THE ROLE OF SUBSTANTIVE LAW IN BUSINESS ARBITRATION AND THE IMPORTANCE OF VOLITION

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INTRODUCTION

Businesses increasingly turn to binding arbitration[1] as a mechanism for dispute resolution. This is manifest not only in the number of arbitration cases, but also by the growing utilization of arbitration clauses in contracts and the expansive variety of transactions that are covered by these agreements.[2] The judiciary has played a role in

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[1] The primary focus of this article is binding arbitration that occurs through agreement of the disputants, as distinguished from arbitration that is merely advisory in effect or arbitration that is court ordered or statutorily mandated.

[2] The American Arbitration Association ("AAA") total arbitration case filings has risen fairly steadily from 36,609 in 1984 to 68,346 in 1996. AAA DISPUTE RESOLUTION TIMES, Summer 1997, at 5. In recent years the AAA has reported rapid growth in the areas of securities, real estate, franchising, computers, employment, banking, patent, trademark, and copyright disputes, and the international case load more than doubled between 1987 and 1993. AAA DISPUTE RESOLUTION TIMES, Spring 1994, at 1. The number of securities industry arbitrations filed with the National Association of Securities Dealers, Inc. ("NASD") has risen even more dramatically from 1,400 in 1985 to 5,631 in 1996 (with a high in 1995 of 6,055). NASD REGULATION THE NEUTRAL CORNER, April 1997, at 11.

furthering this interest and activity by enforcing contractual arbitration clauses[3] and by showing deference to the decisions of arbitrators.[4]

Arbitration is intended to provide a quicker, less expensive, and more private alternative to litigation. Other extolled virtues include simplicity, informality, and the benefit of having experienced and knowledgeable decision-makers. Although some arbitrations are merely advisory in effect, this article is directed at binding arbitration. Thus, finality is another positive and complementary attribute of arbitration.

Arbitration is similar to litigation in that it involves an adjudicative process including the presentation of proofs and arguments and the making of a decision by a third party.[5] It is different in other respects.[6] Notably, the disputants, through their agreement to arbitrate, have the opportunity to design specific features of the process. They can set the procedural rules, which include, for example, establishment of a method for selecting the third party decision-maker. Additionally, the disputants can designate the decision-making principles that are to be applied by the arbitrators in reaching their decision.

This latter feature raises some uncertainty about the role of substantive law[7] in arbitration. In litigation, the judge decides the case based on applicable rules of substantive law. Judges strive to apply the law correctly because a prejudicial error can result in an appeal, negating a judgment. In arbitration, arbitrators may be, but usually are not, directed to establish their decision on principles of substantive law, and typical arbitration awards are not subject to appellate review.

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[3] The U. S. Supreme Court recently laid to rest any questions about the enforceability of arbitration clauses in transactions involving or affecting interstate commerce. *See* Allied-Bruce Terminix Cos., Inc. v. Dobson, 513 U.S. 265 (1995).

[4] *See infra* notes 101-03 and accompanying text.

[5] STEPHEN B. GOLDBERG ET AL., DISPUTE RESOLUTION 4 (2d ed. 1992).

[6] *See generally* Kenneth R. Davis, *Due Process Right To Judicial Review Of Arbitral Punitive Damages Awards*, 32 AM. BUS. L.J. 583, 588-89 (1995) (comparing arbitration and litigation).

[7] Substantive law is defined as "[t]hat part of the law which creates, defines, and regulates rights, as opposed to 'adjective or remedial law,' which prescribes methods of enforcing the rights or obtaining redress for their invasion." BLACK'S LAW DICTIONARY (5th ed. 1979). In the context of arbitration, notions of procedure and substance sometimes coalesce. *See infra* text accompanying notes 56-61. Other than as briefly treated in these referenced pages, this article does not address the substantive right to arbitrate. Moreover, in this article, unless otherwise indicated, the author intends "substantive law" to be read narrowly. The author desires to distinguish that which he refers to as "substantive law" from all aspects of the law that relate to procedures for enforcement of rights and duties in courts and other forums. The intent is to refer to the rights and duties of people as they act in society (such as the common law of torts or contracts or the non-procedural components of statutory securities, employment discrimination, or antitrust laws) rather than in the process of dispute resolution.

Thus, the extent to which arbitrators should and do apply substantive law in deciding cases is less clear.

This vague aspect of arbitration has received surprisingly little attention in the legal literature and the world of dispute resolution. One may conjecture that a great many arbitrants and even their attorneys erroneously believe that arbitration is to be resolved in accordance with principles of substantive law.

This article will examine the role of substantive law in commercial arbitration.[8] This will include an evaluation of arbitration statutes and typical contractual agreements that establish the right to arbitration. It will also explore the judicial treatment of the substantive law issue. This article will evaluate the merits of arbitration as an adjudicative dispute resolution process that is not devoted to the application of principles of substantive law. The importance of maintaining arbitration as an alternative that is conceived only through volition emerges from this analysis. Finally, this article will propose a solution to the associated concern that businesses sometimes are unfairly forcing weaker parties into arbitration agreements. The proposed solution assures the viability of arbitration as a meaningful alternative dispute resolution process, but protects against unfair loss of legal rights.

ARBITRATION STATUTES AND THE SUBSTANTIVE LAW ISSUE

A natural starting point in exploring the role of substantive law in arbitration is an examination of the governing statutory law. The Federal Arbitration Act (FAA)[9] and the Uniform Arbitration Act (UAA)[10] are the most prevalent sources of statutory law affecting arbitration. The FAA, which was enacted in 1925, is applicable in the case of agreements to arbitrate maritime transactions[11] and transactions in

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[8] The term "commercial arbitration" is used in a fairly broad manner in this article to refer to arbitrations involving businesses (i.e., not just arbitrations between businesses) regarding business related matters. It is not the intent of the author, however, to include in this definition arbitration in the organized labor context. Despite this focus on business arbitration, the article does include occasional references to and discussion of organized labor cases and non-commercial cases as they may be relevant to an understanding of the role of substantive law in arbitration. The broad range of arbitration contexts and the general lack of regard for unique contextual differences complicate the evaluation of arbitration. *See infra* text accompanying notes 269-72.

[9] 9 U.S.C. §§ 1-14 (1996).

[10] 7 U.L.A. 5 (1985).

[11] The act defines "maritime transactions" as "charter parties, bills of lading of water carriers, agreements relating to wharfage, supplies furnished vessels or repairs of vessels, collisions, or any other matters in foreign commerce which, if the subject of controversy, would be embraced within admiralty jurisdiction." 9 U.S.C. § 1 (1996).

foreign or interstate commerce.[12] Other arbitrations are subject to state laws. In 1955, the Commissioners on Uniform State Laws proposed the UAA, which has been explicitly adopted in thirty-four states[13] and the District of Columbia.[14]

In light of the 1995 Supreme Court decision in *Allied-Bruce Terminix Cos. v. Dobson*[15] it appears that the FAA governs the overwhelming majority of all commercial arbitrations. The Court ruled that the FAA applies to the full extent of the Commerce Clause power. Thus the FAA applies to any transaction which in fact involves or affects interstate commerce, even if the parties did not contemplate interstate commerce at all. Accordingly, the state arbitration statutes govern only purely local matters.

Neither the FAA nor the UAA address the role that substantive law is to play in arbitral decision-making. While neither act provides for appellate review by the courts, both acts do provide for judicial intervention in the form of vacation of an arbitration award. Section 10 of the FAA provides that a federal district court may, upon the application of any party to the arbitration, make an order vacating the award in the following situations:

> (a) Where the award was procured by corruption, fraud, or undue means.
> (b) Where there was evident partiality or corruption in the arbitrators, or either of them.
> (c) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to

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[12] To be precise, the act governs any arbitration provision in "a contract evidencing a transaction involving commerce," which is defined as "commerce among the several States or with foreign nations, or in any Territory of the United States or in the District of Columbia, or between any Territory and another, or between any such Territory and any State or foreign nation, or between the District of Columbia and any State or Territory or foreign nation, but nothing contained herein shall apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce." 9 U.S.C. § 1 (1996). "Involving commerce" has been read broadly to mean "affecting" commerce. Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265 (1995).

[13] These states are Alaska, Arizona, Arkansas, Colorado, Delaware, Florida, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Montana, Nebraska, Nevada, New Mexico, North Carolina, North Dakota, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, and Wyoming.

[14] A significant attribute of the FAA, the UAA, and the modern arbitration statutes now in effect in other states is that they provide for enforcement of not only agreements to arbitrate existing controversies, but also any controversies arising in the future. This approach has significantly furthered the use of arbitration in commercial contexts. Two exceptions are Alabama and West Virginia, which honor only the agreement to arbitrate existing controversies. ALA. CODE § 6-6-1 (1993); W. VA. CODE §§ 55-10-1 to -8 (1994).

[15] 513 U.S. 265 (1995).

> hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.
> (d) Where the arbitrators exceeded their power, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made. [16]

Section 12 of the UAA is similarly worded. It authorizes vacation of an arbitration award where:

> (1) The award was procured by corruption, fraud, or other undue means;
> (2) There was evident partiality by an arbitrator appointed as a neutral or corruption in any of the arbitrators or misconduct prejudicing the rights of any party;
> (3) The arbitrators exceeded their powers;
> (4) The arbitrators refused to postpone the hearing upon sufficient cause being shown therefor or refused to hear evidence material to the controversy or otherwise so conducted the hearing, contrary to the provisions of Section 5, as to prejudice substantially the rights of a party;
> (5) There was no arbitration agreement and the issue was not adversely determined in proceedings under Section 2 and the party did not participate in the arbitration hearing without raising the objection.[17]

The UAA further clarifies that the grounds for vacating an award are very limited, stating "the fact that the relief was such that it could not

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[16] 9 U.S.C. § 10 (1996). It is further stated that where an award is vacated and the time for making an award has not yet expired, the court has the discretion to direct a rehearing by the arbitrators. *Id.* at (e).

Section 11 further authorizes a federal district court to modify or correct an award in the following circumstances:

> (a) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award.
> (b) Where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted.
> (c) Where the award is imperfect in matter of form not affecting the merits of the controversy.
> The court may modify and correct the award, so as to effect the intent thereof and promote justice between the parties.

9 U.S.C. § 11 (1996).

[17] UAA, *supra* note 10, § 12.

Paragraph 4 refers to Section 5, which establishes required hearing procedures regarding the notices, adjournment, postponement, proceeding with the hearing in the absence of a duly notified party, presentation of evidence, cross examination, authority of the panel to proceed if panel members are not unanimous or a panel member ceases to act.

Paragraph 5 refers to Section 2, which addresses proceedings to compel or stay arbitration.

or would not be granted by a court of law or equity is not ground for vacating or refusing to confirm the award."[18]

Neither statute includes error of law as a ground for vacation of an arbitration award.[19] These statutes do include some vague language, such as "other undue means" or "misconduct prejudicing the rights of any party," which arguably could encompass error of law. Similarly, it has been argued that arbitrators who do not correctly apply the law have "exceeded their powers." The courts, however, have generally rejected these arguments.[20] Thus, as long as the process of applying decision-making criteria — whether rules of substantive law or some other standards — has not been tainted by the specifically enumerated grounds, such as "corruption" or "evident partiality," arbitrators' awards have routinely withstood judicial challenge.

In the minority of states that have not adopted the UAA, the provisions regarding the issue of vacation of an award are often strikingly similar to section 10 of the FAA and section 12 of the UAA.[21] Most of these states' statutes do not mention error of law as a basis for vacation of an award. Nor do they otherwise address the role of substantive law.

A very few state arbitration statutes do contain provisions relevant to the issue of the role that substantive law should play in arbitration. Typically these references are contained within the section(s) describing the grounds for vacation, correction or modification of an award. For example, New Hampshire law permits a court to correct or modify an

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[18] *Id.* Section 13 provides for modification or correction of an award on the same grounds as Section 11 of the United States Arbitration Act. *See supra* note 16.

[19] There is some disagreement about whether the statutorily enumerated grounds for vacation under both the FAA and the UAA are exclusive. *See infra* notes 103 and 160-62.

[20] *See infra* notes 121-28 and accompanying text.

[21] For example, the California statute provides:

> The court shall vacate the award if the court determines that:
> (a) The award was procured by corruption, fraud or other undue means;
> (b) There was corruption in any of the arbitrators;
> (c) The rights of such party were substantially prejudiced by misconduct of a neutral arbitrator;
> (d) The arbitrators exceeded their powers and the award cannot be corrected without affecting the merits of the decision upon the controversy submitted; or
> (e) The rights of such party were substantially prejudiced by the refusal of the arbitrators to postpone the hearing upon sufficient cause being shown therefor or by the refusal of the arbitrators to hear evidence material to the controversy or by other conduct of the arbitrators contrary to the provisions of this title.

CAL. CIV. CODE § 1286.2 (West Supp. 1995).

award for "plain mistake,"[22] and the New Hampshire courts have interpreted "plain mistake" as meaning mistakes of both fact and law.[23]

Some of the references relevant to the role of substantive law are contained within special arbitration acts or provisions that are limited in application. For example, California provides for vacation on the basis of error of law only in the case of public construction contract arbitration.[24] Pennsylvania has added to the UAA a provision authorizing the courts to review arbitration awards for error of law in three special situations: (1) where the Commonwealth government submits a controversy to arbitration, or (2) where a political subdivision submits a controversy with an employee or representative of employees to arbitration, or (3) where any person has been required by law to submit or agree to submit a controversy to statutory arbitration. The courts are directed to "modify or correct the award where the award is contrary to law and is such that had it been a verdict of a jury the court would have entered a different judgment or a judgment notwithstanding the verdict."[25] The New Jersey Alternative Procedure for Dispute Resolution Act expresses a rare requirement that arbitrators decide all cases according to substantive law.[26] This Act further specifies that arbitration awards must be in a writing, specifically stating findings of fact and conclusions of law; and these awards are fully reviewable in court for prejudicial legal errors. This provision, however, applies only to disputants who have agreed to alternative dispute resolution pursuant to this specific Act.[27] Otherwise New Jersey arbitrations are

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[22] N.H. REV. STAT. ANN. § 542:8 (1974).

[23] New Hampshire Ins. Co. v. Bell, 427 A.2d 27 (N.H. 1981). In *Rand v. Aetna Life & Casualty Co.*, 571 A.2d 282 (N.H. 1990), the court explained that the error must be "one which is apparent on the face of the record and which would have been corrected had it been called to the arbitrator's attention." In this case the court denied the request to vacate because there was no record and further declined to order the arbitrator to explain his decision, noting that the AAA rules do not require it. *See also* Masse v. Commercial Union Ins. Co., 593 A.2d 1164 (N.H. 1991) ("[A]rbitrator must have manifestly fallen into such error with regard to facts or law as must have prevented free and fair exercise of his judgment.").

[24] CAL. CIV. CODE § 1296 (West 1982).

[25] 42 PA. CONS. STAT. ANN. § 7302(d). Pennsylvania adopted the UAA in 1980. Previously 5 P.S. § 171(d) (Arbitration Act of 1927) broadly authorized vacation where the award was against the law so that a court could have granted a judgment notwithstanding the verdict. *See, e.g.*, Utica Mutual Ins. Co. v. Contrisciane, 473 A.2d 1005 (Pa. 1984).

Pennsylvania continues to recognize common law arbitration, and in that context an award may be vacated if "it is clearly shown that a party was denied a hearing or that fraud, misconduct, corruption or other irregularity caused the rendition of an unjust, inequitable or unconscionable award." 42 PA. CONS. STAT. ANN. § 7341.

[26] N.J. STAT. ANN. §§ 2A:23A-1 to -30 (West 1987 & Supp. 1995).

[27] *Id.* at §§ 2A:23A-12(a), -12 (e), -13(c)(5), -13(e)(4) (West 1987).

governed by the general New Jersey Arbitration Act which does not include any substantive law direction.[28]

Moreover, arbitration statutes call for the application of substantive law in very few states and, even then, mostly under limited circumstances. It remains unclear what further limiting effect the *Allied-Bruce Terminix* decision may have on the applicability of these unusual state statutory provisions to commercial transactions. Overwhelmingly, statutory law does not prescribe a role for substantive law in arbitration. Thus, it can be said that most arbitration legislation reflects a critical distinction between adjudication and arbitration — in adjudication, law rules; in arbitration this is not necessarily so. In arbitration, it is up to the parties to delineate the process, including the role, if any, that substantive law is to play.

CONTRACTS TO ARBITRATE

Arbitrants have the ability to control the form that their own arbitration is to take. This is done through the agreement to arbitrate. Thus, arbitrations can operate under different sets of rules by design of the parties. Arbitrants can fashion a procedure in which an arbitrator is obligated to apply designated legal principles, and they can specify a right to appeal based on an error of law. Alternatively, they can designate some other guiding principle such as the unconstrained wisdom of their selected arbitrators.

While disputants have the right to specify in their arbitration agreement that their arbitrators are to render a decision based on particular substantive laws,[29] this approach is rarely taken.[30] It seems that most arbitration agreements do not address this aspect of the

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[28] *Id.* at § 2A:24. The New Jersey courts, however, have vacillated on whether to recognize error of law as a basis for reversing an arbitration award. *See infra* notes 134-43 and accompanying text.

[29] *See, e.g.*, Medika Int'l, Inc. v. Scanlan Int'l, Inc., 830 F. Supp. 81 (D.P.R. 1993) ("[A]rbitration will take place in St. Paul, Minnesota with the substantive laws of the State of Minnesota applying."); *cf.* Western Waterproofing Co., Inc. v. Lindenwood Colleges, 662 S.W.2d 288, 291 n.2 (Mo. Ct. App. 1983) ("Arbitrators must follow the law if they are commanded to do so by the terms of the arbitration agreement.").

[30] In international contexts, it is more common for parties to identify the law of a particular country. Although in Europe there has been a common practice of empowering arbitrators as *amiables compositeurs* — that is, without obligation to observe the rules of law but subject to "natural justice" or fundamental principles of commercial practice. *See* Julian D.M. Lew, *New Act / New Look for English Arbitration*, 1 ADR CURRENTS 7 (1996); Karyn S. Weinberg, *Equity In International Arbitration: How Fair Is "Fair"? A Study Of Lex Mercatoria And Amiable Composition*, 12 B.U. INT'L L.J. 227 (1994). Regarding choice of law in international arbitration *see infra* note 86.

process.[31] Agreements to arbitrate, which are often contained within other transactional contracts, are typically very simple agreements. Usually they consist of little more than an express agreement to arbitrate a particular kind of dispute in accordance with an identified set of procedural rules. The effect is that most arbitrators are not obligated to follow substantive law. The situation was aptly summarized by one court as follows:

> [B]oth the arbitration agreement . . . and the Uniform Arbitration Act . . . are silent as to what substantive law should be applied by the arbitrator or even whether any substantive law must be applied. Generally, arbitrators are not bound by either substantive or procedural rules of law, except as required under terms of the arbitration agreement.[32]

The American Arbitration Association Influence

The most widely used arbitration clause is probably that of the American Arbitration Association ("AAA"). The AAA proclaims that its standard arbitration provision "has proven highly effective in over a million disputes."[33] This brief provision includes no direction regarding the role of substantive law:

> Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration in accordance with the [applicable] Rules of the American Arbitration Association and judgment upon the award rendered by the arbitrator may be entered in any court having jurisdiction thereof.[34]

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[31] Perini v. Greate Bay Hotel & Casino, Inc., 610 A.2d 364, 389 (N.J. 1992) (Wilentz, C.J., concurring) ("[P]arties practically never express any intention whatsoever on this subject in their arbitration agreements, their true intent being that the arbitrators will decide what is just and equitable without regard to any state law, it is rare that there is any 'agreement to the contrary,' indeed, rare that there is any agreement at all that mentions state law.").

[32] Cabus v. Dairyland Ins. Co., 656 P.2d 54, 56 (Colo. Ct. App. 1982). *See also* University of Ala. v. Modern Const., Inc., 522 P.2d 1132, 1140 (Ala. 1974) ("The general rule in both statutory and common-law arbitration is that arbitrators need not follow otherwise applicable law when deciding issues before them unless they are commanded to do so by the terms of the arbitration agreement."); Lentine v. Fundaro, 278 N.E.2d 633, 635 (N.Y. 1972) ("Absent provision to the contrary in the arbitration agreement, arbitrators are not bound by principles of substantive law.").

[33] AMERICAN ARBITRATION ASSOCIATION, DRAFTING DISPUTE RESOLUTION CLAUSES: A PRACTICAL GUIDE 2 (1992) (hereinafter "DRAFTING CLAUSES").

[34] *Id.* The suggested clause for the arbitration of existing disputes is similarly silent regarding the role of law:

> We, the undersigned parties, hereby agree to submit to arbitration under the [applicable] Rules of the American Arbitration Association the following controversy [cite briefly]. We further agree that we will faithfully observe this agreement and the rules, and that we will abide by and perform any award rendered by the

Although this widely used arbitration clause does not directly address the role that substantive law should play in arbitration, it does invoke one of the several AAA arbitration rules. The AAA has adopted procedural rules for use in a variety of contexts, such as general commercial, construction industry, textile and apparel industries, insurance claims, and international.[35] These rules provide additional insight regarding the relationship between arbitration, legal rights, and the authority of arbitrators.[36] For example, AAA Commercial Arbitration Rule 43 states that in making an award an arbitrator is free to "grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement of the parties . . . ."[37] While this rule and other similarly worded AAA rules[38] are more explicitly focused on the remedial function, they emphasize the arbitrator's sense of justice and equity, and thereby at least acknowledge that arbitrators are not obligated to apply the law rigidly.[39]

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arbitrator(s) and that a judgment of the court having jurisdiction may be entered upon the award.

Id.

The AAA pamphlet *A Guide For Commercial Arbitrators* is also silent regarding the role of substantive law in arbitration. This pamphlet states under the heading "What It Takes To Be a Good Arbitrator" that "[t]he arbitrator should be a person of integrity, sound judgment, and specialized knowledge" and "must be able to decide cases in accordance with the contractual agreement of the parties and the applicable rules of procedures." AMERICAN ARBITRATION ASSOCIATION, A GUIDE FOR COMMERCIAL ARBITRATORS at 2 (April 1991) [hereinafter AAA Arbitrator's Guide]. The pamphlet explains that the "arbitrator's authority is created by the contract, subject to applicable arbitration law" but that "the parties breathe life into the arbitrator." *Id.* at 4.

[35] *See* ROBERT COULSON, BUSINESS ARBITRATION — WHAT YOU NEED TO KNOW 33-40, 60-68, 84-92, 106-18, and 133-36 (rev. 3d ed. 1987).

[36] *See also* CODE OF ETHICS FOR ARBITRATORS IN COMMERCIAL DISPUTES. The AAA and the American Bar Association, together, have set forth generally accepted standards of ethical conduct for the guidance of arbitrators and parties in commercial disputes. Canon V of this Code of Ethics prescribes that an arbitrator should "make decisions in a just, independent and deliberate manner," elaborating that "[a]n arbitrator should decide all matters justly, exercising independent judgment, and should not permit outside pressure to affect the decision." CODE OF ETHICS FOR ARBITRATORS IN COMMERCIAL DISPUTES (1977).

[37] COMMERCIAL ARBITRATION RULES OF THE AAA, Rule 43 (1996).

[38] *E.g.*, CONSTRUCTION INDUSTRY ARBITRATION RULES, Rule 43 (1996); ARBITRATION RULES OF THE GENERAL ARBITRATION COUNCIL OF THE TEXTILE AND APPAREL INDUSTRIES, Rule 36 (1996).

