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Mitigating Arbitration's Externalities: A Call for Tailored Judicial Review

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ABSTRACT

Arbitration has changed dramatically since Congress enacted the Federal Arbitration Act in 1925. Increasingly, unsophisticated parties are asked to enter into binding arbitration agreements before any dispute has arisen. As a result, mandatory laws are frequently interpreted and enforced by arbitrators rather than judges. Nonetheless, judicial review of arbitration awards is still largely limited to determining whether the arbitrator made procedural errors, rather than substantive errors.

As the law of arbitration has fallen behind arbitration practice, four negative externalities have developed. First, legally inaccurate arbitration awards, if left uncorrected, may allow for ongoing legal violations that harm third parties. Second, inaccurate awards undermine enforcement and may thereby reduce the law's deterrent effect. Third, unreasoned or inaccurate awards create uncertainty about the legal rights and obligations of third parties. Finally, arbitration can elicit public controversy if outside observers believe victims are being denied their day in court.

Mitigating these externalities requires tailoring judicial review of arbitration awards based on the timing of the agreement to arbitrate, the types of claims involved, and the relative sophistication of the parties. Unequal bargaining power at the contracting stage must be addressed without unduly limiting parties' freedom to avoid the costs of litigation. This Comment argues that the proper balance can be struck by drawing on federal securities law. Rule 144A of the Securities Act of 1933 classifies certain investors as qualified institutional buyers who may enter into transactions without the additional protections otherwise afforded by the law. This Comment explains how the principles behind Rule 144A can be extended to arbitration, allowing what I call qualified arbitration participants greater control over the level of substantive judicial review applicable to their arbitration awards without sacrificing safeguards for less sophisticated parties.

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This Comment is dedicated to my grandparents. I am grateful for the thoughtful feedback and editing assistance provided by Katherine Stone and the *UCLA Law Review* board and staff. All errors are my own.

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INTRODUCTION

From commercial contracts and employment agreements to iTunes software updates, arbitration clauses are everywhere.[1] These provisions are often uncontroversial because third parties are rarely interested in the process or outcome when two companies arbitrate a commercial contract dispute. The Federal Arbitration Act (FAA) was written with these types of disputes in mind.[2] Increasingly, however, arbitrators are interpreting mandatory laws and resolving disputes between parties of unequal bargaining power.[3] In these situations, arbitration generates at least four negative externalities.

First, legally inaccurate arbitration awards, if left uncorrected, may allow for ongoing legal violations that harm third parties.[4] Second, inaccurate awards undermine enforcement and may thereby reduce the law's deterrent effect.[5] Third, unreasoned or inaccurate awards create uncertainty about the legal rights and obligations of third parties.[6] Fourth, arbitration can elicit controversy if observers believe victims are being denied their "day in court."[7] These externalities result in collective doubts about the procedural justice implications of promoting arbitration as an alternative to litigation.[8]

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1. *See* Katherine Van Wezel Stone, *Rustic Justice: Community and Coercion Under the Federal Arbitration Act*, 77 N.C. L. REV. 931, 934 (1999) (listing several contexts in which arbitration agreements have become common).
2. The Federal Arbitration Act (FAA) was enacted over ninety years ago when arbitration was primarily a tool for businesses to resolve their commercial disputes with one another. *See* Jean R. Sternlight, *Creeping Mandatory Arbitration: Is It Just?*, 57 STAN. L. REV. 1631, 1636 (2005) (explaining that at the time the FAA was enacted, arbitration was limited to "business-to-business or management/union contexts"). While the FAA has not been substantially amended since its passage, judicial interpretations of the statute have varied wildly over time. Simultaneously, arbitration has grown to include a wide range of parties and disputes. *See infra* Part I.
3. Mandatory laws are those that cannot be avoided by contract. *See infra* Part IV.B. The importance of tailoring to adjust for unequal bargaining power is discussed *infra* in Part IV.C.
4. Margaret L. Moses, *Arbitration Law: Who's in Charge?*, 40 SETON HALL L. REV. 147, 181 (2010) ("[W]hen arbitrators are deciding claims under public law, there is a high potential for negative externalities. For example, if an arbitrator makes a wrong decision in a matter arising under the antitrust laws, that decision may negatively affect not only the claimants but the rights of everyone else affected by the anti-competitive behavior.").
5. *See infra* notes 147–149 and accompanying text.
6. *See infra* notes 150–152 and accompanying text.
7. *E.g.*, Dahlia Lithwick, *Open the Shut Case: Why Is KBR So Afraid of Letting Jamie Leigh Jones Have Her Day in Court?*, SLATE, Jan. 28, 2010, http://www.slate.com/id/2242792; *see infra* notes 187–194 and accompanying text.
8. Thomas V. Burch, *Manifest Disregard and the Imperfect Procedural Justice of Arbitration*, 59 U. KAN. L. REV. 47, 57 (2010) ("Enforcing these mandatory-arbitration agreements negatively affects perceptions of procedural justice. It seems unfair that a party can design a process that limits basic procedural rights and impose it on another, particularly if that process limits

This Comment argues that tailored substantive judicial review of arbitration awards would help mitigate arbitration's negative externalities. Substantive judicial review allows judges to evaluate the legal accuracy of arbitration awards and vacate them when necessary. Such review may serve an important enforcement role when arbitrators decide disputes involving mandatory laws.[9] Judicial review may also reduce procedural justice concerns.[10] Currently, however, substantive judicial review of arbitration awards is extremely limited and has an uncertain future.

Resistance to substantive judicial review arises in part because it drains judicial resources and makes arbitration slower and more expensive for the parties involved.[11] Additionally, substantive review has become especially controversial in light of two recent U.S. Supreme Court decisions. In 2008, *Hall Street Associates, L.L.C. v. Mattel, Inc.*[12] created new confusion about the appropriate scope of substantive judicial review of arbitration awards.[13] In 2010, the Court declined to resolve the circuit split that *Hall Street* had created.[14] In light of this uncertainty, the law of substantive judicial review should be modernized and stabilized by comprehensive amendments to the FAA's provisions on vacatur, found in section 10.[15]

I argue that section 10 should be amended to mitigate arbitration's externalities by tailoring substantive judicial review to the facts and circumstances of each dispute. In determining the appropriate level of judicial review

judicial review."); *see also* Lawrence B. Solum, *Procedural Justice*, 78 S. CAL. L. REV. 181, 183 (2004) ("[P]rocedural justice is deeply entwined with the old and powerful idea that a process that guarantees rights of meaningful participation is an essential prerequisite for the legitimate authority of action-guiding legal norms. Meaningful participation requires notice and opportunity to be heard, and it requires a reasonable balance between cost and accuracy.").

9. *See infra* notes 246–247 and accompanying text.
10. *See infra* Part III.A.2.
11. *See infra* Part III.A.1.
12. 552 U.S. 576 (2008).
13. After *Hall Street*, a circuit split developed over the continued legitimacy of the manifest disregard of the law doctrine, which authorized courts to vacate an arbitration award if the arbitrator had clearly ignored relevant law. Some courts have read *Hall Street* as holding that manifest disregard is no longer a valid ground on which to vacate arbitration awards. Others have attempted to "reconceptualize" the doctrine to fit within the FAA's enumerated grounds. See *infra* Parts II.A and II.B for a discussion of the doctrine's various forms prior to *Hall Street* and the circuits' positions on the issue after the case.
14. Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., 130 S. Ct. 1758, 1768 n.3 (2010) ("We do not decide whether manifest disregard survives our decision in *Hall Street* . . . as an independent ground for review or as a judicial gloss on the enumerated grounds for vacatur set forth at 9 U.S.C. § 10." (internal quotation marks omitted)).
15. Federal Arbitration Act, 9 U.S.C. § 10 (2009).

for domestic[16] arbitration awards, the revised FAA should account for (1) the timing of the agreement to arbitrate, (2) the nature of the claims involved, and (3) the relative sophistication or bargaining power of the parties.

Though each of these factors has been discussed in the arbitration literature before, this Comment builds on that literature in two ways. First, I draw on federal securities law to propose a new measure for sophistication and bargaining power in the arbitration context. Second, I incorporate this new measure of sophistication into a comprehensive proposal for tailored judicial review. Under this approach, traditional arbitration—involving purely commercial disputes between sophisticated players—would not be subject to substantive judicial review absent the parties' explicit agreement.[17] At the same time, tailored judicial review would mitigate arbitration's externalities by increasing the level of substantive judicial review in cases that are more likely to generate negative externalities.

This Comment proceeds as follows. Part I provides a brief overview of the historical context and policy behind the FAA, the changes in arbitration since the statute was enacted, and the development of judicially created grounds for vacating arbitration awards. Part II focuses on the Supreme Court's *Hall Street*[18] and *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*[19] decisions, and the reactions that lower courts and commentators have had to those decisions. Part III analyzes the costs and benefits of substantive judicial review, including four negative externalities associated with modern arbitration practice—persistent legal violations, diminished deterrence, increased uncertainty for third parties, and threats to our collective confidence in procedural justice.[20]

16. Given the very different priorities and concerns involved in nondomestic and international arbitration, such awards are beyond the scope of this Comment.
17. Thomas J. Stipanowich, *Arbitration: The "New Litigation"*, 2010 U. ILL. L. REV. 1, 58 ("[T]hose engaged in proposing or enacting laws motivated by concerns over consumer and employee welfare must proceed with care to avoid imposing unnecessary 'spillover' transaction costs in arm's-length commercial settings.").
18. Hall St. Assocs., L.L.C. v. Mattel, Inc., 552 U.S. 576 (2008).
19. 130 S. Ct. 1758.
20. Additionally, litigation may have positive externalities that arbitration does not. These benefits have been documented elsewhere. *See, e.g.*, Kathryn A. Sabbeth & David C. Vladeck, *Contracting (Out) Rights*, 36 FORDHAM URB. L.J. 803, 830–31 (2009) ("Adjudication by public courts produces the following societal benefits that are missing from arbitration: development of a consistent body of precedent, through reasoned opinions that interpret statutes as applied to facts and may be corrected by appeals courts, democratic dialogue between courts and legislatures about correct interpretation of laws, public education of potential bad actors regarding limits of the law, potential victims who might bring suit to challenge bad conduct, citizenry with influence on their legislators, and customers who might influence bad actors by voting with their dollars, and the democratic value of jury deliberations and awards.").

Part IV introduces the dimensions along which arbitration agreements should be distinguished, discusses relevant prior proposals, and provides the details of my proposal for narrowly tailored judicial review.[21] Part V explores potential implications by applying the proposed amendment to two hypothetical disputes.

I. THE FEDERAL ARBITRATION ACT AND JUDICIAL REVIEW OF ARBITRATION AWARDS

A. A Brief History of the FAA

Prior to enactment of the FAA, "American courts were generally hostile to arbitration,"[22] while state legislatures regulated arbitration inconsistently. Some states borrowed from English procedures that emphasized an ongoing interaction between arbitrators and the courts in resolving legal questions.[23] Others sought to carve out a more independent role for arbitrators. In 1920, New York broke from traditional English arbitration law by enacting a statute that enforced predispute agreements to arbitrate, ended the practice of courts

21. My call for "narrowly tailored" judicial review has much in common with Thomas Burch's recent call for "case-centric" judicial review. *See* Burch, *supra* note 8, at 75 (introducing a "Case-Centric Method for Applying Manifest Disregard"). Our ultimate proposals, however, differ significantly. Most notably, Burch does not explore how courts might measure bargaining power. Instead, Burch suggests that "courts should expand [manifest disregard] to review awards for legal error in mandatory arbitration—although only for parties who did not draft the arbitration agreement." *Id.* at 48.

22. *Hall St.*, 552 U.S. at 593 (Stevens, J., dissenting).

23. Michael A. Scodro, *Arbitrating Novel Legal Questions: A Recommendation for Reform*, 105 YALE L.J. 1927, 1941 (1996) ("[T]he [ABA] . . . passed a statutory recommendation that limited the authority of private arbitrators more than did even the interventionist British laws . . . . [The proposal] did not empower the courts to enforce arbitration agreements entered into in advance of the dispute *and* permitted the parties to arbitration to submit purely legal questions to the courts, either during or at the conclusion of the arbitration."). Early English arbitration law reflected deep concerns about the extent to which arbitrators might interfere with the development of the common law. *See* Thomas E. Carbonneau, *Judicial Approbation in Building the Civilization of Arbitration*, 113 PENN ST. L. REV. 1343, 1348 (2009) ("As early as eighteenth century practice, English courts entertained common law petitions against arbitral awards; in these pleadings, the parties could challenge either the arbitrators' factual determinations or legal conclusions."). The Common Law Procedure Act of 1854 reemphasized the importance of judicial review by introducing procedures that authorized arbitrators to submit legal questions to the courts. *Id.* (explaining a "procedure, under which arbitrators were authorized to refer a legal question that arose in an arbitration for court decision"); *see also* Scodro, *supra*, at 1940 (explaining a practice "whereby [arbitrators] rendered their awards in the form of alternative outcomes, leaving it to the courts to choose among them based on their judgment about specified legal questions that had arisen during the arbitration").

hearing questions of law during the course of arbitration, and provided for only limited judicial review of the final award.[24]

In 1925, Congress followed New York's lead by enacting the United States Arbitration Act, later renamed the Federal Arbitration Act. The FAA was a "response to the refusal of courts to enforce commercial arbitration agreements."[25] Importantly, the legislative history reveals that the FAA was originally intended to protect arbitration agreements related to commercial disputes, rather than the employment or consumer arbitration agreements so common today.[26] More specifically, the FAA was enacted with the understanding that most arbitration would take place between relatively sophisticated companies with similar bargaining power.[27] Despite this history, the Supreme Court now maintains that the FAA "is a congressional declaration of a liberal federal policy favoring arbitration agreements."[28] The Court has subsequently relied on this judicially created federal policy in favor of arbitration to justify numerous pro-arbitration interpretations of the FAA.[29]

24. Scodro, *supra* note 23, at 1941.

25. Circuit City Stores, Inc. v. Adams, 532 U.S. 105, 125 (2001). The statute's express purpose was to ensure that "written provisions or agreements for arbitration of disputes arising out of contracts, maritime transactions, or commerce among the States or Territories or with foreign nations" would be "valid and enforceable." United States Arbitration Act, 9 U.S.C. § 1, 43 Stat. 883 (1925). For thorough accounts of the FAA's legislative history, see James E. Berger & Charlene Sun, *The Evolution of Judicial Review Under the Federal Arbitration Act*, 5 N.Y.U. J.L. & BUS. 745 (2009); Carbonneau, *supra* note 23 (providing a brief history of the passage of the FAA); Stone, *supra* note 1 (same).

26. Stone, *supra* note 1, at 942 ("[T]he FAA was intended to facilitate self-regulation within commercial communities, not to regulate relationships between consumers and large corporations in arm's length, anonymous transactions."); *see also Circuit City Stores, Inc.*, 532 U.S. at 126 ("[N]either the history of the drafting of the original bill by the ABA, nor the records of the deliberations in Congress during the years preceding the ultimate enactment of the Act in 1925, contain any evidence that the proponents of the legislation intended it to apply to agreements affecting employment."); Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 409 (1967) (Black, J., dissenting) (explaining that the history of the FAA "indicates that the Act was to have a limited application to contracts between merchants for the interstate shipment of goods"); Sternlight, *supra* note 2, at 1636 ("[W]hen one Senator voiced a concern that arbitration contracts might be 'offered on a take-it-or-leave-it basis to captive customers or employees,' the Senator was reassured by the bill's supporters that they did not intend for the bill to cover such situations.").

27. Arbitration Fairness Act of 2009, H.R. 1020, 111th Cong. (2009); S. 931, 111th Cong. (2009) (explaining that the FAA "was intended to apply to disputes between commercial entities of generally similar sophistication and bargaining power").

28. Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983). *But see* Carbonneau, *supra* note 23, at 1361 ("The federal judicial policy favoring arbitration was the Court's invention. Neither the statute nor its legislative history gave an inkling of—let alone identified—such a phrase or policy.").

