are likely to be more concerned with preserving harmony within the firm and therefore more likely to prefer arbitration. The founder has been with the firm since its inception and typically has both a large economic stake and a large psychic stake in its welfare. In economic terms, the CEO has large firm-specific investments that should lead her to prefer arbitration to litigation to preserve their value. We therefore posit the following hypothesis:

> H9: Contracts with CEO founders are more likely to include arbitration clauses than are contracts that do not involve founders.

Table 11 presents the results of our tests of this hypothesis. We note that we have relatively few founders in our sample, with only 6.5 percent of the contracts being in this category. The chi-square statistic is not statistically significant, indicating that these distributions are not statistically different.[82] We therefore conclude that there is no support for this prediction of board capture theory. CEO founders are

81. Schwab & Thomas, *supra* note 9, at 237–38.

82. For a discussion of this statistic, see generally WILLIAM MENDENHALL & JAMES E. REINMUTH, STATISTICS FOR MANAGEMENT AND ECONOMICS (2d ed. 1974).

neither more nor less likely to include arbitration clauses in their contracts.

TABLE 11: FOUNDER CEOS AND ARBITRATION PROVISIONS

	Sample with arbitration provision	*Sample with no arbitration provision*	*Total*
Number (percent) who are founders	16 (2.9%)	19 (3.5%)	35 (6.5%)
Number (percent) who are not founders	262 (47.6%)	254 (46.1%)	516 (93.7%)
Total	278 (50.5%)	273 (49.6%)	551 (100.0%)
$\chi^2 = 0.34$ (p-value = 0.56)			

Finally, one might expect a relationship between the path taken to the CEO position and the presence of arbitration clauses. Founders tend to have more bargaining power than outsiders, while outsiders in turn tend to have greater bargaining power than do insiders.[83] As we discussed above, greater CEO power is more likely to lead to the inclusion of an arbitration provision. We provide the hypothesis:

H10: CEOs with more bargaining power are more likely to bargain for arbitration.

Panels A through C of Table 12 are contingency tables of observed frequencies of different subsamples of our data. Panels A, B, and C present our tests of three different versions of the bargaining power hypothesis: Panel A shows outsiders versus insiders and founders, Panel B compares outsiders and insiders only, and Panel C compares insiders with founders. The chi-square statistic tests the null hypothesis of independence among the proportions. If we reject the null hypothesis (i.e., if the p-value is less than 0.05), then we can conclude that there is an association between the variables of interest—for example, whether the CEO is an outsider and whether the CEO's contract contains an arbitration provision.

83. Schwab & Thomas, *supra* note 9, at 237–38.

TABLE 12: CEO POWER AND ARBITRATION PROVISIONS

PANEL A: OUTSIDER CEOs			
	Sample with arbitration provision	*Sample with no arbitration provision*	*Total*
Number (percent) who are outsiders	121 (22.0%)	120 (21.8%)	241 (43.7%)
Number (percent) who are not outsiders	157 (28.5%)	153 (27.8%)	310 (56.3%)
Total	278 (50.5%)	273 (49.6%)	551 (100.0%)
$\chi^2 = 0.01$ (p-value = 0.92)			

PANEL B: CEOs WHO ARE NOT FROM FOUNDING FAMILY			
	Sample with arbitration provision	*Sample with No arbitration provision*	*Total*
Number (percent) who are outsiders	119 (23.1%)	119 (23.1%)	238 (46.1%)
Number (percent) who are insiders	143 (27.7%)	135 (26.2%)	278 (53.9%)
Total	262 (50.8%)	254 (49.2%)	516 (100.0%)
$\chi^2 = 0.11$ (p-value = 0.74)			

PANEL C: CEOs WHO ARE EITHER INSIDERS OR FROM FOUNDING FAMILY			
	Sample with arbitration provision	*Sample with no arbitration provision*	*Total*
Number (percent) who are insiders	143 (46.1%)	135 (43.6%)	278 (89.7%)

Number (percent) who are from founding family	14 (4.5%)	18 (5.8%)	32 (10.3%)
Total	157 (50.7%)	153 (49.4%)	310 (100.0%)
$\chi^2 = 0.68$ (p-value = 0.41)			

None of the chi-square statistics are statistically significant, which indicates that these distributions are not statistically different. We therefore conclude that there is no support for either hypothesis. However, one implication of this finding is that a CEO's bargaining power does not appear to affect her preference for arbitration provisions, all else being equal.