[39] Other organizations active in arbitration similarly emphasize this equitable, extra-legal approach to fashioning a remedy in arbitration. For example, the Securities Industry Conference on Arbitration commences its publication "The Arbitrator's Manual" with the following statement:

Equity is justice in that it goes beyond the written law. And it is equitable to prefer arbitration to the law court, for the arbitrator keeps equity in view, whereas the

The AAA publication *Drafting Dispute Resolution Clauses: A Practical Guide*[40], in addition to presenting and promoting the standard AAA clause, also includes examples of other arbitration clauses. This resource cautions, however, that "the Association does not specifically recommend these clauses."[41] This presentation is organized under a series of topical headings such as "Provisional Remedies," "Conditions Precedent To Arbitration," and "Locale Provisions." Under the heading "Governing Law," five illustrative clauses are presented, and it is noted that "[i]t is not uncommon for parties to specify the law that will govern the contract and/or the arbitration proceedings."[42] Only one of the five brief sample clauses, however, specifically directs the arbitrators to apply substantive law;[43] the others relate to procedural law or are ambiguous in this regard.[44] Elsewhere, under the heading "Appeal" there is a lengthy sample clause providing for appeal to an appellate arbitrator. This clause empowers the appellate arbitrator to reverse, modify or remand on three grounds: 1) those specified in sections 10 or 11 of the FAA; 2) if the award contains material errors of applicable law; or 3) if the award is arbitrary or capricious. The accompanying commentary explains that "[e]xperienced parties and their attorneys rarely write arbitration clauses which allow for appeal of the arbitrator's award."[45]

Other AAA resource information is more explicit in addressing the issue, though not entirely clear in resolving it. For example, the widely

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judge looks only to the law, and the reason why arbitrators were appointed was that equity might prevail.

SECURITIES INDUSTRY CONFERENCE ON ARBITRATION, THE ARBITRATOR'S MANUAL i (1992).

[40] DRAFTING CLAUSES, *supra* note 33.

[41] *Id.* at 5.

[42] *Id.* at 9.

[43] *Id.* This example reads: "In rendering the award, the arbitrator shall determine the rights and obligations of the parties according to the substantive and procedural law of [state]."

[44] *Id.* These examples are provided:

"... shall be resolved by arbitration in accordance with Title 9 of the U. S. Code (United States Arbitration Act) and the Commercial Arbitration Rules of the American Arbitration Association."

"This contract shall be governed by the laws of the state of [specify]."

"... shall be settled by arbitration in accordance with [state] Arbitration Law and under the [applicable] Rules of the American Arbitration Association."

"The parties acknowledge that this agreement evidences a transaction involving interstate commerce. The United States Arbitration Act shall govern the interpretation, enforcement, and proceedings pursuant to the arbitration clause in this contract."

See infra notes 55-86 and accompanying text regarding the interpretation and effect of such language.

[45] *Id.* at 26.

disseminated AAA publication, *Business Arbitration — What You Need To Know*,[46] by Robert Coulson (former long-time president of the AAA), approaches the subject in several different passages. Generally, these references are couched in terms of the inadvisability of subjecting arbitration to judicial review. Consider the following statement contrasting judicial decision-making with arbitration:

> In litigation the emphasis is on procedure. The judicial machinery is designed to correct mistakes. The procedure is supposed to protect the parties against errors, with appellate review playing an important role.
>
> In arbitration, the parties rely on their own ability to select a wise and impartial decision maker. They waive their right to have a judge review the arbitrator's decision. The emphasis is on the integrity and experience of the decision maker.[47]

Coulson flatly rejects the view that judges ought to review arbitrators' awards, especially as to legal issues:

> Some judges might like to review arbitrators' awards, particularly as to legal issues. That is not possible under the American system. By referring the issues to an arbitrator, the parties have agreed to a final and nonreviewable award. Final arbitration is not compatible with judicial review. An occasional mistake by an arbitrator, left uncorrected by the courts, is the price that must be paid for a healthy system of binding arbitration.[48]

Further, by discouraging the use of written opinions, the AAA procedures help to assure that judicial review cannot occur.[49] Ordinarily, AAA commercial awards "consist of a brief direction to the parties on a

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[46] COULSON, *supra* note 35.

[47] *Id.* at 16.

[48] *Id.* at 28-29. *See also* AAA ARBITRATOR'S GUIDE, *supra* note 34, at 2 ("Under prevailing arbitration laws, courts will not review awards (arbitrators' decisions) on their merits. This has long been a settled principle in the relationship between arbitration and the law.").

[49] Other organizations involved in promoting and administering arbitration have taken a different stance on this aspect of arbitration. For example, the Rules of Arbitration of the Council of Better Business Bureaus, Inc. ("BBB") require the arbitrator to provide the disputants with a written decision, including a thorough explanation of the arbitrator's reasoning. In establishing this rule, the BBB was initially responding to Federal Trade Commission and state "lemon law" requirements for automobile warranty disputes. Now, they emphasize that this process promotes sound decision-making. *See* Rich Woods, *Why Write Reasons?*, BBB SOLUTIONS, July 1993, at 3. The Center For Public Resources, another advocate for business use of ADR mechanisms, also requires arbitrator decisions to include the basis for an award. CPR RULES AND COMMENTARY FOR NON-ADMINISTERED ARBITRATION OF BUSINESS DISPUTES, Rule 13.2 (1989). Also, in the field of labor arbitration it is customary for arbitrators to include a written explanation of the decision. The AAA has opted for written opinions in its new National Rules for the Resolution of Employment Disputes, sec. 32 (b) (effective June 1, 1996).

single sheet of paper."[50] Without a written opinion explaining the reason for the decision, the award is "virtually immune from attack."[51]

The following quote from Coulson perhaps best reflects the awkward relationship between law and arbitration:

> It is sometimes said that arbitrators are not bound by the law in reaching their decisions. This is misleading. Commercial arbitrators are carefully briefed by each opposing lawyer as to the applicable law. At the same time, attorneys argue the equitable and practical considerations that should be weighed by the arbitrator. It is improper for an arbitrator to refuse to listen to any pertinent arguments raised by either counsel. The arbitrator should carefully consider the legal arguments, even though not required to make findings on legal issues.[52]

This cautious statement epitomizes the ambiguous character of the interplay between law and arbitration. Why is it misleading to say that the law does not bind arbitrators? Because, we are told, they are briefed on the law by the adversaries and should listen to and consider legal

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[50] COULSON, *supra* note 35, at 29.

[51] *Id.* at 31. *See also* AAA ARBITRATOR'S GUIDE, *supra* note 34, at 24 (advocating brevity as a means of avoiding a challenge to the award by the losing party; noting further that in situations where an arbitrator feels it necessary to write an opinion, it should be contained in a separate document). *Cf.* Rand v. Aetna Life & Casualty Co., 571 A.2d 282, 284 (N.H. 1990) (denying vacation in the absence of a record, stating that error must be "one which is apparent on the face of the record").

There is disagreement regarding whether a court should remand a case to an arbitrator for an explanation or clarification of the reasoning. Some courts have remanded "ambiguous awards" or expressed favor with the approach. *E.g.*, Olympia & York Fla. Equity Corp. v. Gould, 776 F.2d 42, 45-46 (2d Cir. 1985); Sargent v. Paine Webber, Jackson & Curtis, 674 F. Supp. 920, 924 (D.D.C. 1987). *See also* Ainsworth v. Skurnick, *infra* note 201.

Unless there is some confusion apparent on the face of the award, the tendency seems to be to adopt a passive, deferential approach — if some plausible explanation can exist, no more need be said. *E.g.*, Robbins v. Day, 954 F.2d 679, 684-85 (11th Cir. 1992); Siegal v. Titan Indus. Corp., 779 F.2d 891, 894 (2d Cir. 1985).

In *Perini Corp. v. Greate Bay Hotel & Casino, Inc.*, 610 A.2d 364, 392 (N.J. 1992), the New Jersey Supreme Court expressed disdain for the absence of arbitrator explanation with the following comment:

> In this case after four years and sixty-four days, the arbitrators simply awarded $14 million to Sands without any explanation whatsoever other than a finding that Perini had 'failed to properly perform its obligations as construction manager pursuant to the contract * * *.' There are no reasons, no findings of fact, no conclusions of law, nothing other than the foregoing. For all we know, the arbitrators concluded that the sun rises in the west, the earth is flat, and damages have nothing to do with the intentions of the parties or the foreseeability of the consequences of a breach.

See infra notes 134-40 and accompanying text for discussion of the *Perini* case.

[52] COULSON, *supra* note 35, at 31.

arguments. Of course, at the same time, the arbitrators are to weigh other "equitable and practical considerations," and they are not required to report specific findings. As a backdrop to all of this, the AAA has forcefully advocated and the courts have overwhelmingly expressed that arbitration awards are not reviewable for error of law.[53]

Functioning primarily in this AAA environment, arbitrators have grappled with a process that includes presentation of law, but allows for, or at least tolerates, an overriding personal sense of justice. An early study of commercial arbitrators revealed that while eighty percent of the surveyed arbitrator respondents felt they ought to render awards in accordance with the law, ninety percent indicated that they believed they were free to ignore substantive rules of law in the interests of "doing justice."[54] Although this author has not identified more current research displaying arbitrator attitudes or practices regarding the proper role of law in arbitration, this assessment is consistent with the author's observations while serving on panels with other arbitrators.

Most commonly, arbitrants do not carefully and specifically delineate in their arbitration agreement that the arbitration is to be decided based on designated principles of substantive law and that a deviation from this directive is a ground for vacation of the award. Typically, arbitration agreements merely phrase a simple decision to substitute arbitration for adjudication. The details are filled in by referencing the rules and practices of an administrative organization, such as the AAA. As is the case with the AAA, the rules of most of these organizations do not express a role for substantive law. The AAA literature clearly advocates that arbitrators be less constrained to follow the law than judges and be free to base decisions on factors such as equitable and practical considerations and personal wisdom and experience. Given this characterization, it is no wonder that some would say that arbitrators are not obligated to follow the law in reaching a decision.

The Effect of a Choice-of-Law Clause

In the United States, when arbitrants have expressed some preference for law in the arbitration context, this has most often been in

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[53] *See infra* notes 101-02.

[54] Soia Mentschikoff, *Commercial Arbitration*, 61 COLUM. L. REV. 846, 861 (1961). *Cf.* Harry T. Edwards, *Arbitration of Employment Discrimination Cases: An Empirical Study*, PROC. OF THE 28TH ANN. MEETING OF THE NAT'L ACAD. OF ARB. 59, 71-72 (1976) (reporting that at least 16 percent of arbitrators have never read any judicial opinions involving Title VII of the Civil Rights Act, and 40 percent do not read advance sheets to keep abreast of Title VII developments; nevertheless, 50 percent of this group who do not monitor Title VII developments feel professionally competent to decide legal issues of employment discrimination).

the form of a general contractual reference, such as a typically worded choice-of-law clause. A choice-of-law provision could appear either within an arbitration clause[55] or as a clause within a contract that is the subject of arbitration.

It is far from clear, however, exactly how a choice-of-law clause should affect procedural law, substantive law, and the law of remedies.[56] In non-arbitration contexts, a simple choice-of-law clause typically has been viewed as encompassing substantive law and not procedural law.[57] For example, if a choice-of-law clause invokes the law of State A in a case before the courts of State B, State B's law will govern procedural matters, but the State B court will determine the rights of the parties based on State A's substantive law. Since the remedy should reflect the substantive right, one would ordinarily expect the appropriate remedy to be that of the chosen state.[58]

In the arbitration context, the choice-of-law clause presents an enigma. The federal and state arbitration statutes represent a strange melding of procedure and substance. For example, while the FAA largely addresses procedural matters, it also is viewed as substantive in that it establishes a right to arbitration.[59] The situation is further confounded since arbitration may be classified as a remedy.[60] It is a unique remedy that "opens up the possibility that the arbitrator will administer other remedies."[61] There are a number of arbitration cases

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[55] *See, e.g.*, In re Arbitration Between U.S. Turnkey Exploration, Inc. and PSI, Inc., 577 So.2d 1131, 1132-33 (La. Ct. App. 1991) where the court evaluated the conduct of the arbitrators in reference to the following clause:

> Any dispute, claims or controversies connected with, arising out of or related to this Contract, or the breach thereof, shall be settled by Arbitration to be conducted in accordance with the Rules of Arbitration of the American Arbitration Association. . . . The place of Arbitration shall be Lake Charles, Louisiana. All questions arising out of this Contract or its validity, interpretation, performance or breach shall be governed by the laws of the State of Louisiana.

[56] The law of remedies is technically separate from either procedural or substantive law. *See* DAN B. DOBBS, LAW OF REMEDIES: DAMAGES-EQUITY-RESTITUTION 1-2 (2d ed. abr. 1993).

[57] *E.g.*, Federal Deposit Ins. Corp. v. Peterson, 770 F.2d 141, 142-43 (10th Cir. 1985). *See* EUGENE S. SCOLES & PETER HAY, CONFLICT OF LAWS 659 (2d ed. 1992).

[58] *See* DOBBS, *supra* note 56, at 22-23. There is surprisingly little authority, however, on the effect of a choice-of-law clause on the law of remedies. In *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 60 n.3 (1993), the Supreme Court declined to address whether there is a meaningful distinction between "substance" and "remedy."

[59] *E.g.*, Moses H. Cone Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 25 n.32 (1983) (noting that the FAA created "a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate.").

[60] DAN B. DOBBS, LAW OF REMEDIES: DAMAGES-EQUITY-RESTITUTION 503 (2d ed. 1993).

[61] *Id.*

in which the courts have grappled with the effect of a choice-of-law clause, including two United States Supreme Court decisions.[62]

In *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Jr. Univ.*[63], the Supreme Court recognized the potential force of a choice-of-law clause in an arbitration agreement. *Volt* addressed conflicting procedural provisions in the FAA and the California arbitration statute. The California superior court had stayed arbitration pursuant to the California arbitration statute. The FAA does not permit such a stay. The parties' contract included a choice-of-law clause, generally referring to California law. The Supreme Court affirmed the stay, holding that it would not disturb a state court finding that the choice-of-law provision was intended by the parties to encompass the California arbitration rules.[64] The Court observed that the liberal policy favoring arbitration does not provide any basis for ignoring choice-of-law provisions in arbitration agreements. Just as parties can limit the issues that they will arbitrate, so too may they specify the rules under which arbitration will be conducted.[65] A major message of the *Volt* decision is that courts should honor the intention of the parties. *Volt*, however, focused on the application of procedural law. It is unclear from *Volt* whether this should be extended to include a choice-of-law direction regarding remedies or regarding substantive law, how explicit such a direction need be, and how courts should scrutinize and react to imperfect applications of such contractual directives.

The Supreme Court decision in *Mastrobuono v. Shearson Lehman Hutton, Inc.*[66] provides further elucidation. *Mastrobuono* involved the use of a New York choice-of-law clause in a securities firm customer-broker agreement, a common practice in the securities industry. According to New York law, arbitrators are not empowered to award punitive damages.[67] Leading up to *Mastrobuono*, federal and state court decisions were divided on the effect of a New York choice-of-law clause on the availability of punitive damages in arbitration.[68] In *Mastrobuono,*

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[62] *See infra* notes 63-86 and accompanying text.

[63] 489 U.S. 468 (1989).

[64] *Id.* at 477.

[65] *Id.* at 476-77.

[66] 514 U.S. 52 (1995).

[67] Garrity v. Lyle Stuart, Inc., 353 N.E.2d 793 (N.Y. 1976). Some New York federal district court judges have begun to take issue with *Garrity*. *See* Prudential v. Laurita, 1997 U.S. Dist. LEXIS 2654 (S.D.N.Y. 1997); Paine Webber, Inc. v. Richardson, 1995 WL 236722 (S.D.N.Y. 1995).

[68] Barbier v. Shearson Lehman Hutton, Inc., 948 F.2d 117, 122 (2d Cir. 1991) (vacating arbitral award of punitive damages because "the parties elected to abide by 'the laws of the State of New York' in the event of a dispute under the Agreement"). Other courts reached different conclusions. *See, e.g.*, Lee v. Chica, 983 F.2d 883 (8th Cir. 1993); Todd Shipyards

Shearson challenged an arbitration award that included $400,000 in punitive damages.[69] The district court and the Seventh Circuit disallowed the punitive damages, concluding that by entering into the agreement with the New York choice-of-law clause the claimants had contractually waived the right to punitive damages.[70] The Supreme Court reversed the lower federal courts, reinstating the award of punitive damages.

The prevailing principle was the same previously enunciated in *Volt* — "private agreements to arbitrate are enforced according to their terms."[71] The case was thus decided on the basis of what the contract had to say about the claim for punitive damages. The two relevant provisions of the contract were (1) the statement that the agreement "shall be governed by the laws of the state of New York" and (2) the very next sentence which provided that any controversies be settled by arbitration in accordance with the rules of the National Association of Securities Dealers (NASD).[72] Noting that the agreement contained no express reference to punitive damages, the Court interpreted the related expressions. The Court observed that the NASD Code of Arbitration Procedure indicates that arbitrators may award "damages and other relief";[73] although not a clear authorization of punitive damages, it "appears broad enough at least to contemplate such a remedy."[74] Furthermore, a manual provided to NASD arbitrators contains a provision alerting arbitrators that they can consider punitive damages as a remedy. This led the Court to conclude that the arbitration clause, by referring to the NASD rules, "does not support — indeed it contradicts — the conclusion that the parties agreed to foreclose claims for punitive damages."[75] The Court explained that both arbitration law precedent[76] and the common law rule of contract interpretation that ambiguous language should be construed against the party that drafted it support the availability of punitive damages in this case. The Court expounded on the issue of contractual intent:

Corp. v. Cunard Line, Ltd., 943 F.2d 1056 (9th Cir. 1991); J. Alexander Sec., Inc. v. Mendez, 21 Cal. Rptr. 2d 826 (Cal. Ct. App. 1993).

[69] Respondents did not challenge the panel's award of compensatory damages in the amount of $159,327. 514 U.S. at 54.

[70] 20 F.3d 713 (7th Cir. 1994).

[71] *Volt*, 489 U.S. at 479; *see Mastrobuono*, 514 U.S. at 57-8.

[72] 514 U.S. at 59 (quoting from App. to Pet. for Cert. 44).

[73] *Id.* at 61 (quoting from NASD Code of Arbitration Procedure P3741(e) (1993)).

[74] *Id.*

[75] *Id.* This conclusion seems quite a stretch. *See id.* at 65-72 (Thomas, J., dissenting).

[76] Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25 (1983) (holding that "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability").

> As a practical matter, it seems unlikely that petitioners were actually aware of New York's bifurcated approach to punitive damages, or that they had any idea that by signing a standard-form agreement to arbitrate disputes they might be giving up an important substantive right. In the face of such doubt, we are unwilling to impute this intent to petitioners.[77]

Mastrobuono illustrates the complexity of the choice-of-law issue as it relates to arbitration. It may also signal a new judicial reluctance to allow businesses to take advantage of consumers and other weaker parties by having them agree to arbitration and unwittingly relinquish certain rights.[78] Previously, the judiciary had not displayed much concern for this possibility.[79] Additionally, the *Mastrobuono* decision includes a final thought that concerns the focal subject of this Article — the role of substantive law in arbitration. In a final effort to reconcile what might be viewed as a contradiction in the contract, the Court stated:

> We think the best way to harmonize the choice-of-law provision with the arbitration provision is to read "the laws of the state of New York" to encompass substantive principles that New York courts would apply, but not to include special rules limiting the authority of arbitrators. Thus, the choice-of-law provision covers the rights and duties of the parties, while the arbitration clause covers arbitration; neither sentence intrudes upon the other.[80]

Thus the Court has recognized a relationship between the choice-of-law clause and substantive law. Nevertheless, it remains unclear how this affects arbitrators functioning pursuant to a contract including a choice-of-law clause. None of the courts that have evaluated the effect

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[77] 514 U.S. at 63.

[78] *See infra* notes 315-18 and accompanying text.

[79] *See infra* notes 307-13 and accompanying text.

[80] 514 U.S. at 63-64. A few other courts have made similar expressions. *See, e.g.*, J. Alexander Sec., Inc. v. Mendez, 21 Cal. Rptr. 2d 826, 830 (Cal. Ct. App. 1993) (acknowledging New York choice-of-law provision that designated the substantive law that the arbitrators must apply in determining whether punitive damages are warranted, but did not deprive the arbitrators of authority to award punitive damages); Osteen v. T.E. Cuttino Constr. Co., 434 S.E.2d 281 (S.C. 1993) (holding that choice of law clause did not cause the South Carolina Arbitration Act to supersede countervailing provisions of the FAA; what the parties intended by including the choice-of-law provision was to designate the substantive law that the arbitrators were to apply in resolving conflicts arising under the parties' construction contract); *cf.* Snowberger v. Young, 536 P.2d 1069 (Ariz. Ct. App. 1975) (rejecting argument that statement that arbitration be "in accordance with the rules then in effect of the American Arbitration Association, to the extent consistent with the laws of the State of Arizona" called for application of Arizona substantive law).

of a simple choice-of-law provision on arbitration have specifically held that such a provision requires arbitrators to use substantive law principles as the primary decision-making criteria. For the most part these cases have addressed other related issues such as whether state or federal law determines the validity and effect of the contractual arbitration provision,[81] whether differing provisions of a state arbitration act or the Federal Arbitration Act control the procedure,[82] or whether remedies such as punitive damages or attorneys' fees are available.[83]

Since contractual choice-of-law clauses are commonly used, and the courts in our country have repeatedly refused to set aside awards on the basis of error of law,[84] one may infer that there is a general unwillingness to identify a special arbitral duty to apply substantive law based on the use of a general choice-of-law clause; at least, not a duty to apply the law flawlessly.[85] It would appear that something more than the simplest choice-of-law reference is required to effectuate a significant change in the relationship between arbitration and law.[86]

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[81] *See, e.g.*, McCain Foods, Ltd. v. Puerto Rico Supplies, Inc., 766 F. Supp. 58, 59 (D.P.R. 1991); Flight Sys. v. Paul A. Laurence Co., 715 F. Supp. 1125, 1127 (D.D.C. 1989).

[82] *E.g.*, Volt Info. Sciences, Inc. v. Board of Trustees, 489 U.S. 468, 476-77 (1989); Madison Beauty Supply, Ltd. v. Helene Curtis, Inc., 481 N.W.2d 644, 645 (Wis. Ct. App. 1992) (looking to Wisconsin law to determine the procedure for enforcing the arbitration agreement even though agreement provided that it "be construed in accordance with the law of the state of Illinois").

[83] *See supra* note 68 and accompanying text. *See also* Pinnacle Group, Inc. v. Shrader, 412 S.E.2d 117 (N.C. Ct. App. 1992) (holding that reference to New York law in arbitration agreement is substantive and entitles party to award of attorneys' fees, despite North Carolina law, under which arbitrators cannot award attorneys' fees).

[84] *See infra* notes 101-03 and accompanying text.

[85] *See infra* notes 101-03 and 143-215 and accompanying text.

[86] One leading treatise on arbitration posits that in order to establish an obligation on the part of the arbitrators to apply the law in resolving a dispute there must be an express reference to *substantive law*. GABRIEL M. WILNER, DOMKE ON COMMERCIAL ARBITRATION § 25.03 (Rev. ed. 1991). *But see* Faherty v. Faherty, 477 A.2d 1257 (N.J. 1984) (vacating an arbitral award under the "exceeded their powers" section of the arbitration statute where there was an agreement that New Jersey law would govern the resolution of disputes).

In the international arbitration context, there have been more systematic endeavors to clarify the effect of contractually designating a nation's law. The Model Law on International Commercial Arbitration, which was adopted by the United Nations Commission on International Trade Law, directs that "[a]ny designation of the law or legal system of a given State shall be construed, unless otherwise expressed, as directly referring to the substantive law of that State and not to its conflict of law rules." UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION, Art. 28, par. 1 (June 21, 1985). Furthermore it rejects the *amiable compositeur* approach unless the parties expressly authorize it. *Id.* at Art. 28, par. 3. But it does place an overriding emphasis on usages of trade, *Id.* at Art. 28, par. 4, and it does not provide for vacation based on error of law.