29. *See* Stone, *supra* note 1, at 943–55 (suggesting that the policy in favor of arbitration has led to a "broad scope of preemption . . . , [a] presumption of arbitrability, the application of arbitration

B. FAA Section 10: Statutory Grounds for Vacatur

Section 10 of the FAA governs judicial review of arbitration awards. Section 10 allows courts to vacate arbitration awards in any of four scenarios:

> (1) "where the award was procured by corruption, fraud, or undue means";[30]
> (2) "where there was evident partiality or corruption in the arbitrators";[31]
> (3) "where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced";[32] or
> (4) "where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made."[33]

Many commentators have concluded that these statutory grounds for vacatur allow judicial "review *only* for procedural irregularities that evince extreme or outrageous conduct."[34] Under this view, the FAA simply does not permit substantive legal review of arbitration awards.[35] Courts, however, quickly engaged in substantive judicial review by developing additional grounds for vacatur.

C. Manifest Disregard of the Law

Despite section 10's focus on procedural irregularities, courts have permitted vacatur if "the award was in manifest disregard of the law, completely irrational, in direct conflict with public policy, arbitrary and

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to statutory rights, the separability doctrine, and [a] narrow standard of review"); *see also* Carbonneau, *supra* note 23, at 1363 (summarizing the Court's expansive readings of the FAA).

30. Federal Arbitration Act, 9 U.S.C. § 10(a)(1) (2009).
31. *Id.* § 10(a)(2).
32. *Id.* § 10(a)(3).
33. *Id.* § 10(a)(4).
34. Hiro N. Aragaki, *The Mess of Manifest Disregard*, 119 YALE L.J. ONLINE 1, 2 (2009), http://yalelawjournal.org/2009/09/29/aragaki.html (first emphasis added).
35. Christopher R. Drahozal, *Codifying Manifest Disregard*, 8 NEV. L.J. 234, 238 (2007) ("Section 10 by its terms does not provide for review of the substance of an arbitration award."); *see also* THOMAS E. CARBONNEAU, THE LAW AND PRACTICE OF ARBITRATION 98 (3d ed. 2009) ("FAA § 10 impliedly excludes the merits review of awards by limiting judicial supervision to procedural matters.").

capricious, or failed to draw its essence from the parties' underlying contract."[36] All of these doctrines have been so narrowly construed that they have had very limited impact on the enforcement of arbitration awards.[37] Studies suggest that, although success is rare, manifest disregard is relied on more frequently than any other ground for vacatur.[38]

The Supreme Court first introduced the term "manifest disregard" in 1953. In *Wilko v. Swan*,[39] the Court stated that "interpretations of the law by the arbitrators *in contrast to manifest disregard* are not subject, in the federal courts, to judicial review for error in interpretation."[40] The Court thus suggested that substantive judicial review for extreme forms of legal error might be permissible, despite the deference generally given to arbitrators' interpretations of the law.

After *Wilko*, lower courts struggled to explain the appropriate extent of judicial review under the manifest disregard doctrine.[41] Despite the challenges involved in applying the doctrine, every U.S. Court of Appeals ultimately adopted some form of manifest disregard review.[42] The various circuits took somewhat different approaches.

The Second Circuit developed a two-pronged test requiring proof that "'(1) the arbitrator knew of a governing legal principle yet refused to apply it

36. CARBONNEAU, *supra* note 35, at 227.

37. *Id.* at 389.

38. *See, e.g.*, Michael H. LeRoy & Peter Feuille, *Happily Never After: When Final and Binding Arbitration Has No Fairy Tale Ending*, 13 HARV. NEGOT. L. REV. 167, 189 (2008) ("[M]anifest disregard of the law was the most common basis for a challenge.").

39. 346 U.S. 427 (1953).

40. *Id.* at 436–37 (emphasis added). Manifest disregard has been criticized for this rather tenuous legal foundation. Commentators complain that, "[a]t best, *Wilko* provides a very shaky foundation for the modern conception of manifest disregard." Drahozal, *supra* note 35, at 238. In fact, Christopher Drahozal argues that "the great bulk of the common law authority—including those on point cited in *Wilko*—conflicts with rather than supports the current standard for manifest disregard of the law." *Id.* at 243.

41. George Watts & Son, Inc. v. Tiffany & Co., 248 F.3d 577, 580 (7th Cir. 2001) (complaining that that *Wilko* court left the doctrine "unexplained and unilluminated by any concrete application"); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker, 808 F.2d 930, 933 (2d Cir. 1986) ("[T]he bounds of this ground have never been defined.").

42. Drahozal, *supra* note 35, at 234; *see also* Birmingham News Co. v. Horn, 901 So. 2d 27, 48–49 (Ala. 2004) (citing cases); Stephen L. Hayford, *Reining in the "Manifest Disregard" of the Law Standard: The Key to Restoring Order to the Law of Vacatur*, 1998 J. DISP. RESOL. 117, 123–24 (1998). State courts, in contrast, have not uniformly accepted the manifest disregard doctrine for use in interpreting their own state statutes. Drahozal, *supra* note 35, at 235 n.11; *see also* Jennifer Samsel, *Evolving Judicial Review of Arbitration Awards: Is Massachusetts Lagging Behind in a "Manifest Disregard" of Arbitrators' Substantive Errors of Law?*, 40 SUFFOLK U. L. REV. 931, 945 (2007) (discussing state approaches to defining vacatur grounds); Stephen Wills Murphy, Note, *Judicial Review of Arbitration Awards Under State Law*, 96 VA. L. REV. 887, 911 (2010).

or ignored it altogether, and (2) the law ignored by the arbitrator was well defined, explicit, and clearly applicable to the case.'"[43] The Fifth[44] and D.C.[45] Circuits adopted the Second Circuit's formulation. The Third,[46] Fourth,[47] Sixth,[48] Eighth,[49] Tenth,[50] and Eleventh[51] Circuits developed tests that largely mirrored the first prong of the Second Circuit test, without an explicit requirement that the law also be well defined, explicit, and clearly applicable.[52]

43. D.H. Blair & Co., Inc. v. Gottdiener, 462 F.3d 95, 110–11 (2d Cir. 2006) (quoting Hoeft v. MVL Group, Inc., 343 F.3d 57, 69 (2d Cir. 2003)).
44. The Fifth Circuit directly quoted the Second Circuit when it adopted manifest disregard. *See* Prestige Ford v. Ford Dealer Computer Servs., Inc., 324 F.3d 391, 395 (5th Cir. 2003) (quoting *Bobker*, 808 F.2d at 933–34); *see also* Citigroup Global Markets, Inc. v. Bacon, 562 F.3d 349, 354 (5th Cir. 2009).
45. LaPrade v. Kidder, Peabody & Co., Inc., 246 F.3d 702, 706 (D.C. Cir. 2001) (quoting DiRussa v. Dean Witter Reynolds, Inc., 121 F.3d 818, 821 (2d Cir. 1997) ("[A] court must find that (1) the arbitrators knew of a governing legal principle yet refused to apply it or ignored it altogether and (2) the law ignored by the arbitrators was well defined, explicit, and clearly applicable to the case.")).
46. Paul Green Sch. of Rock Music Franchising, LLC v. Smith, 389 F. App'x 172, 177 (3d Cir. 2010) (requiring "that the arbitrator (1) knew of the relevant legal principle, (2) appreciated that this principle controlled the outcome of the disputed issue, and (3) nonetheless willfully flouted the governing law by refusing to apply it").
47. Patten v. Signator Ins. Agency, Inc., 441 F.3d 230, 235 (4th Cir. 2006) (requiring that "the 'arbitrator[ ] understand[s] and correctly state[s] the law, but proceed[s] to disregard the same'" (quoting Upshur Coals Corp. v. United Mine Workers, Dist. 31, 933 F.2d 225, 229 (4th Cir. 1991))).
48. The Sixth Circuit has similarly explained that "an arbitrator acts with manifest disregard if '(1) the applicable legal principle is clearly defined and not subject to reasonable debate; and (2) the arbitrators refused to heed that legal principle.'" Coffee Beanery, Ltd. v. WW, L.L.C., 300 F. App'x 415, 418 (6th Cir. 2008) (quoting Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Jaros, 70 F.3d 418, 421 (6th Cir. 1995)).
49. Schoch v. InfoUSA, Inc., 341 F.3d 785, 788 (8th Cir. 2003) (quoting Boise Cascade Corp. v. Paper Allied-Indus., Chem. & Energy Workers, 309 F.3d 1075, 1080 (8th Cir. 2002)) (explaining that "[a]n arbitrator's award 'manifest[ed] disregard for the law where the arbitrators clearly identif[ied] the applicable, governing law and then proceed[ed] to ignore it'").
50. The Tenth Circuit "characterized the 'manifest disregard' standard as 'willful inattentiveness to the governing law.'" U.S. Energy Corp. v. Nukem, Inc., 400 F.3d 822, 830 (10th Cir. 2005) (quoting Jenkins v. Prudential-Bache Sec., Inc., 847 F.2d 631, 634 (10th Cir. 1988)).
51. The Eleventh Circuit "require[d] clear evidence that the arbitrator was 'conscious of the law and deliberately ignore[d] it.'" B.L. Harbert Int'l, LLC v. Hercules Steel Co., 441 F.3d 905, 910 (11th Cir. 2006) (quoting Montes v. Shearson Lehman Bros., Inc., 128 F.3d 1456, 1461 (11th Cir. 1997)).
52. The First Circuit's approach was less focused and is irrelevant to this Comment. For an explanation of applicable First Circuit law, see *Kashner Davidson Sec. Corp. v. Mscisz*, 531 F.3d 68, 74 (1st Cir. 2008).

The Seventh Circuit originally developed a standard similar to those described above.[53] In 2001, however, the Seventh Circuit narrowed its understanding of manifest disregard.[54] Under the new definition, manifest disregard means only that "an arbitrator may not direct the parties to violate the law."[55] More importantly, the Seventh and Ninth Circuits have both concluded that their respective definitions of manifest disregard fit within section 10's fourth ground for vacatur—where the arbitrators exceeded their powers.[56] In so doing, the Seventh and Ninth Circuits have expressed unease about the legitimacy of manifest disregard as an independent extra-statutory ground for vacatur, and now consider manifest disregard a component of section 10.

II. *HALL STREET* AND *STOLT-NIELSEN*

A. The Supreme Court's *Hall Street* Decision

The legitimacy of manifest disregard was drawn further into doubt by the Court's 2008 *Hall Street* decision. The parties in *Hall Street* had entered into a postdispute arbitration agreement that provided for substantive judicial review of the resulting arbitration award.[57] The district court attempted to comply with the parties' agreement for judicial review, but the Ninth Circuit held that "the terms of the arbitration agreement controlling the mode of judicial review are unenforceable."[58]

53. Drahozal, *supra* note 35, at 237. For an example of a case applying the original standard, see *Health Services Management Corp. v. Hughes*, 975 F.2d 1253 (7th Cir. 1992). For a discussion of the variations between what might otherwise sound like very similar standards, see Hayford, *supra* note 42, at 125–32 (discussing the courts' struggle to maintain a distinction between the arbitrators' actual error of law and the mental state leading to the error).

54. George Watts & Son, Inc. v. Tiffany & Co., 248 F.3d 577 (7th Cir. 2001).

55. *Id.* at 580.

56. Wise v. Wachovia Sec., LLC, 450 F.3d 265, 268 (7th Cir. 2006) (explaining that the court's narrow definition of manifest disregard "fits comfortably under the first clause of the fourth statutory ground—'where the arbitrators exceeded their powers'"); Kyocera Corp. v. Prudential-Bache Trade Servs., Inc., 341 F.3d 987, 997 (9th Cir. 2003) (explaining that an arbitrator exceeds his powers when his award exhibits a manifest disregard of the law).

57. Hall St. Assocs., L.L.C. v. Mattel, Inc., 552 U.S. 576, 579 (2008) (providing the relevant text of the arbitration agreement, which stated that the "Court shall vacate, modify or correct any award: (i) where the arbitrator's findings of facts are not supported by substantial evidence, or (ii) where the arbitrator's conclusions of law are erroneous").

58. Hall St. Assocs., L.L.C. v. Mattel Inc., 113 F. App'x 272, 272–73 (9th Cir. 2004), *cert. granted*, 550 U.S. 968 (2007), *vacated*, 552 U.S. 576. This summary of the procedural history is drawn from *Hall Street*, 552 U.S. at 579–81.

The dispute eventually made its way to the Supreme Court, which noted an existing circuit split over the validity of opt-in contracts for expanded judicial review.[59] Additionally, in what have become particularly controversial assertions, the Court ambiguously agreed with the Ninth Circuit's position that "the grounds for vacatur and modification provided by §§ 10 and 11 of the FAA are exclusive"[60] and held "that §§ 10 and 11 respectively provide the FAA's exclusive grounds for expedited vacatur and modification."[61] The circuit courts have since split on the proper reading of *Hall Street*.

B. Circuit Court Split on the Meaning of *Hall Street*

The Fifth,[62] Eighth,[63] and Eleventh[64] Circuits have read *Hall Street* to completely eliminate judicially created grounds for vacatur, including manifest disregard. In contrast, the Second, Seventh, and Ninth (and perhaps the Tenth) Circuits[65] have held that the doctrine survives. As discussed above,

59. *Hall St.*, 552 U.S. at 583 ("The Courts of Appeals have split over the exclusiveness of these statutory grounds when parties take the FAA shortcut to confirm, vacate, or modify an award, with some saying the recitations are exclusive, and others regarding them as mere threshold provisions open to expansion by agreement."). See *infra* Part III.B for a discussion of this circuit split.

60. *Hall St.,* 552 U.S. at 581.

61. *Id.* at 584.

62. Citigroup Global Markets, Inc. v. Bacon, 562 F.3d 349, 350 (5th Cir. 2009) ("*Hall Street* restricts the grounds for vacatur to those set forth in § 10 of the Federal Arbitration Act . . . and consequently, manifest disregard of the law is no longer an independent ground for vacating arbitration awards under the FAA."); *see also* Householder Group v. Caughran, 354 F. App'x 848, 850 (5th Cir. 2009) ("Arbitration awards can no longer be vacated on nonstatutory, common law grounds.").

63. Med. Shoppe Int'l, Inc. v. Turner Invs., Inc., 614 F.3d 485, 489 (8th Cir. 2010) (holding "that an arbitral award may be vacated only for the reasons enumerated in the FAA").

64. Frazier v. CitiFinancial Corp., LLC, 604 F.3d 1313, 1324 (11th Cir. 2010) ("[J]udicially-created bases for vacatur are no longer valid in light of *Hall Street*. In so holding, we agree with the Fifth Circuit that the categorical language of *Hall Street* compels such a conclusion.").

65. The Tenth Circuit initially declined to decide whether the section 10 grounds are exclusive. Hicks v. Cadle Co., 355 F. App'x 186, 197 (10th Cir. 2009) ("We need not decide whether § 10 provides the exclusive grounds for vacating an arbitrator's decision, because defendants demonstrate neither manifest disregard of the law nor violation of public policy."), *cert. denied*, 131 S. Ct. 160 (2010) (mem.); *see also* Legacy Trading Co., Ltd. v. Hoffman, 363 F. App'x 633, 635 n.2 (10th Cir. 2010) ("[W]e need not decide what, if any, judicially-created grounds for vacatur survive in the wake of *Hall Street* . . . ."). Then, without any mention of *Hall Street*, the court explained that "[a]n arbitration award will only be vacated for the reasons enumerated in the Federal Arbitration Act, 9 U.S.C. § 10, or for '*a handful of judicially created reasons*.'" Burlington N. & Santa Fe Ry. Co. v. Pub. Serv. Co. of Okla., 636 F.3d 562, 567 (10th Cir. 2010) (emphasis added) (quoting Sheldon v. Vermonty, 269 F.3d 1202, 1206 (10th Cir. 2001)). It thus seems possible that the Tenth Circuit will retain manifest disregard, but the court has given no explanation for that decision.

the Seventh and Ninth Circuits had already determined that their respective definitions of manifest disregard fit within the FAA's enumerated grounds.[66] Both circuits have maintained this view.[67] After *Hall Street*, the Second Circuit has "reconceptualized" manifest disregard as a judicial gloss on section 10 and has retained the doctrine in that form.[68]

Early case law provides some support for the idea that substantive judicial review could fall within section 10. In his *Wilko* dissent, Justice Frankfurter advocated for arbitration on the understanding that "failure to observe [the] law 'would constitute grounds for vacating the award pursuant to section 10 of the Federal Arbitration Act.'"[69] Others, however, argue that manifest disregard simply cannot fit within section 10,[70] and the Supreme Court has recently suggested that "review under § 10 focuses on misconduct rather than mistake."[71] Thus far, the First,[72] Third,[73] Fourth,[74]

66. *See infra* Part I.C.