B. Multivariate Testing

While the univariate tests are very suggestive of several important underlying relationships, multivariate regression analysis ensures that we are controlling for the potential effects of other variables. In Table 13, we present the results of a multivariate logistic regression analysis. Our dependent variable is a dummy variable equal to one if an arbitration clause is present and zero if it is not. This form of estimation allows us to determine if the presence of any one of the independent variables increases or decreases the probability of an arbitration clause being included in a CEO's employment contract. Our independent variables[84] include all of the variables used

84. The following summarizes the independent variables: "Total Pay" is the total inflation-adjusted pay in constant year-2000 thousands of dollars. "Long-Term Pay" is the fraction of "Total Pay" that is comprised of long-term sources of compensation. "Length" is the length of the contract in years. "Founder" is 1 if CEO is a founder or member of the founding family. "Outsider" is 1 if the CEO was not previously employed by the firm. "Board Independence" is the fraction of the board that is considered independent. "Sales Per Capita" is company sales divided by the population of the firm's headquarters state. "Industry Uncertainty" is industry uncertainty as measured by the standard deviation of the annual percentage change in industry sales over the period from 1989 to 2006. "Industry Change" is industry change as measured by the percentage of companies in a firm's industry deleted from Compustat due to acquisition, merger, bankruptcy, or liquidation. "Five-Year Average ROC" is the 5-year average return on capital beginning with the year prior to the start year of the CEO's contract. "Arbitration in Prior Contract" is a dummy variable equal to 1 if a previous CEO contract at the company included an arbitration clause, 0 if not. "Year" is equal to the beginning calendar year of the contract. Regressions (2) and (4) include a dummy variable, "Sales Per Capita Dummy," set equal to 1 for Fannie Mae and Albertson's, and zero for all other observations, to control for the extreme outlying observations on "Sales Per Capita."

in Tables 3 through 12 in order to determine if any of the univariate results that we found in those tables hold up after controlling for the other variables.

We estimate four different versions of the model. In versions 1 and 2, we omit the length-of-contract variable because we have fewer observations on this variable. A smaller sample size could potentially reduce the power of the tests derived from these results.[85] Versions 1 and 3 omit the sales-per-capita dummy variable that we included in order to control for two large outliers in this variable. Versions 2 and 4 include this control variable.

Version 4 of the model includes all of our potential independent variables and explains the most variation in the data. We therefore rely most heavily upon its results but note that our results are robust to the inclusion or deletion of contract length in versions 1 and 2, and of the sales-per-capita dummy variable in versions 1 and 3.

85. A substantial number of the contracts in our sample do not have a fixed term.

TABLE 13: LOGISTIC REGRESSION RESULTS
DEPENDENT VARIABLE: ARB = 1 IF CONTRACT INCLUDES ARBITRATION CLAUSE, 0 IF NOT
(P-VALUES IN PARENTHESES)

	Version			
Independent Variables	(1)	(2)	(3)	(4)
Intercept	-56.16 (0.45)	-55.21 (0.46)	-21.42 (0.81)	-21.38 (0.81)
Total Pay	0.000006 (0.77)	0.00002 (0.37)	-0.00001 (0.65)	0.0000002 (0.99)
Long-Term Pay	0.46 (0.28)	0.37 (0.38)	0.44 (0.36)	0.39 (0.43)
Length			-0.06 (0.47)	-0.08 (0.38)
Founder	-0.07 (0.86)	-0.05 (0.9)	0.2 (0.66)	0.22 (0.63)
Outsider	0.08 (0.71)	0.04 (0.86)	0.04 (0.85)	0.03 (0.9)
Board Independence	-0.58 (0.37	-0.49 (0.45)	-0.6 (0.43)	-0.57 (0.46)
Sales Per Capita	0.02 (0.71)	-0.15 (0.21)	0.07 (0.33)	-0.03 (0.79)
Sales Per Capita Dummy		18.82 (0.98)		15.16 (0.99)
Industry Uncertainty	0.92 (0.49)	0.94 (0.48)	0.77 (0.6)	0.77 (0.6)
Industry Change	3.30** (0.02)	3.21** (0.02)	3.37** (0.03)	3.34** (0.03)
Five-Year Average ROC	-0.02*** (0.01)	-0.02** (0.02)	-0.03*** (0.01)	-0.03*** (0.01)
Arbitration in Prior Contract	2.23*** (0.00)	2.21*** (0.00)	2.32*** (0.00)	2.31*** (0.00)
Year	0.03 (0.47)	0.03 (0.47)	0.01 (0.82)	0.01 (0.82)
N	545	545	415	415
Likelihood ratio Chi-Square	114.81***	118.19***	89.76***	91.01***
(p-value)	(0.00)	(0.00)	(0.00)	(0.00)

*** $p < 0.01$; ** $p < 0.05$

The multivariate results in all four specifications show that three independent variables are consistently significant across all specifications: "Industry Change," "Five-Year Average ROC," and "Arbitration in Prior Contract." The Likelihood Ratio χ^2 statistic, which is a test of goodness-of-fit for the entire regression, is statistically significant in each of the four regressions.