Similarly, the International Arbitration Rules of the AAA provide that "[t]he tribunal shall apply the substantive law(s) . . . designated by the parties as applicable to the dispute. Failing such a designation by the parties, the tribunal shall apply such law(s) . . . as it

JUDICIAL TREATMENT OF THE SUBSTANTIVE LAW ISSUE

Since neither the arbitration statutes nor the arbitration rules are likely to specify a role for substantive law, questions regarding the appropriate use of law and the effect of the non-use or flawed use of the law have been left to the courts. Nevertheless, there has been surprisingly little judicial attention directed to the precise issue of the proper role for substantive law in the arbitral decision-making process. For the most part the courts have merely skirted the issue while addressing attempts to vacate arbitration awards because of alleged errors of or lack of regard for the law.

Support For A Flexible Equitable Approach Rather Than Decision-Making Based On The Law

Consistent with the view of the AAA,[87] many courts have expressed support for a process that involves decision-making that is not controlled by substantive law. Courts have rationalized that the disputants, in choosing arbitration, are more interested in the sensibilities of arbitrators who are knowledgeable about industry practice and custom than they are about the correct application of law. For example, an Indiana court explained that "part of what the parties have bargained for is dispute resolution based upon the sense of equity or fairness of an impartial umpire who is familiar with their problems and who should not be constrained by legal technicalities."[88] Similarly, a federal district court in Louisiana[89] observed that the disputants in their arbitration agreement "specifically stipulated that the arbitrators were to be 'men of commerce' and by implication not admiralty lawyers."[90] This influenced the court in declining to find that the arbitrators had disregarded the law, which cleared the way for a denial of a motion to vacate.

The California courts have for many years recited that "arbitrators are not bound to award on principles of dry law, but may decide on principles of equity and good conscience, and make their award ex aequo

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determines to be appropriate." INTERNATIONAL ARBITRATION RULES OF THE AAA, Art. 28(1) (1997). These rules further direct the arbitrator(s) to take into account usages of trade in arbitrations involving application of contracts. *Id.* at Art. 28(2). And these rules clarify that "[t]he tribunal shall not decide as amiable compositeur or ex aequo et bono unless the parties have expressly authorized it to do so." *Id.* at Art. 28(3).

[87] *See supra* text accompanying notes 39-54.

[88] School City v. East Chicago Fed'n of Teachers, Local 511, 422 N.E.2d 656, 662 (Ind. Ct. App. 1981).

[89] Fukaya Trading Co., S.A. v. Eastern Marine Corp., 322 F. Supp. 278 (D. La. 1971).

[90] *Id.* at 284.

et bono [according to what is just and good]."[91] In *Sapp v. Barenfeld*[92] the California Supreme Court acknowledged the potential effect of this freedom from the strictures of law. The court observed that "arbitrators, unless specifically required to act in conformity with rules of law, may base their decision upon broad principles of justice and equity, and in doing so may expressly or impliedly reject a claim that a party might successfully have asserted in a judicial action."[93]

Other courts have proclaimed that the arbitrator may do "justice as he sees it, applying his own sense of law and equity"[94] or his "notion of justice without regard to the applicable law,"[95] or that the arbitrators are "free to fashion law to 'fit the facts before them.'"[96] In *Sprinzen v. Nomberg*,[97] the New York Court of Appeals stated that an "arbitrator's paramount responsibility is to reach an equitable result, and the courts will not assume the role of overseers to mold the award to conform to their sense of justice."[98] This notion does, however, have its limitation. In *Advest, Inc. v. Asseoff*,[99] a party seized upon this statement, creatively asserting that arbitrators erred by basing their decision on settled principles of substantive law rather than fulfilling their duty to reach an equitable result. The judge emphatically rejected this convoluted notion "that the decision to apply the law is inequitable as a matter of law."[100]

Judicial Treatment Of Error Of Law

The judicial attention relating to the role of substantive law in arbitration has been largely directed at the effect of an error of law. While not all courts have been as expressive about the paramount importance of doing what is fair and just as those quoted in the preceding section, overwhelmingly the courts have recited the view that arbitration awards should not be subject to normal appellate review for

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[91] *E.g.*, Moncharsh v. Heily & Blase, 832 P.2d 899, 904 (Cal. 1994); Muldrow v. Norris, 2 Cal. 74, 77 (1852).

[92] 212 P.2d 233 (Cal. 1949).

[93] *Id.* at 239.

[94] Silverman v. Benmor Coats, Inc., 461 N.E.2d 1261, 1266 (N.Y. 1984).

[95] David Co. v. Jim W. Miller Const., Inc., 428 N.W.2d 590, 594 (Minn. Ct. App. 1988), *aff'd*, 444 N.W.2d 836 (Minn. 1989).

[96] Israel Discount Bank Ltd. v. Rosen, 565 N.Y.S.2d 29, 30 (N.Y. App. Div. 1991); Exercycle v. Marotta, 174 N.E.2d 463, 466 (N.Y. 1961).

[97] 389 N.E.2d 456 (N.Y. 1979).

[98] *Id.* at 458. *See also* Lentine v. Fundaro, 278 N.E.2d 633, 636 (N.Y. 1972) ("In the absence of provisions to the contrary in the arbitration agreement, arbitrators are not bound by principles of substantive law or rules of evidence.").

[99] No. 92 Civ. 2269, 1993 U.S. Dist. LEXIS 4839 (S.D.N.Y. April 14, 1993).

[100] *Id.* at *17.

error of law.[101] Indeed, there is authority in most jurisdictions specifically rejecting error of law as a ground for overturning or vacating an arbitration award.[102] Some courts have emphatically declared that mistake or error of law cannot be a basis for judicial intervention, reasoning that the statutory grounds for vacation are exclusive.[103]

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[101] *E.g.*, Department of Pub. Safety v. Public Safety Employees Ass'n, 732 P.2d 1090, 1097 (Ala. 1987) (holding that public policy necessitates very limited review); City of Middletown v. Police Local, No. 1361, 445 A.2d 322, 323-24 (Conn. 1982) (favoring arbitration as a means of settling private disputes, courts undertake judicial review of arbitration awards in a manner designed to minimize interference with an efficient and economical system of alternative dispute resolution).

[102] *E.g.*, Burchell v. Marsh, 58 U.S. 344, 349 (1854); Northrop Corp. v. Traid Int'l Marketing, S.A., 811 F.2d 1265, 1269 (9th Cir. 1987); Moncharsh v. Heily & Blase, 832 P.2d 899, 900 (Cal. 1992); Cabus v. Dairyland Ins. Co., 656 P.2d 54 (Colo. Ct. App. 1982); Bodner v. United States Auto Ass'n, 610 A.2d 1212, 1223 (Conn. 1992); Keyes Co. v. Ogee, 590 So.2d 954, 955 (Fla. Dist. Ct. App. 1991); Arbitration of Bd. of Directors of Ass'n of Apartment Owners of Tropicana Manor, 830 P.2d 503, 511 (Haw. 1992); Iowa City Community Sch. Dist. v. Iowa City Educ. Ass'n, 343 N.W.2d 139 (Iowa 1983); Jackson Trak Group, Inc. v. Mid States Port Auth., 751 P.2d 122, 127 (Kan. 1988); Concerned Minority Educators of Worcester v. School Comm. of Worcester, 466 N.E.2d 114, 116 (Mass. 1984); Koranda v. Austin Mut. Ins. Co., 397 N.W.2d 357, 360 (Minn. Ct. App. 1986); David A. Brooks Enters., Inc. v. First Systems Agencies, 370 N.W.2d 434, 436 (Minn. Ct. App. 1985); Western Waterproofing Co. v. Lindenwood Colleges, 662 S.W.2d 288 (Mo. Ct. App. 1983); Silverman v. Benmor Coats, Inc., 461 N.E.2d 1261, 1266 (N.Y. 1984); Crutchley v. Crutchley, 293 S.E.2d 793, 797 (N.C. 1982); Harold Schnitzer Properties v. Tradewell Group, Inc., 799 P.2d 180, 183 (Or. Ct. App. 1990); Batten v. Howell, 389 S.E.2d 170, 171-72 (S.C. Ct. App. 1990).

Courts have expressed the same view regarding errors of fact. *E.g.*, Air Line Pilots Ass'n Int'l v. Aviation Assocs., Inc., 955 F.2d 90, 93 (1st Cir. 1992); Garver v. Ferguson, 389 N.E.2d 1181, 1183 (Ill. 1979); Cape Elizabeth Sch. Bd. v. Cape Elizabeth Teachers Ass'n, 459 A.2d 166, 174 (Me. 1983); House Grain Co. v. Obst, 659 S.W.2d 903, 905-06 (Tex. Ct. App. 1983).

[103] *See, e.g.*, Moseliey, Hallgarten, Estabrook & Weeded, Inc. v. Ellis, 849 F.2d 264 (7th Cir. 1988); Verdex Steel and Const. Co. v. Board of Supervisors, 509 P.2d 240 (Ariz. Ct. App. 1973); Schnurmacher Holding, Inc. v. Noriega, 542 So.2d 1327, 1328-29 (Fla. 1989); Bingham County Comm'n v. Interstate Elec. Co., 665 P.2d 1046 (Idaho 1983); Konicki v. Oak Brook Racquet Club, Inc., 441 N.E.2d 1333 (Ill. 1982); In re Estate of Sandefur v. Greenway, 898 S.W.2d 667, 670 (Mo. Ct. App. 1995); New Shy Clown v. Baldwin, 737 P.2d 524 (Nev. 1987); Cyclone Roofing Co. v. LaFave Co., 321 S.E.2d 872 (N.C. 1984); Beck Suppliers, Inc. v. Dean Witter Reynolds, Inc., 558 N.E.2d 1187 (Ohio Ct. App. 1988); Aamot v. Eneboe, 352 N.W.2d 647 (S.D. 1984); Utility Trailer Sales v. Fake, 740 P.2d 1327 (Utah 1987); Westmark Properties Inc. v. McGuire, 766 P.2d 1146 (Wash. Ct. App. 1989). *But see* Texas West Oil & Gas Corp. v. Fitzgerald, 726 P.2d 1056, 1061-62 (Wyo. 1986) (finding statutory grounds to vacate an arbitration award not exclusive).

Courts in some non-UAA states have similarly found the statutory grounds to be exclusive. *E.g.*, Moncharsh v. Heily & Blase, 832 P.2d 899 (Cal. 1992); Morrison-Knudson v. Makahuena, 675 P.2d 760 (Haw. 1983); City of Sulphur v. Southern Builders, 579 So.2d 1207 (La. Ct. App. 1991).

Some courts, however, have identified certain of the standard statutory grounds with error of law. *See infra* notes 121-27 and accompanying text.

A small number of states do have some authority for judicial review on the basis of error of law.[104] Typically this is limited to special situations. For example, a distinction is drawn between arbitration that is mandated by statute and arbitration that is agreed upon by contract. Where disputants are required by law to submit certain kinds of claims to arbitration, the arbitrants are afforded a right to review for error of law.[105] The specific standard of review or the review procedure varies, however, depending on the jurisdiction.[106]

Prior to the adoption of modern arbitration statutes, courts were more distrustful of arbitration[107] and more willing to intervene.[108] This willingness, or at least opportunity, may endure in some jurisdictions where statutory and common law arbitration coexist.[109] For example, in Pennsylvania courts continue to express that under common law arbitration a court could vacate an award if it is "clearly shown that . . . fraud, misconduct, corruption or other irregularity caused the rendition

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[104] *See infra* notes 105-12 and 117-26 and accompanying text.

See supra notes 22-28 and accompanying text for discussion of the limited statutory authority for judicial review based on error of law.

[105] *E.g.*, Price v. State Farm Mut. Ins. Co., 458 N.Y.S.2d 315, 316-17 (N.Y. App. Div. 1983) (holding that regarding compulsory arbitration insurance law, award can be vacated if decision is based on inapplicable law). *Cf.* City of New Haven v. AFSCME, Council 15, Local 530, 544 A.2d 186, 189 (Conn. 1988) (holding that where parties mutually agree to arbitration, award is not reviewable for errors of law or fact).

[106] *See, e.g.*, Alaska v. Public Safety Employees Ass'n, 798 P.2d 1281, 1287 (Ala. 1990) (holding that, as a matter of common law, the "arbitrary and capricious" standard of judicial review applies in compulsory arbitration cases); Robert Matzkin Co. v. Pedersen Assocs., Inc., 457 N.Y.S.2d 365, 366 (N.Y. Sup. Ct. 1982) (recognizing civil court rule [N.Y.Ct. Rules, sec. 28.7] providing arbitration award may be vacated upon showing of "good cause" for mandatory arbitration of dispute where amount in controversy is $6,000 or less); Diversified Realty, Inc. v. McElroy, 703 P.2d 323, 325 (Wash. Ct. App. 1985) (holding that Washington Supreme Court Rules require de novo review of mandatory arbitration cases).

[107] A major purpose of the FAA and UAA was to change the common law rule that an executory agreement to arbitrate was unenforceable. *See* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987); Bunge Corp. v. Perryville Feed & Produce, Inc. 685 S.W.2d 837, 838-39 (Mo. 1985).

[108] *See, e.g.*, County Mut. Ins. Co. v. National Bank, 248 N.E.2d 299, 302 (Ill. Ct. App. 1969) (discussing that at common law awards were reviewable for "gross errors of fact or law, a plain mistake of law if the submission agreement required the arbitrator to determine the rights of the parties according to law, and a mistake of law if the award showed on its face that the arbitrator intended to decide according to the law but mistook or misconstrued it"). *See also* Board of Educ. of Prince George's County v. Prince George's County Educators' Ass'n, Inc., 522 A.2d 931, 941 (Md. 1987) (holding that common law review criteria included mistake so gross as to work manifest injustice).

[109] Common law arbitration may come into play when arbitration statutes exempt or do not cover certain kinds of disputes or agreements. *E.g.*, Anderson v. Federated Mut. Ins. Co., 481 N.W.2d 48 (Minn. 1992) (holding that the UAA as adopted in Minnesota does not supersede common law arbitration).

of an unjust, inequitable or unconscionable award."[110] In Texas it has been stated that in common law arbitration an award could be vacated by showing that "it is tainted with fraud, misconduct or such gross mistake as would imply bad faith and failure to exercise honest judgment."[111] One common law approach that seems to retain vitality in some states is to provide judicial relief in the case of an error appearing on the face of an award. While it is not entirely clear how this might be utilized as a basis for vacation regarding an error of law, case language suggests this is a possibility.[112] In the context of commercial arbitration, since arbitrators ordinarily do not provide a written opinion explaining their award,[113] there is small opportunity for errors of law to be identified in this way. Furthermore, at least one court has taken the position that the arbitrator's opinion should be viewed separately from the award, and the error must be identifiable from the award alone.[114]

Prior to the statutory endorsement of arbitration, resort to equity was a common method of challenging an arbitration award. A bill in equity for vacation could be sought for causes that ordinarily gave rise to equitable jurisdiction such as bias, partiality, fraud, corruption, or *mistake*. Today, since arbitration statutes are viewed as affording an effective remedy, courts normally refuse to intervene using their equitable powers.[115] Yet in some states, equity jurisdiction may provide an avenue for defeating an arbitration award based on an error of law. This is probably more likely to occur in those few jurisdictions which

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[110] *E.g.*, Hall v. Amica Mut. Ins. Co., 648 A.2d 755, 757 (Pa. 1994).

[111] Carpenter v. North River Ins. Co., 436 S.W.2d 549, 553 (Tx. Ct. Civ. App. 1968).

[112] *See, e.g.*, McElroy v. Waller, 731 S.W.2d 789, 791 (Ark. Ct. App. 1987) ("Unless the illegality of the decision appears on the face of the award, courts will not interfere merely because the arbitrators have mistaken the law, or decided contrary to the rules of established practice as observed by courts of law and equity."); Edward Elec. Co. v. Automation, Inc., 593 N.E.2d 833, 839 (Ill. Ct. App. 1992) (reversing trial court vacation and cautioning that this exception is severely limited: the mistake must appear "on the face of the award (and not in the arbitrator's opinion)"); Board of Educ. v. Prince George's County Educators' Ass'n, Inc., 522 A.2d 931, 941 (Md. 1987); Gordon Sel-way, Inc. v. Spence Bros. Inc., 440 N.W.2d 907, 912 *aff'd in part, rev'd in part*, 475 N.W.2d 704 (Mich. Ct. App. 1989); Kennewick Educ. Ass'n v. Kennewick Sch. Dist. No. 17, 666 P.2d 928, 930 (Wash. App. 1983).

[113] *See supra* note 49-51 and accompanying text.

[114] Edward Elec. Co. v. Automation, Inc., 593 N.E.2d 833, 839 (Ill. App. Ct. 1992).

[115] *E.g.*, Humphreys v. Joe Johnston Law Firm, 491 N.W.2d 513, 515 (Iowa 1992) (quoting from Burchell v. Marsh, 58 U.S. 344, 349 (1855), "[A]rbitrators are judges chosen by the parties to decide the matters submitted to them, finally and without appeal. . . . If the award is within the submission, and contains the honest decision of the arbitrators, after a full and fair hearing of the parties, a court of equity will not set it aside for error, either in law or fact. A contrary course would be a substitution of the judgment of the chancellor in place of the judges chosen by the parties, and would make an award the commencement, not the end, of litigation.").

continue the separation between law and equity or where modern arbitration statutes have not been enacted.[116]

In *Carrs Fork Corp. v. Kodak Mining Co.*,[117] a divided Kentucky Supreme Court recognized a unique equitable basis for vacating an arbitration award. Regarding a dispute over rights to a mining lease, the arbitration award included a determination that the lease was terminated by the lessee's failure to mine in a diligent manner for approximately four years. Acknowledging the well-settled rule that an award should not be set aside for an error of law,[118] the Kentucky Supreme Court identified an equitable exception:

> [t]he reason this arbitration award must be vacated is that the majority of arbitrators and the circuit court ignored the legal maxim that the law abhors a forfeiture of a coal lease. Carrs Fork was arbitrary in its attempt to cancel the lease. . . .
>
> It was error for the arbitration panel to fail to find that Carrs Fork waived any complaint of the failure to operate the lease with due diligence from 1976 through 1981 by the acceptance of royalties under the lease for the years in question . . . . The failure of Carrs Fork to give Kodak notice prior to the filing of the lawsuit that a forfeiture would be demanded . . . precludes the action for forfeiture.[119]

The court cautioned, however, that "[t]his decision should not be taken as a signal that arbitration awards will be casually overturned. We reverse this case only because of the failure of the award to provide equity so as to produce palpable error."[120]

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[116] WILNER, *supra* note 86, § 33.04.

[117] 809 S.W.2d 699 (Ky. 1991)

[118] *Id.* at 701.

[119] *Id.* at 701-702 (indicating that despite the general rule that vacations should not be based on error of law, "the courts will act in a proper case" and an "award may be so grossly inadequate or excessive as to be in effect a fraud and subject to vacation by a court although no actual fraud is claimed") (quoting from 5 AM. JUR. 2D *Arbitration and Award* § 167 (1962) and Second Soc'y of Universalists v. Royal Ins. Co., 109 N.E. 384 (Mass. 1915)).

[120] *Id.* at 703. The Kentucky justices were divided in their reasoning and conclusion. In a concurring opinion, Justice Combs confidently supported the judicial intervention. He expressed an extreme view that the arbitration statute usurped the state constitutional judicial power over questions of law — matters of law should always rest with the judiciary. *Id.* In dissent, Justice Leibson chided his fellow jurists for ignoring the standard that both parties agreed upon in presenting the case to arbitration:

> [Kodak] insisted on its right to arbitrate and got it; it should now be prepared to accept the results absent proof of some illegality amounting to a fraud . . . .
>
> We should keep a clear line of demarcation between the standard for reviewing the decision of a lower court and an agreed arbitration. By failing to abide by the difference, the Majority Opinion strikes at the heart of the process of arbitration.

Id. at 704.

In a small number of cases, courts have interpreted statutory provisions regarding grounds for vacation, that do not expressly provide for vacation on the basis of error of law, to encompass error of law. For example, it has been argued that when an arbitrator decides a case not in accordance with the law the arbitrator has exceeded his or her powers.[121] Most courts have taken the position that arbitrators' errors of law are not reviewable under this standard.[122] Some courts, however, have justified vacations in this way[123] or have at least acknowledged the possibility of treating an error of law as an act in excess of power, especially when there is some contractual mandate to follow the law.[124]

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[121] *E.g.*, 9 U.S.C. § 10(d) and UAA § 12(3). *See supra* text accompanying notes 16 and 17.

[122] *E.g.*, Chicago Typographical Union No. 16 v. Chicago Sun-Times, Inc., 935 F.2d 1501 (7th Cir. 1991); Smitty's Super-Valu, Inc. v. Pasqualetti, 525 P.2d 309 (Ariz. Ct. App. 1974); Moncharsh v. Heily & Blase, 832 P.2d 899 (Cal. 1992); Freeport Constr. Co. v. Star Forge, Inc., 378 N.E.2d 558 (Ill. App. Ct. 1978); Western Waterproofing Co. v. Lindenwood Colleges, 662 S.W.2d 288 (Mo. Ct. App. 1983); Grudem Bros. Co. v. Great Western Piping Corp., 213 N.W.2d 920 (Minn. 1973); Northwestern Sec. Ins. Co. v. Clark, 448 P.2d 39 (Nev. 1968); Carolina Va. Fashion Exhibitors, Inc. v. Gunter, 255 S.E.2d 414 (N.C. Ct. App. 1979); Brewer v. Allstate Ins. Co., 436 P.2d 547, 548-49 (Or. 1968); Batten v. Howell, 389 S.E.2d 170, 172 (S.C. Ct. App. 1990). *See generally*, Andrew D. Campbell, *Annotation: Construction and Application of § 10(a)(4) of Federal Arbitration Act (9 USCS § 10(a)(4)) Providing for Vacation of Arbitration Awards Where Arbitrators Exceed or Imperfectly Execute Powers*, 136 A.L.R. Fed. 183 (1997).

[123] *E.g.*, In re Arbitration Between Grover and Universal Underwriters Ins. Co., 403 A.2d 448 (N.J. 1979); Walton Acoustics, Inc. v. Currahee Const. Co., Inc., 399 S.E.2d 265 (Ga. Ct. App. 1990) (ruling that an award of attorney fees, which in the court's view was not authorized by law, warranted vacation because the arbitrator overstepped his authority); *cf.* Garrity v. McCaskey, 612 A.2d 742, 746-47 (Conn. 1992) (speculating that an arbitrator would exceed his powers "if the memorandum of an arbitrator revealed that he had reached his decision by consulting a ouija board"); County Mut. Ins. Co. v. National Bank, 248 N.E.2d 299, 302 (Ill. App. Ct. 1969) (finding arbitrator erred with respect to statute of limitations and by proceeding to hear matter and make award arbitrator exceeded his power).

[124] *E.g.*, Baravati v. Josepthal, Lyons & Ross, Inc., 28 F.3d 704, 706 (7th Cir. 1994) (considering arbitrators' application of Illinois defamation law and award of punitive damages and finding the award to have been lawful); Barbier v. Shearson Lehman Hutton Inc., 948 F.2d 117, 122 (2d Cir. 1991) (explaining where arbitrators are not entitled to award punitive damages due to a choice of law provision in the parties' agreement, it is "manifest" that the arbitrators would exceed their powers by awarding punitive damages); Stifel Nicolaus & Co., Inc. v. Francis, 872 S.W.2d 484 (Mo. Ct. App. 1994) ("Parties may agree that the arbitration will be decided as a court of law or equity would decide it. In such a case, an arbitrator's failure to follow case precedent would be an act exceeding authority.").

In *Faherty v. Faherty*, 477 A.2d 1257 (N.J. 1984), the parties' separation agreement provided for arbitration of any later disputes and contained a provision that New Jersey law would govern the resolution of such disputes. Based on that provision, the court vacated an arbitral award under the "exceeded their powers" section because the arbitrator, in granting alimony to the wife after she had remarried, had failed to follow New Jersey law. *See also infra* text accompanying notes 134-43.