67. Nine days after the *Hall Street* decision, but without mention of it, the Seventh Circuit reaffirmed its narrow approach in *Jonites v. Exelon Corp.*, 522 F.3d 721, 726 (7th Cir. 2008). The Ninth Circuit has "determine[d] that *Hall Street Associates* does not undermine [its] prior precedent," and "[a]s a result . . . an arbitrator's manifest disregard of the law remains a valid ground for vacatur of an arbitration award under § 10(a)(4) of the Federal Arbitration Act." Comedy Club, Inc. v. Improv W. Assocs., 553 F.3d 1277, 1281 (9th Cir. 2009), *cert. denied*, 130 S. Ct. 145 (2009) (mem.).

68. Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., 548 F.3d 85, 94 (2d Cir. 2008) (stating that *Hall Street*'s holding that the FAA sets forth the "exclusive" grounds for vacatur is "undeniably inconsistent with some dicta by this Court treating the 'manifest disregard' standard as a ground for vacatur entirely separate from those enumerated in the FAA," but nonetheless holding "that 'manifest disregard,' reconceptualized as a judicial gloss on the specific grounds for vacatur enumerated in Section 10 of the FAA, remains a valid ground for vacating arbitration awards"), *rev'd and remanded*, 130 S. Ct. 1758 (2010).

69. Wilko v. Swan, 346 U.S. 427, 440 (1953) (Frankfurter, J., dissenting) (quoting Wilko v. Swan, 201 F.2d 439, 445 (2d Cir. 1953), *rev'd*, 346 U.S. 427), *overruled by* Rodriguez de Quijas v. Shearson/Am. Exp., Inc., 490 U.S. 477 (1989).

70. *See, e.g.*, John C. Steffens, *Consistent With Inconsistency: The Sixth Circuit Keeps Manifest Disregard After* Hall Street, 2009 J. DISP. RESOL. 531, 542 (2009) ("While section 10 contains four grounds for vacatur, many courts find manifest disregard to be an interpretation of section 10(a)(4), which allows vacatur where an arbitrator has exceeded her powers or imperfectly executed them. However, this line of reasoning is inconsistent with *Hall Street* and the traditional interpretations of section 10(a)(4).").

71. AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740, 1752 (2011).

72. Kashner Davidson Sec. Corp. v. Mscisz, 601 F.3d 19, 22 (1st Cir. 2010) (explaining that the circuit has "not squarely determined whether [its] manifest disregard case law can be reconciled with *Hall Street*").

73. Paul Green Sch. of Rock Music Franchising, LLC v. Smith, 389 F. App'x 172, 176–77 (3d Cir. 2010) (acknowledging the circuit split over the continued validity of manifest disregard, but making clear that the circuit had "not yet entered that debate").

74. MCI Constructors, LLC v. City of Greensboro, 610 F.3d 849, 857 n.5 (4th Cir. 2010) (emphasizing that to resolve the case at bar, the court "need not decide whether courts may

Sixth[75] and D.C.[76] Circuits have either declined to address whether manifest disregard survives, or have offered conflicting statements. Additionally, commentators have suggested that *Hall Street* may not have been intended to have any impact on judicially created grounds for vacatur. This latter reading is discussed below.

C. An Alternate Reading

Prior to *Hall Street*, several circuits and many academics had taken the position that arbitration agreements could expressly provide for substantive judicial review, unconstrained by section 10.[77] Parties to arbitration agreements drafted these so-called "opt-in" provisions without any involvement from the courts.[78] The *Hall Street* decision resolved a circuit split on the validity of opt-in provisions by prohibiting private contracts for judicial review. Hiro Aragaki argues that this was the only holding in *Hall Street*, and that the decision does not impact any of the judicially created grounds for vacatur.[79] Aragaki maintains that the Court was limiting only the parties' power to decide the grounds for judicial review applicable to their arbitration awards, not the courts' power to expand vacatur beyond section 10.[80]

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still vacate an arbitration award if the award fails to draw its essence from the controlling agreement, or if it flows from a manifest disregard of the applicable law").

75. Grain v. Trinity Health, Mercy Health Servs. Inc., 551 F.3d 374, 380 (6th Cir. 2008) ("[W]e have said that 'manifest disregard of the law' may supply a basis for vacating an award, at times suggesting that such review is a 'judicially created' supplement to the enumerated forms of FAA relief. . . *Hall Street*'s reference to the 'exclusive' statutory grounds for obtaining relief casts some doubt on the continuing vitality of that theory."); *see also* Martin Marietta Materials, Inc. v. Bank of Okla., 304 F. App'x 360, 362–63 (6th Cir. 2008) (acknowledging uncertainty as to the "continuing vitality" of manifest disregard). *But see* Coffee Beanery, Ltd. v. WW, L.L.C., 300 F. App'x 415, 418–19 (6th Cir. 2008) (asserting that the Supreme Court's decision in *Hall Street* "did not foreclose federal courts' review for an arbitrator's manifest disregard of the law," and emphasizing *Hall Street*'s holding "that the FAA does not allow private parties to supplement by contract the FAA's statutory grounds for vacatur of an arbitration award"); Dealer Computer Servs., Inc. v. Dub Herring Ford, 547 F.3d 558, 561 n.2 (6th Cir. 2008) ("A court may also vacate an award on non-statutory grounds if the arbitration panel demonstrates a 'manifest disregard of the law.'").

76. Regnery Pub., Inc. v. Miniter, 368 F. App'x 148, 149 (D.C. Cir. 2010) ("Assuming without deciding that the 'manifest disregard of the law' standard survives Hall Street . . . .").

77. *See, e.g.*, Christopher R. Drahozal, *Contracting Around* Hall Street, 14 LEWIS & CLARK L. REV. 905, 914 (2010) (summarizing the history of the theory, and stating that prior to *Hall Street*, the weight of authority "recognized the ability of parties to contract for expanded review by limiting the authority of arbitrators").

78. The costs and benefits of opt-in provisions are discussed in Part III.B.

79. Aragaki, *supra* note 34, at 2 ("*Hall Street* bears no implication whatsoever for manifest disregard (or, indeed, for any other judicially-crafted vacatur standard).").

80. *Id.* at 5.

D. *Stolt-Nielsen v. AnimalFeeds International Corp.*[81]

In April 2010, despite evident disagreement between the lower courts, the Supreme Court in *Stolt-Nielsen* stated, "We do not decide whether 'manifest disregard' survives our decision in *Hall Street* . . . as an independent ground for review or as a judicial gloss on the enumerated grounds for vacatur set forth at 9 U.S.C. § 10."[82] Thus, the circuit split remains unresolved, leaving parties to arbitration agreements uncertain whether their arbitration awards will be subject to substantive judicial review.[83]

III. COSTS AND BENEFITS OF POTENTIAL REFORMS

The current uncertainty surrounding manifest disregard and the other judicially created grounds for vacatur is frustrating for the lower courts.[84] It leaves the future of existing arbitration agreements in limbo. Moreover, after *Hall Street*, parties cannot resolve the confusion on their own with explicit contractual provisions. Thus, parties contemplating entering into arbitration agreements cannot confidently predict whether any resulting arbitration awards would be reviewable for substantive errors. Given the Court's refusal to give sufficient guidance, Congress should clarify the future of substantive judicial review of arbitration awards. This Part explores the costs and benefits of judicial review of arbitration awards in general, and the unique costs and benefits of allowing parties to contract for their preferred level of judicial review.

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81. 130 S. Ct. 1758 (2010). For the Court's latest fractured views on the interaction between arbitration and class action proceedings, including class arbitration, see *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740, 1752 (2011).

82. *Stolt-Nielsen*, 130 S. Ct. at 1768 n.3.

83. The Court's discussion of manifest disregard is not the only part of the opinion that has been criticized for its lack of clarity. The Court claimed to be applying the standard section 10 grounds for vacatur, but some argue that the opinion reads more like de novo review of the arbitrator's legal conclusions. In effect, the Court appeared to be telling lower courts to "Do as I say, not as I do." *See* Allan Dinkoff, 'Stolt-Nielsen'*: So What Is the Standard of Review of Arbitration Awards?*, N.Y. L.J., July 26, 2010, at 4 (stating that the Court "showed little deference to the arbitrators' award, which arguably portends a shift to more rigorous judicial review"). Moreover, the Court concluded without any analysis that, if manifest disregard survived, the standard was satisfied. This claim has been attacked as unsupportable. Dinkoff explains that the Court concluded that the arbitrators had misunderstood the law, which "would appear to be precisely the opposite of 'knowing the relevant legal principle and nonetheless willfully flouting the governing law by refusing to apply it,' and thus there would be no basis for vacating the award on manifest-disregard grounds." *Id.*

84. *See, e.g.*, Goldman Sachs Execution & Clearing, L.P. v. Official Unsecured Creditors' Comm. of Bayou Grp., LLC, 758 F. Supp. 2d 222, 225 (S.D.N.Y. 2010) (sarcastically praising the Supreme Court's decision in *Stolt-Nielsen* for "so helpfully stat[ing]" that it did not decide whether manifest disregard survives *Hall Street*).

After weighing the costs and benefits, I conclude that section 10 should be revised to mitigate arbitration's modern externalities. Such a revision should go beyond the question of whether or not to codify manifest disregard. Instead, an amended section 10 should enact a new, tailored framework for determining the level of judicial review for different types of arbitration awards.

A. Costs and Benefits of Substantive Judicial Review

Allowing substantive judicial review of arbitration awards on appeal is controversial. Critics believe that judicial review should be limited to procedural problems. They fear that substantive judicial review "has the potential to erode some of the great benefits that arbitration offers."[85] On the other side, proponents of substantive judicial review acknowledge the unique benefits of arbitration in certain circumstances,[86] but believe the benefits of substantive judicial review outweigh the harms. This Subpart considers each side of the debate.

1. Costs of Substantive Judicial Review

Substantive judicial review of arbitration awards can be costly for everyone involved. Judicial review may harm the parties involved in a dispute, undermine the integrity of arbitration as an alternative to litigation, burden the courts, and have a negative impact on employees and consumers in general. The primary costs to the parties are reductions in efficiency, finality, and privacy. However, judicial review may also uniquely harm parties with fewer resources. Judicial intrusions threaten the integrity of arbitration by encouraging unreasoned, unwritten arbitration awards. The additional burden on the courts is obvious, as judges must spend time and resources reviewing arbitration awards. Finally, society may ultimately bear the increased costs of arbitration through higher prices and lower wages. Each of these potential costs is considered below.

Costs to the parties involved. Arbitration is meant to be a faster, cheaper alternative to litigation.[87] Some arbitration advocates go so far as to declare

85. Brent S. Gilfedder, *"A Manifest Disregard of Arbitration?": An Analysis of Recent Georgia Legislation Adding "Manifest Disregard of the Law" to the Georgia Arbitration Code as a Statutory Ground for Vacatur*, 39 GA. L. REV. 259, 288 (2004).

86. *See, e.g.*, Sternlight, *supra* note 2, at 1672 ("In terms of such features as speed, cost, and privacy, arbitration, even the mandatory version, may offer a superior result to many disputants.").

87. Christopher Walsh, Stolt-Nielsen*'s Comfort for the "Average Arbitrator": An Analysis of the Post–*Hall Street *"Manifest Disregard" Award Review Standard*, 27 ALTERNATIVES TO HIGH COST LITIG. 19, 21 (Feb. 2009) ("[A]rbitration's essential virtue [is] resolving disputes straightaway." (quoting Hall St. Assocs., L.L.C. v. Mattel, Inc., 552 U.S. 576, 588 (2008)) (internal quotation marks omitted)).

the issue empirically settled. Peter Rutlege declares confidently, "Arbitration produces quicker results. All of the available studies have found the time from the commencement of the dispute to its resolution is shorter in arbitration than litigation."[88] Others are more skeptical. Judge Rakoff in the Southern District of New York recently observed, "Although arbitration is touted as a quick and cheap alternative to litigation, experience suggests that it can be slow and expensive."[89] Regardless of one's beliefs or interpretation of the data, it is uncontroversial that judicial review of an arbitration award will lengthen the process and delay a final resolution.[90] For this reason, Kevin Murphy has argued that Congress should intervene to eliminate the manifest disregard doctrine entirely because substantive judicial review "not only delays judicial enforcement of arbitration awards, but also encourages parties to resort to judicial enforcement rather than voluntarily satisfying the award."[91]

Some arbitration advocates consider finality, rather than speed or efficiency, to be arbitration's "most essential feature."[92] Critics of manifest disregard argue that expanding judicial review beyond the procedural grounds enumerated in the FAA gives "parties disappointed with the result reached in arbitration reason to believe they may be able to circumvent objectionable awards by resort to the courts."[93] Of course, even without the option of substantive judicial review, parties may seek vacatur on the other section 10 grounds. It is difficult, however, to seek vacatur on procedural grounds without evidence of procedural irregularities. Critics argue that manifest disregard is a sufficiently vague standard that parties will frequently bring vacatur motions even when they do not have a particularly strong case.[94] As a result, substantive judicial review "increase[s] the expense, time to resolution and consternation

88. Peter B. Rutledge, *Arbitration Reform: What We Know and What We Need to Know*, 10 CARDOZO J. CONFLICT RESOL. 579, 582 (2009).

89. *Goldman Sachs*, 758 F. Supp. 2d at 224.

90. Interference with the arbitration process may be less problematic when the dispute involves parties with unequal bargaining power. In these cases, the argument goes, the dominant party is more likely to have drafted the agreement, and it is possible that the weaker party did not meaningfully consent to arbitration. Thus, it is a stretch to assume that both parties weighed their options and selected arbitration for its speed or finality. *See infra* note 177 (discussing arbitration where consent might be said to be lacking). My proposal takes unequal bargaining power into account when selecting the appropriate level of judicial review. *See infra* Part IV.

91. Kevin Patrick Murphy, Note, *Alive but Not Well: Manifest Disregard After* Hall Street, 44 GA. L. REV. 285, 314 (2009).

92. Hayford, *supra* note 42, at 118.

93. *Id.* at 118–19.

94. To some extent, the data bears this out. LeRoy & Feuille, *supra* note 38, at 189 (finding that among the "common law standards for reviewing an award, manifest disregard of the law was the most common basis for a challenge" but still "rarely led to vacatur").

associated with commercial arbitration."[95] Thus, critics advocate for limitations on, or the elimination of, substantive judicial review to avoid these potential losses to the core arbitration values of efficiency and finality.[96]

To the extent that manifest disregard increases the number of vacatur motions, it also threatens privacy, a key feature of arbitration.[97] Typically, the "attendance of 'observers' [at arbitration proceedings] is either presumptively prohibited or is at the option of parties and the arbitrator."[98] Certain parties value the privacy of arbitration because it allows them "to protect business and other confidences,"[99] "to 'save face' and avoid public defeat,"[100] and to avoid the "disclosure of embarrassing information that otherwise would have been publicly revealed in trial."[101] By exposing arbitral proceedings to the public during the appeals process, substantive review would make privacy, at most, a temporary feature of arbitration.

While both parties may suffer from reductions in efficiency, finality, and privacy, some arbitration advocates argue that substantive judicial review will result in unique harms to parties with fewer resources. Peter Smith argues that parties with fewer resources to expend on the resolution of their disputes will generally "[fare] better with an arbitrator than a judge."[102] His conclusion is based on two assumptions.

First, Smith believes that, in general, "courts will apply the letter of the law with less deference to what is 'fair, just or sensible under the circumstances.'"[103] Assuming that arbitrators take a more equitable approach, and that parties with fewer resources benefit disproportionately from this approach,

95. Hayford, *supra* note 42, at 118–19.

96. *See, e.g.*, Walsh, *supra* note 87, at 21 ("[I]f a manifest disregard standard of review is to survive *Hall Street*, it should be so narrowly circumscribed that it can plausibly find a basis in the Section 10 language, and continue to promote the 'national policy favoring arbitration with just the limited review needed to maintain arbitration's essential virtue of resolving disputes straightaway.'" (quoting Hall St. Assocs., L.L.C. v. Mattel, Inc., 552 U.S. 576, 588 (2008))).