These results confirm the univariate results from Table 6; arbitration provisions are more likely in industries undergoing greater change. Also, arbitration provisions are more likely in firms with worse long-term performance, as measured by the five-year average return on capital (as in Table 8). In contrast to the univariate results of Table 3 and Table 4, "Total Pay" and "Long-Term Pay" are not significant in the multivariate tests. This finding leads us to discount those particular univariate results. Additionally, none of the variables serving as proxies for CEO power are significant. However, the presence of an arbitration clause in the previous CEO's contract is positively and significantly correlated with the use of an arbitration clause in the next CEO's contract.

Overall, these results are consistent with the prediction of optimal contracting theory that only economic variables influence the contents of the employment relationship between the CEO and her firm. In particular, measures of firm performance and risk are important determinants of the presence of an arbitration provision.

SUMMARY AND CONCLUSIONS

In this Article, we examine whether and when CEOs as workers bargain to include arbitration provisions in their employment contracts. We also ask if CEOs impose their will on the shareholders of their firms, as assumed by board capture theory. We survey the potential justifications for why a CEO might seek arbitration and then formulate a series of testable hypotheses based on these justifications. Using a large sample of CEO employment contracts, we run univariate and multivariate analyses of each of these hypotheses and find strong support for three of them.

First, we find that CEOs in industries experiencing rapid changes—such as mergers, acquisitions, bankruptcies, or liquidations—are more likely to have arbitration provisions in their contracts. This finding is consistent with the theory that CEOs want their disputes to be arbitrated quickly in such situations to help ensure that they do not face a new decisionmaker in the event of a change in firm ownership. Second, we find that CEOs at relatively poorly performing firms are more likely to have arbitration provisions in their agreements. One of two possible explanations may explain this finding. One explanation is that arbitration is perceived to be cheaper than litigation, and cost savings are important at weaker firms; thus, arbitration clauses are more common. Alternatively, at poorly performing firms, the contracting parties may be sending a positive signal of their commitment to performance of the contract by agreeing to arbitrate their disputes in a situation where external factors are ex ante the most likely cause of their disagreement. Third, we find that once an arbitration clause is inserted into a CEO employment contract, that clause is very likely to appear in future CEO contracts. This result could occur because old contracts are used as models for new ones. It also suggests that companies that use arbitration clauses are likely to be willing to continue to use them over time.

Our results shed light on two important debates in the legal literature. First, we can see that not all employment contracts are contracts of adhesion with arbitration provisions, as predicted by the strong form of that theory. Rather, the CEO employment contracts show what all employees' preferences for arbitration provisions might look like if their bargaining power was relatively equal to that of their employers. Broadly speaking, we find that despite the purportedly overwhelming benefits of arbitration (especially in the employment area), the incidence of arbitration clauses is about even with that of no arbitration. In other words, when employees and employers have reasonably equal levels of leverage in contract negotiations, we would expect arbitration provisions to appear only where CEOs believe that they are warranted, or at least where they do not strenuously object to them. The fact that we find arbitration in only half of our large sample of contracts casts doubt on any claims of the universal superiority of arbitration as a means of resolving employment disputes.

This mixture of choices between courts and arbitration suggests that either categorical enforcement or nonenforcement of arbitration clauses in employment contracts would be unwise. Instead, regulatory policy surrounding these provisions should be more nuanced, based on more careful studies of the use of arbitration clauses in employment contracts generally. Consider, for example, an empirical fact about these contracts that we have not highlighted so far: nearly half of the contracts with arbitration clauses included a provision carving out some claim(s) for resolution by courts.[86] Common examples of carve-outs include a provision stating that disputes based on the noncompetition clause or a confidentiality clause could be resolved in courts rather than

86. We found that 127 contracts out of the 273 contracts with arbitration clauses have these carve-out provisions.

through arbitration. If the parties themselves are bargaining to give one of them a right to resort to courts for a subset of possible disputes that might arise between them, then it also might be appropriate as a policy matter to enforce arbitration clauses in employment contracts generally but to prohibit some claims from proceeding to arbitration (e.g., claims based on civil rights violations). Put differently, pro-arbitration advocates typically argue that all claims need to be arbitrated in order for the parties to preserve the value of arbitration. But the behavior of the parties themselves indicates that they do not view arbitration as desirable in every situation. Regulatory policy should take this contracting behavior into account.

Our results also provide some insight into the executive compensation debate. Optimal contracting theory claims that only economic factors influence the content of the employment relationship between firms and their CEOs, whereas board capture theory argues that measures of a CEO's control over her board of directors should also be important. Our results are consistent with optimal contracting theory but not with board capture theory. We find several statistically significant economic variables that are correlated with the presence of arbitration provisions, while none of our measures of CEO power are significant.

Finally, one important extension of these results would be to look at the content of these arbitration provisions to see how they are structured. We think it particularly important to know if the rules of the arbitration are slanted heavily in favor of one side. Furthermore, we would like to know more about the significant carve-outs from the arbitration provisions as well as what motivates parties to preserve particular types of claims for court resolution. These and a host of other related questions are good subjects for future research.