In other cases error of law has similarly been associated with statutory provisions authorizing vacation in the event that the arbitrators "imperfectly executed" their powers[125] or that the award was procured by "undue means."[126] Other unclassifiable error of law cases exist in which courts either have vacated awards or seem to endorse such action with reference to statutory provisions.[127] Certainly, when arbitrators are under a specific charge to apply particular rules of substantive law, and they decide issues otherwise, it would seem that a court might be justified in vacating the arbitrators' award on the statutory grounds that the arbitrators were guilty of "misbehavior by which the rights of any party have been prejudiced" or "the arbitrators exceeded their power or . . . imperfectly executed them" or committed other "misconduct prejudicing the rights of any party."[128] Few seem to have so acted, probably because a clear mandate of this kind is rare.[129]

Cf. Mastrobuono, 20 F.3d at 715 ("Our narrow scope of review does not immunize an award clearly unauthorized by the terms of the agreement."); Miller Brewing Co. v. Brewery Workers Local Union No. 9, 739 F.2d 1159, 1164 (7th Cir. 1984) (stating that court may reverse award that "clearly" was not "within the contemplation of the parties and . . . implicitly authorized by the agreement"); Kearny N.J. PBA Local # 21 v. Town of Kearny, 405 A.2d 393, 398 (N.J. 1979) ("When the parties intend that their contract be interpreted in accordance with the law, [the arbitrator's] authority is circumscribed by being limited to carrying out that intent.").

[125] *E.g.*, 9 U.S.C. § 10(d). *See supra* text at note 16. *See, e.g.*, McHugh Inc. v. Soldo Constr. Co. Inc., 569 A.2d 293 (N.J. Super. Ct. App. Div. 1990) (vacating award directing that the claimant pay part of the award to a subcontractor because there was no evidence supporting that part of the award); Lindon Commodities Inc. v. Bambino Bean Co, Inc., 790 P.2d 228 (Wash. Ct. App. 1990) (vacating an arbitration award, finding that award clearly contradicted UCC section 2-209, which eliminates the consideration requirement for an agreement modifying a contract for the sale of goods).

[126] *E.g.*, 9 U.S.C. § 10(a) and UAA § 12(1). *See supra* text accompanying notes 16 and 17. *See, e.g.*, Perez v. American Bankers Ins. Co., 409 A.2d 269 (N.J. 1979) (equating a mistake of law with undue means); In re Arbitration Between Grover and Universal Underwriters Ins. Co., 403 A.2d 448, 452-53 (N.J. 1979) (setting aside an award viewing a mistake as both "undue means" and "exceeding power"); Held v. Comfort Bus Line, 57 A.2d 20 (N.J. 1948); *but see* Perini Corp. v. Greate Bay Hotel & Casino, Inc. 610 A.2d 364, 395 (N.J. 1992) (Wilentz, C.J., concurring) (asserting that the idea that "corruption, fraud or undue means" could be converted into a rule that reverses awards for errors of law would be unthinkable if viewed anew).

[127] *E.g.*, Russo v. Chittick, 548 N.E.2d 314 (Ohio App. Ct. 1988) (stating that while legal and factual conclusions are not reviewable, a court can ascertain whether fraud or evident mistake made the award unjust or unconscionable and citing OHIO REV. CODE ANN. § 2711.01 *et seq.*, which included a vacation provision that closely tracks the language in section 10 of the FAA).

[128] *E.g.*, 9 U.S.C. § 10(c), (d); UAA § 12(2), (3). *See supra* text accompanying notes 16-17.

[129] *See* Perini Corp. v. Greate Bay Hotel & Casino, Inc., 610 A.2d 364, 399 (N.J. 1992), where in the concurring opinion Chief Justice Wilentz provided the following critical observation:

Modern decisions from the states of California and New Jersey illustrate the reluctance of some judges to accept unwaveringly the predominant view that an error of law by an arbitrator should not be negated by a reviewing court. These decisions display a desire by some members of the judiciary to make distinctions among different degrees of error, identifying, for example, a right to vacate an award that is the product of an especially egregious error of law.

The California case *Moncharsh v. Heily & Blase*[130] involved an employment contract dispute between an attorney and the law firm by which he was formerly employed. Moncharsh sought judicial intervention after an arbitration panel ruled against him on a claim for fees. The trial court refused to vacate the award since no error appeared on the face of the award. The Court of Appeal affirmed this judgment, expressing that an award could be vacated if an error appearing on the face of the award "would result in substantial injustice."[131] On further appeal, the majority of justices of the California Supreme Court resoundingly rejected error of law as a basis for review, additionally expressing that this would apply even for an arbitration award that is erroneous on its face. In a dissenting opinion, Justice Kennard (joined by Justice Mosk) advocated distinguishing between "a mere mistake" and one that creates "substantial injustice."[132] Justice Kennard was particularly disturbed because of the role that courts play in the process of confirming arbitration awards. She reviled at the notion that in confirming an award premised on a major error of law, a court not only would be tolerating substantial injustice, but also would be an active agent in the process.[133]

> [P]arties are free to expand the scope of judicial review by providing for such expansion in their contract; that they may, for example, specifically provide that the arbitrators shall render their decision only in conformance with New Jersey law, and that such awards may be reversed either for mere errors of New Jersey law, substantial errors, or gross errors of New Jersey law and define therein what they mean by that. I doubt if many will. And if they do, they should abandon arbitration and go directly to the law courts.

[130] 832 P.2d 899 (Cal. 1992).

[131] *Id.* at 902.

[132] *Id.* at 920. Both the majority and dissenting opinions included an exhaustive recounting of prior California case law and a thorough policy analysis.

[133] *Id.* at 919-20. "Worst of all, the majority has forsaken the goal that has defined and legitimized the judiciary's role in society — to strive always for justice." *Id.* at 920. Despite the disagreement regarding the reasoning of the majority opinion, Justice Kennard was of the belief that this case did not involve an error apparent on the face of the award that would cause substantial injustice and, therefore, agreed with the result. *Id.* at 924.

See also *Intel v. Advanced Micro Devices, Inc.*, 885 P.2d 994, 1012 (Cal. 1994) where Justice Kennard, dissenting, described arbitration as "an instrument of injustice." The majority upheld an award despite the fact that there was unanimous agreement that the

In the New Jersey case *Perini v. Greate Bay Hotel & Casino, Inc.*,[134] a plurality of justices of the New Jersey Supreme Court endorsed the concept of judicial review for certain egregious mistakes of law.[135] The plurality recognized a need to guard against arbitrator errors that on their face are undebatable, unmistakable, gross, or in manifest disregard of applicable law.[136] They concluded that these gross errors were embraced by the "undue means" and "exceeded their powers" provisions of the arbitration statute.[137] Although a majority of those who sat in *Perini* agreed on the controlling standard, they could not agree on its application to the circumstances of the case. A majority did not find such an error in the arbitration under review. In a concurring opinion, Chief Justice Wilentz completely rejected the standard of review expressed in the plurality opinion, labeling it "unworkable and unjustifiable."[138] In a separate opinion Justice Stein, joined by Justice Handler, concurred with the rule expressed in the plurality opinion, but concluded that there had been an "egregious error of law" justifying vacation of part of the award.[139]

The *Perini* judicial decision demonstrates the frailties of a "gross error" rule — three judges concluded that there was no gross error and ruled in favor of sustaining the award, while two others were "convinced of the enormity of the arbitrators' legal mistake" and expressed that

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arbitrator had gone beyond what any court could do in ordering that AMD receive a permanent, royalty-free license to specified Intel intellectual property.

[134] 610 A.2d 364 (N.J. 1992). This case focuses on the following issues: (1) whether the asserted mistake of law was reviewable by the courts; (2) the continued validity of the principle that mistakes of law are the equivalent of undue means; and (3) the alleged disproportionality of the arbitration award.

[135] *Id.* at 372-73.

[136] *Id.* at 373.

[137] *Id.* at 370.

[138] *Id.* at 389. The only explanation for judicial intervention on the basis of error of law that seems to account for arbitration as a system that is not beholden to the law is that expressed by Chief Justice Wilentz :

> The approach permitting judicial reversals for mistakes of law grew out of what was meant to be a minor exception to these otherwise firm rules against judicial intervention in the arbitration process. [I]f arbitrators mean to decide according to law but mistake the law, in a material respect, and their mistake appears on the face of the award, or they admit it, the award will be set aside because it does not express their real judgment; but in cases where they do not intend to let the law govern their judgment, but to decide according to their own notions of what is just and right, the courts will not interfere, but allow their award to stand. (Citing Leslie v. Leslie, 50 N.J. Eq. 103, 107-08 (Ch. 1892)).
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> *Id.* at 386.

[139] *Id.* at 402-03. The part that they would have vacated was an award of over $4,000,000 for delay damages that accrued after the date of substantial completion.

vacation was, therefore, necessary.[140] Subsequently, in *Tetrina Printing, Inc. v. Fitzpatrick & Associates, Inc.*[141] a new slim majority[142] of New Jersey Supreme Court justices rejected the *Perini* plurality gross error standard. The controlling rule in New Jersey is now the one advocated by Chief Justice Wilentz in *Perini* that arbitration awards may be vacated only for fraud, corruption or similar wrongdoing.[143]

Rulings such as those in *Carrs Fork* and *Perini* and the dissenting views of the California Justices continue to raise hope for dissatisfied arbitrants. Thus, despite the pervasive authority rejecting error of law as a ground for vacation, many dissatisfied arbitrants persist in arguing that certain forms of incorrect interpretation or application of the law ought to be distinguished from the simple mistakes of law that have proven inadequate in the past. While recognizing that arbitration may be a less exacting process than adjudication, these arguments presume arbitrators really ought to be rendering decisions based on established principles of substantive law. Although these cases may indicate that the door remains open at least a crack on the error of law issue, it is hard to ignore the substantial body of case law demonstrating that challenging arbitration awards on the basis of alleged errors of law has nearly always been a losing proposition.

Judicial Reaction To Claims Of Manifest Disregard of the Law

In this endeavor to distinguish certain errors of law, a number of arbitrants have asserted that clear *disregard* of the law by an arbitrator ought to be viewed as a more serious problem that should render an award vacatable. The notion that such circumstances are improper and may justify vacation of an arbitration award can be traced to dictum in the 1953 U.S. Supreme Court decision in *Wilko v. Swan*.[144] Commenting on the limited power of courts to vacate an award, the *Wilko* 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."[145] From this quote and a statement in Justice

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[140] *Id.* at 390. Chief Justice Wilentz summarily declared "[j]udges are not adept at making such distinctions." *See also infra* text accompanying notes 148-60 (discussing *I/S Stavborg* and *San Martine* cases).

[141] 640 A.2d 788 (N.J. 1994).

[142] Justice Clifford switched positions declaring "the plain truth of the matter is that I have thought more about it and have changed my mind." *Id.* at 797 (Clifford, J., concurring).

[143] *Id.* at 793.

[144] 346 U.S. 427 (1953).

[145] The full statement in *Wilko* was as follows:
Power to vacate an award is limited. While it may be true . . . that a failure of the arbitrators to decide in accordance with the provisions of the Securities Act would 'constitute grounds for vacating the award pursuant to section ten of the Federal

Frankfurter's dissenting opinion that "[a]rbitrators may not disregard the law"[146] others have derived a common law ground for vacating an arbitration award on the basis of "manifest disregard of the law."[147]

The years since *Wilko* have provided many opportunities for the courts to evaluate the significance of this reference to manifest disregard of the law. These cases display a struggle to give meaning to the concept. For example, in *I/S Stavborg v. National Metal Converters, Inc.*,[148] the Second Circuit Court assailed the *Wilko* statement for being "ungrammatical in structure"[149] and "unnecessary to the decision" and unworkable in application:

> How courts are to distinguish in the Supreme Court's phrase between "erroneous interpretation" of a statute, or for that matter, a clause in a contract, and "manifest disregard" of it, we do not know: one man's "interpretation" may be another's "disregard." Is an "irrational" misinterpretation a "manifest disregard"?[150]

Indeed, one judge's "interpretation" may be another judge's "disregard," as *I/S Stavborg* illustrates.[151] The majority of the court concluded that there was no ground to reverse the arbitration award even though the arbitrators based their decision on a clearly erroneous interpretation of the contract in question, stating "[w]hatever arbitrators' mistakes of law may be corrected, simple misinterpretations of contracts do not appear one of them."[152] In a strongly worded dissent,

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> Arbitration Act,' that failure would need to be made clearly to appear. In unrestricted submissions, such as the present margin agreements envisage, the 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.

346 U.S. at 436-37 (quoting Wilko v. Swan, 201 F.2d 439, 445 (2d Cir. 1953)).

[146] 346 U.S. at 440.

[147] Alternatively, a few courts seem to view manifest disregard as a subspecies of certain statutory grounds for vacation such as "undue means" or "exceeding power." *E.g.*, A.G. Edwards & Sons, Inc. v. McCullough, 764 F. Supp. 1365 (D. Ariz. 1991), *rev'd*, 967 F.2d 1401 (9th Cir. 1992). *See infra* notes 159-60 and accompanying text.

[148] 500 F.2d 424 (2d Cir. 1974).

[149] *Id.* at 431 n.13.

[150] *Id.* Actually the first to point out the ungrammatical structure and the lack of necessity to the decision was Justice Jackson in his concurring opinion in *Wilko*. 346 U.S. at 438-39. *See also* Brandeis Intsel Ltd. v. Calabrian Chems. Corp., 656 F. Supp. 160, 164 (S.D.N.Y. 1987).

[151] For a similar display of this problem regarding an attempt to distinguish between a "gross error" and a "minor mistake," see *supra* notes 134-40 and accompanying text.

[152] It appears that the arbitrators found a conflict among contract clauses where one did not exist and that they then looked to parol evidence, which would not have been admissible in a court of law, to resolve it. 500 F.2d at 431-32. As an aside the court observed that had the arbitrators not rendered a written opinion in the case (which the

Circuit Judge Mansfield expressed that he could not agree with the proposition that the arbitrators' decision, which the majority conceded was "clearly erroneous," was based upon a "misinterpretation of the contract."[153] In his view, the decision "manifestly disregards the clear and unambiguous terms of the controlling contract . . . ."[154] He wrote: "Although we are obligated to avoid frustrating the purpose of arbitration, which is to resolve disputes quickly and inexpensively by minimizing judicial review or interference, we may not go so far as to countenance a wholly baseless and irrational award. To do so would be to deny due process."[155]

In the 1961 case *San Martine Compania de Navegacion v. Saguenay Terminals, Ltd.,*[156] the Ninth Circuit Court engaged in one of the earliest attempts to define the "manifest disregard" standard. The court rejected the idea that the Supreme Court was thinking of the degree of error as the standard:

> Frankly, the Supreme Court's use of the words "manifest disregard", has caused us trouble here. Conceivably the words may have been used to indicate that whether an award may be set aside for errors of law would be a question of degree. Thus if the award was based upon a mistaken view of the law, but in their assumption of what the law was, the arbitrators had not gone too far afield, then, the award would stand; but if the error is an egregious one, such as no sensible layman would be guilty of, then the award could be set aside. Such a "degree of error" test would, we think, be most difficult to apply. Results would likely vary from judge to judge. We believe this is not what the court had in mind when it spoke of "manifest disregard".[157]

The court reasoned that manifest disregard of the law had to be "something beyond and different from a mere error in the law or failure on the part of the arbitrators to understand or apply the law"[158] and conjectured that manifest disregard of the law "might be present when arbitrators understand and correctly state the law, but proceed to

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American Arbitration Association discourages and is rarely provided in commercial arbitration) the courts ability to review the decision would be greatly limited. *Id.* at 429.

[153] *Id.* at 432.

[154] *Id.*

[155] *Id.* at 433. *See infra* text accompanying notes 216-42 regarding vacating irrational awards.

[156] 293 F.2d 796 (9th Cir. 1961).

[157] *Id.* at 801 n.4. For a similar and more contemporary reaction in a state court, see Chief Justice Wilentz's concurring opinion in *Perini*, 610 A.2d at 390.

[158] *Id.* at 801.

disregard the same."[159] Finally, the court mused whether "manifest infidelity to what the arbitrators know to be the law, but deliberately disregard . . . ." might be regarded as a use of "undue means" or a display of "partiality" within the meaning of subdivisions (a) and (b) of Section 10 of the FAA.[160]

In the subsequent years, other courts have pondered whether manifest disregard of the law exists separate and apart from those grounds set forth in arbitration statutes.[161] Most courts that have expressed a willingness to recognize the concept have viewed it as existing independently of these statutory grounds.[162]

In a number of cases the courts have been able to dispense with the manifest disregard concept by finding that the law was correctly applied. If the law was correctly applied, then obviously it could not have been manifestly disregarded.[163] Consequently, although there are many cases in which claims of manifest disregard have been raised, relatively few courts have actually applied or seriously evaluated the manifest disregard theory.

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[159] *Id.* The court found no evidence of such impropriety in the case before it. The party seeking vacation of the arbitration award had asserted that the arbitrators had erred in awarding profits received from the use of a vessel on the basis of unjust enrichment and awarding damages for abuse of process regarding the non-malicious attachment detention of a vessel. The court acknowledged that the arbitrators may have been mistaken in their view of the law respecting these matters, but it was not clear that their decision was based on these rationales. *Id.* at 800.

[160] *Id. Cf.* A.G. Edwards & Sons, Inc. v. McCullough, 764 F. Supp. 1365, 1372 (D. Ariz. 1991), *rev'd,* 967 F.2d 1401 (9th Cir. 1992) (The District Court noted that there was no authority construing the meaning of "undue means" in the Ninth Circuit, and concluded that "raising multiple facially meritless defenses constituted procurement of an award by 'undue means' within the meaning of 9 U.S.C. § 10(a)." The Ninth Circuit reversed, specifically ruling that sloppy or over zealous lawyering coupled with facially meritless defenses do not constitute "undue means.")

[161] *E.g.*, Metal Products Workers Union v. Torrington Co., 242 F. Supp. 813 (D. Conn. 1965), *aff'd*, 358 F.2d 103 (2d Cir. 1966) (discussing whether manifest disregard is an aspect of misbehavior by arbitrators (FAA sec. 10(c)) or exceeding or imperfectly executing their powers (FAA sec. 10(d)).

[162] *E.g.*, Jenkins v. Prudential-Bache Sec., Inc., 847 F.2d 631 (10th Cir. 1988); Sheet Metal Workers Int'l Ass'n Local Union No. 420 v. Kinney Air Conditioning Co., 756 F.2d 742, 746 (9th Cir. 1985) ("Independent of section 10 of the Act, a district court may vacate an arbitral award which exhibits manifest disregard of the law."); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker, 808 F.2d 930, 933 (2d Cir. 1986).

[163] *See, e.g.*, Rostad & Rostad v. Investment Mgmt. & Res., 923 F.2d 694 (9th Cir. 1991) (ruling that arbitrators did not manifestly disregard the law by awarding punitive damages because, contrary to assertion of defendant, arbitrators are not prevented from awarding punitive damages on a common law fraud count associated with claims brought under the Montana Securities Act); In re U.S. Offshore, Inc., 753 F. Supp. 86, 90 (S.D.N.Y. 1990) ("there was no error at all, let alone manifest error").

Following in the path charted in *San Martine*, courts that have endeavored to define the phrase have done so narrowly.[164] Some of these courts have expressed a subjective awareness standard — whether the record reveals that the arbitrators knew the law, but expressly disregarded it.[165] Other courts have expressed a more objective standard by which awareness may be inferred. These courts have asked whether the error was of such a nature that it would have been obvious and instantly perceived by the average person qualified to serve as an arbitrator. Using this objective standard, the courts have typically required that the governing law be well defined, explicit, and clearly applicable.[166]

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[164] *E.g.*, Siegel v. Titan Indus. Corp., 779 F.2d 891, 892-93 (2d Cir. 1985); Trafalgar Shipping Co. v. International Milling Co., 401 F.2d 568, 573 (2d Cir. 1968) (characterizing "manifest disregard" of law as an exception to the enforceability of arbitration awards that must be "severely limited"); Warth Line, Ltd. v. Merinda Marine Co., Ltd., 778 F. Supp. (S.D.N.Y. 1991) (indicating common law doctrine of manifest disregard of the law does not significantly expand Arbitration Act's grounds for vacating award); Lukowski v. Dankert, 503 N.W.2d 15 (Wis. Ct. App. 1993) (explaining that since the precedent was not ignored, but distinguished [albeit possibly erroneously], this was not a disregard of the law.)

[165] *E.g.*, Health Servs. Mgmt. Corp. v. Hughes, 975 F.2d 1253, 1267 (7th Cir. 1992) (explaining arbitrator must deliberately disregard what he or she knows to be the law); Marshall v. Green Giant Co., 942 F.2d 539 (8th Cir. 1991) (finding party failed to demonstrate that the arbitrators both recognized and ignored the law); O.R. Sec., Inc. v. Professional Planning Assoc., 857 F.2d 742, 746 (11th Cir. 1988); Fairchild & Co., Inc. v. Richmond, F. & P.R. Co., 516 F. Supp. 1305, 1315 (D.D.C. 1981) ("Nowhere is it alleged that the arbitrators undertook to correctly state the law and then proceeded to disregard their own pronouncement." Instead Fairchild's allegations fall within the realm of "errors in the understanding or application of the law."); Reynolds Sec., Inc. v. Macquown, 459 F. Supp. 943 (D. Pa. 1978) (declaring one must establish that arbitrators understood and correctly stated law but proceeded to ignore it); Fukaya Trading Co., S.A. v. Eastern Marine Corp., 322 F. Supp. 278 (D. La. 1971) (holding arbitrators did not manifestly disregard the law since they did not understand the law); Western Waterproofing Co. v. Lindenwood Colleges, 662 S.W.2d 288 (Mo. Ct. App. 1983) (indicating it must be shown that the arbitrator understood and correctly stated the law, but ignored it).

The Tenth Circuit would also seem to be in this camp with the expression that the manifest disregard of the law standard requires a "willful unattentiveness to the governing law." Jenkins v. Prudential-Bache Sec., Inc., 847 F.2d 631, 634 (10th Cir. 1988).

The Securities and Exchange Commission has described the "manifest disregard" concept as follows:

> The error must have been obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator. Moreover, the term 'disregard' implies that the arbitrator appreciates the existence of a clearly governing legal principle but decides to pay no attention to it.

Securities Exchange Act Release No. 26,805 [1989-90 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,109 n.45 (May 10, 1989).

[166] *E.g.*, Glennon v. Dean Witter Reynolds, Inc., 83 F.3d 132 (6th Cir. 1996) (stating that decision must fly in the face of clearly established legal precedent); Advest, Inc. v. McCarthy, 914 F.2d 6, 10 (1st Cir. 1990) ("In certain circumstances, the governing law may have such widespread familiarity, pristine clarity, and irrefutable applicability that a court

While there is much discussion of the manifest disregard theory, the many manifest disregard challenges have produced only a few reported decisions in which arbitration awards have been vacated. Nearly all of these, however, have been either reversed or justified on other grounds on appeal.[167] A search of reported commercial case law reveals that there are no final decisions in which a court truly has based a vacation upon a finding of manifest disregard of the law. This author was able to find only two nominal examples of manifest disregard of the law vacations, and the Supreme Court of Nevada directed both.[168] While that court claims to have applied the manifest disregard doctrine, it has engaged in what must accurately be described as a review for error of law.[169]

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could assume the arbitrators knew the rule, and notwithstanding, swept it under the rug."); Bell Aerospace Co. Div. of Textron, Inc. v. Local 516, 356 F. Supp. 354, 356 (W.D.N.Y. 1973), *rev'd on other grounds*, 500 F.2d 921 (2d Cir. 1974).

Some courts have discussed the concept confusing objective and subjective criteria. *E.g.*, Marshall v. Green Giant Co., 942 F.2d 539, 550 (8th Cir. 1991) ("Manifest disregard of the law exists when an arbitrator commits an error that was obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator. Moreover, 'disregard' implies that the arbitrator appreciates the existence of a clearly governing legal principle but decides to ignore or pay no attention to it." [quoting from Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker, 808 F.2d 930, 933 (2d Cir. 1986)]).