97. Amy J. Schmitz, *Ending a Mud Bowl: Defining Arbitration's Finality Through Functional Analysis*, 37 GA. L. REV. 123, 158 (2002) ("Arbitration long has been valued for its privacy because it allows parties to resolve disputes off the public record and outside of a public forum.").

98. Judith Resnik, *Whither and Whether Adjudication?*, 86 B.U. L. REV. 1101, 1137 (2006).

99. Schmitz, *supra* note 97, at 158.

100. *Id.*

101. *Id.*

102. Peter J. Smith IV, *Investors Win:* Howsam v. Dean Witter Reynolds, Inc. *Makes Entering Arbitration Quicker, Easier, and Less Expensive*, 4 PEPP. DISPUTE RESOL. L.J. 127, 140 (2003).

103. *Id.* (quoting Margaret M. Harding, *The Cause and Effect of the Eligibility Rule in Securities Arbitration: The Further Aggravation of Unequal Bargaining Power*, 46 DEPAUL L. REV. 109, 141 (1996)).

the fear is that substantive judicial review might result in equitable awards being overturned by more formalistic judges.[104]

Second, Smith argues that parties with fewer resources benefit from that fact that "arbitration allows for 'more simplicity, informality and expedition.'"[105] Many arbitration critics would agree that the costs and delays of litigation are highly problematic.[106] By increasing costs, and the time to recovery, substantive judicial review might put parties with fewer resources at a disadvantage. Those parties might be less able to afford the costs of pursuing or defending vacatur motions,[107] and may be more concerned about the timing of any damage award. Thus, substantive judicial review might not be of much benefit to parties facing financial hardships and could provide a method for the party with greater resources to drag out the process in the hopes of an advantageous settlement.

Costs to the integrity of arbitration. In addition to the potential harms to parties engaged in arbitration, substantive judicial review may threaten the integrity and autonomy of arbitration.[108] Intrusions into the arbitral sphere may lead to more unreasoned, unwritten arbitration awards. Stephen Hayford argues that expanding judicial review to include nonstatutory grounds, such as manifest disregard, undermines the perceived legitimacy of arbitration by creating a perverse "disincentive to reasoned awards that reveal the manner in which the arbitrator decides disputed questions of fact, contract interpretation and law."[109] Hayford believes that reasoned, written arbitration awards increase public confidence in "the rigor and reliability of arbitration as a surrogate for adjudication in the courts."[110] Substantive review might discourage written awards because arbitrators, concerned for their careers, may decide not to issue

104. Smith's assertion that arbitrators will be more likely to make awards which favor the party with fewer resources is controversial. *See infra* Part III.A.2.

105. *Id.* (internal citations omitted).

106. Sternlight, *supra* note 2, at 1672 ("[L]itigation poses problems of lack of justice that can lead to significant substantive injustice.").

107. Schmitz, *supra* note 97, at 159–60 ("[I]t seems parties with few financial resources to fund expenses of judicialized arbitration procedures, let alone to launch a substantive post-award appeal, often would be those most harmed by substantive judicial review of arbitration awards.").

108. *See* CARBONNEAU, *supra* note 35, at 99 ("Arguing that the arbitral rulings in the award 'manifestly disregard the law,' are capricious and irrational, or offend public policy invites the courts to examine the substance of the arbitrator's determination, to disagree with it, and to substitute their judgment for that of the arbitral tribunal. Unlike English law, there is no overarching policy to justify the practice. The U.S. courts are not preoccupied with maintaining the integrity of domestic commercial law. Rather, the practice of assessing the merits of awards appears to be haphazard both in origin and implementation. It does, however, invest the courts with power over the arbitral process. For all these reasons, the U.S. practice arguably poses a greater danger and threat to the autonomy of arbitration than its English counterpart.").

109. Hayford, *supra* note 42, at 118–19.

110. *Id.*

written awards so that their legal reasoning cannot be challenged on appeal. Additionally, substantive judicial review might make arbitrators more "apprehensive to render awards based on equity, or to fashion creative remedies that may not be available in court."[111] By discouraging written awards and innovative remedies, substantive judicial review might prevent arbitration from developing into its otherwise optimal form because arbitrators will be constrained and distracted by the threat of judicial review.[112]

Costs to the courts. Critics argue that substantive judicial review will place a greater burden on the courts.[113] It is indisputable that expanding substantive judicial review would create additional costs for the courts, at least in the short run.[114] Arbitration advocates often tout arbitration as "a means for easing judicial caseloads and sparing expenditure of public resources that otherwise would be allocated to resolution of private disputes."[115] Moreover, substantive judicial review would "burden courts with an awkward task due to unclear distinctions between fact and law, as well as fundamental differences between arbitration and litigation."[116]

Costs to society. Finally, critics argue that the increased costs associated with substantive judicial review will be passed on through the market to the rest of society. Under this theory, arbitration participants, "along with the rest of the populace, may suffer lower wages or higher prices flowing from increased expenses of judicialized arbitration."[117] The argument is straightforward. Businesses save money when they can resolve disputes in arbitration without the added expense of judicial review. In a competitive market, these cost savings are passed on to consumers and employees. Because substantive judicial review makes arbitration more costly for businesses, it will necessarily lead to higher prices for consumers or lower wages for employees.[118]

111. Schmitz, *supra* note 97, at 161.
112. *Id.* at 123–61 ("[A]s the line between arbitration and litigation fades due to expanded judicial review of awards, arbitrators are likely to spend less time focusing on efficient resolution of disputes and more time producing court-like records created to withstand substantive appeals.").
113. EDWARD BRUNET ET AL., ARBITRATION LAW IN AMERICA: A CRITICAL ASSESSMENT 81 (2006).
114. It is possible that without substantive judicial review, the legal uncertainty created by inaccurate, unreviewable arbitration awards might actually lead to a long-term increase in litigation, as parties turn to the courts for definitive resolution of newly ambiguous areas of law. This is an empirical question and is beyond the scope of this Comment.
115. Schmitz, *supra* note 97, at 160.
116. *Id.* at 132.
117. *Id.* at 160.
118. Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. DISP. RESOL. 89, 93 ("[E]nforceable consumer arbitration agreements lower the dispute-resolution costs of businesses that choose to use such agreements. These cost-savings

2. Benefits of Substantive Judicial Review

The benefits of substantive judicial review are as widely dispersed as the costs. Substantive judicial review may benefit the parties involved, the integrity of arbitration as an alternative to litigation, the courts, and society. Substantive judicial review allows disputants to correct arbitrator errors. By reducing concerns about procedural justice, substantive judicial review may also improve the perceived integrity of arbitration. Moreover, courts will be able to reclaim their traditional role in interpreting the law, creating public precedent, and developing social norms. Finally, society as a whole benefits from a reduction in the four externalities identified in the Introduction—persistent legal violations, reduced deterrence, increased uncertainty, and diminished faith in procedural justice.

Benefits to the parties involved. At the most basic level, substantive judicial review of arbitration awards will sometimes correct arbitrator errors. Such errors are inevitable, and potentially costly.[119] The opportunity to correct an inaccurate award may be of great value to the wronged party. In fact, it is unlikely that a party would seek judicial review unless its expected gains from a correction exceed its anticipated costs in the process. On the other hand, a victory for one party is necessarily a loss for the other.

Benefits to the integrity of arbitration. In addition to the benefit of error correction for the parties, substantive judicial review may lend integrity to the arbitration system as a whole: "[W]hen a disappointed litigant knows he can ask a different and ostensibly neutral court to reconsider his case, the litigant will have more reason to believe that his case has received adequate consideration; that may well instill respect for, and engender accession to, the judgments of the adjudicative system."[120] This increase in perceived legitimacy could be valuable to arbitration's proponents as its critics increasingly express serious doubts about the system.[121]

lead, through competition among businesses for capital, to lower prices for consumers. The greater the cost-savings to business, the greater the price reduction for consumers. To put it another way, the more costly arbitration is to business, the more consumers pay for goods, services and credit.").

119. This is one reason our judicial system includes an appeals process. *See* Steven Shavell, *The Appeals Process as a Means of Error Correction*, 24 J. LEGAL STUD. 379 (1995).

120. *Id.* at 426.

121. For additional discussion of the specific issues surrounding arbitration agreements entered into by parties with unequal bargaining power, see Part IV.C. For more on predispute and postdispute arbitration agreements, see Part IV.A.

Jean Sternlight has explained the general unease with arbitration as follows: "When one party designs a process and then imposes it on another, thereby depriving that party of access to the default dispute resolution mechanism chosen by society (here, litigation), I believe this will naturally, if not inevitably, raise concerns that the imposed process is unfair."[122] Two of the specific concerns that critics of arbitration have highlighted are the repeat-provider and repeat-player problems.[123]

The repeat-provider problem arises from the fact that arbitrators "handling compulsory proceedings often rely on repeat-player drafters for much of their business. This creates a situation in which arbitrators are beholden to drafters for their livelihood and, consciously or unconsciously, have a motivation to decide cases in a manner congenial to those sending them business."[124] Elizabeth Bartholet, a Harvard law professor and former arbitrator with the National Arbitration Forum, has publicly discussed her belief that her career as an arbitrator was over the first time she ruled against a credit card company.[125]

The repeat-provider problem is compounded by the fact that some experienced corporate arbitration participants will be quite familiar with the arbitration process, putting most individuals at a tactical disadvantage.[126] In other words, the repeat provider might be biased in favor of the repeat player who has hired her, and the repeat player may additionally have the benefit of experience with the arbitral process. While empirical research on the repeat-player effect is inconclusive,[127] the concern is compounded by the fact that arbitration agreements may prohibit the use of class action procedures. The individuation critique of arbitration focuses on this problem, drawing attention to the possibility that "businesses use arbitration to prevent [the] aggregation [of claims], forcing consumer and employee claimants into individualized proceedings where neither they nor their lawyers can counter the advantages enjoyed by more powerful repeat players."[128]

122. Sternlight, *supra* note 2, at 1671.
123. *Id.* at 1650.
124. Stephan Landsman, *Nothing for Something? Denying Legal Assistance to Those Compelled to Participate in ADR Proceedings*, 37 FORDHAM URB. L.J. 273, 279–80 (2010).
125. Wade Goodwyn, *Rape Case Highlights Arbitration Debate*, NPR, June 9, 2009, http://www.npr.org/templates/story/story.php?storyId=105153315 ("Bartholet counters that arbitrators know full well that if they rule against corporations too often, their income will dry up.").
126. Landsman, *supra* note 124, at 279–80.
127. *See* W. Mark C. Weidemaier, *Arbitration and the Individuation Critique*, 49 ARIZ. L. REV. 69, 74 n.27 (2007) (summarizing empirical work in the area).
128. *Id.* at 69. Of course, it is possible that individuals involved in arbitration can minimize the repeat-player advantage by hiring attorneys who are experienced in arbitral proceedings.

Arbitration comes under attack every time new evidence of procedural unfairness emerges.[129] In addition to the repeat-provider and repeat-player effects, the restrictive clauses that are built into some arbitration agreements raise concerns. These include, but are not limited to, class action waivers,[130] forum selection clauses requiring arbitration in distant locations,[131] onerous cost-splitting provisions,[132] and limitations on damages.[133] For arbitration to succeed as an alternative to litigation, confidence in the integrity of the system must be restored.[134] Recently, concerns have led to legislative proposals to render certain types of arbitration agreements entirely unenforceable.[135] Substantive judicial review may be an appealing middle ground to avoid such extreme measures. Indeed, studies on arbitration "have shown that parties prefer direct control over the outcome in the form of appeal mechanisms. Giving such control to the parties enhances procedural justice . . . because it represents an opportunity to exercise control [and] indicates that the system safeguards against error and bias."[136]

However, attorney involvement itself undermines the cost savings typically asserted by arbitration advocates and is unlikely in low-value claims.

129. *See, e.g.*, Sternlight, *supra* note 2, at 1635 ("[I]t is highly problematic to permit the most powerful actors in a society to craft a dispute resolution system that is best for them but not necessarily their opponents or the public at large.").

130. Myriam Gilles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373, 398 (2005) ("The AmEx waivers are pretty typical: they provide that the claimant may not participate in any class action or classwide arbitration, and may not join its claims with those of any other merchant inside the arbitral arena."); *see also* AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740 (2011) (supporting the use of class action waivers in arbitration agreements).

131. Sternlight, *supra* note 2, at 1641 ("[S]ome companies have included clauses in their arbitration agreements that . . . require a claimant to file in a distant forum . . . ."). *But see* Weidemaier, *supra* note 127, at 88 ("[P]rovider rules typically limit the up-front costs of arbitration and may also protect consumers and employees from contract terms requiring them to travel great distances to attend an arbitration hearing.").

132. Katherine Van Wezel Stone, *Mandatory Arbitration of Individual Employment Rights: The Yellow Dog Contract of the 1990s*, 73 DENV. U. L. REV. 1017, 1036–37 (1996) ("In these agreements, employees are typically required to pay their own legal fees and one-half of the arbitrator's fees, a sum that could easily exceed $1,000.").

133. *Id.* at 1039 ("[M]any nonunion arbitration agreements require employees to waive their rights to punitive damages, consequential damages, attorneys' fees, injunctive relief, reinstatement, or other remedies that might be available in court.").

134. *Cf.* Shelley McGill, *Consumer Arbitration Clause Enforcement: A Balanced Legislative Response*, 47 AM. BUS. L.J. 361, 411 (2010) ("Consumers will not likely choose arbitration unless they have confidence in the industry. Currently, that confidence is lacking, as recent allegations of bias against a major American consumer arbitration provider demonstrate.").

135. *See infra* Part IV.A.

136. Burch, *supra* note 8, at 59 (footnote omitted).

Of course, as this discussion of costs and benefits highlights, the choice between arbitration and litigation necessarily implicates many factors. In the real world, accuracy and efficiency are often competing goals, requiring tradeoffs.[137] Still, arbitration is unlikely to succeed if there is a general perception that awards are systematically unjust or incorrect, and that no recourse is available. Providing some form of judicial review for the merits of arbitration awards may mitigate these concerns by involving an objective outsider, thereby promoting confidence in the integrity of the arbitration system as a whole.

Benefits to the courts. Courts have historically been valued for their "evenhanded treatment of disputants, decision making predicated on facts and constrained by obligations to be obedient to law, and the public performance of the rendering of judgments."[138] Arbitration has removed some of these core adjudicatory functions from judges' hands. From the courts' perspective, substantive judicial review may restore their power to interpret the law, create binding precedent, and develop legal norms.

Benefits to society. As mentioned above, the choice between arbitration and litigation has always involved tradeoffs for the parties involved.[139] While these tradeoffs persist today, the costs and benefits of arbitration can no longer be analyzed exclusively with regard to the parties involved. As arbitration has grown and changed, its impacts have extended beyond any given dispute. Arbitration now imposes negative externalities on society at large. The next Subpart explains how substantive judicial review may benefit society by helping to mitigate arbitration's externalities.

3. Arbitration's Externalities

In June 2010, an arbitration panel ordered Goldman Sachs Group, Inc., to pay $20.6 million to the unsecured creditors of a hedge fund for whom the investment bank had cleared trades.[140] The unsecured creditors accused

137. Sternlight, *supra* note 2, at 1672 ("In terms of such features as speed, cost, and privacy, arbitration, even the mandatory version, may offer a superior result to many disputants.").

138. Resnik, *supra* note 98, at 1108.

139. As Justice Reed explained in *Wilko v. Swan*, "Congress has afforded participants in transactions subject to its legislative power an opportunity generally to secure prompt, economical and adequate solution of controversies through arbitration if the parties are willing to accept less certainty of legally correct adjustment." 346 U.S. 427, 438 (1953), *overruled by* Rodriguez de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477 (1989).

140. Susanne Craig, *Goldman Told to Pay Bayou Fund Creditors*, WALL ST. J., June 26, 2010, at B1, *available at* http://online.wsj.com/article/SB10001424052748704569204575329270478907334.html.