[167] *See, e.g.*, Willemijn Houdstermaatschappij, BV v. Standard Microsystems Corp., 103 F.3d 9 (2d Cir. 1997) (district court finding no legal basis for the arbitrator's award and ordering vacation based on manifest disregard of the law; court of appeals finding "at least one barely colorable justification" and reversing); Horn v. Maryland Casualty Co., 661 A.2d 1032 (Conn. 1995). For discussion of other such cases, see *infra* text accompanying notes 174-214 and 231-41.

[168] Coblentz v. Hotel Employees & Restaurant Employees Union Welfare Fund, 925 P.2d 496 (Nev. 1996); Wichinsky v. Mosa, 847 P.2d 727 (Nev. 1993).

[169] *Wichinsky* is a peculiar one at that. Since the arbitration proceedings were without a record, the court relied on the affidavit of counsel for Wichinsky, which was not met with a counter affidavit by opposing counsel. From this, the court proceeded to identify three errors. First, all of the elements of tortious interference with economic expectations had not been established. Second, the "record" did not support the arbitrator's finding of a breach of fiduciary duty. Third, the "record" did not disclose evidence that would support a finding of fraud, oppression or malice justifying punitive damages. *Id.* at 730. The opinion includes no justification for such an appellate review. The court simply declared: "when an arbitrator manifestly disregards the law, a reviewing court may vacate an arbitration award." *Id.* (citing from French v. Merrill Lynch, Pierce, Fenner & Smith, 784 F.2d 902, 906 (9th Cir. 1986) ("an arbitrator's decision must be upheld unless it is 'completely irrational,' or it constitutes a 'manifest disregard of the law'")).

In *Coblentz,* the court, in much the same summary manner, pronounced that the arbitrators' conclusion rendered a lease agreement provision meaningless and thus constituted manifest disregard of the law. 925 P.2d at 501. At the time of the *Coblentz* decision, judicial review for error of law apparently was appropriate in New Mexico. The court explained that the Nevada statutes provided that following an arbitration award either party could request a trial on any of the issues arising out of the action. Id. (citing

Manifest disregard has been a particularly popular theory for those challenging securities arbitration awards. It has been raised to a lesser extent in other contexts. Although some state courts have referred to the concept,[170] it is primarily a creature of the federal courts. Most Federal Circuits seem to have endorsed the theory;[171] in others the position is unclear;[172] and a couple have expressly rejected it.[173] The following

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NEV. REV. STAT. § 38.109). This provision was subsequently repealed. 1995 Nev. Stat., ch. 660, § 4 at 2538.

But see Graber v. Comstock Bank, 905 P.2d 1112, 1116 (Nev. 1995), (describing manifest disregard of the law in conventional terms: "when searching for manifest disregard of the law, a court should attempt to locate arbitrators who appreciate the significance of clearly governing legal principles but decide to ignore or pay no attention to those principles").

[170] *See, e.g.*, Garrity v. McCaskey, 612 A.2d 742, 747 (Conn. 1992) ("The 'manifest disregard of the law' ground for vacating an arbitration award is narrow and should be reserved for circumstances of an arbitrator's extraordinary lack of fidelity to established legal principles."); Southwest Parke Educ. Ass'n v. Southwest Parke Community Sch. Trustees Corp., Bd. of Sch. Trustees, 427 N.E.2d 1140, 1147-48 (Ind. Ct. App. 1981) (holding even if an erroneous interpretation of the law, it was a conscientious attempt to apply the law and therefore not a manifest disregard of the law); I.D.C., Inc. v. Natchitoches Dev. Co., 482 So.2d 958, 960 (La. App. 1986); Perini Corp. v. Great Bay Casino, 610 A.2d 372 (N.J. 1992); Wayne Distrib. Co. v. Piti Bldg. Co., Inc., 512 A.2d 870 (R.I. 1986) (indicating allegations of manifest disregard of the law could warrant a vacation); Muzzy v. Chevrolet Div., General Motors Corp., 571 A.2d 609, 613 (Vt. 1989) (referring to manifest disregard of the law and holding that "only under extreme circumstances can we intervene to correct an error of law").

In *Stifel, Nicolaus and Co., Inc. v. Francis*, 1994 Mo. App. LEXIS 76, the Court of Appeals of Missouri for the Western District refused to recognize manifest disregard of the law as a basis for vacating an arbitration award, reversing a trial court vacation. *But see* Western Waterproofing Co., Inc. v. Lindenwood Colleges, 662 S.W.2d 288, 292 (Mo. Ct. App. 1983) (Eastern District Court of Appeals endorsed the concept).

[171] *E.g.*, Glennon v. Dean Witter Reynolds, Inc., 83 F.3d 132 (6th Cir. 1996); Michigan Mut. Ins. Co. v. Unigard Sec. Ins. Co., 44 F.3d 826 (9th Cir. 1995); United Indus. Workers v. Gov't of the Virgin Islands, 987 F.2d 162 (3d Cir. 1992); Advest, Inc. v. McCarthy, 914 F.2d 6 (1st Cir. 1990); Jenkins v. Prudential-Bache Sec., Inc., 847 F.2d 631 (10th Cir. 1988); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker, 808 F.2d 930 (2d Cir. 1986); San Martine Compania de Navegacion, S.A. v. Saguenay Terminals Ltd., 293 F.2d 796 (9th Cir. 1961); Johnston Lemon & Co. v. Smith, 886 F.Supp. 54 (D.D.C. 1995), *aff'd*, 84 F.3d 1452.

[172] *See, e.g.*, Lee v. Chica, 983 F.2d 883 (8th Cir. 1991) (briefly referring to the manifest disregard doctrine with seeming approval) and Marshall v. Green Giant & Co., 942 F.2d 539 (8th Cir. 1991) (noting court has never adopted manifest disregard of the law and specifically refraining from deciding the matter in that case).

In *Chameleon Dental Products, Inc. v. Jackson*, 925 F.2d 223, 226 (7th Cir. 1991), the Seventh Circuit court rejected the theory. Later in *Health Services Management Corp. v. Hughes*, 975 F.2d 1253 (7th Cir. 1992) and in *Eljer Manufacturing, Inc. v. Kown Development Corp.*, 14 F.3d 1250 (7th Cir. 1994) the court expressed favor for the concept. And in *Baravati v. Josepthal, Lyons & Ross, Inc.*, 28 F.3d 704, 706 (7th Cir. 1994), Judge Posner writing for the same court refused to apply it and criticized its recognition:

> We can understand neither the need for the formula nor the role that it plays in judicial review of arbitration (we suspect none — that it is just words). If it is meant to smuggle review for clear error in by the back door, it is inconsistent with the

cases, involving judicial vacations that were ultimately set aside, illustrate the confusion about manifest disregard and the role of law in arbitration.

In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*[174] a "manifest disregard" challenge centered on an arcane securities law issue regarding tender offers. In response to a tender offer from Phillips Petroleum Co. in 1985, Bobker instructed his broker to tender all of his 4,000 shares of stock. Three days later, Bobker instructed another Merrill Lynch broker to sell short 2,000 shares of Phillips stock. Both orders were executed, but two days later Merrill Lynch cancelled the short sale since it believed that such a sale would constitute a violation of section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-4, which requires a shareholder to have a "net long" position in a security both on the date a security is tendered and on the date the tender offer expires.[175] Bobker claimed a loss of $23,000 profits that he would have realized upon completion of the short sale. The arbitration panel awarded him $12,500.

When Merrill Lynch sought in federal court to set aside the award, the SEC filed an *amicus curiae* brief supporting Merrill Lynch's position that SEC Rule 10b-4 prohibited "short tendering" (i.e. tendering more shares during a pro rata tender offer than the shareholder actually owns). Invoking the manifest disregard of the law doctrine, the district court vacated the award, and expressed that "[p]ermitting this award to stand would have the unacceptable result of penalizing Merrill Lynch for acting in accordance with the law."[176]

On appeal, the Second Circuit endeavored to give meaning to the words "manifest disregard":

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entire modern law of arbitration. If it is intended to be synonymous with the statutory formula that it most nearly resembles — whether the arbitrators "exceeded their powers" — it is superfluous and confusing. There is enough confusion in the law. The grounds for setting aside arbitration awards are exhaustively stated in the statute. Now that *Wilko* is history, there is no reason to continue to echo its gratuitous attempt at nonstatutory supplementation.

[173] *E.g.*, R.M. Perez & Assocs., Inc. v. Welch, 960 F.2d 534, 539-40 (5th Cir. 1992); Robbins v. Day, 954 F.2d 679 (11th Cir. 1992); Raiford v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 903 F.2d 1410 (11th Cir. 1990); O.R. Sec., Inc. v. Professional Planning Assoc., 857 F.2d 742 (11th Cir. 1988). Although the 11th Circuit has rejected manifest disregard of the law as a basis for vacation, it seems to have embraced another nonstatutory theory — irrationality. *See* Ainsworth v. Skurnick, 909 F.2d 456 (11th Cir. 1990) and 960 F.2d 939 (11th Cir. 1992), discussed *infra* at notes 231-42. *See also* Brandeis Intsel Ltd. v. Calabrian Chems. Corp., 656 F. Supp. 160, 165 (S.D.N.Y. 1987) (rejecting application of manifest disregard concept to cases involving international law).

[174] 636 F. Supp. 444 (S.D.N.Y.), *rev'd*, 808 F.2d 930 (2d Cir. 1986).

[175] 808 F.2d at 931-32.

[176] 636 F. Supp. at 447-48.

> Although the bounds of this ground have never been defined, it clearly means more than error or misunderstanding with respect to the law. The error must have been obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator. Moreover, the term 'disregard' implies that the arbitrator appreciates the existence of a clearly governing legal principle but decides to ignore or pay no attention to it . . . . The governing law alleged to have been ignored by the arbitrators must be well defined, explicit, and clearly applicable. We are not at liberty to set aside an arbitration panel's award because of an arguable difference regarding the meaning or applicability of laws urged upon it.[177]

The court observed that the arbitration transcript reflected that differing views concerning the application and interpretation of Rule 10b-4 were discussed in detail at the hearing. Indeed, one arbitrator stated on the record that the case depended on an "interpretation of the law" regarding Rule 10b-4.[178] The arbitrators had considered the rule and applied it as they saw fit.[179] Thus according to the Court of Appeals, this was not a matter of *disregarding* the law, but of interpreting (or misinterpreting) it, which true to the *Wilko* dictum should not be subject to vacatur.

That was not the full extent of the court's analysis, however. Judge Mansfield, writing for the majority, proceeded to take exception with the trial court's interpretation of the operative securities law rule, expressing that the arbitrators' interpretation of the securities laws was not incorrect.[180] In a concurring opinion, Judge Meskill took to task the majority's analysis. He propounded the more restrictive subjective standard for manifest disregard analysis and chastised the majority for attending to the correctness of the arbitrators' determination:

> Manifest disregard of the law may be found only where the arbitrators 'understood and correctly stated the law but proceeded to ignore it.' . . . Whether the majority disagrees with [the district court's] decision on the merits is entirely beyond the point. . . . The majority opinion in this case perpetuates the district court's error by reversing the district court on the merits of the arbitrators' decision and by engaging in unnecessary speculation over the validity of Rule 10b-4. We need not express any view on the correctness of the arbitrators' or district court's decision. All that is needed here is recognition of the arbitrators' efforts to apply an unclear rule of law to a complex factual situation.

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[177] 808 F.2d at 934.
[178] *Id.* at 933 and 936-37.
[179] *Id.* at 937.
[180] *Id.* at 936-37.

> When the appropriate legal principles are applied, it is clear that the arbitration panel did not act in manifest disregard of the law.[181]

Judge Meskill raises an interesting issue about the extent to which speculative interpretation of unclear rules ought to be undertaken when addressing an attempt to vacate an arbitration award. Although Judge Meskill may be correct in stating that it was unnecessary for the court to address the merits of the arbitrators' interpretation of the law, perhaps this aspect of judicial review should be reconsidered in light of the growing use of arbitration. As greater numbers of disputes are resolved through arbitration there are fewer opportunities for courts to interpret the law. If arbitration becomes the predominant approach to dispute resolution in a particular area, as for example it is fast becoming in the securities industry,[182] important legal issues may be very slow in getting resolved.[183] Suppose a normal course of events: an arbitration panel hears the arguments of the parties on a contested legal issue, renders a decision, and a party seeks judicial intervention on the belief that the arbitrators failed to apply the law correctly. In most jurisdictions the arbitrant cannot seek review on the basis of mere error of law; however, there may be recourse based on manifest disregard of the law.[184] By Judge Meskill's approach, if the court believes that the arbitrators honestly attempted to apply the law (albeit possibly incorrectly), the court may not certify a correct rule of law. The court is limited to upholding the arbitrators' decision since the arbitrators did not willfully ignore the law, whatever the law may be. Alternatively, if

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[181] *Id.* at 937-38. *See also* Brandeis Intsel Ltd. v. Calabrian Chems. Corp., 656 F. Supp. 160, 168 (S.D.N.Y. 1987) (endorsing Judge Meskill's approach: "I do not find it necessary or appropriate to agree or disagree with the arbitrators' conclusions. It is sufficient to say that their award reflects the arbitrators' awareness of the governing statute and efforts to apply its terms to the facts as found. . . . I am 'not at liberty to set aside an arbitration panel's award because of an arguable difference regarding the meaning or applicability of laws urged upon it.'").

[182] According to a 1988 Securities and Exchange Commission study, 96% of margin accounts, 95% of option accounts, and 39% of cash accounts were subject to arbitration clauses. Order Approving Proposed Rule Changes by the NYSE, NASD and AMEX Relating to the Arbitration Process and the Use of Predispute Arbitration Clauses, Rel. No. 34-26805, 54 Fed. Reg. 21,144 (1989).

This trend toward increased use of arbitration may reverse. Brokerage firms appear to be less enthralled with arbitration now that arbitrators have made awards based on RICO claims and have issued a number of large punitive damage awards against firms. This may cause firms to rethink the decision to routinely incorporate arbitration agreements in brokerage contracts.

[183] Of course, opportunities for legislative and administrative clarification remain.

[184] The same comment would apply to challenges couched in terms of the grounds for vacation set forth in the FAA and UAA and the irrationality and public policy grounds discussed later in this article.

the court determines that the arbitrators manifestly disregarded the law, one can probably discern what the law is not, but not necessarily what it is. According to the restricted review favored by Judge Meskill there need not be and therefore should not be any pronouncement about the correct interpretation of law. In areas where arbitration is pervasive, if the courts refrain from declaring their interpretation of the law in such cases, the law may never be clarified authoritatively. Perhaps the substantial displacement of litigation by arbitration justifies a more expressive treatment. As the use of arbitration grows and courts have fewer opportunities to address contested legal issues, it seems that it would be helpful if courts would supply more of such dicta. In this way they can provide guidance for future arbitrators who may be influenced by the law or who are operating under a contractual directive to decide in accordance with the law.

Robbins v. Day[185] and *Ainsworth v. Skurnick*[186] present two other failed judicial attempts to vacate arbitration awards based on the manifest disregard theory. Both are decisions of federal district courts of the Eleventh Circuit. Previously the Eleventh Circuit Court had so narrowly defined the manifest disregard standard that it had openly expressed doubt that it would ever adopt it because of the difficulty involved in meeting it.[187] Nevertheless, in *Robbins* and *Ainsworth,* two district court judges were of the belief that they had encountered just such circumstances.

Robbins involved a claim of unauthorized trading of options, account churning, and preferential allocations in relation to the options trading in two trust accounts. The claimant sought $4.2 million in actual damages, plus RICO treble damages, punitive damages, attorneys' fees, costs and expenses, all totaling in excess of $26.8 million. After 14 days of arbitration hearings the arbitrators issued a decision holding one of the several named respondent brokers and Paine Webber, Inc. jointly and severally liable to the claimants for $325,000. The panel denied the claim for punitive damages and treble damages under RICO and dismissed with prejudice the claim for damages for emotional pain and suffering. The arbitrators also dismissed with prejudice claims against six other individual respondents who allegedly participated in the fraudulent options activities.

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[185] 761 F. Supp. 773 (N.D. Ala. 1991), *rev'd*, 954 F.2d 679 (11th Cir. 1992).

[186] 909 F.2d 456 (11th Cir. 1990) (order of the District Court for the Southern District of Florida vacating the arbitration award is included in Appendix 1 of this per curiam certification).

[187] Raiford v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 903 F.2d 1410, 1412-13 (11th Cir. 1990).

The claimants then sought to have the award vacated. The Alabama federal district court fit the case within the definition of manifest disregard of the law previously enunciated by the Eleventh Circuit Court of Appeals — (1) "the error is so obvious that it would be 'readily and instantly perceived' by a typical arbitrator," (2) "the arbitrator was subjectively aware of the proper legal standard but proceeded to disregard it in fashioning the award," and (3) the knowing disregard was "apparent on the face of the record."[188]

The court identified two instances of manifest disregard of the law.[189] First, the arbitrators failed to award a mandatory remedy per Alabama securities statutes. The court reasoned that "[i]n making its award, the panel by necessity had to have found fraud. The record on its face supports a finding of fraud and deceit."[190] Yet, the Alabama Securities Act requires the award of attorneys' fees and costs in a case of securities fraud.[191] Second, the arbitrators failed to award treble damages, attorneys' fees and costs as required by RICO.[192] Again, the court pointed to the "fraud shown," and noted that RICO specifically includes "fraud in the sale of securities."[193]

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[188] 761 F. Supp. 773, 776-77 (citing Raiford v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 903 F.2d 1410, 1412-13 (11th Cir. 1990)). The court noted that while the Eleventh Circuit Court of Appeals had not adopted the manifest disregard of the law standard, it had defined it. It further acknowledged the Eleventh Circuit's earlier expressions of skepticism whether the manifest disregard standard could ever be met.

The court also identified a statutory ground for vacating this award. The court found that the award should be vacated on the basis of FAA section 10(c). During the hearings four of the individual respondents pled the Fifth Amendment provision against self-incrimination, refusing to testify except as to their names and addresses. Permitting this blanket refusal to testify (especially since these respondents had already answered a broad spectrum of questions during depositions thereby losing their privilege) was an egregious error constituting "a refusal 'to hear evidence pertinent and material to the controversy.'" *Id.* at 776 (citation omitted).

[189] Given the scarcity of such findings in other cases, it would seem that this is a case with either a very zealous court or a very shabby arbitration panel.

Although the disregarded law was remedial law, rather than substantive, the handling of the manifest disregard issue is still illuminating regarding the issue of the role of substantive law in arbitration.

[190] 761 F. Supp. at 777.

[191] ALA. CODE §§ 8-6-17, -19 (1996).

[192] 761 F. Supp. at 777, citing 18 U.S.C. § 1964(c).

[193] *Id.* citing 18 U.S.C. § 1961 (1)(D). The court was most emphatic on this point: "The court must express its amazement at the panel's denial of RICO . . . claims." The court did not address the obvious possibility that the arbitrators may have denied the RICO claim because other elements of this complex cause of action were lacking.

On appeal,[194] the Eleventh Circuit reversed the district court's decision to vacate.[195] After a very brief discussion of the parameters of the manifest disregard theory,[196] the court abruptly declared: "[f]ollowing Eleventh Circuit precedent, we decline to adopt the manifest disregard of the law standard."[197] Additionally, the court proceeded, though not explicitly, with what appears to be an analysis of whether the award in question should be vacated because it was irrational.[198] The court concluded that this particular award was not vacatable on that ground either.[199]

Ainsworth v. Skurnick centered on alleged violations of two statutory provisions of Florida's securities laws (sections 517.12 and 517.301), and common law claims of breach of fiduciary duty, fraud, deceit and negligence. The arbitrators' award declared that they found for the claimant, but determined that the claimant sustained no

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[194] Robbins v. Day, 954 F.2d 679 (11th Cir. 1992).

[195] The court first addressed the appropriate standard of appellate review. The court explained the need for a double standard. Confirmation of an arbitration award should be narrowly reviewed — an abuse of discretion standard. *Id.* at 681 (citing Schmidt v. Finberg, 942 F.2d 1571 (11th Cir. 1991) and Raiford v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 903 F.2d 1410, 1412 (11th Cir. 1990)). In contrast a judicial granting of a motion to vacate an arbitration award should be broadly reviewed — a de novo review. *Id.* (citing Employers Ins. of Wausau v. National Union Fire Ins. Co., 933 F.2d 1481 (9th Cir. 1991); Forsythe Intern., S.A. v. Gibbs Oil Co. of Texas, 915 F.2d 1017 (5th Cir. 1990); Anderman/Smith Operating Co. v. Tennessee Gas Pipeline Co., 918 F.2d 1215 (6th Cir. 1991); Independent Employees' Union v. Hilshire Farm Co., 826 F.2d 530 (7th Cir. 1987)). Such a de novo review of a district court's order is nonetheless very narrow because it entails applying the same legal standards that bound the district court. 954 F.2d at 682 (citing Stay, Inc. v. Cheney, 940 F.2d 1457 (11th Cir. 1991)). This unusual approach "emphasize[s] the unique context of arbitration, which requires deferential judicial review to promote the primary advantages of arbitration — speed and finality." 954 F.2d at 682.

[196] For example, it noted that the courts are not in agreement about the degree of the "showing on the record" required — some require actual statements showing subjective awareness and others are willing to infer awareness. *See supra* notes 164-66 and accompanying text.

[197] 954 F.2d at 684 (citing Raiford v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 903 F.2d 1410, 1412 (11th Cir. 1990)).

The court also reversed the district court's ruling that the arbitrators' award should be vacated on the basis of section 10(c) (for refusing to hear evidence pertinent and material to the controversy). *Id.* at 684-85. Prior to the arbitration, the respondents moved to postpone the hearings until after the outcome of pending criminal proceedings. The claimants opposed this, representing that the brokers' testimony was unimportant and that the brokers had the right to invoke the Fifth Amendment. For this reason the court decided that the arbitrators' refusal to hear this evidence had not prejudiced the rights of the claimants and had not denied them a fair hearing.

[198] *See infra* notes 215-41 and accompanying text.

[199] The court reasoned that when no rationale is given for a lump sum award, as in this case, and a rational ground for the arbitrators' decision can be inferred from the facts of the case, the award should be confirmed. 954 F.2d at 684-85.

damages. This prompted claimant's motion to vacate on two grounds — evident partiality and manifest disregard of the law. Uncertain whether the arbitrators had found a violation of Florida Statutory section 517.12 (which seemed to trigger the application of a mandatory damages provision) or whether the liability was for a common law violation (which would not necessitate an award of damages), the Florida federal district court remanded the matter to the arbitration panel for clarification.[200]

The arbitrators then reconvened and issued a new award specifically finding that the respondent was negligent in handling claimant's account, that the claimant had sustained no damages as a consequence of this negligence, and that claimant had not established his right to recover on any of the other claims.[201] This again prompted claimant to assert that this finding, in that it indicated that respondent had not violated section 517.12 of the Florida Statutes, exhibited evident partiality or manifest disregard of the law.

Florida Statute section 517.12 requires all persons selling securities in the state to be registered,[202] and section 517.211 provides that for every sale made in violation of section 517.12 the seller is "liable to the purchaser in an action for rescission if the purchaser still owns the security, or for damages, if the purchaser has sold the security . . . ." [203]

The district court concluded that the evidence produced at the arbitration hearing made it abundantly clear that (1) the respondent was never registered with the Florida Department of Banking and Finance, (2) the respondent acted as a securities dealer for the claimant and (3) the respondent sold securities to claimant. The only issue was whether the subject sales were made in Florida. To this the respondent argued that he did all his business in his offices in New York and Connecticut, through brokerage houses outside of Florida, and therefore he never sold securities in Florida. Though the court found no Florida authority directly construing the meaning of the phrase "sell securities in this state," it considered cases interpreting Florida's long-arm statute to be instructive. Using the test for jurisdiction propounded in those cases, the court determined that the sales were made in Florida. Furthermore, the court expressed that common sense indicates that

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[200] 909 F.2d at 459.