Goldman Sachs of ignoring signs of fraud at the hedge fund, while Goldman Sachs argued that it had no legal obligation to monitor the fund or its trades.[141] As is often the case, the arbitration panel offered no explanation for its award.[142] The following month, the Securities Industry and Financial Markets Association (SIFMA) submitted an amicus brief, urging Judge Rakoff to vacate the award.[143] SIFMA argued that "[i]f clearing firms were required to analyze trading . . . or to make determinations concerning whether the records and documents in their possession . . . indicated possible wrongdoing, the speed and efficiency demanded in the contemporary securities markets would not be possible."[144]

Judge Rakoff ultimately confirmed the arbitration award, but did not determine whether the award was legally correct.[145] This is a common outcome in such cases, because an error of law alone is generally insufficient to vacate an arbitration award under the manifest disregard standard.[146] Thus, even when judges determine that arbitrators have reached incorrect legal conclusions or misapplied the law, they generally must confirm the awards.[147] When this occurs, illegal conduct may go unpunished and violations are likely to persist. Given the public interest in law enforcement, "dispute resolution methods that dilute enforcement and permit violators to escape liability are contrary to the public good."[148] This is especially problematic in areas of law where litigation serves a deterrent role in addition to providing compensation for individual plaintiffs. In these circumstances, "while the civil justice

141. *Id.* ("Goldman said the law 'does not require clearing firms or prime brokers to monitor the suitability of the transactions they process or to investigate their account holders.' Imposing such a standard 'would slow commerce, raise costs and imperil financial markets,' the firm said.").

142. *Id.*

143. Susanne Craig, *Trade Group Seeks to Have Bayou Award Thrown Out*, WALL ST. J., Aug. 6, 2010, at C3, *available at* http://online.wsj.com/article/SB10001424052748704657504575411673200130074.html.

144. *Id.* (quoting Memorandum of Amicus Curiae Secs. Indus. and Fin. Markets Assoc. in Support of Petition to Vacate Arbitration Award at 14–15, Goldman Sachs Execution & Clearing, L.P. v. Official Unsecured Creditors' Comm. of Bayou Grp., LLC, 758 F. Supp. 2d 222 (S.D.N.Y. 2010) (No. 10 Civ. 5622)).

145. *Goldman Sachs Execution & Clearing, L.P.*, 758 F. Supp. 2d 222. Judge Rakoff also criticized the ambiguous, limited role that judges currently play in reviewing arbitration awards.

146. *See supra* Part II.

147. While courts may often stop short of directly challenging an arbitrator's legal conclusions, they may hint that they are uncertain about the result. *See, e.g.*, Luong v. Circuit City Stores, Inc., 368 F.3d 1109, 1112 (9th Cir. 2004) ("However, without expressing a view one way or the other on whether the arbitrator got *Toyota* right, it is clear that the arbitrator did not *ignore* it.").

148. Stone, *supra* note 1, at 1035.

system may be erratic and time-consuming from the vantage point of the individual litigant, it could well be efficient for society as a whole."[149]

After Judge Rakoff confirmed the award against Goldman Sachs, the *New York Times* highlighted the uncertainty the award had created for other Wall Street firms. Their primary concern was that the award "could raise the standard for clearing businesses."[150] As SIFMA's request indicates, clearing firms feared that the award might call their legal duties into question. This type of confusion is highly problematic because it leaves third parties unable to efficiently and reliably comply with their legal obligations.[151] While ambiguity is sometimes strategically built into the law, erroneous arbitration awards are not part of any deliberate coordinated effort to optimize the mix of legal rules and standards.[152]

Thus, the Goldman Sachs case reveals two ways in which arbitration can generate negative externalities even when both parties involved are relatively sophisticated. Because courts do not correct legal errors in arbitration awards, incorrect awards may allow for persistent violations and diminished deterrence. Additionally, ambiguous, poorly reasoned, or unwritten awards increase legal uncertainty for third parties.

Further social costs arise when the dispute involves parties with unequal bargaining power. Consider Jamie Leigh Jones, who was twenty years old when she went to work for Halliburton in Iraq.[153] Her employment contract provided that "any and all claims that you might have against Employer related to your employment, including . . . any and all personal injury claim[s] arising in the workplace . . . must be submitted to binding arbitration."[154] Jones alleges that just four days after arriving in Iraq, she was drugged and raped repeatedly by

149. *Id.*

150. Susanne Craig, *Goldman's $20 Million Consequence*, DEALBOOK (Nov. 30, 2010, 6:16 PM), http://dealbook.nytimes.com/2010/11/30/goldmans-20-million-consequence ("If ultimately upheld, the Bayou award could have ramifications across the financial sector. Wall Street firms, which handle billions of dollars in transactions, say that their job is to clear trades, not police clients. This award could raise the standard for clearing businesses.").

151. Arbitration awards generally are not public and do not have precedential value. However, in some circumstances, the parties involved, an overseeing body, or the arbitration organization may release the award or encourage other arbitrators to strive for uniformity. Third parties may then review any published awards to help clarify their rights and obligations. *Cf.* John F. Coyle, *Rethinking the Commercial Law Treaty*, 45 GA. L. REV. 343, 405 (2011) ("Where disputes are resolved by arbitration rather than litigation, therefore, there will be fewer published decisions and, consequently, less certainty as to the content of a state's commercial law.").

152. Ambiguous standards are sometimes preferable to bright line rules because they make it more difficult for parties to circumvent the intent of the law by deliberately toeing the line.

153. Goodwyn, *supra* note 125.

154. Lithwick, *supra* note 7.

one or more co-workers.[155] Halliburton relied on the arbitration provision in Jones's employment contract to attempt to keep her allegations out of court.[156]

The public outcry that surrounded Jones's case demonstrated the negative impact that arbitration can have on our collective belief in the procedural justice of our dispute resolution system.[157] In response, Senator Al Franken successfully lobbied for an amendment to the Department of Defense Appropriations Act to ban defense contracts with companies that require arbitration of "any claim under title VII of the Civil Rights Act of 1964 or any tort related to or arising out of sexual assault or harassment."[158]

Jones's case dramatically highlighted the potential problems that arise when more sophisticated parties require those with less bargaining power to enter into arbitration agreements. In the aftermath, surrounding media coverage began to take a critical look at the prevalence of mandatory arbitration clauses in employment contracts, which regularly require arbitration of employment discrimination and other claims.[159] In an interview with ABC News, Congressman Ted Poe sided with Jones: "Air things out in a public forum of a courtroom. That's why we have courts in the United States."[160] The media coverage surrounding *Jones v. Halliburton*[161] revealed great social unease about arbitration's impact on our justice system.

One of the important benefits of substantive judicial review is the ability to mitigate the externalities that arise from arbitration. Substantive judicial review may correct incorrect awards and thereby stop persistent legal violations.

155. Goodwyn, *supra* note 125.

156. *Id.* ("Heather Browne, director of communications at KBR, . . . argues that any dispute with Jones, even one involving charges of rape, must go to arbitration."). Ultimately, the Fifth Circuit ruled that Jones would not have to arbitrate all of her claims because "the incident was not 'related to' her employment for purposes of arbitration" and the incident did not occur "in or about the workplace." Jones v. Halliburton Co., 583 F.3d 228, 241 (5th Cir. 2009), *cert. denied*, 130 S. Ct. 1756 (2010).

157. *Cf.* Editorial, *The Arbitration War*, N.Y. TIMES, Nov. 27, 2010, at A18, *available at* http://www.nytimes.com/2010/11/27/opinion/27sat1.html?ref=arbitrationconciliationandmediation ("This is the latest in the arbitration war—a battle over whether the United States will increasingly have a privatized system of justice that bars people from enforcing rights in court and, if so, what will be considered fair in that system.").

158. Department of Defense Appropriations Act of 2010, H.R. 3326, 111th Cong. § 8116 (2009).

159. National Public Radio interviewed a former arbitrator who suggested "that arbitrators know full well that if they rule against corporations too often, their income will dry up." Goodwyn, *supra* note 125. Slate.com lamented that "nobody wants to be told their legal disputes ought to be worked out in secret, off the books, and in dark rooms, just so the justice system can be preserved for other people." Lithwick, *supra* note 7.

160. Brian Ross, Maddy Sauer & Justin Rood, *Victim: Gang-Rape Cover-Up by U.S., Halliburton/KBR*, ABCNEWS.COM, Dec. 10, 2007, http://abcnews.go.com/Blotter/story?id=3977702&page=1.

161. 583 F.3d 228.

This, in turn, helps to restore the deterrent effect of the law. Additionally, substantive judicial review can help resolve legal uncertainty in the form of a written legal opinion analyzing the applicable law. Finally, substantive judicial review may reduce procedural justice concerns by ensuring that parties can ultimately have their day in court, even if only at the review stage.

B. Costs and Benefits of Allowing Parties to Contract for Tailored Judicial Review

Prior to *Hall Street*, parties in some jurisdictions successfully expanded judicial review of arbitration awards by contract. The circuits were split on the issue of whether these agreements were valid.[162] Many commentators favored these expanded review provisions, and several courts upheld them.[163] Proponents focused primarily on the theory that arbitration is a "creature of contract."[164] Those who rejected such agreements countered by arguing that liberty of contract "does not justify specific enforcement of expanded review clauses that amount to private directions of judicial authority in defiance of legislative policy and provisions."[165] *Hall Street* resolved the circuit split by holding such agreements invalid because the language of the FAA suggested that the section 10 grounds are exclusive.[166] Nonetheless, it is important to consider the costs and benefits of such provisions to determine whether they might place a useful role if section 10 were revised.

The costs of allowing parties to determine the level of judicial review by contract are similar to those for substantive review in general: decreased efficiency, finality, and privacy, and an increased burden on the courts. In this context, however, these costs may be less problematic than the costs associated with compulsory substantive judicial review. In addition to the benefits of substantive judicial review discussed above, enforcing contracts for specified

162. For a discussion of this circuit split prior to *Hall Street*, see Margaret Moses, *Can Parties Tell Courts What to Do? Expanded Judicial Review of Arbitral Awards*, 52 U. KAN. L. REV. 429, 432–44 (2004).

163. Some argue that it might be possible to contract for expanded review even after *Hall Street*. *See* Drahozal, *supra* note 77, at 927 (finding "only a limited likelihood that expanded-review provisions are enforceable in federal court after Hall Street, but a greater likelihood that expanded-review provisions are enforceable in state court"). Even courts that previously allowed for expanded judicial review, however, have not been receptive to this argument.

164. Gateway Techs., Inc. v. MCI Telecomms. Corp., 64 F.3d 993, 996 (5th Cir. 1995) (approving of contractual terms providing for expanded judicial review), *abrogated by* Hall St. Assocs., L.L.C. v. Mattel, Inc., 552 U.S. 576 (2008).

165. Schmitz, *supra* note 97, at 180.

166. *Hall St.*, 552 U.S. at 586–88.

levels of judicial review reinforces the "consensual nature"[167] of arbitration, encourages conscious drafting, and may improve arbitrator quality. These costs and benefits are discussed below.

1. Costs of Contracting for Tailored Judicial Review

As with all substantive judicial review, allowing parties to contract for tailored judicial review will sometimes lead to increased costs, reduced finality, and less privacy. However, these costs are arguably less problematic when the parties have selected their preferred set of tradeoffs. An agreement to expand judicial review reflects the parties' determination that greater legal accuracy is worth the corresponding costs.

Courts may also face increased costs if parties contract for expanded review. However, some of these costs may be offset by allowing parties to contract for less judicial review in certain situations.[168] Moreover, it is possible that allowing parties additional access to substantive review will actually increase arbitration, thereby reducing the overall burden on the courts. The theory is that without the option of substantive judicial review, "parties who want a legally proper decision cannot submit to arbitration, or at least will be less likely to do so, because there can be only minimal ex post monitoring of arbitral awards."[169] Thus, allowing parties to select their desired level of judicial review could actually reduce the aggregate burden on the courts.[170]

2. Benefits of Contracting for Tailored Judicial Review

Allowing parties to contract for modified judicial review reinforces the "consensual nature"[171] of arbitration, encourages conscious drafting, and may improve arbitrator quality. For some, "the central and primary value of arbitration is not speed, or economy, or privacy, or neutral expertise, but rather the

167. Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., 130 S. Ct. 1758, 1774 (2010).

168. My proposal would, in some circumstances, allow parties to increase or decrease the level of judicial review. *See infra* Part IV.

169. Tom Ginsburg, *The Arbitrator as Agent: Why Deferential Review Is Not Always Pro-Arbitration*, 77 U. CHI. L. REV. 1013, 1023 (2010).

170. *Cf. id.* at 1023–24 ("By preventing courts from policing arbitral interpretations of law, *Hall Street* may end up *reducing* the number of cases sent to arbitration and, perversely, shifting contract disputes to the courts, precisely because there is no alternative way for parties to ensure that arbitrators *do* follow the law. The *Hall Street* logic may end up sacrificing judicial economy in an attempt to preserve it, and hurting arbitration in the name of helping it.").

171. *Stolt-Nielsen*, 130 S. Ct. at 1774.

ability of users to make key process choices to suit their particular needs."[172] The contract model of arbitration teaches that "[a]rbitration belongs to the disputants who should be able to control arbitration procedure."[173] Under this theory, "[r]efusing to enforce the parties' agreement to increase judicial review flies in the face of the original intent of the FAA—to uphold and enforce the parties' arbitration bargain."[174]

In fact, the Supreme Court has explained that enforcing "agreements to arbitrate under different rules than those set forth in the Act itself" is necessary to preserve the FAA's "primary purpose" of guaranteeing that arbitration agreements "are enforced according to their terms."[175] This view aligns with the court's position that arbitration "is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit."[176] Thus, allowing parties to contract for their desired level of judicial review would be more in line with the consensual nature of arbitration.[177]

Of course, it is uncertain how many parties will opt out of any given default level of judicial review.[178] Parties will have to balance potential efficiency losses with the desire for judicial review.[179] However, when arbitration awards are difficult to overturn, it is likely that "parties sometimes harbor fears

172. Stipanowich, *supra* note 17, at 51.
173. BRUNET ET AL., *supra* note 122, at 80–81.
174. *Id.*
175. Volt Info. Scis., Inc. v. Bd. of Trs. of the Leland Stanford Junior Univ., 489 U.S. 468, 479 (1989).
176. *Id.*
177. The notion that arbitration is "consensual" can be challenged in situations where actual consent to arbitration appears to be missing. Katherine Stone has explored situations in which arbitration awards are enforced even where standard contract rules alone do not establish consent to arbitration. Stone, *supra* note 1, at 1021–22. This practice emerged when courts began to hold "that membership in [a stock or commodity] exchange was sufficient to constitute consent to arbitration, whether or not there was contractual assent." *Id.* at 1022. In these cases, courts appeared to rely on community membership as a proxy for consent, recognizing that community norms were as relevant to determining consent as explicit agreements. *Id.* at 1023 ("In a setting of joint membership, both parties can not only be presumed to know of and have shared in making the arbitration rules, they also can be presumed to share in the normative principles and precepts that an arbitrator will bring to bear in deciding the dispute.").
178. *Cf.* John S. Baker, IV, Hall Street Associates v. Mattel, Inc.*: What Are the Exclusive Grounds for Modifying an Arbitration Award Under the Federal Arbitration Act?*, 32 AM. J. TRIAL ADVOC. 207, 211 (2008) ("Other arguments put before the Court were that parties would flee from arbitration if expanded review is not open to them and, to the contrary, that parties will flee if it is.").
179. *See* Drahozal, *supra* note 77, at 908 ("The limited court review of arbitration awards can make arbitration a less desirable means of dispute resolution for 'bet-the-company' cases, such as cases in which 'an aberrational award could have a devastating effect on the company.' Expanded review may reduce the risk of such aberrational arbitration awards—sometimes called 'knucklehead awards' or 'roll-the-dice' or 'Russian roulette' arbitration awards—making arbitration a more attractive dispute resolution option." (footnotes omitted) (some internal quotation marks omitted)).

that a maverick arbitrator will render an egregious award, which cannot be challenged even though wrong on the facts and the law."[180] Allowing for expanded review provisions would mitigate these fears.

Additionally, allowing parties to select their preferred level of judicial review would encourage the conscious drafting of arbitration agreements. I borrow the concept of "conscious drafting" from Aubrey Thomas.[181] Thomas emphasizes that parties should make thoughtful decisions in drafting their arbitration clauses, as the details of such provisions can have tremendous real world impacts. Unfortunately, "the usual approach in these contracts is to drop in standard boilerplate without much reflection or discussion."[182] Allowing parties to select a preferred level of judicial review might encourage drafters to thoughtfully address other procedural issues as well. When disputes ultimately arise, carefully drafted arbitration agreements would improve the arbitration experience by ensuring that the process is tailored to the parties' needs and preferences.[183]

Finally, Tom Ginsburg argues that allowing parties to contract for their preferred level of judicial review may improve the market for arbitrators and arbitrator quality. Ginsburg argues that minimal judicial review may end up attracting bad arbitrators because there is little risk that their mistakes will be detected.[184] "Letting parties designate the standard of review, on the other hand, would improve the functioning of the market for arbitrators by allowing good arbitrators to signal their status."[185] That is, arbitrators who are confident in their abilities will be more willing than less confident arbitrators to take assignments in which their awards will be subject to substantive judicial review.

180. Moses, *supra* note 162, at 429.

181. Aubrey L. Thomas, Comment, *Nonsignatories in Arbitration: A Good-Faith Analysis*, 14 LEWIS & CLARK L. REV. 953, 983 n.172 (2010) (coining the term "conscious drafting" to capture the idea "that attorneys should make thoughtful, calculated decisions about every phrase that is put into a contract").

182. Stipanowich, *supra* note 17, at 52.

183. *Id.* ("It is for parties to establish definite priorities for arbitration and to translate those priorities into action through their arbitration agreement and subsequent decisions. In order to fulfill the promise of arbitration, parties must be more deliberate in taking advantage of the spectrum of available choices.").

184. Ginsburg, *supra* note 169, at 1024 ("An arbitrator who is not skilled, however, might prefer a lower level of judicial scrutiny. Mistakes by the bad-type arbitrator will not be easily identified under such a regime.").

185. *Id.* at 1025.

IV. TAILORED JUDICIAL REVIEW

Part III discussed the costs and benefits of substantive judicial review. The appropriateness of such review, however, varies based on the timing of the agreement and the parties and claims involved. Thus, the FAA should take into account the wide variety of circumstances under which arbitration now takes place, and should differentiate between the many different types of arbitration agreements that have come to be governed by the statute. Specifically, the FAA should draw distinctions (1) between predispute arbitration agreements and arbitration agreements that are entered into after a dispute has arisen, (2) between arbitration awards that involve mandatory legal rules and those that do not, and (3) between arbitration agreements entered into by parties with unequal bargaining power and those between equals.

I argue that more searching judicial review is appropriate for predispute agreements, mandatory law claims, and agreements entered into by parties with unequal bargaining power. Standing alone, these recommendations are not novel. However, I offer two new proposals in this Part. First, I draw on federal securities law to help define bargaining power. Second, I propose varying the default level of judicial review based on the combination of the three key variables identified above, while sometimes allowing parties to contract for more or less judicial review than the default would permit.[186] This Part proceeds as follows. Subparts A, B, and C explain why more searching judicial review is appropriate for predispute agreements, mandatory law claims, and agreements entered into by parties with unequal bargaining power. Subpart C also draws on federal securities law to introduce and define the qualified arbitration participant. Subpart D discusses several possible levels of judicial review for arbitration awards, and Subpart E outlines the details of my proposal.

A. Predispute Agreements

The Supreme Court has recently reiterated that it is a "foundational FAA principle that arbitration is a matter of consent."[187] Nonetheless, under current U.S. law, parties may enter into binding arbitration agreements long before

186. My proposal establishes a hierarchy of levels of judicial review, from procedural error to full de novo review for legal error. In this scheme, to contract up means to contract for heightened review, while to contract down means to contract for lesser review.

187. Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., 130 S. Ct. 1758, 1775 (2010).

any dispute has arisen.[188] Some computer software programs or websites, for example, may require potential users to enter into a click-through arbitration agreement before permitting use. Even after a contract has been formed, companies may attempt to unilaterally add arbitration clauses to existing contracts,[189] or to modify existing dispute resolution provisions.[190] All of these practices result in binding predispute arbitration agreements.[191] Critics of predispute arbitration agreements argue that the crucial element of consent is not meaningfully present in most such agreements.

Moreover, predispute arbitration agreements differ from postdispute agreements because, at the time they enter into the agreement, the parties are uncertain as to which rights or obligations will be implicated in a future dispute.[192] In contrast, postdispute agreements are focused on the resolution of a particular existing dispute, or set of disputes, rather than on the entire universe of possible disputes that may arise during the parties' relationship. The distinction between predispute and postdispute agreements has been central to judicial reasoning and academic commentary on arbitration.[193]

188. Some other countries place limits on the use of predispute arbitration agreements. *See* Sternlight, *supra* note 2, at 1647 ("Consumer arbitration does exist outside the United States, but it is not imposed on a predispute, mandatory basis.").

189. *See* David Horton, *The Shadow Terms: Contract Procedure and Unilateral Amendments*, 57 UCLA L. REV. 605, 623–28 (2010) ("Some judges went further still, upholding ex post arbitration terms that were neither legitimized by statute nor gave adherents the chance to opt out.").

190. *See id.*

191. The Arbitration Fairness Act of 2009 (2009 Act) would have defined a "pre-dispute arbitration agreement" as "any agreement to arbitrate disputes that had not yet arisen at the time of the making of the agreement." H.R. 1020, 111th Cong. § 3 (2009); *see also* S. 931, 111th Cong. § 3 (2009). Predispute agreements are so controversial that a dispute over terminology has developed. Critics of such agreements often refer to them as "mandatory" or "adhesionary." Most proponents favor the more neutral "predispute" or "contractual" labels and argue that "[a]rbitration is not mandatory when it arises out of a contract, because contracts are formed voluntarily." Stephen J. Ware, *Contractual Arbitration, Mandatory Arbitration, and State Constitutional Jury-Trial Rights*, 38 U.S.F. L. REV. 39, 41 (2003). I use the term "predispute" here because it helps separate the timing issue from the other factors I discuss, such as unequal bargaining power.

192. Identifying the precise moment that a dispute has arisen is not without its own set of complications. *See* Rutledge, *supra* note 88, at 580–81 ("If a statute defines 'dispute' as having arisen chronologically too early, then the underlying goal of enabling the individual to make decisions with complete information is not advanced. Alternatively, if 'dispute' is defined as having arisen too late in a given context, one may meaningfully preclude the essential cooperation upon which successful commercial arbitration depends.").

193. *See, e.g.*, Wilko v. Swan, 346 U.S. 427, 430 (1953) (noting that the court was analyzing an "agreement to arbitrate a *future* controversy" (emphasis added)), *overruled by* Rodriguez de Quijas v. Shearson/Am. Exp., Inc., 490 U.S. 477 (1989); Arbitration Fairness Act of 2009, H.R. 1020, 111th Cong. § 4 (2009) ("No *predispute* arbitration agreement shall be valid or enforceable if it requires arbitration of . . . ." (emphasis added)); Linda J. Demaine & Deborah R. Hensler, *"Volunteering" to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience*, LAW & CONTEMP. PROBS. 55, 72 (Winter/Spring 2004) ("Critics of arbitration

Congress has also considered numerous proposals to render certain predispute agreements unenforceable.[194]

In 2002, Congress took targeted action, providing "that form contracts requiring arbitration between [car] manufacturers and dealerships would not be enforceable unless both parties agreed to waive access to courts and administrative remedies *after* disputes arose."[195] The Arbitration Fairness Act of 2007 (2007 Act) would have taken this approach much further, rendering predispute agreements unenforceable to the extent they required arbitration of any "employment, consumer, or franchise dispute" or "a dispute arising under any statute intended to protect civil rights or to regulate contracts or transactions between parties of unequal bargaining power."[196]

The Arbitration Fairness Act of 2009 (2009 Act) proposed making a more limited set of predispute agreements unenforceable.[197] The text of the Act explained the underlying concerns:

> Most consumers and employees have little or no meaningful option whether to submit their claims to arbitration. Few people realize, or

pursuant to predispute contracts between consumers and businesses have questioned whether arbitration provides the same substantive remedies and procedural protections as would be accorded by a court."); Bradley Dillon-Coffman, *Revising the Revision: Procedural Alternatives to the Arbitration Fairness Act*, 57 UCLA L. REV. 1095, 1095 (2010) ("In the past decade, debate over the fairness of predispute arbitration agreements has intensified.").

194. Rutledge, *supra* note 88, at 579. ("According to one estimate, ten different bills introduced in the 110th Congress would chip away at the enforceability of pre-dispute arbitration agreements."); E. Gary Spitko, *Exempting High-Level Employees and Small Employers From Legislation Invalidating Predispute Employment Arbitration Agreements*, 43 U.C. DAVIS L. REV. 591, 597 (2009) ("[S]ince the mid-1990s, Congress has repeatedly considered legislation that would prohibit enforcement of predispute arbitration agreements insofar as they relate to employment discrimination claims and other federal employment statutes."). Spitko provides a nice summary of several of these legislative proposals. *Id.* at 597–98.

195. Resnik, *supra* note 98, at 1152; *see also* 21st Century Department of Justice Appropriations Authorization Act, Pub. L. No. 107-273, § 11028, 116 Stat. 1758, 1835–36 (2002) (codified at 15 U.S.C. § 1226 (Supp. IV 2004)); The Motor Vehicle Franchise Contract Arbitration Fairness Act, S. REP. NO. 107-266, at 2 (2002).

196. Arbitration Fairness Act of 2007, H.R. 3010, 110th Cong. (2007). The proposed bill included definitions for "employment disputes," "consumer disputes," and "franchisee disputes" but provided no definition of "unequal bargaining power" and no guidance on what might qualify as a statute intended to "regulate contracts or transactions between parties of unequal bargaining power." *Id.* at § 3(2)–(5).

197. *See* Arbitration Fairness Act of 2009, H.R. 1020, 111th Cong. (2009); *see also* S. 931, 111th Cong. (2009). The House version provided that "[n]o predispute arbitration agreement shall be valid or enforceable if it requires arbitration of—(1) an employment, consumer, or franchise dispute; or (2) a dispute arising under any statute intended to protect civil rights." H.R. 1020 § 4. A comparison between the Arbitration Fairness Act of 2007 (2007 Act) and the 2009 Act shows that the 2009 proposal eliminated the language regarding "any statute intended to . . . regulate contracts or transactions between parties of unequal bargaining power." H.R. 3010 § 4.

> understand the importance of the deliberately fine print that strips them of rights; and because entire industries are adopting these clauses, people increasingly have no choice but to accept them. They must often give up their rights as a condition of having a job, getting necessary medical care, buying a car, opening a bank account, getting a credit card, and the like. Often times, they are not even aware that they have given up their rights.[198]

Many arbitration scholars have expressed similar concerns to Congress over predispute agreements. Robert Rueben, for example, has called on Congress to prohibit the enforcement of *all* predispute arbitration agreements.[199]

Even assuming that both parties read and understood the relevant predispute agreement, optimism bias may lead parties to underestimate the likelihood of a future dispute.[200] Moreover, parties cannot foresee which, if any, of many possible disputes will arise in the future. The differences between arbitration and litigation suggest that one procedure or the other may be more appropriate for certain disputes—some disputes will be very complicated, and others less significant. For example, the limited discovery available in arbitration may be sufficient in resolving a contract interpretation dispute, but not an employment discrimination case involving many factual questions. In a predispute agreement, neither party is able to make a calculated judgment as to whether or not arbitration is appropriate for the ultimate dispute.[201] Thus, predispute agreements will sometimes force parties to arbitrate claims that would have been better suited to litigation.[202] Substantive judicial review may be especially important for preserving society's confidence in procedural justice in this context. Thus, all else being equal, arbitration awards resulting from predispute agreements should receive more searching substantive judicial review.

198. H.R. 1020; *see also* S. 931.

199. Richard C. Reuben, *Process Purity and Innovation: A Response to Professors Stempel, Cole, and Drahozal*, 8 NEV. L.J. 271, 313 (2007) ("Congress should mandate that arbitration under the FAA is always based on the actual consent of the parties, *disallowing predispute agreements to arbitrate* under the act." (emphasis added)).

200. Daniel B. Klaff, *Debiasing and Bidirectional Bias: Cognitive Failure in Mandatory Employment Arbitration*, 15 HARV. NEGOT. L. REV. 1, 12 (2010) ("Optimism bias describes the circumstance in which individuals believe the probability of facing a negative outcome is lower than the actual probability of experiencing that negative outcome.").

201. Bruce L. Hay, *Procedural Justice—Ex Ante vs. Ex Post*, 44 UCLA L. REV. 1803, 1813 (1997) ("[L]itigants may be uncertain, before the dispute arises, about the nature of the case in which they will be involved; in particular, they may be uncertain whether adoption of a given procedure will make them 'winners' or 'losers.'").

202. Admittedly, the parties may have directly opposing views as to which procedure is preferable for a given claim.

B. Mandatory Law

Different types of legal claims present different issues for arbitrators, judges, and arbitration law. Over the years, special treatment has been proposed for disputes involving statutory claims,[203] public policy issues,[204] public law claims,[205] mandatory law claims,[206] civil rights claims,[207] civil liberty claims,[208] and torts "related to or arising out of sexual assault or harassment."[209] Some proposals would entirely prohibit the enforcement of arbitration agreements involving certain claims,[210] while others would modify the applicable standard of review.[211] One proposal would even permit parties to "sue the arbitrator for a failure to apply a mandatory law."[212]

Several concerns underlie these proposed distinctions among legal claims. First, it may be especially important for some laws to be publicly enforced for expressive or deterrent purposes. Second, the role of public precedent may be critical for clarifying rights and obligations in certain areas of law. Additionally, many laws are not optional, and some may fear that arbitration allows

203. *See* Wilko v. Swan, 346 U.S. 427, 435 (1953), *overruled by* Rodriguez de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477 (1989) (expressing the classic concern that even though statutory provisions apply in arbitration proceedings, "their effectiveness in application is lessened in arbitration as compared to judicial proceedings"); Norman S. Poser, *Judicial Review of Arbitration Awards: Manifest Disregard of the Law*, 64 BROOK. L. REV. 471, 471 (1998) ("Speed, economy, and finality, the principal goals of arbitration, suggest that judicial review should be narrow; on the other hand, fairness and justice require that there be meaningful review of awards, particularly when a party is asserting *statutory* rights." (emphasis added)); Stone, *supra* note 132, at 1020 ("[C]ourts should not force parties to arbitrate statutory claims, should not presume that promises to arbitrate include promises to arbitrate statutory claims, and should not give arbitral rulings on *statutory* issues preclusive effect." (emphasis added)).

204. *See* Schmitz, *supra* note 97, at 127 ("Perhaps the FAA and UAA *should* be revised to provide options for expanded judicial review of awards, especially in disputes involving statutory or public policy issues.").

205. *See, e.g.*, Ginsburg, *supra* note 169, at 1023 n.58 ("[I]n public law claims, judges are agents with two principals: the parties and the public. Less deferential review is a form of balancing the competing interests of multiple principals.").

206. *See, e.g.*, Hans Smit, *Mandatory Law in Arbitration*, 18 AM. REV. INT'L ARB. 155 (2007).

207. *See, e.g.*, Arbitration Fairness Act of 2007, H.R. 3010, 110th Cong. § 4(4) (2007) (singling out "dispute[s] arising under any statute intended to protect civil rights").

208. When civil rights or civil liberty claims are the primary focus of an arbitration proceeding, Thomas Carbonneau proposes the following special procedure: "[T]he parties shall brief the arbitrators fully on the applicable statutory and decisional law. The arbitrators shall render an award with a complete explanation of the reasoning that underlies their determination on the statutory claim. The award is subject to review for manifest error." CARBONNEAU, *supra* note 35.

209. Department of Defense Appropriations Act of 2010, H.R. 3326, 111th Cong. § 8116(a)(1) (2009).

210. *See, e.g.*, H.R. 3010.

211. *See, e.g.*, Burch, *supra* note 8 (proposing heightened judicial scrutiny for certain statutory claims).