[201] 909 F.2d at 459-60.

[202] Section 517.12 specifically provides:

> No dealer, associated person, or issuer of securities shall sell or offer for sale any securities in or from offices in this state, or sell securities in this state to persons thereof from offices outside this state, by mail or otherwise, unless the person has been registered with the department pursuant to provisions of this section.

FLA. STAT. ANN. § 517.12 (West 1996).

[203] *Id.* at § 517.211.

selling securities by mail[204] to a person in Florida constitutes selling securities in Florida. In the words of the district court, "the only reasonable conclusion to be drawn from the facts adduced at the arbitration hearing is that [claimant] violated Fla. Stat. Section 517.12. Because the arbiters found otherwise, this Court will vacate its ruling as being in manifest disregard of the law."[205] On appeal, the Eleventh Circuit Court certified to the Florida Supreme Court the question of how one determines whether securities have been sold in Florida.[206]

If this case involved a consideration of whether arbitrators engaged in a manifest disregard of the law, which is all that the record displayed at this point, then this would seem to be a curious approach. In turning the question over to the Florida Supreme Court, the Circuit Court was acknowledging that there was some legitimate uncertainty about the interpretation and applicability of the Florida registration statute.[207] Under circumstances of such uncertainty manifest disregard should not pertain. By proceeding in this way, the Circuit Court engaged in an analysis more akin to normal appellate review for error of law.[208]

The certification, of course, was not the end of the case. What ensued demonstrates another approach to addressing such efforts to vacate that may be related to the alleged misuse of substantive law — an irrationality analysis. The section on irrationality that follows will include discussion of the remainder of the *Ainsworth* case.

In endeavoring to discern the role of substantive law in arbitration the manifest disregard cases point to an extreme that is not to be exceeded by an arbitrator. A more in depth look at these cases, however, displays how this attempt to define the parameters of the use of law has been an exercise of great frustration. Given how narrowly the manifest disregard standard has been defined and that arbitrators seldom give reasons for their decisions, some observers have questioned whether

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[204] The claimant was deaf and never spoke with respondent over the telephone. The record included numerous letters from the broker to his client regarding transactions. 909 F.2d at 462-63.

[205] *Id.* at 462. Since uncontradicted expert testimony at the arbitration hearing was offered to show that the claimant's damages were $54,108.78, the court entered a judgment against respondent for that amount plus interest.

[206] *Id.* at 458.

[207] Compare the approach of the court in *Clemons v. Dean Witter Reynolds, Inc.*, 708 F. Supp. 62, 63-64 (S.D.N.Y. 1989) (addressing a similar brokerage registration law in Kentucky, the court responded that, since the Kentucky courts had not decided the issue, the circumstances were insufficient to establish that the arbitrators deliberately ignored a well defined, explicit and clearly applicable law as is necessary before finding manifest disregard of the law).

[208] *See also* Kane v. Shearson Lehman Hutton, Inc., 916 F.2d 643 (11th Cir. 1990) (vacating an award under the Florida Blue Sky Law even though no showing that arbitrators deliberately ignored any well defined and clearly applicable legal authority).

circumstances can ever arise to enable a dissatisfied arbitrant to utilize the theory as a basis for vacation of an award.[209] The current formulation of manifest disregard of the law certainly lacks potency.[210] Indeed, one must question whether it actually affords any protection beyond that provided in the arbitration statutes. If manifest disregard of the law is defined so that an arbitrator must clearly manifest on the record a decision to disregard a comprehended law, this would seem to constitute one of the statutory grounds for vacation, such as a showing of "evident partiality or corruption"[211] or engaging in "any other misbehavior by which the rights of any party have been prejudiced"[212] or, possibly, that "the arbitrators exceeded their power."[213] Suffice it to say, it is one thing to find a case that acknowledges the "manifest disregard" theory, it is quite another to find a case in which this theory has actually served as the basis for vacating an arbitration award. Although the manifest disregard theory has been asserted numerous times in efforts to defeat arbitration awards, it has had a mixed reception and has ultimately produced little in the way of desired results. Because of this, manifest disregard of the law remains an elusive concept that can be understood better in terms of what it is not,[214] rather than what it is.

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[209] C. Evan Stewart, *Securities Arbitration Appeal: An Oxymoron No Longer?*, 79 KENTUCKY L. REV. 347, 352 (1990-91); C. Edward Fletcher, *Privatizing Securities Disputes Through the Enforcement of Arbitration Agreements*, 71 MINN. L. REV. 393, 457 (1987); *see also* David E. Robbins, *A Practitioner's Guide to Securities Arbitration*, in SECURITIES ARBITRATION 1989 (PLI) 130 (analogizing the success of applying the "manifest disregard" doctrine to "a snow ball's chance in hell").

[210] One commentator has suggested that recognition of the manifest disregard of the law standard actually promotes disregard of the law since arbitrators that are aware of the standard can avoid any complicated legal analysis by ignoring the issue altogether, as long as they take care not to explain that they acted in this way. Bret F. Randall, *Comment, The History, Application, and Policy of the Judicially Created Standards of Review for Arbitration Awards*, 1992 B.Y.U. L. REV. 759, 768.

[211] 9 U.S.C. § 10(b) (1996) or UAA § 12(1), (2).

[212] 9 U.S.C. § 10(c) (1996) or UAA § 12(2), (4).

[213] 9 U.S.C. § 10(d) (1996) or UAA § 12(3).

[214] *See, e.g.*, Kanuth v. Prescott, Ball & Turben, Inc., 949 F.2d 1175 (D.C. Cir. 1991) (ruling that panel presiding over employment dispute did not manifestly disregard Ohio law in making incentive compensation award to employee); Americas Ins. Co. v. Seagull Compania Naviera, S. A., 774 F.2d 64 (2d Cir. 1985) (holding there is nothing to indicate that the arbitrators' intent not to permit set-off evidenced manifest disregard of the law regarding an issue of a maritime insurer's right to set-off); Office of Supply, Gov't of Republic of Korea v. New York Navigation Co., 469 F.2d 377, 379 (2d Cir. 1972) (concluding that claim was time barred by one year statute of limitations provision of Carriage of Goods by Sea Act of the U.S. (COGSA) incorporated by reference into the contract of the parties did not constitute manifest disregard); Amicizia Societa Navegazione v. Chilean Nitrate & Iodine Sales Corp., 274 F.2d 805 (2d Cir. 1960) (ruling that misapplication of the rules of contract interpretation in interpreting the meaning of the term "double rigged" in a contract

Judicial Reaction To Claims Of Irrationality (Arbitrary and Capricious Decision-Making)

Irrationality, as a basis for vacating an arbitration award, is another ill-defined theory that can relate to the role of law in arbitration. There are strong parallels between how the courts have worked with the concepts of irrationality and manifest disregard of the law. Neither is explicitly identified as a ground for vacation in either the FAA or the UAA. As is the case with manifest disregard of the law, some courts, however, have characterized irrationality as fitting within the "undue means" or "exceeded their powers" statutory provisions for vacation.[215]

Most of the cases provide no explanation of what constitutes irrationality. Since there are hardly any findings of irrationality, the cases best serve to illustrate what does not qualify as irrational decision-making, rather than what does.[216] A number of courts have been careful to clarify that an arbitrator's interpretation is not irrational just because the arbitrator has misinterpreted[217] or misapplied [218] the law. Moreover, while many cases refer to and seemingly recognize irration-

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description of how vessels were to be constructed did not rise to the level of manifest disregard of the law); Elite Inc. v. Texaco Panama Inc., 777 F. Supp. 289 (S.D.N.Y. 1991) (ruling that refusal to sustain statute of limitations defense did not constitute manifest disregard of the law where one year statute of limitations was based upon an interpretation of a complex series of documents); Fine v. Bear, Stearns & Co., Inc., 765 F. Supp. 824 (S.D.N.Y. 1991) (ruling that it is not manifest disregard of the law where award can be explained as a product of conflicting testimony from expert witnesses regarding the standard of care owed by the defendant).

[215] *E.g.*, Tate v. Saratoga Sav. & Loan Ass'n, 265 Cal. Rptr. 440, 447 (Cal. Ct. App. 1989) (explaining if the award rests on a "completely irrational" construction of the contract, the arbitrator exceeded his or her powers); O-S Corp. v. Samuel A. Kroll, Inc., 348 A.2d 870, 872 (Md. Ct. Spec. App. 1975) ("Statutory support for this is found not only in the fact that arbitrators 'exceeded their powers' when they reach a completely irrational result, but also in the connotation of the words 'undue means' in § 3-224(b)(1).").

[216] *E.g.*, Hacket v. Milbank, Tweed, Hadley & McCloy, 654 N.E.2d 95, 100 (N.Y. 1995) (ruling trial court was not justified in substituting its characterization of partnership agreement for that of arbitrator); Diaz v. Pilgrim State Psychiatric Center, 465 N.E.2d 32 (N.Y. 1984) ("It cannot be said that arbitrator's procedural resolution of the issue concerning compliance with the contractual requirement that demand for arbitration be made in specified time and manner was irrational."); Smith v. Chubb & Sons, Inc., 528 N.Y.S.2d 236 (N.Y. App. Div. 1988) (ruling that it was not irrational to conclude that in order to be entitled to no fault benefits claimant must have personally suffered a bodily injury as a result of use of insured vehicle).

[217] *E.g.*, Local 771, I.A.T.S.E. v RKO General, Inc., WOR Div., 419 F. Supp. 553 (S.D.N.Y. 1976); Prudential Property and Casualty Ins. Co. v. Ogubro, 500 N.Y.S.2d 561 (N.Y. App. Div. 1986).

[218] *E.g.*, Sprinzen v. Nomberg, 389 N.E.2d 456 (N.Y. 1979).

ality as a ground for vacation,[219] one has to search long and hard to find a vacation that is actually based on a determination of irrationality.[220]

The irrationality concept, which seems to have its roots in the fields of administrative law and labor law,[221] has been most frequently referenced by the New York courts.[222] Although few other state courts have mentioned it,[223] a number of Federal District [224]and Circuit [225]courts

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[219] *E.g.*, French v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 784 F.2d 902, 906-07 (9th Cir. 1986) (stating award should be upheld because it was not "completely irrational"); Local 1445, United Food & Commercial Workers v. Stop & Shop Cos., 776 F.2d 19, 21-22 (1st Cir. 1985). *Cf.* Safeway Stores v. American Bakery & Confectionery Workers, 390 F.2d 79, 82 (5th Cir. 1968) ("if . . . no judge, or group of judges, could ever conceivably have made such a ruling"); Gunther v. San Diego & Ariz. E. Ry., 382 U.S. 257, 261 (1965) ("wholly baseless and completely without reason").

[220] The relatively few cases actually involving vacations of arbitration awards because of irrationality relate more to irrational contract interpretation than to misuse of principles of substantive law. *E.g.*, O-S Corp. v. Samuel A. Kroll, Inc., 348 A.2d 870, 872 (Md. Ct. Spec. App. 1975) (finding arbitrator's award of wages pursuant to a reimbursable wages provision of a construction contract to be based on a completely irrational interpretation of the contract); In re Riverbay Corp., Operating Co-op City and Local 32-E, S.E.I.V., AFL-CIO, 456 N.Y.S.2d 378 (N.Y. App. Div. 1982) (finding award that was premised upon lack of clear warning to be a totally irrational construction of collective bargaining agreement, which did not require that any warning be given); Swift Indus., Inc. v. Botany Indus., Inc., 325 F. Supp. 577 (W.D. Pa. 1971), *aff'd*, 466 F.2d 1125 (3d Cir. 1972) (finding award of a $6 million cash surety bond completely irrational where the agreement did not specify a bond as a remedy for breach of warranty and in accordance with a formula for sharing liabilities set forth in reorganization agreement the maximum liability would have been approximately $1.5 million).

[221] The irrationality concept is also associated with the review of compulsory arbitrations. *See, e.g.*, Board of Educ. of Carlsbad Mun. Sch. v. Harrell, 882 P.2d 511, 526 (N.M. 1994) ("The scope of review constitutionally required for compulsory arbitration is the review required for administrative adjudications. . . . [J]udicial review of administrative action . . . requires a determination whether the administrative decision is arbitrary . . . .")

[222] *E.g.*, Matter of Silverman, 461 N.E.2d 1261 (N.Y. 1984); Weidman v. Fuchsberg, 576 N.Y.S.2d 232 (N.Y. App. Div. 1991); Diaz v. Pilgrim State Psychiatric Center of New York, 465 N.E.2d 32 (N.Y. App. Div. 1984); Lieberman v. Lieberman, 566 N.Y.S.2d 490 (N.Y. Sup. Ct. 1991). While *Lentine v. Fundaro*, 278 N.E.2d 633 (N.Y. 1972), is repeatedly cited as the leading authority for vacating on the basis of irrationality, the court did not find that the award in question was the product of irrationality. The dispute centered on a liquidating distribution upon the break-up of a partnership. Since the arbitration award directly contradicted the partnership agreement, which provided for equal distribution to the partners upon partnership liquidation, the award was attacked as being irrational. The court, however, ruled that even though the partnership agreement was not ambiguous, by taking into account the unequal capital contributions of the partners (other than as contemplated in the agreement) the award could not be said to be irrational.

[223] *E.g.*, World Invest Corp. v. Breen, 684 So.2d 221 (Fla. Ct. App. 1996) ("arbitrary and capricious"); Foley Co. v. Grindsted Prods., Inc., 662 P.2d 1254 (Kan. 1983) (stating errors of law do not justify vacating; award must be "completely irrational"); Snyder v. Berliner Const. Co., Inc., 555 A.2d 523 (Md. Ct. Spec. App. 1989). *But see* Messersmith, Inc. v.

have acknowledged irrationality as a ground for vacating an arbitration award. Other federal courts, however, have rejected it.[226] Most references to irrationality are without explanation or analysis.[227] Usually it is simply listed along with other grounds, such as manifest disregard of the law, as an available basis for vacation, or it is stated as a qualification that error of law is not a ground for vacation, "unless totally irrational."[228] Many of the irrationality cases relate more to the fact-finding process than the use or misuse of principles of substantive law.[229]

The *Ainsworth* case represents a rare example of an arbitration award that was supposedly vacated based on irrationality. Though the Eleventh Circuit has rejected the "manifest disregard" test, it has

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Barclay Townhouse Ass'ns, 547 A.2d 1048, 1051 n.2 (Md. Ct. Spec. App. 1988) (calling the irrationality doctrine into question).

[224] *E.g.*, Prudential-Bache Sec., Inc. v. Caporale, 664 F. Supp. 72 (S.D.N.Y. 1987); Sargent v. Paine Webber, Jackson & Curtis, Inc., 674 F. Supp. 920 (D.D.C. 1987).

[225] *E.g.*, French v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 784 F.2d 902, 906 (9th Cir. 1986); Industrial Mut. Ass'n v. Amalgamated Workers, 725 F.2d 406 (6th Cir. 1984); Andros Compania Maritima, S.A. v. Marc Rich & Co., A.G., 579 F.2d 691 (2d Cir. 1978); Swift Indus. v. Botany Indus., 466 F.2d 1125, 1131 (3d Cir. 1972); Safeway Stores v. American Bakery & Confectionery Workers Int'l Union, Local 111, 390 F.2d 79, 82 (5th Cir. 1968) (stating award may be vacated as arbitrary and capricious "if the reasoning is so palpably faulty that no judge, or group of judges, could ever conceivably have made such a ruling").

[226] The First Circuit discussed this basis for vacating an award in *Advest, Inc. v. McCarthy*, 914 F.2d at 9 n.6 (1st Cir. 1990), and concluded that it was superfluous because "any case which purports to fall into this residual category involves an award made contrary to the plain meaning of the contract authorizing arbitration or one made in manifest disregard of the law." For a commentary that takes issue with this conclusion as it might pertain to an error in fact finding, see Stephen H. Kupperman and George C. Freeman III, *Selected Topics in Securities Arbitration: Rule 15c 2-2, Fraud, Duress, Unconscionability, Waiver, Class Arbitration, Punitive Damages, Rights of Review, and Attorneys' Fees and Costs*, 65 TUL. L. REV. 1547, 1625 (1991).

[227] In one of the few exceptional cases in this regard, the court made the following observation: "[we] generally will not vacate an arbitrator's award where the error claimed is the incorrect application of a rule of substantive law . . . unless it is so 'irrational as to require vacatur.' Even apart from its apparent circularity, this standard is substantially less exacting than that applied in the review of the legal conclusions of administrative agencies." Motor Vehicle Mfrs.' Ass'n of the U.S. v. State, 550 N.E.2d 919, 929 (N.Y. 1990) (quoting from Matter of Smith Fireman's Ins. Co., 55 N.Y.2d 224, 232 (1982)).

[228] *E.g.*, Amalgamated Transit Union v. Green Bus Lines, Inc., 409 N.E.2d 1354 (N.Y. 1980); SRC Construction Corp. v. Town of Poughkeepsie, 643 N.Y.S.2d 396 (N.Y. App. Div. 1996).

[229] *E.g.*, Sobel v. Hertz, Warner & Co., 469 F.2d 1211, 1216 (2d Cir. 1972) (stating if decision cannot be inferred from facts of case then it is arbitrary and capricious). *See also* O-S Corp. v. Samuel A. Kroll, Inc., 348 A.2d 870 (Md. Ct. Spec. App. 1975); Swift Indus., Inc. v. Botany Indus., Inc., 325 F. Supp. 577 (W.D. Pa. 1971).

embraced irrationality.[230] The court has explained that an award may be vacated as arbitrary and capricious in two kinds of cases: (1) when the award exhibits a wholesale departure from the law and (2) when the award is not grounded in the contract which provides for the arbitration.[231]

Apparently it was the court's view that the *Ainsworth* case involved such a wholesale departure from the law. In *Ainsworth*, the Florida Supreme Court responded to the certified question[232] by confirming that the respondent was selling securities *in the state* in violation of section 517.12 of the Florida Statutes, thereby entitling claimant to mandatory damages under section 517.211.[233] Armed with this new input, the Eleventh Circuit renewed its evaluation of the district court's handling of the case.[234]

The court first acknowledged that courts are generally prohibited from vacating an award on the basis of errors of law or interpretation. Next the court observed that it had never adopted the "manifest disregard" standard and that in its prior dealings with the issue it had not clarified whether vacating an arbitration award on the basis of manifest disregard of the law would constitute an error. Finally, the court noted that "although great deference is normally accorded an arbitration award, an award that is arbitrary and capricious is not required to be enforced."[235] This latter point, raised at the appellate level for the first time and apparently on the court's own initiative, served as the foundation for affirming the district court's vacation of the arbitration award.

The court declared, "[a]n award is arbitrary and capricious only if 'a ground for the arbitrator's decision cannot be inferred from the facts of the case.'"[236] Next the court explained:

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[230] Brown v. Rauscher Pierce Refsnes, Inc., 994 F.2d 775 (11th Cir. 1993); Ainsworth v. Skurnick, 960 F.2d 939 (11th Cir. 1992); Ierna v. Arthur Murray Int'l Inc., 833 F.2d 1472 (11th Cir. 1987).

[231] Brown, 994 F.2d at 781. In *Brown* the court, however, rejected the effort at vacation before it. *See infra* note 241.

[232] *See supra* text accompanying notes 200-08 for discussion of the earlier proceedings in this case.

[233] Skurnick v. Ainsworth, 591 So.2d 904, 906 (Fla. 1991).

[234] Ainsworth v. Skurnick, 960 F.2d 939 (11th Cir. 1992).

[235] *Id.* at 941.

[236] *Id.* (quoting from *Raiford*, 903 F.2d at 1413). This case does not seem to fit this description. One need not search for inferences in this case; on remand the arbitrators specifically stated that they found the respondent was negligent in handling the account, but that there were no resulting damages, and further that claimant had not established recovery on the other claims, including a violation of Fla. Stat. ch. 517.12. 909 F.2d at 941. From this it might be said that the arbitrators committed an error by misinterpreting this law or, if there was no disagreement about the law, that they acted in manifest disregard

> We have to assume that the arbitrators' decision was arbitrary or capricious for two reasons: first, it was a reasonable interpretation of the statute made by the district court in questioning the vagueness of the panel's first decision; and second, the district court told [the arbitrators] what the law was, and their second award does not indicate that they differ with the point nor does it give any reason for not awarding mandatory damages. Since they knew the law required damages, their refusal to grant damages is clearly arbitrary. There was no reasonable basis upon which the panel may have acted.[237]

It is unclear how the first part of this statement is relevant to the issue whether the arbitrators acted in an arbitrary and capricious manner. The second part does not seem substantiated. The court did not direct the arbitrators that the operative facts definitely constituted a violation of the Florida mandatory damages provision. The pertinent part of the actual Order of Remand reads as follows:

> The [first] award . . . fails to adequately explain how the conclusion was reached . . . . In essence, the vagueness invites speculation and emasculates effective judicial review.
>
> . . . If a statutory violation is found, damages should be awarded. However, if the liability was for a common law violation, rather than a statutory violation, then an award of damages is not mandatory. . . . Until such clarification is made, Petitioner cannot begin to prove nor can this Court determine whether the arbitration panel was evidently partial or acting in manifest disregard of the law in not awarding Al Ainsworth damages.[238]

This was not a direction to the panel that based on the facts of this case the law required them to award damages; it was a direction that if they found a violation of the statute, then damages were mandatory. From the language expressed in the Order of Remand it seems that the court was willing to accept and the panel ultimately did provide the explanation that they did not find a violation of this statute. Only later did the district court reject as implausible the panel's interpretation that the Florida statute did not apply to the facts of the case. And then ultimately, the Florida Supreme Court ruled that the type of transaction in question definitely constituted a violation of the Florida securities

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of it; but not that they acted arbitrarily or capriciously. The arbitrants argued two different interpretations of the relevant statute. The arbitrators expressed a rational ground for their decision; it was later established that their interpretation of the statute was nonmeritorious. Though the arbitrators may have engaged in an erroneous analysis, it was not lacking in rationality.

[237] 960 F.2d at 941.

[238] 909 F.2d at 459.

statute. At the time that the panel rendered its decision they did not "know the law required damages."[239]

Finally, the court stated that "[i]n this case it is not a question of deciding the law and getting it wrong or for some reason disregarding the law. The decision was simply an apparent arbitrary and capricious denial of relief with no factual or legal basis."[240]

Though this court purports to distinguish *arbitrariness* from *misinterpretation or error of law*, it is hard to see how they have done so. The limited record reveals that the panel acknowledged the existence of the Florida brokerage statute, considered the arguments of the respective parties concerning its application to the transaction, and were persuaded by the respondent that the transaction did not come within its purview. The panel did find that the respondent was negligent, but that the negligence did not result in damages to the claimant. There is no lack of rationality in this analysis; the panel simply committed an error of law — as the Florida district court later declared and the Florida Supreme Court ultimately confirmed. The abstruse analysis by the circuit court is strained and flawed. For an award to be arbitrary and irrational there should be no plausible explanation. The decision of these arbitrators is rational considering that they misinterpreted Florida law. If one adheres to the view that error of law is not a ground for vacation, then in a case such as this the irrationality argument should fail also.[241]

If the irrationality theory has applicability with respect to misapplication or misconstruction of the law, it would seem necessary to draw some sort of distinction between a justifiable error of law (as in the case where the law is susceptible to multiple interpretations) and unjustifiable error of law (where the authority is beyond debate). In the "irrationality" cases, the courts have not endeavored to draw such a distinction.

Judicial Reaction To A Public Policy or Illegality Argument

Another vacation theory that may be related to the role of substantive law in arbitration involves a public policy or illegality based argument. This is tied to the basic contract law principle whereby courts may refuse to enforce contracts that are illegal or violate public

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[239] 960 F.2d at 941.

[240] *Id.* (citations omitted).

[241] In *Brown v. Rauscher Pierce Refsnes, Inc.*, 994 F.2d 775 (11th Cir. 1993), the court did reach that conclusion, rejecting the effort at vacation. The court explained that "[w]ith the benefit of hindsight we now know that the Panel's interpretation of the Florida statute is incorrect . . . . Nevertheless, at the time the panel rendered its decision, *Ainsworth* had not yet been decided. As there was no definitive interpretation of the statute, the Panel's interpretation was not wholly unfounded." *Id.* at 781.

policy. Some courts have identified "illegality" or "public policy" along with other non-statutory grounds for vacation.[242] For example, if an arbitration award is contrary to law or if it requires an act prohibited by law, a court may set it aside as being contrary to public policy.[243] As is true for many other arbitration issues, this one is rooted in and has received most attention in the context of organized labor arbitrations. In *United Paperworkers International Union v. Misco, Inc.*[244] the Supreme Court severely limited the application of this doctrine, indicating that a public policy based vacation cannot be based on "general considerations of supposed public interest."[245] The public policy argument is limited to situations where "the contract as interpreted would violate some explicit public policy that is well defined and dominant, and is to be ascertained by reference to the laws and legal precedents."[246] From this statement it would seem that certain arbitration awards based on non-law decision-making standards may run afoul of the law and be subject to judicial reversal. Both before and after *Misco*, the lower courts have struggled with the public policy ground for vacation.[247]

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[242] *E.g.*, Culinary Workers Union, Local 165 v. Riverboat Casino, 817 F.2d 524 (9th Cir. 1987) (stating that awards are not vacatable unless illegal, contrary to public policy or in manifest disregard of the law); Maross Const., Inc. v. Central New York Regional Transp. Auth., 488 N.E.2d 67 (N.Y. 1985) (stating that arbitration award may include misapplication of substantive rules of law and still not be vacatable unless the court concludes it is totally irrational or violative of strong public policy).

[243] *See* W.R. Grace & Co. v. Local Union 759, Int'l Union of United Rubber Workers, 461 U.S. 757,766 (1983) ("As with any contract, . . . a court may not enforce a collective bargaining agreement that is contrary to public policy. . . . If the contract as interpreted [by the arbitrator] violates some explicit public policy, we are obliged to refrain from enforcing it."); Loving & Evans v. Blick, 204 P.2d 23 (Cal. 1949) and All Points Traders, Inc. v. Barrington Assoc., 211 Cal.App.3d 723 (Cal Ct. App. 1989) (permitting judicial review of arbitrators' rulings where a party claimed the entire contract or transaction was illegal).

[244] 484 U.S. 29 (1987).

[245] *Id.* at 44.

[246] *Id.* at 43. In *Misco*, the arbitrator had ordered reinstatement of a worker who had been arrested for possession of illicit drugs. The district court vacated the award, ruling that reinstating this worker to a position where he operated a dangerous machine violated public policy. The court of appeals affirmed, and the Supreme Court reversed because there was no evidence that the employee was operating the machinery under the influence of drugs. *Id.* at 44.

[247] *See, e.g.*, Stead Motors v. Automotive Machinists Lodge 1173, 886 F.2d 1200 (9th Cir. 1989) (by a plurality decision, a divided en banc panel rejected the employer's public policy arguments, limiting the public policy exception to situations where the award compels violation of the law; dissenting Judge Trott expressed that this "chokes the 'public policy' exception . . . into oblivion."); AFL-CIO v. Department of Central Mgmt., 671 N.E.2d 668 (Ill. 1996). *See* Bret F. Randall, Comment, *The History, Application, and Policy of the Judicially Created Standards of Review for Arbitration Awards*, 1992 B.Y.U. L. REV. 759, 769-83.

The illegality and public policy cases have much in common with the other non-statutory grounds for vacation discussed in this article. This is especially reflected in the level of confusion and disagreement among judges struggling to reconcile arbitration and substantive law. Yet a greater number of the illegality and public policy based challenges to arbitration awards have actually succeeded.[248] These examples, however, represent a relatively small percentage of the public policy and illegality attempts to defeat arbitrations, and they are almost entirely in the collective bargaining contract arbitration context.[249]

Judicial Ambivalence

An examination of how courts have dealt with arbitrator shortcomings with respect to the use of the law reveals a state of modern judicial ambivalence. While the courts have progressed from early distrust and frequent rejection of arbitration to the present state of widespread favor and support, there remains an undercurrent of suspicion. Dissatisfied arbitrants have many times raised the issue of error of law, and the courts most often have dispensed with the matter in a summary fashion, declaring an error of law to be an insufficient basis for negation of an arbitration award. It is primarily in this way that the judiciary has addressed the role of law in arbitration. This is an important matter that has been resolved with much consistency, but it is narrowly focused. The manifest disregard, irrationality and public policy theories suggest broader implications. Thus, the larger issue of the role of law, including for example the extent to which and under what circumstance arbitrators should endeavor to follow the law, is less clear. Moreover, despite the prevailing view that awards are not subject to appellate review for error of law, there remains an underlying theme of distrust for arbitration when it is viewed as a process which provides an outcome and a form of justice that may not conform with established principles of law.

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[248] *E.g.*, Stroehmann Bakeries, Inc. v. Local 766, Int'l Broth. of Teamsters, 969 F.2d 1436 (3d Cir. 1992) (vacating award granting reinstatement to employee who was fired for sexually harassing a customer's employee); United States Postal Serv. v. American Postal Workers Union, AFL-CIO, 736 F.2d 822 (1st Cir. 1984) (holding award for reinstatement of convicted embezzler violates public policy).

[249] *Cf.* Haynes Constr. Co. v. Cascella & Son Constr., Inc., 1993 Conn. Super. LEXIS 1521, *rev'd* 647 A.2d 1015 (Conn. Cir. Ct. 1994) (trial court explored vacating construction contract award on public policy ground, but did not need to resolve that issue as they vacated the award on basis of evident partiality of arbitrator); Dean Witter Reynolds, Inc. v. Trimble, 631 N.Y.S. 2d 215 (N.Y. Sup. Ct. 1995) (a rare non-labor context arbitration where court stayed remedial claim for punitive damages because New York public policy prohibits their award).

The preceding exploration shows the role of substantive law in arbitration to be enigmatic. The question of precisely how arbitrators are to relate to substantive law has not been directly addressed. Many may think it goes without saying that arbitrators should endeavor to decide cases based on the law. Nevertheless, the commentary and related judicial discourse suggest otherwise, and the related case law provides much opportunity for freedom from constraint of the law by overwhelmingly rejecting error of law as a basis for award vacation. Indeed, arbitral practice seems to consist of a discretionary combination of law and common sense. Some may be so bold as to call this *arbitrary*.[250] Although some disgruntled losers have attempted without success to invoke the law, and some members of the judiciary have denounced the potential arbitrariness of arbitration, the volume of arbitration activity, which includes many voluntary repeat players, seems to indicate that this system serves a valuable alternative dispute resolution function.

Arbitration As An Alternative

In considering the relationship between arbitral decision-making and established principles of substantive law, one should not lose sight of the essential purpose of arbitration. It should foremost serve as an alternative to traditional litigation. Critics who advocate that arbitration laws should be fundamentally changed to require that arbitrations be decided in accordance with law, including the opportunity for judicial appellate review, have ignored this important point.

It is paradoxical that one would select the alternative of arbitration, but then insist on extensive discovery, adherence to judicial rules of evidence, faultless application of the law, and the opportunity for appellate review. Infusing arbitration with most of the trappings of litigation so eviscerates arbitration as to render it meaningless as an *alternative*.[251] The alternative dispute resolution menu provides numerous alternatives to meet the wants and needs of disputants. For

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[250] *See* Reicks v. Farmers Commodities Corp., 474 N.W.2d 809, 811 (Iowa 1991) ("A refined quality of justice is not the goal in arbitration matters. Indeed such a goal is deliberately sacrificed in favor of a sure and speedy resolution. Under our common-law view the purpose of arbitration is to end disputes without court participation. It is no idle coincidence that the words "arbitration" and "arbitrary" are both derived from the same Latin word.").

[251] Arbitration has been trending toward litigation for some time. Historian Jerald Auerbach blamed the legal profession for this result, characterizing it as the "price for the cooperation of the legal community." JERALD S. AUERBACH, JUSTICE WITHOUT LAW? 109 (1983).

example, those who want a more litigation-like process should opt for private judging.[252] While sharing some of the attributes of arbitration, such as privacy, expedition, and participation in selection of the neutral, private judging utilizes conventional judicial procedures and decision-making by law that is subject to appellate review. Perhaps too many disputants and lawyers fail to appreciate that alternative dispute resolution includes a more complex array of procedures than just arbitration and mediation. Simply put, if one does not desire arbitration as it has been defined through statutes, arbitration rules, case law and tradition, then one should not agree to arbitration. Other forms of dispute resolution can be designated or even custom designed in the dispute resolution agreement.

A meaningful alternative dispute resolution world should include many alternatives. Arbitration takes its place on the continuum of alternatives by not requiring decision by law and by offering a process that is less structured than private judging or litigation.[253] Arbitration is different enough to provide the opportunity for a more expeditious, economical, flexible, private and complete adjudicative dispute resolution experience, while maintaining an essential level of fairness.

Since it is an alternative to litigation, the fairness of arbitration need not be measured in terms of justice according to the law.[254] New Jersey Chief Justice Wilentz astutely observed this reality of arbitration:

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[252] *See* GOLDBERG ET AL., *supra* note 5, at 5, 290-94.

[253] Yet arbitration does offer flexibility of design under the control of the disputants. Thus, arbitrants have the opportunity, should they so desire, to require, through their arbitration agreement or by subsequent agreement, that the arbitrator decide the matter in accordance with specified principles (of law or some other belief system) and to structure the procedure more like litigation. *See supra* notes 29-45 and accompanying text. Apparently many disputants and even their lawyers have not understood these attribute distinctions. Over time this confusion should be reduced.

[254] Indeed, the law may or may not produce fair and just results. *See* AUERBACH, *supra* note 251, at 144-45. Auerbach concluded that social context and political choice determine whether courts or alternative institutions can render justice. He observed that adjudication in the courts and arbitration both "can be discretionary, arbitrary, domineering — and unjust." Moreover, "[l]aw can symbolize justice, or conceal repression. It can reduce exploitation, or facilitate it." *Id.*

To some extent it may be dissatisfaction with the law that justifies arbitration without adherence to the law. This author has observed many business students, including fairly sophisticated graduate students with considerable work experience, express a preference for common sense over the law. Simply put, it seems that some disputants favor arbitration without devotion to the law precisely because they distrust the law. This lack of regard (if not disdain) for the law is similarly manifest in the jury nullification phenomenon. *See* NORMAN J. FINKEL, PERFECTION BY NULLIFICATION — COMMON SENSE JUSTICE: JURORS' NOTIONS OF THE LAW (1996); Major Michael J. Davidson, *Jury Nullification: A Call for Justice or an Invitation to Anarchy?*, 139 MIL. L. REV. 131 (1993).

> [I]mplicit in [the New Jersey court's] treatment of arbitration has been the notion that justice cannot be assured outside of the courts. It is a notion totally at war with the basic intent of those who submit their disputes to arbitrators. They too want justice, but they look solely to the arbitrators and to the process of arbitration to achieve it. That is their right, and the courts have no right to take it away from them.
>
> Will they get better justice from them? That is not for us to decide. That's their decision to make, theirs alone. When knowledgeable people, experienced in business, decide that they want arbitrators rather than judges, that they want arbitrators familiar with their business and its customs, arbitrators just as experienced as they are, rather than judges who may have no business experience at all, when they tell us that brand of justice is better for them than ours, we have absolutely no right to tell them that they are wrong.[255]

Arbitration should be fair, but in a different sense. In any given case, the operative arbitration statutes and especially those provisions establishing the right to vacation of an abusive arbitration award[256] ensure a minimal level of fairness from a societal perspective. The arbitration rules that have been developed through the efforts of such organizations as the American Arbitration Association and the American Bar Association further advance arbitral fairness. The greatest assurance of fairness in the process in general, however, should rest in the voluntariness of arbitration. That is to say, disputants will not select the alternative of arbitration if they are not comfortable with the process and the results it generally produces.

Empirical evidence supports the notion that adherence to the law is not central to the fairness of arbitral decision-making. For example, an AAA survey asked respondents to rank order nine choices regarding the qualities that people look for in an arbitrator. The highest priority choice was "impartiality," followed by "substantive knowledge in the subject area." The least important quality was "law orientation," with a 7.66 response average on a nine point scale. Only 2% of respondents ranked it first.[257] A pilot study conducted by the author of this article similarly points to a lack of concern among users of arbitration for adherence to the law.[258] Executives from sixty construction firms were asked to indicate their level of agreement with fifty-one statements about arbitration and mediation. Only 17% of the respondents signified agreement with the statement "the fact that arbitrators do not strictly

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[255] *Perini,* 610 A.2d at 384-85 (Wilentz, C.J. concurring).

[256] *See supra* text accompanying notes 16-17.

[257] AAA Arbitration Times, Winter 1991-92, at 7.

[258] Murray S. Levin & Doug Joyce, Pilot Study: Arbitration Survey, University of Kansas School of Business (August 1990) (unpublished paper available from author).

adhere to rules of law negatively affects the fairness of arbitration."[259] Consistent with this, only 25% and 27% of the respondents indicated disagreement with the statements that "the level of justice achieved through arbitration is comparable or better than in court,"[260] and "arbitration results in more equitable rulings than court proceedings."[261] The respondents clearly appreciated the diminished role of law in arbitration. Only 7% of the respondents disagreed with the statement that "arbitrators are more concerned with achieving equitable results than with strict adherence to law."[262] They also showed very high agreement with the statement that "arbitrators are able to consider evidence that may not be admissible in court."[263] And apparently respondents were content with these differences as there was considerable agreement with the statement that "arbitration is an effective means of resolving disputes"[264] and "our arbitration experiences have been satisfactory."[265] Respondents were nearly evenly split on the statement that "our experience with arbitration has been more favorable than our experience with court proceedings."[266]

The Importance of Voluntariness

By focusing on the existing role of substantive law in arbitration one can see that voluntariness of arbitration should be of paramount importance. That is to say, arbitration that is not driven by the rule of substantive law makes sense and is fair if that is truly what the parties

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[259] Respondents indicated their level of agreement by selecting either "strongly agree," "agree," "neutral," "disagree," or "strongly disagree." Average positive or negative scores were calculated for each statement by scoring the choices as 2, 1, 0, -1, and -2 points respectively. The level of disagreement for the statement "the fact that arbitrators do not strictly adhere to rules of law negatively affects the fairness of arbitration" averaged -.29.

[260] There was a +.25 average agreement score for this statement.

[261] This statement was supported with a +.08 average agreement score.

[262] Average agreement score was +.78.

[263] Average agreement score was +.80.

[264] Average agreement score was +.93.

[265] Average agreement score was +.39, with only 17% disagreeing with the statement.

[266] The following statements elicited the strongest levels of agreement:

Experienced and knowledgeable arbitrators are the key to continuing development and increased use of arbitration (+1.15);

Arbitration results in significant cost savings (+1.08);

Arbitration results in more timely resolution of disputes (+1.05);

Arbitrators have greater knowledge of subject matter than jurors (+.95).

The following statements elicited the strongest levels of disagreement:

A lack of familiarity with arbitration has resulted in our electing to use other methods of dispute resolution (-.84);

We only enter into contracts which call for binding arbitration (-.62);

A reason that we use arbitration is that it results in less publicity than court proceedings (-.39).

who will be affected desire. It does not make sense and is not fair and should not control if the disputants are not truly desirous of decision by arbitrator rather than decision by law. If we are to accept arbitration as a process that is not beholden to the law, it would seem that it must be a truly voluntary process. Those who are concerned with the growing use of arbitration and its possible disregard for the law should re-focus their attention. The critical issue should be whether parties to the process have selected it of their own volition. Thus far, the courts have been very restrictive in considering this issue.[267] This seems associated with the strong modern tendency (1) to favor arbitration generally and (2) not to discriminate among different arbitral contexts and circumstances.

The broad range of arbitration contexts today complicates any evaluation of arbitration. Arbitration has early historical roots in pure commercial disputes between merchants. Such business versus business arbitration has been particularly popular in international contexts. In the United States, throughout the greater part of the twentieth century arbitration has been strongly associated with interpretation and enforcement of labor-management collective bargaining agreements. Also, arbitration is well established in the construction industry. During the last ten or fifteen years, however, the ADR movement has spawned an enormous contextual expansion for arbitration. For example, arbitration now is used to resolve disputes between non-unionized employees and employers, disputes between consumers and businesses, a variety of securities industry disputes, property valuation disputes, attorneys' fee disputes, family disputes, community disputes, baseball salary disputes, auto accident claims, medical malpractice claims, and civil rights claims. When considering arbitration issues relevant to the role of substantive law in arbitration, by and large the courts have not drawn distinctions based on differing contexts.[268] This indiscriminate

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[267] *See infra* notes 301-12 and accompanying text.

[268] *Johnson v. American Family Mut. Ins. Co.*, 426 N.W.2d 419 (Minn. 1988), represents a rare exception to this. In *Johnson*, the court acknowledged that "[g]enerally, arbitration law states that arbitrators are the final judges of both law and fact." The court, however, proceeded to distinguish between arbitration of insurance claims and labor arbitration. The court stated:

> We think that consistency mandates that the courts interpret the no-fault statutes, not various panels of arbitrators. Therefore, we hold that in the area of automobile reparation, arbitrators are limited to deciding issues of fact, leaving the interpretation of law to the courts. In this case, the measure of the gap between Johnson's damages and the available liability insurance is an issue of law which must be determined by the court, not by the arbitration panel.

Id. at 421.

See also Cole v. Burns Intern. Sec. Servs., 105 F.3d 1465, 1467 (D.C. Cir. 1997) (acknowledg-ing distinctions between arbitration of labor disputes under collective

extension of rulings across such a broad range of contexts characterized by fundamentally different attributes is troublesome.

The three established arbitration contexts — pure commercial, organized labor, and construction — are characterized by disputing focused on contract interpretation, bargaining among relative equals, and strong communal interests. In their endeavor to discern contractual intent the arbitrators are expected to draw heavily on experience and knowledge of common commercial, technical, and industrial practices. Though legal rules for interpreting contract language may be useful, they are not paramount. It has been said, for example, that merchants favor commercial arbitration because they "value their commercial relationships (and their profits) over the assertion of legal rights," and they are more trusting of "informed business experts [who are] sympathetic to commercial imperatives [than they are of] inscrutable judges or ignorant juries."[269]

This non-legal paradigm is not as well suited to some of the newly developing arbitration contexts, which involve disputes that are often based on non-contractual claims of right, arbitration agreements that are adhesive, and relationships that are more remote and less stable. Moreover, new context arbitrations often involve disputants who are unwittingly or reluctantly drawn into arbitration, who lack experience with arbitration, and who do not share common interests.

These circumstance and relationship differences are important in establishing the level of respect that will be afforded arbitration outcomes. A voluntary and intelligent assent to an alternative dispute resolution mechanism that allows for decision-making other than by law involves a commitment and credibility. This is true whether the decision is to be based on the toss of a coin or the personal wisdom of a selected arbitrator. Those who are forced or coerced into "accepting" or

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bargaining agreement and mandatory arbitration of individual statutory claims outside of that context).

[269] AUERBACH, *supra* note 251, at 33. In the Steelworkers Trilogy (United Steelworkers v. American Mfg. Co., 363 U.S. 564 (1960), United Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574 (1960), United Steelworkers v. Emterprise Wheel & Car Corp., 363 U.S. 593 (1960)) the Supreme Court laid out a different vision of the role of arbitration in the collective bargaining context. The Court contrasted the commercial context where arbitration is the substitute for litigation with the collective bargaining context where "arbitration is the substitute for industrial strife" and a "means of solving the unforeseeable by molding a system of private law for all the problems which may arise and to provide for their solution in a way which will generally accord with the variant needs and desires of the parties." 363 U.S. at 578-79. The court also recognized that in the collective bargaining context arbitrators perform functions different from those performed by courts. *Id.* at 581-582. Moreover, "[i]t is the arbitrator's construction [of the collective bargaining agreement] which was bargained for; . . . the court's have no business overruling him because their interpretation of the contract is different from his." *Id.* at 599.

otherwise reluctantly accept arbitration have not committed to the process and, consequently, are more likely to view the outcome as not credible.

Lack of experience has the potential to subtly and adversely affect the entire process. In the well established arbitration contexts one finds repeat players on both sides of the dispute who often have first hand experience with individual arbitrators and have easy access to networks for sharing information about potential arbitrators. This information is used to advance the selection of capable and reputable neutrals. Arbitrators appreciate that continued demand for their services is dependent on their ability to demonstrate to these astute repeat players that they are able to produce credible outcomes. In this way having repeat players on both sides of the dispute can further the integrity of arbitration and render arbitration an attractive alternative, even though it is not beholden to the law. This repeat player balancing force is absent in many new context arbitrations.

Historian Jerold Auerbach has observed that arbitration, as a form of equitable justice without law, is based on reciprocal access and trust among members of a community.[270] From this, Auerbach reached the limiting conclusion that justice without law is possible "[o]nly when there is a congruence between individuals and their community, with shared commitment to common values."[271] Many of the new arbitration contexts fail to encompass these features.

Moreover, significant differences exist in the circumstances and character of arbitrations and arbitration agreements. The idea that arbitrators are to use their judgment in a manner that may be independent of the law seems fair and sensible in some contexts and for some disputes, but not for all.

The Troubling Adhesive Agreement To Arbitrate

Arbitration that is not beholden to the law seems well suited to the resolution of disputes between businesses pursuant to a voluntary, bargained-for agreement. These arbitrants have, for their own reasons, both freely selected this alternative.

Unfortunately, arbitration is sometimes not truly the product of free choice, which naturally raises concern about certain arbitrations.[272]

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[270] AUERBACH, *supra* note 25, at 4.

[271] *Id.* at 16.

[272] *See* Jean R. Sternlight, *Panacea Or Corporate Tool? Debunking The Supreme Court's Preference For Binding Arbitration*, 74 WASH. U. L. Q. 637, 647-51 (1996). Based on an analysis of legislative history and an analysis of public policy, Sternlight criticizes the courts for enforcing arbitration agreements in transactions involving consumers, employees, franchisees and other "little guys."

Unconstrained arbitration is more questionable in disputes such as those between a consumer and a business or an employee and employer that have come to arbitration because of the dictates in an adhesion contract.[273] For example, BankAmerica Corporation and Wells Fargo & Company have instituted policies making customer disputes subject to arbitration. The banks "informed" depositors and credit card holders of this change through a notice set in small type, mailed along with monthly statements. This change in contract rights was effectuated without even obtaining a signature to indicate acknowledgment and agreement. The statement provided that mere use of the card or account signifies acceptance of the new terms.[274]

The United States Supreme Court decision in *Gilmer v. Interstate/Johnson Lane Corp.*[275] has triggered considerable interest on the part of employers in extending the use of arbitration to employment claims not arising in the organized labor context.[276] In *Gilmer* the Court enforced arbitration of an age discrimination claim based on a pre-dispute arbitration clause contained within a New York Stock Exchange contract. In the aftermath of *Gilmer* there has been a substantial movement to have non-union workers agree to arbitration and thereby

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Similarly, the propriety of arbitration is more questionable when disputes are imbued with broader public concerns. *See, e.g.,* Safety Equip. Corp. v. J.P. Maguire & Co., 391 F.2d 821 (2d Cir. 1968) (concluding that public interest in enforcement of the antitrust laws and the nature of claims arising in such cases render antitrust claims inappropriate for arbitration); Aimcee Wholesale Corp. v. Tomar Prods., Inc. 237 N.E.2d 223, 225 (N.Y. 1968) (stating that since arbitrators "are not bound by rules of law" they should not be allowed to decide certain issues of antitrust law which could by their nature [e.g. discriminatory pricing] affect the people as a whole). The Supreme Court, however, seems to have laid this issue to rest. For example, in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.,* 473 U.S. 614 (1985), the Court upheld the enforcement of an arbitration clause in an international transaction regarding counterclaims based on the Sherman Act. In *Shearson/American Express, Inc. v. McMahon,* 482 U.S. 220 (1987), the Court rejected arguments that factors such as industry-sponsored panels, the complexity of securities law claims, and criminal attributes of RICO, necessarily render arbitration inappropriate. And in *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991), the Court decided to compel arbitration of a statutory age discrimination claim. This decision was in spite of the protestation of Justices Stevens and Marshall that compelling arbitration of employment discrimination claims "eviscerates the important role played by an independent judiciary in eradicating employment discrimination." *Id.* at 42 (Stevens, J., dissenting).