212. Andrew T. Guzman, *Arbitrator Liability: Reconciling Arbitration and Mandatory Rules*, 49 DUKE L.J. 1279, 1283 (2000).

parties to escape the reach of these laws. Finally, there may be particular concerns about allowing arbitration of claims arising from laws that are designed to reduce externalities. For example, "in areas such as securities regulation, antitrust, intellectual property, and bankruptcy, mandatory laws exist in order to prevent the imposition of costs on the uninformed or on third parties."[213]

Some of the broadest categories overlap. For example, mandatory laws are those laws that "the parties could not have formed an enforceable contract to avoid."[214] Many statutes are mandatory. But not all mandatory laws are statutes. There are many mandatory common law rules as well, such as strict product liability, which generally cannot be waived by contract. Thus, focusing on the mandatory law category is especially useful in the arbitration context because it encompasses even nonstatutory rules that the parties should not be able to escape by contract.

Moreover, if arbitrators are given "a choice between applying mandatory rules and ignoring those rules in favor of the arbitration agreement, reputational concerns will cause arbitrators to favor the latter because an arbitrator who is able to establish a reputation for honoring the arbitration agreement will be more appealing to the parties."[215] Therefore, when there is no threat of judicial review, arbitrator incentives are not aligned with the public's goal of enforcing mandatory law. Arbitrators who understand that their awards will be subject to substantive judicial review, however, will have an incentive to properly apply the law. Moreover, even if a court ultimately declines to vacate an arbitration award, the written opinion may provide useful guidance to outside parties seeking to understand their rights and obligations. Thus, all else being equal,

213. *Id.* at 1284. Interestingly, however, some of these same areas of law were the first in which the courts began to allow the enforcement of arbitration agreements. *See, e.g.*, Shearson/Am. Express Inc. v. McMahon, 482 U.S. 220 (1987) (securities regulation); Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985) (antitrust). In *Gilmer v. Interstate/Johnson Lane Corp.*, the Court rejected the idea that the statutory framework of the Age Discrimination in Employment Act required plaintiffs to be able to litigate their claims and held that "so long as the prospective litigant effectively may vindicate [her] statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function." 500 U.S. 20, 28 (1991) (quoting *Mitsubishi Motors Corp.*, 473 U.S. at 637) (internal quotation marks omitted). "There is obvious concern within the legal community that the Court's delegation to private citizen-arbitrators of broad power to decide questions of mandatory law with no possible review for error has had a deleterious effect on our legal system." Moses, *supra* note 4, at 185.

214. Stephen J. Ware, *Interstate Arbitration: Chapter 1 of the Federal Arbitration Act*, *in* ARBITRATION LAW IN AMERICA: A CRITICAL ASSESSMENT 114 (Edward Brunet et al. eds., 2006). Phrased differently, mandatory laws are all those "the application of which may not be circumvented by the parties." Smit, *supra* note 206, at 155 n.1.

215. Guzman, *supra* note 212, at 1303.

arbitration awards involving mandatory law claims should be subject to more searching substantive judicial review.[216]

C. Unequal Bargaining Power and Sophistication

Arbitration agreements between parties of unequal bargaining power are a relatively recent phenomenon. As Justice Breyer has observed, the Congress that enacted the FAA "may well have thought that arbitration would be used primarily where merchants sought to resolve disputes of fact, not law, under the customs of their industries, where the parties possessed roughly equivalent bargaining power."[217] Unsurprisingly then, unequal bargaining power or sophistication is one of the primary concerns underlying many critiques of the modern use of arbitration.[218] Numerous proposals explicitly or implicitly differentiate between arbitration awards based on the relative bargaining power or sophistication of the parties involved. One approach is to use the type of dispute as a proxy for unequal bargaining power or sophistication.[219] Most commonly, this categorical approach has focused on employment disputes, consumer disputes, and franchise disputes.[220]

Moving beyond the use of categories, the 2007 Act would have rendered predispute agreements unenforceable if they required arbitration of "a dispute arising under any statute intended to . . . regulate contracts or transactions between parties of unequal bargaining power."[221] While the 2009 Act

216. Stephen Ware has proposed that "when arbitrators hear claims arising out of mandatory rules, courts should review de novo the arbitrators' legal rulings on such claims." Ware, *supra* note 214, at 114.

217. AT&T Mobility LLC v. Concepcion, 131 S. Ct. 1740, 1759 (2011) (Breyer, J., dissenting).

218. *See, e.g.*, Landsman, *supra* note 124, at 280 ("*Unsophisticated* and ill-prepared adhering parties are most often the ones being dragged into arbitration by corporate opponents seeking vindication of some contractual claim." (emphasis added)); William W. Park, *The Lex Loci Arbitri and International Commercial Arbitration*, 32 INT'L & COMP. L.Q. 21, 29 (1983) ("The value of a uniform application of legal principles perhaps is strongest when there is a danger that private dispute resolution may become a means for the strong to oppress the weak through disproportionately *unequal bargaining power* . . . ." (emphasis added)); Stone, *supra* note 132, at 1036 ("At the moment of hire, employees lack bargaining power and are needful of employment, so they frequently agree to such terms without giving them much thought.").

219. CARBONNEAU, *supra* note 35, at 309 (proposing "that all consumer and employment arbitrations be open to the public").

220. *See, e.g.*, Arbitration Fairness Act of 2007, H.R. 3010, 110th Cong. § 4 (2007) (proposing that predispute agreements be rendered unenforceable to the extent they require arbitration of "an employment, consumer, or franchise dispute").

221. The proposed bill included definitions for "employee disputes," "consumer disputes," and "franchisee disputes" but provided no definition of "unequal bargaining power" and no guidance on what might qualify as a statute intended to "regulate contracts or transactions between parties of unequal bargaining power." *Id.* § 3(6). Similarly, Burch's recent proposal

eliminated this language, it included a finding that the FAA "was intended to apply to disputes between commercial entities of generally similar sophistication and bargaining power."[222]

Despite the changes from the 2007 Act, Gary Spitko remained concerned by the broad scope of the 2009 Act.[223] The 2009 Act would still have prohibited the enforcement of predispute arbitration agreements related to any employment dispute.[224] Writing when the 2009 Act was still under consideration, Spitko was skeptical that unequal bargaining power would be a serious problem in all employment disputes. Thus, Spitko proposed an exemption for high-level employees and small employers that used employee compensation "as a proxy for sufficient employee bargaining power and sophistication."[225] Spitko's proposal was narrowly focused on employment agreements,[226] but other scholars have taken a broader look at the issue.[227]

In light of this scholarly attention, it is unsurprising that the Supreme Court has also suggested that sophistication is important in differentiating among arbitration contracts. In *Stolt-Nielsen*, the majority referred to the two parties involved as "sophisticated business entities"[228] and suggested that the parties' sophistication indicated that silence as to the question of class arbitration could not be interpreted as consent.[229] The dissent pointed to this

for case-centric judicial review, which would have applied to "any arbitration involving . . . parties with grossly unequal bargaining power," does not identify how bargaining power would be measured. Burch, *supra* note 8, at 48 n.3.

222. Arbitration Fairness Act of 2009, H.R. 1020, 111th Cong. § 2(1) (2009).

223. *See* Spitko, *supra* note 194.

224. H.R. 1020 § 4(4).

225. Spitko, *supra* note 194, at 644.

226. Suzette Malveaux offers another interesting proposal for the employment context. She advocates for a one-way arbitration agreement, which "gives the employee, but not the employer, the option of rejecting the arbitrator's decision." Suzette M. Malveaux, *Is It the "Real Thing"? How Coke's One-Way Binding Arbitration May Bridge the Divide Between Litigation and Arbitration*, 2009 J. DISP. RESOL. 77, 78.

227. Katherine Stone has suggested that power imbalances in the arbitration agreement could be limited by varying the level of judicial review "depending upon whether the dispute is between two insiders to a self-regulating community or between an outsider and an insider." *See* Stone, *supra* note 1, at 942–43. My proposal builds on the lessons of Stone's work and offers an alternative approach to solving the problem. Here, I have attempted to limit my discussion to particularly relevant proposals. Generic references to sophistication and bargaining power abound in the arbitration literature. *See, e.g.*, Aaron-Andrew P. Bruhl, *The Unconscionability Game: Strategic Judging and the Evolution of Federal Arbitration Law*, 83 N.Y.U. L. REV. 1420 (2008) ("In a fairly short period of time, arbitration has grown from a method of resolving disputes between *sophisticated* business entities into a phenomenon that pervades the contemporary economy." (emphasis added)).

228. Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp., 130 S. Ct. 1758, 1775 (2010).

229. *Id.*

language as support for the argument that the majority's holding should have a limited application. Justice Ginsburg, citing the majority's observation that "'the parties [here] are sophisticated business entities,'" and "'that it is customary for the shipper to choose the charter party that is used for a particular shipment,'" suggested that the opinion could be read to exempt contracts of adhesion presented on a take-it-or-leave-it basis from its analysis.[230]

Although it is commonly accepted that sophistication varies widely in the arbitration context, and that the parties' relative levels of sophistication and bargaining power may impact their agreements and the arbitration process, it is difficult to know which parties could be protected without unintended consequences. It is important that arbitration laws try to avoid the need for preliminary litigation over whether or not new rules apply to certain parties.[231] A law based on self-regulated communities,[232] for example, may be difficult to administer in court and hard for contracting parties to understand. At the same time, overly simplified categories may be overinclusive or underinclusive.

Thus, there is no consensus on how to measure sophistication or bargaining power in the arbitration context.[233] Proposals vary widely, and some scholars have deferred developing a workable definition altogether.[234] In the following Subpart, I propose a solution for drawing this line.

1. A Proposal for Measuring Bargaining Power: Qualified Arbitration Participants

Securities law offers a useful model for arbitration because it has already been forced to grapple with the best method for distinguishing between sophisticated and unsophisticated parties. U.S. securities laws are based on the idea that mandatory disclosure requirements are necessary to correct information asymmetries and level the playing field for investors. The laws acknowledge, however, that not all investors require such protection. Some investors have

230. *Id.* at 1783 (Ginsburg, J., dissenting) (alteration in original).

231. *See, e.g.*, Spitko, *supra* note 193, at 632 ("An arbitration gatekeeping standard that breeds litigation would conflict with the central goal of arbitration—expeditious adjudication of the dispute that will save the disputants both time and money.").

232. *See supra* note 227.

233. The use of broad categories, such as consumers, employees, and franchisees, as a proxy for lack of sophistication or bargaining power may be the most common. These proposals have two potential limitations. First, the boundaries of the categories may sometimes be difficult to determine, forcing the courts to grapple with the definitions and leaving unnecessary uncertainty for the parties. Second, they are likely to be both over and underinclusive.

234. *See* Burch, *supra* note 8, at 48 n.3 (defining mandatory arbitration to include "any arbitration involving . . . parties with grossly unequal bargaining power").

the resources to independently negotiate for the information they require to make their investment decisions. Rule 144A of the Securities Act of 1933 introduced the concept of the "qualified institutional buyer"[235] (QIB) in recognition of the significant differences between unsophisticated individual investors on the one hand and powerful institutional investors on the other.

QIBs are defined by the aggregate worth of the securities that they own and invest[236] and are permitted to purchase certain securities even if the seller fails to otherwise comply with general registration and disclosure requirements.[237] The Securities and Exchange Commission (SEC) gave the following rationale for the introduction of QIBs: "Congress and the Commission historically have recognized the ability of professional institutional investors to make investment decisions without the protections mandated by the registration requirement of the Securities Act."[238] Such professional institutional investors are appropriately distinguished from members of the "investing public" who are "intended to benefit from the registration provisions of the Securities Act" and are primarily "unsophisticated, individual investors."[239]

By introducing a separate, less invasive, regulatory scheme for QIBs, the SEC recognized that investors could be meaningfully distinguished based on their resources, access to information, sophistication, and experience. These differences result in varying investor needs and regulatory concerns. QIBs are better able to make investment decisions without the benefit of government-mandated registration and the accompanying disclosures. In other words, such investors are expected to "fend for themselves."[240] Allowing QIBs to operate outside the standard regulatory framework enabled new types of financing to emerge, without exposing the investing public to the risk associated with these private transactions.

The Rule 144A exemption for QIBs provides a useful framework for judicial review in arbitration law. Just as investors differ widely in terms of their

235. 17 C.F.R. § 230.144A (1991).

236. *See id.* (requiring that qualified institutional buyers "in the aggregate *own[ ] and invest[ ] on a discretionary basis at least $100 million* in securities of issuers that are not affiliated with the entity" (emphasis added)).

237. *Id.*

238. Resale of Restricted Securities, Securities Act Release No. 33-6806, 42 SEC Docket 76 (Oct. 25, 1988).

239. *Id.*

240. *See, e.g.*, Sec. & Exch. Comm'n v. Ralston Purina Co., 346 U.S. 119, 125 (1953) ("Since exempt transactions are those as to which 'there is no practical need for . . . [the bill's] application,' the applicability of § 4(1) should turn on whether the particular class of persons affected need the protection of the Act. An offering to those who are shown to be able *to fend for themselves* is a transaction 'not involving any public offering.'" (emphasis added)).

resources and sophistication, parties to arbitration agreements range from large public companies to individual consumers and employees. Moreover, just as QIBs require less protection in their investment decisions, some arbitration participants should require less judicial oversight of their arbitration agreements and awards.[241] Borrowing from Rule 144A and the QIB definition, I propose an analogous category of qualified arbitration participants (QAPs).

While QIBs are classified based on their assets under management, QAPs would be classified by their assets, revenue, or income. Thus, QAPs would encompass both (1) businesses whose assets or annual revenues for the prior fiscal year exceeded a congressionally determined threshold, and (2) employees whose annual compensation for the prior or upcoming year exceeds a separate threshold. Arbitration awards should be subject to more searching judicial review when a QAP and a non-QAP are involved.

The QAP concept accounts for the wide variety of parties involved in arbitration and looks to their resources as a better measure of bargaining power or sophistication. The QAP approach therefore eliminates some of the overinclusion inherent in categorical approaches. All employees, for example, are not similarly situated. As Spitko has observed, some employees may be able to aggressively negotiate the terms of their employment, including any arbitration provisions.[242]

These sophisticated employees may also be less vulnerable to some of the alleged systematic inequalities of arbitration. In fact, while there is some evidence that employment arbitration outcomes are similar to those in litigation, a clear "exception to this trend appears in cases of individuals earning income below a certain threshold, or those arbitrating pursuant to promulgated (as opposed to individually negotiated) agreements."[243] In other words, employees

241. When two sophisticated, repeat arbitration participants enter into an arbitration agreement, there is less reason to suspect that either party was coerced or forced to accept unfavorable terms. Thus, procedural justice concerns are greatest when individuals who have little or no familiarity with the arbitration process, or its relationship to the courts, find themselves up against a more sophisticated party. *Cf.* CARBONNEAU, *supra* note 35, at 16 (stating that one of the FAA's "significant omissions" is "the lack of distinction between commercial arbitration and adhesionary arbitration in consumer transactions and employment relationships").

242. Spitko, *supra* note 194, at 628 ("[C]ompared to low-level employees, high-level employees are more likely to possess greater bargaining leverage, sophistication, and informational advantages in negotiating the terms of any employment agreement with their employer or potential employer.").

243. Rutledge, *supra* note 88, at 582–83.

with higher incomes and bargaining power appear to achieve better results in arbitration than other employees.[244]

In addition to being less overinclusive than prior categorical approaches, the QAP proposal may be more administrable than many noncategorical approaches. Other approaches run the risk of being difficult to implement at both the contracting and judicial stages. Vague references to bargaining power or sophistication leave too much work for the courts and make it difficult for parties to know at the time of contract negotiation whether a court will ultimately decide that they will be subject to elevated judicial review.

Of course, the QAP concept is imperfect. Some potential critiques are immediately apparent. First, there is still much work to be done in establishing the appropriate asset, revenue, and income thresholds, and I have not attempted to determine optimal figures.[245] Ideally, final numbers would rest on rigorous empirical analysis of the bargaining and arbitration processes. However, they will almost surely instead be determined as a matter of political compromise and may be influenced by special interests. Second, there will still be some cases in which the standard remains overinclusive or underinclusive or difficult to apply. Both critics and proponents of arbitration may be frustrated that the search for precision risks burdening certain groups more their preferred proposals. In spite of these weaknesses, however, the QAP scheme is a step forward from existing proposals.

D. Selecting the Level of Judicial Review

Subparts A, B, and C have argued that arbitration awards should generally be subject to more searching substantive judicial review when they arise from a predispute agreement, involve mandatory law claims, or involve a QAP and a non-QAP. These general conclusions do not immediately suggest an appropriate

244. Of course, these correlations do not necessarily indicate that arbitration systematically disadvantages low-income workers. It could be that "meritorious claims for this cohort may settle at an earlier stage" or "that, absent arbitration, this group might not have a day in court." *Id.* at 583. Even if these alternate explanations are accurate, however, the data still indicates that income level correlates with different experiences in the dispute resolution system.

245. Regardless of the precise numbers, they should be indexed to inflation. The alternative minimum tax is evidence enough of the dangers of failing to take this basic step. *See* Richard J. Kovach, *Technical and Policy Standards for Inflation Adjustments Under the Internal Revenue Code*, 33 OKLA. CITY U. L. REV. 603, 611–12 (2008) ("In recent years, the alternative minimum tax ('AMT') has spurred much discussion because an increasing number of taxpayers have become subject to its bite. The AMT was originally designed to catch high-income taxpayers who were too successful in compounding various allowances legitimately granted under the Code. However, today, the AMT affects a growing number of taxpayers because the level of income that triggers its application is not adjusted to reflect inflation.").

level of review for any given dispute. This Subpart considers several potential levels of judicial review, and Subpart E offers specific proposals for each combination of the three variables discussed above.

Selecting the appropriate level of judicial review is an exercise in tradeoffs. As Tom Ginsburg explains, "The basic issues of institutional design here are familiar across many areas of law, whenever superior decisionmakers discipline primary decisionmakers, such as factfinders, administrative agencies, or lower courts."[246] The tradeoffs associated with substantive judicial review were discussed in Part III.A. Here, I review several existing proposals for potential levels of substantive judicial review of arbitration awards.[247]

Some proposals would restrict substantive judicial review even further than the traditional manifest disregard standard. For example, Christopher Drahozal suggests that the FAA should be amended to allow vacatur "only if (1) the arbitrators state in a written award that they are disregarding the law, or (2) the record shows that counsel for the prevailing party urged the arbitrators to disregard the law."[248] Drahozal concedes that this formulation would not do much to promote compliance with the law, but believes it is necessary to preserve "the integrity of the judicial process."[249] As discussed in Part III.A.1, Kevin Murphy would go even further to eliminate manifest disregard review entirely.[250]

At the other extreme, proposals have been made for de novo review of at least some subset of arbitration awards.[251] Other commentators advocate for intermediate levels of judicial review that are more searching than the traditional manifest disregard standard. In 1998, Norman Poser suggested replacing manifest disregard with "a standard that would require the reviewing court to modify or vacate an award if the award egregiously departs from established legal principles, even if the arbitrator is ignorant of the correct law."[252]

246. Ginsburg, *supra* note 170, at 1013.

247. As an alternative to substantive judicial review, Michael Scodro proposed "an amendment to the FAA to provide for a procedure, analogous to federal-state certification, whereby parties can receive a federal court's decision on a novel point of law raised in arbitration." Scodro, *supra* note 23, at 1959. Though not directly relevant to this Comment, Scodro's proposal deserves mention here.

248. Drahozal, *supra* note 35, at 247.

249. *Id.*

250. *See supra* note 91 and accompanying text.

251. Stone, *supra* note 1, at 1026–27 ("Courts could also protect outsiders in insider-outsider arbitrations by changing the standard of review of arbitral outcomes. They could abandon the judge-made 'manifest disregard' and instead impose de novo review for questions of law decided in arbitration. Recently some scholars have suggested that courts review arbitral awards de novo for questions of law in the areas of attorney-client arbitration and employment arbitration.").

252. Poser, *supra* note 203, at 473.

Twelve years later, Thomas Burch suggested that manifest disregard should, in some circumstances, be expanded to cover intentional and unintentional legal errors.[253] However, Burch would apply this expanded form of judicial review only to mandatory arbitration agreements.[254]

Calvin Sharpe has proposed "a substantive integrity standard of review" for arbitration awards.[255] Under Sharpe's proposal,

> the court looks independently at the record first to determine whether the arbitrator's decision is correct; a correct decision ends the matter. If the decision is incorrect, the court closely examines the arbitrator's law-finding for correctness. If the law is correctly selected, the court evaluates the arbitrator's fact-finding and law applying only to determine whether the arbitrator's conclusions have been reasoned from the materials in the record. Reasoned conclusions are entitled to deference, even though the court would have reached a different result.[256]

This proposal emphasizes arbitrator integrity and is similar to manifest disregard in that legally inaccurate awards may still be confirmed if the arbitrator provided clear, but incorrect, reasoning.

Finally, some proposals focus on allowing parties to contract for expanded review, rather than attempting to define a new, broadly applicable standard of review. Sarah Rudolph Cole, for example, suggests that "Congress amend the FAA to permit parties to agree to expanded judicial review, so long as the court's review of the award does not compromise the institutional integrity of the courts."[257] Tom Ginsburg has also advocated for allowing parties to contract for expanded judicial review. He concludes that the agency costs associated with arbitration indicate that parties should be able to contract for the standard of review they prefer, with the FAA setting only a floor.[258] He believes that permitting parties "to choose higher levels of monitoring by

253. Burch, *supra* note 8, at 74.
254. *Id.* Burch defines mandatory arbitration to include "employment disputes, consumer disputes, and franchise disputes as those disputes are defined in the Arbitration Fairness Act of 2009" and "any arbitration involving (a) a statute that protects civil rights or (b) parties with grossly unequal bargaining power." *Id.* at 48 n.3.
255. Calvin William Sharpe, *Integrity Review of Statutory Arbitration Awards*, 54 HASTINGS L.J. 311, 371 (2003).
256. *Id.*
257. Sarah Rudolph Cole, *Revising the FAA to Permit Expanded Judicial Review of Arbitration Awards*, 8 NEV. L.J. 214, 214 (2007).
258. Ginsburg, *supra* note 169, at 1022–23.

contract, will reduce agency slack and allow parties to determine what type of arbitrator they are hiring."[259]

In selecting the appropriate default level of judicial review, and determining whether or not to permit parties to contract for tailored judicial review, the costs and benefits discussed in Part III must be considered. Standards that are more deferential to arbitrators will tend to be less costly, but may not capture all of the benefits associated with substantive judicial review. De novo review may be more costly, but would better achieve certain benefits of judicial review. Subpart E below combines the principles established in Parts IV.A–IV.C with the cost–benefit analysis of Part III to propose a tailored system of judicial review.

E. Proposal and Further Details

Given the numerous variables behind every arbitration award, I propose a system with four distinct default levels of judicial review. This Subpart describes the basic mechanics of the proposal, and Part V fleshes out the proposal further in the context of two hypothetical arbitration agreements. The lowest level of judicial review (Tier 1) would be limited to the FAA's statutory procedural grounds, excluding the recent incorporation of manifest disregard by some circuits.[260] The next level of review (Tier 2) would be manifest disregard, as defined by the Second Circuit prior to *Hall Street*.[261] A third level of judicial review (Tier 3) would be for egregious legal error, regardless of the arbitrator's state of mind. I call this level of review "Poser review," in recognition of his development of the idea in the late 1990s.[262] Finally, the most searching level of review (Tier 4) would entail de novo review for legal error. This final level of review should be required only for those arbitration awards in which every variable raises a red flag: predispute agreements regarding mandatory laws entered into by a QAP and a non-QAP.

As one or more variable shifts, less searching defaults are appropriate, and more freedom can be given to allow contracting for tailored judicial review. Thus, predispute arbitration agreements are subject to Poser review (Tier 3) if they involve mandatory law claims, but do not involve a dispute between a QAP and a non-QAP. In these situations, the parties can contract for increased judicial review for legal error (Tier 4). Predispute arbitration

259. *Id.* at 1026.
260. *See* discussion *supra* Part I.B.
261. Hall St. Assocs., L.L.C. v. Mattel, Inc., 552 U.S. 576 (2008).
262. *See* discussion *supra* Part I.C.

agreements are subject to judicial review for manifest disregard (Tier 2) if they involve nonmandatory law claims in a dispute between a QAP and a non-QAP. In these situations, the parties can contract for Poser review (Tier 3) or review for legal error (Tier 4). Predispute arbitration agreements are subject only to judicial review for procedural error (Tier 1) if they involve only nonmandatory law claims and the dispute is not between a QAP and a non-QAP. In this situation, the parties can contract for increased judicial review for manifest disregard (Tier 2), Poser review (Tier 3), or legal error (Tier 4). This regime for predispute agreements is summarized in Table 1.

TABLE 1. Predispute Agreements

	Mandatory Law	**Nonmandatory Law**
QAP vs. Non-QAP	Default: Legal Error (Tier 4) Contract Alternative: None	Default: Manifest Disregard (Tier 2) Contract Alternative: Poser Review (Tier 3) or Legal Error (Tier 4)
Non-QAP vs. Non-QAP	Default: Poser Review (Tier 3) Contract Alternative: Legal Error (Tier 4)	Default: Procedural Error (Tier 1) Contract Alternative: Manifest Disregard (Tier 2), Poser Review (Tier 3), or Legal Error (Tier 4)

Awards arising from postdispute arbitration agreements are subject to Poser review (Tier 3) if they involve mandatory law claims in a dispute between a QAP and a non-QAP. Parties may contract up for judicial review for legal error (Tier 4), or contract down for manifest disregard (Tier 2) or procedural error (Tier 1). Postdispute arbitration agreements are subject to judicial review for manifest disregard (Tier 2) if they involve either mandatory law claims, or a dispute between a QAP and a non-QAP, but not both. In either of these situations, the parties can contract up for Poser review (Tier 3) or legal error (Tier 4), or can contract down for procedural error (Tier 1). Postdispute arbitration agreements are subject to judicial review for procedural error (Tier 1) if they involve nonmandatory law claims, and the dispute is not between a QAP and a non-QAP. In this situation, the parties can contract up for increased

judicial review for manifest disregard (Tier 2) or Poser review (Tier 3). In order to conserve judicial resources and maintain the distinction between arbitration and litigation, however, parties would not be permitted to contract for full de novo review for legal error (Tier 4). This regime for postdispute agreements is summarized in Table 2.

TABLE 2. Postdispute Agreements

	Mandatory Law	**Nonmandatory Law**
QAP vs. Non-QAP	Default: Poser Review (Tier 3) Contract Alternative: Legal Error (Tier 4), Manifest Disregard (Tier 2), or Procedural Error (Tier 1)	Default: Manifest Disregard (Tier 2) Contract Alternative: Procedural Error (Tier 1), Poser Review (Tier 3), or Legal Error (Tier 4)
QAP vs. QAP or Non-QAP vs. Non-QAP	Default: Manifest Disregard (Tier 2) Contract Alternative: Procedural Error (Tier 1), Poser Review (Tier 3), or Legal Error (Tier 4)	Default: Procedural Error (Tier 1) Contract Alternative: Manifest Disregard (Tier 2) or Poser Review (Tier 4)

In addition to default levels of review and limited rights to contract for alternative levels of review, two important additional provisions would be necessary to make tailored judicial review effective. First, all awards that will be subject to any level of substantive review[263] would be required to be made in writing, with the legal and factual reasoning behind the decision explained.[264] Arbitration agreements should explicitly direct the arbitrators to issue such reasoned awards. To enforce this requirement, courts should refuse to confirm arbitration awards that should have been, but were not, reasoned and written. Second, as others have previously suggested, courts would be permitted to impose sanctions for frivolous appeals.[265]

263. Substantive review takes place under manifest disregard review, Poser review, and review for legal error.

264. Burch, *supra* note 8, at 81 ("While requiring reasoned opinions would increase the formality and expense of the arbitration, which is the main objection to such a rule, it would simplify the task of reviewing the awards for legal error.").

265. *Id.* at 79.

V. IMPLICATIONS

It is likely that tailored judicial review would have first- and second-order effects. The obvious first-order effect is changing the applicable level of judicial review for a given dispute. Second-order effects will occur if and when parties modify their behavior and agreements based on the new rules. We can analyze the potential implications of tailored judicial review by applying the proposal to hypothetical disputes and considering the likely consequences. Here, I consider two types of disputes: a traditional commercial contract dispute at one end of the spectrum, and a Title VII employment dispute at the other.

The quintessential commercial dispute involves two QAPs, a breach of contract, and a predispute or postdispute agreement to arbitrate. For example, a national concert promoter might place a large order with a regional catering company. If the promoter cancels the concert at the last minute and fails to pay, the parties might enter into an arbitration agreement to resolve the dispute. This case involves a postdispute agreement governing a nonmandatory law claim between two QAPs. Arbitration's externalities are at a low point in this context.

First, the only foreseeable result of arbitration is an economic loss to one party or the other. Thus, an erroneous arbitration award would not allow for any ongoing legal violations that could harm third parties. Second, the importance of deterrence is minimal in this contract dispute, in which efficient breach by the concert promoter may have been the appropriate outcome. Third, because the terms of the contract will be the primary focus of the arbitration, the legal rights and obligations of third parties are unlikely to be thrown into uncertainty by an unreasoned arbitration award. Finally, few observers would be concerned that a large catering company is a victim that is being denied its day in court.

Because judicial review is not necessary to mitigate arbitration's externalities under these facts, the default level of review will be procedural error (Tier 1). The parties would also be permitted to provide for a higher level of review in their contract—manifest disregard (Tier 2) or Poser review (Tier 3). Because the parties have entered into the agreement postdispute, with full knowledge of the claims involved, they would not be permitted to contract for review for legal error. Assuming they have not contracted for heightened scrutiny, a court will review the arbitration award only on the current section 10 grounds (Tier 1). Thus, the parties and the court will not need to spend time and resources inquiring into the substance of the arbitration award unless the

parties agreed beforehand that these costs were worth the added accuracy they might afford.

Contrast this commercial contract dispute with a hypothetical employment dispute. Consider a low-level employee working for a national retail chain who has been the victim of employment discrimination under Title VII. If the employment contract contains an arbitration provision, this case involves a predispute agreement governing a mandatory law claim between a QAP (the employer) and a non-QAP (the employee). Arbitration's externalities are at a high point in this context.

First, an erroneous arbitration award may allow for ongoing employment discrimination by the employer that may harm other employees. Second, an erroneous award could undermine the deterrent power of Title VII. Third, the legal rights and obligations of other employers may be thrown into uncertainty by an unreasoned award. Finally, observers may be concerned that the employee is a victim who deserves, but is being denied, her day in court.

Because judicial review can mitigate arbitration's externalities under these facts, the default level of review will be legal error (Tier 4). This standard cannot be modified by contract. As a result, the costs of arbitrating employment discrimination claims may increase because the arbitrator is required to produce a written, reasoned award. Additionally, the process may be more likely to drag on through appeal. A critical question will then become whether arbitration with the additional safeguards of tailored judicial review remains a cost-effective alternative to litigation. If parties ultimately determine that arbitration is not attractive once its externalities have been internalized through judicial review, they will modify their behavior accordingly. Enabling the market to determine the appropriate mix of arbitration and litigation is an attractive alternative to recent proposals that would prohibit certain types of arbitration outright without first attempting to address the underlying concerns.

CONCLUSION

The current trend towards further restricting substantive judicial review of arbitration awards fails to take account of four important externalities generated by modern arbitration: ongoing legal violations, reduced deterrence, uncertainty about the legal rights and obligations of third parties, and collective doubts about the procedural justice of our legal system. These externalities were less of a concern when Congress enacted the FAA in 1925. Today, they create serious problems for the arbitration and legal systems.

These externalities can be mitigated by tailoring judicial review of arbitration awards. Arbitration awards should be subject to more searching substantive judicial review when they arise from a predispute agreement, involve mandatory law claims, or involve parties of unequal bargaining power. To measure bargaining power, we can learn from securities law and classify arbitration participants by their assets, revenue, or income.

When it comes to understanding how arbitration fits within our system of justice, judicial review of arbitration awards is only a small piece of the puzzle. Further efforts to improve the relationship between arbitration and litigation can benefit from two lessons underlying tailored judicial review. First, arbitration generates significant externalities. Policymakers and judges should explicitly take these externalities, both positive and negative, into account going forward. Second, future legal changes should begin with an honest interrogation of the underlying basis for the concern and should attempt to address those concerns without unnecessary overreaching. If these principles govern reform, arbitration may become a useful alternative to litigation in appropriate circumstances, rather than a tool for oppression or a failed experiment undone by its own success.