[273] *See* Richard Shell, *Is Arbitration A Just Route?*, NAT'L L. J., Feb. 11, 1991, at 13.

[274] *Banks Force Griping Customers To Forgo Courts for Arbitration*, WALL ST. J., Jan. 20, 1993, at B1. According to this report, major banks elsewhere are similarly preparing to impose new dispute resolution policies. The *Journal* commented: "If the practice becomes a fixture in retail banking, other consumer service companies, including merchandisers and airlines, also are expected to make arbitration a condition of doing business with them."

[275] 500 U.S. 20 (1991).

[276] *See* Mei L. Bickner et al., *Developments In Employment Arbitration*, DISP. RES. J. 8, 13-14 (1997).

waive their rights to sue over issues such as discrimination and wrongful discharge.[277] Such agreements to arbitrate have become a condition of employment for many hourly and salaried employees.[278] This has occurred even though the Equal Employment Opportunity Commission has for some time held the view that mandatory binding arbitration imposed as a condition of employment is contrary to civil rights laws and does not promote the principles of a sound ADR program.[279] The *Gilmer* decision has prompted much criticism,[280] and this critical reaction has led to Congressional consideration of legislation (Civil Rights Procedures Protection Act of 1997) that would prevent involuntary arbitration of employment discrimination claims altogether.[281]

Various organizations involved in employment disputes and arbitration have been working to resolve the many issues associated with the expansion of arbitration to the non-organized labor context. In 1994 a commission established by the U.S. Department of Commerce and Labor (commonly referred to as the "Dunlop Commission") evaluated the prospect of the expansion of employment arbitration and issued a report encouraging the development of private arbitration alternatives for workplace disputes. The Commission recognized the

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[277] *Employee Pacts To Arbitrate Sought by Firms*, WALL ST. J., Oct. 22, 1992, at B1; Kevin P. McGowan, *Arbitration: Employers Pursue Mandatory Arbitration Despite EEOC's Opposition To Practice*, 1996 DAILY LABOR REPORT 197 d8 (BNA Oct. 10, 1996). This article reports specifically that the EEOC's stance against mandatory arbitration has not deterred 120,000 employee Darden Restaurants Inc. Darden requires new hires to agree to arbitration as a condition of employment. When this program was first instituted, existing employees were given three months notice of the change.

[278] Margaret A. Jacobs, *Arbitration Policy Faces EEOC Challenge*, WALL ST. J., Apr. 12, 1995, at B6.

[279] II EEOC COMPLIANCE MANUAL § 132, Aug. 17, 1995. On this issue the EEOC has had mixed results in court. *See, e.g.,* EEOC v. Midland Food Services, L.L.C., N.D. Ohio, No. 1:96-MC-107 (N.D. Ohio) (company successfully rebuffed EEOC's motion for preliminary injunction to bar company from requiring prospective employees to sign arbitration agreement as a condition of employment); EEOC v. River Oaks Imaging & Diagnostic, 1995 U.S. Dist. LEXIS 6140, *1 (S.D. Tex. 1995) (enjoining employer from requiring employees to agree to arbitration, finding "the so-called 'ADR Policy' . . . so misleading and against the principles of Title VII . . . that its use violates such law").

[280] *E.g.*, Robert A. Gorman, *The Gilmer Decision and the Private Arbitration of Public-Law Disputes*, 3 U. ILL. L. REV. 635 (1995); Lewis Maltby, *Paradise Lost — How the* Gilmer *Court Lost the Opportunity for Alternative Dispute Resolution to Improve Civil Rights*, 12 N.Y.L. SCH. J. HUM. RTS. 1 (1994); Patrick D. Smith, *Arbitration — The Court Opens Door to Arbitration of Employment Disputes: Gilmer v. Interstate/Johnson Lane Corp.*, 17 J. CORP. L. 865 (1992). *See also* Samuel Estreicher, *Arbitration of Employment Disputes without Unions*, 66 CHI.-KENT L. REV. 753, 758 (1990) ("To extend the special status that arbitration enjoys under the Trilogy . . . to settings where collective bargaining does not take place would be to divorce the Court's doctrine from its underlying justification.").

[281] S. 63, 105th Cong. (1997).

need, however, for standards to govern those procedures. Among other things, it called for use of neutral arbitrators who know the law and sufficient judicial review to ensure consistency with governing laws.[282] The Commission did not, however, propose a new standard for appellate review. In 1995 the Task Force on Alternative Dispute Resolution in Employment supplemented the work of the Dunlop Commission with its report focusing on practices and procedures to assure due process in arbitration of statutory claims.[283] The Task Force's Due Process Protocol called for, among other things, use of arbitrators schooled in the relevant statutes, including training in substantive, procedural and remedial issues.[284] It further proposed that arbitrators be empowered "to award whatever relief would be available in court under the law," that they provide written opinions, and that the award be final and binding and subject to "limited" review.[285] The one issue that the diverse Task Force members[286] could not agree upon was whether pre-dispute arbitration agreements requiring arbitration of statutory claims, such as those involving employment discrimination, should be enforced.[287] To the extent that arbitration is not beholden to the law, this is obviously a very important issue. The proposals of the Dunlop Commission and the Task Force seem to envision a form of arbitration that is more law focused than is presently customary in either labor or business arbitration. Neither body, however, was explicit on that point.

Organizations involved in administering employment arbitration have also displayed some concern about adhesive employment agreements to arbitrate. The AAA recently adopted a new set of National Rules for the Resolution of Employment Disputes.[288] In a preamble to these rules, the AAA has stated that it will administer arbitrations that are the product of pre-dispute, mandatory arbitration programs that are a condition of employment. The preamble further states, however, that the AAA reserves the right to refuse to administer

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[282] *Report and Recommendations*, Commission on the Future of Worker-Management Relations, Dec. 1994, at 30-31.

[283] *A Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of the Employment Relationship*, May 1995.

[284] *See* George Nicolau, *The Future of Labor Arbitration*, 51 DISP. RES. J. 74, 80 (Apr.-Sept. 1996).

[285] *Id.*

[286] This task force consisted of representatives from groups such as the AAA, Federal Mediation & Conciliation Service, the National Employment Lawyer's Association, American Civil Liberties Union, Society of Professionals in Dispute Resolution, the Arbitration Committee of the Labor & Employment Section of the ABA, and the International Ladies Garment Workers Union.

[287] Nicolau, *supra* note 284, at 80.

[288] AAA, National Rules for the Resolution of Employment Disputes (effective June 1, 1996) [hereinafter National Rules].

a case if the dispute resolution program, on its face, does not meet the minimum due process standards of the rules and the Due Process Protocol.[289] These rules, much like the other AAA arbitration rules, do not specifically address the role that substantive law should play in the arbitration process.[290] For example, the rules do not require inclusion of legal claims or a statement of legal right to relief in the complaint. They state that the complaint shall set forth "a brief statement of the nature of the dispute; the amount in controversy, if any; [and] the remedy sought."[291] The arbitrator is empowered with what seems to be typical arbitral discretion[292] to "grant any remedy or relief that the arbitrator deems just and equitable, including, but not limited to, any remedy or relief that would have been available to the parties had the matter been heard in court."[293] The rules further indicate that specific matters to be addressed at a pre-hearing Arbitration Management Conference include "the law, standards, rules of evidence and burdens of proof that are to apply to the proceedings."[294] It is unclear whether this reference is simply to procedural aspects of the arbitration. If the reference to law is meant to denote substantive law, then the reference to other "standards" may encompass other ways of recognizing duties and deciding cases. In any event, consistent with the general AAA view,[295] the AAA employment dispute rules do not provide for an appellate process. They contemplate a place within the current arbitration environment where there is no review for error of law. One may anticipate, however, that these employment awards will be more consistent with operative substantive law than awards in other arbitration contexts where there would be greater opportunity for involvement of lay arbitrators. The AAA employment dispute rules specify that arbitrators "shall be experienced in the field of employment law"[296] and the rules provide a procedure for disqualifying an arbitrator who does not meet the standards of experience.[297]

Others involved in arbitration have displayed more concern about the relinquishment of rights. JAMS/Endispute, one of the nation's largest private dispute resolution companies, announced in 1996 that it would no longer assist companies in the development of programs requiring mandatory arbitration of employment disputes. It will

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[289] *Id.* at 3-4.
[290] *See supra* notes 35-39 and accompanying text.
[291] National Rules, *supra* note 288, at § 32(c).
[292] *See supra* text accompanying notes 85-98.
[293] National Rules, *supra* note 288, at § 4(b)(i)(1).
[294] *Id.* at § 8.
[295] *See supra* text accompanying notes 45-48.
[296] National Rules, *supra* note 288, at § 11(a)(i).
[297] *Id.* at § 11(c).

continue to take involuntary cases, but only after a worker has the opportunity to challenge the employer's arbitration policy in court.[298] In 1997, the board of governors of the National Academy of Arbitrators, a more than 600 member association of labor arbitrators, issued a statement officially opposing mandatory arbitration and urging the Academy's members to refuse to hear cases in which employers impose "unfair" procedures.[299]

In consumer, employment and similar adhesion contract transactions it is a stretch to characterize the typical agreement to arbitrate as a true act of choice.[300] In this vein, one may ponder whether an adhesive agreement to arbitrate constitutes a sufficient legal waiver of the constitutional right to a trial.[301] In *Carnival Cruise Lines v. Shute*,[302] the United States Supreme Court was presented with such a challenge to an adhesive forum selection clause.[303] The Court, however, was able to decide the case without addressing the constitutional issue.[304] In *Allied-Bruce Terminix Cos., Inc. v. Dobson*[305] the Supreme Court rejected the contention that arbitration provisions in consumer contracts are unfair.[306] The Court was much influenced by a Congressional Report and AAA data showing that consumers were better able to pursue relatively small claims through arbitration.[307] The Court noted that abusive situations can be handled by contract law

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[298] Andrea Gerlin & Margaret A. Jacobs, *JAMS/Endispute Policy*, WALL ST. J., Feb. 21, 1996, at B9. Both the AAA and JAMS/Endispute were under pressure from the National Employment Lawyers Association, a 2,000 member group of lawyers, who called for a boycott of private justice providers who were involved in hearing involuntary employment arbitration cases. Margaret A. Jacobs, *Firms With Policies Requiring Arbitration Are Facing Obstacles*, WALL ST. J., Oct. 16, 1995, at B6.

[299] *Voluntary Arbitration In Worker Disputes Endorsed by 2 Groups*, WALL ST. J., June 20, 1997, at B13. This article also reported "the American Arbitration Association, which until recently had remained neutral on this issue, now says that employment arbitration 'is most effective' when the parties 'knowingly and voluntarily' agree to use it."

[300] *See* Sternlight, *supra* note 272, at 675-77.

[301] *See* Edward Brunet, *Arbitration and Constitutional Rights*, 71 N.C. L. REV. 81 (1992). As a threshold matter the constitutional challenge is dependent on sufficient state action. Professor Brunet argues that state action is present in the aggressive judicial enforcement of arbitration, but acknowledges the recent contraction of the state action doctrine. *Id.* at 111-13. *See also* Thomas E. Carbonneau, *Arbitral Justice: The Demise of Due Process in American Law*, 70 TUL. L. REV. 1945 (1996) (asserting that in the interest of reducing the judicial caseload, the courts have essentially surrendered arbitrants' rights).

[302] 499 U.S. 585 (1991).

[303] *Cf.* Sherk v. Alberto-Culver Co., 417 U.S. 506, 519 (1974) ("An agreement to arbitrate . . . is, in effect, a specialized kind of forum-selection clause.").

[304] 499 U.S. at 589-90.

[305] 513 U.S. 265 (1995).

[306] 513 U.S. at 280 (responding to *amicus* brief).

[307] *Id.* at 280-81 (referring to H.R. REP. NO. 542, 97th Cong., at 13 (1982)).

principles relating to unconscionability, fraud, or duress.[308] It seems that the requirement for an effective waiver of a civil right to trial that leads to the substitution of arbitration is only that the waiving party has satisfied contract law principles.[309]

One would expect that very few adhesive agreements to arbitrate would be the product of circumstances giving rise to avoidance based on fraud or duress. These agreements do not typically result from misrepresentation or threats. The concept of unconscionability, though potentially broad, has not been interpreted and applied to embody adhesion contracts simply because they include arbitration clauses. Courts that have systematically analyzed unconscionability require gross unfairness in both the way the contract was formed — procedural unfairness — and the terms of the contract — substantive unfairness. Though adhesion contract circumstances may evidence procedural unfairness, the typical arbitration clause is not substantively unfair.[310] Thus in most cases the mere use of an adhesion contract has not been a sufficient ground for defeating an arbitration clause.[311] Moreover, in light of the strong federal policy favoring arbitration, the courts have construed the contract law defenses of fraud, duress, and unconscionability very narrowly in favor of arbitration.[312]

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[308] *Id.* at 281. The FAA explicitly provides that arbitration agreements may be voided on "such grounds as exist at law or in equity for the revocation of *any* contract." 9 U.S.C. § 2 (1994). Some legal commentators have expressed a very different view that traditional contract law is inadequate. *See, e.g.,* Mark E. Budnitz, *Arbitration of Disputes Between Consumers and Financial Institutions: A Serious Threat to Consumer Protection*, 10 OHIO ST. J. ON DISP. RESOL. 267 (1995).

[309] *See* Brunet, *supra* note 301, at 108.

[310] Some particular arbitration clauses have been found substantively offensive. *E.g.*, Graham v. Scissor-Tail, Inc., 623 P.2d 165, 176 (Cal. 1981) (finding an adhesion contract prepared by the American Federation of Musicians calling for use of an American Federation of Musicians arbitrator failed to meet "minimum levels of integrity"); Hope v. Superior Ct., 175 Cal. Rptr. 851, 856 (Cal. Ct. App. 1981) (finding adhesive and unconscionable a contract to arbitrate an employment dispute); Wheeler v. St. Joseph Hosp., 133 Cal. Rptr. 775, 783 (Cal. Ct. App. 1976) (refusing to enforce arbitration clause in hospital admission agreement signed by patient suffering from coronary insufficiency); Emerald Texas, Inc. v. Peel, 920 S.W. 2d 398, 401 (Tex. Ct. App. 1996) (refusing to enforce arbitration clause because of fraud and unconscionability).

[311] *See, e.g.*, Brookwood v. Bank of America, 53 Cal. Rptr. 2d 515, 519 (Cal. Ct. App. 1996) (ruling that employee's challenge that her 'unilateral lack of understanding' constituted grounds for contract revocation was not sufficient basis for court to refuse to enforce arbitration clause).

[312] *See, e.g.,* David L. Threlkeld & Co. v. Metallgesellschaft, Ltd., 923 F.2d 245, 248 (2d Cir. 1991); Cohen v. Wedbush, Noble, Cooke, Inc., 841 F.2d 282 (9th Cir. 1988); Benoay v. E.F. Hutton & Co., 699 F. Supp. 1523 (S.D. Fla. 1988). *See also* MACNEIL ET AL., FEDERAL ARBITRATION LAW: AGREEMENTS, AWARDS AND REMEDIES UNDER THE FEDERAL ARBITRATION ACT § 19.2.1 (1994) (asserting that contract law challenges to arbitration clauses "hardly ever" prevail).

A more protective approach for certain types of contract clauses is not unprecedented. For example, there is an established body of authority supporting the position that a choice of law clause should not be enforced when it is part of a contract that was drafted unilaterally and imposed upon a weaker party by an economically stronger party and works to the detriment of the weaker party.[313] In selecting arbitration, the choice is potentially more extreme in that it could be a choice of no law whatsoever. *Graham Oil Co. v. Arco Prods. Co.*[314] involves a treatment of an arbitration clause similar to that afforded to choice of law clauses. The Ninth Circuit Court invalidated an arbitration clause, ruling that enforcement of the clause would be contrary to the purpose of the Petroleum Marketing Practices Act, which is to protect franchisees from the greater bargaining power of petroleum franchisors.[315] This decision, which can be justified in terms of the special statutory context, represents a rare departure from the modern wholesale embracement of arbitration.[316] Similarly, the Colorado Supreme Court ruled that a Sun Microsystems Inc. agreement forcing employees to

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Cole v. Burns Int'l. Sec. Servs., 105 F.3d 1465 (D.C. Cir. 1997), is a thought provoking illustration of judicial treatment of an adhesive and arguably unconscionable arbitration agreement. The District of Columbia Circuit Court rejected an unconscionability challenge to enforcement of employer mandated arbitration, but ruled that in such situations employee arbitrants cannot be required to pay arbitrator fees. The court expressed that current opportunities for judicial review based on the FAA, manifest disregard of the law, and public policy afforded sufficient protection of legal rights. *Id.* at 1486-87. An employee should not, however, have "to pay an arbitrator's compensation in order to secure the resolution of statutory claims under Title VII any more than an employee can be made to pay a judge's salary." *Id.* at 1468. It is amazing that the court can show such concern for the effects of requiring employees to pay arbitration fees and be blind or dispassionate to the absence of a meaningful review process and the consequences for decision-making standards.

[313] RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187, cmt. b, e (1971). *But see* Carnival Cruise Lines v. Shute, 499 U.S. 585 (1991).

[314] 43 F.3d 1244 (9th Cir. 1994), *cert. denied*, Arco Prods. Co. v. Graham Oil Co., 116 S.Ct. 275 (1995).

[315] 43 F.3d at 1249.

[316] Four days after the *Graham Oil* decision, the Ninth Circuit Court also ruled in a sexual harassment case that an arbitration clause should be enforced only if the employees knowingly and voluntarily elected arbitration. Prudential Ins. Co. of Am. v. Lai, 42 F.3d 1299 (9th Cir. 1994). *But see* Hall v. Metlife Resources, 1995 U.S. Dist. LEXIS 5812 (S.D.N.Y. 1995) (finding the very same securities industry employment agreement used in *Prudential* enforceable because one who signs a contract is presumed to understand its terms). *Cf.*, Board of Educ. of Carlsbad Mun. Schs. v. Harrell, 882 P.2d 511 (N.M. 1994) (ruling that statutory compulsory arbitration of a school superintendent's wrongful discharge claim violated the constitutional right to a fair hearing because of the limited right of appeal of arbitration).

arbitrate all wage disputes was invalid because the Colorado Wage Claim Act expressly reserves an employee's right to go to court.[317]

Improving The Environment Of Free Choice

There have been some efforts to improve the environment of free choice in the ADR designation process. A handful of states have enacted statutes requiring that special notices be given to parties that they are agreeing to arbitration.[318] For example, some states have regulated the point size of the arbitration clause;[319] others have required that the arbitration clause be prominently displayed.[320] One state requires that an arbitration clause be accompanied by a separate written acknowledgment,[321] and another requires advance approval of arbitration forms by the state.[322] In Iowa, the arbitration statute uniquely excludes contracts of adhesion from enforcement.[323] The recent Supreme Court decision in *Doctor's Associates v. Casarotto*,[324] however, would seem to vitiate the effect of these statutes for the typical commercial transaction. In that case the Montana Supreme Court had ruled an arbitration agreement unenforceable because it was not in compliance with the Montana law mandating that an arbitration clause appear in underlined capital letters on the first page of a contract.[325] The United States Supreme Court determined that the FAA preempted this state law. The Court reasoned that through the FAA "Congress precluded States from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed 'upon the same footing as other contracts.'"[326] Thus, for transactions involving interstate commerce it appears that the state legislatures may be of little help in this regard.[327]

The NASD has recently adopted rules requiring more detailed and emboldened explanations of arbitration in securities industry customer

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[317] Lambdin v. Levi, 903 P.2d 1126 (Colo. 1995).

[318] *E.g.*, MO. REV. STAT. § 435.460 (1992); MONT. CODE ANN. § 27-5-114(4) (1995); S.C. CODE ANN. § 15-48-10 (Law. Co-op. Supp. 1996); VT. STAT. ANN. tit. 12, § 5652(b) (Supp. 1996).

[319] *See, e.g.*, CAL. CIV. PROC. CODE §§ 1295, 1298 (West Supp. 1997); MO. REV. STAT. § 435.460 (1992).

[320] *See, e.g.*, ALA. STAT. § 09.55.535 (1994); COLO. REV. STAT. ANN. § 13-64-403 (West Supp. 1996); MONT. CODE ANN. § 27-5-114 (1995).

[321] VT. STAT. ANN. tit. 12, § 5652 (Supp. 1996).

[322] ALA. STAT. § 09.55.535 (1996).

[323] IOWA CODE ANN. § 679A.1(2)(a)(1996).

[324] 116 S.Ct. 1652 (1996).

[325] 886 P.2d 931 (1994).

[326] 116 S.Ct. at 1656 (quoting from Scherk v. Alberto-Culver Co., 417 U.S. 506, 511 (1974)).

[327] *See also* Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. at 282 (O'Connor concurring opinion).

contracts.[328] The 1996 Arbitration Policy Task Force of the NASD has recommended that securities industry members use expanded arbitration clauses that are in "plain English" and a "user friendly" format. These clauses should spell out in detail the implications of arbitration, including a comparison with judicial rights and remedies.[329] Of course, these improvements will be of questionable value if arbitration is a non-negotiable issue and it is imposed throughout the industry. Enhanced knowledge and understanding, without the opportunity to choose an alternative method for dispute resolution, renders the revised clause rather meaningless for the typical individual who has no choice but to sign one of these agreements if he or she wants to buy or sell a security.[330]

The Need For Change

Critics of the existing role of law in arbitration seem to consist primarily of two types. There are those who appear content to participate in arbitration until they are on the receiving end of an adverse award, at which time they go on the attack and protest that the award is not consistent with the law. And there are those who have signed an adhesion contract with an arbitration clause, and then recant when a dispute arises, claiming that their legal rights will not be protected in arbitration. The first group's reaction is particularly repugnant when the complainer is the party who prepared the contract calling for arbitration, which often is the case.[331] The second group evokes a more sympathetic reaction, since it includes many people who did not appreciate that they were giving up claims of legal right, and in

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[328] Rule 21(f), NASD Rules of Fair Practice (1989). The Securities Industry Conference on Arbitration's suggestion that customers separately initial the highlighted statement has not been adopted by the securities industry self-regulatory organizations. Securities Arbitration Reform, Report of the Arbitration Policy Task Force, at 14 n.15, January 1996 [hereinafter The Ruder Report].

[329] The Ruder Report, *supra* note 328, at 14-21. The Task Force rejected proposals that the arbitration agreement be set forth in a separate document or that the section of the agreement containing the arbitration clause be separately initialed. The commission explained that this would require burdensome additional paperwork that would not further advance the customer's awareness or understanding. *Id.* at 20.

[330] This notion finds support in the *Mastrobuono* decision where the Supreme Court expressed a reluctance to recognize an intent to give up important rights simply by signing a standard form agreement to arbitrate. *See supra* text accompanying note 77.

[331] *See, e.g.,* Rostad & Rostad v. Investment Mgmt. & Res., 923 F.2d 694 (9th Cir. 1991). Judge Noonan quipped that the appeal of the arbitration award by the brokerage firm "is a kind of man bites dog case. . . . Having enthusiastically welcomed the enforcement of agreements to arbitrate, the securities industry might be expected not to encourage retrial of a case in federal court. But when a broker loses an arbitration it is hard for the disappointed litigant to realize that the rules now permit only a restricted review of what arbitrators have decided." *Id.* at 697.

any event had no choice other than to "agree" to arbitrate. For the first group, arbitration is the product of volition; for the second it is not.

In *Gilmer* the Supreme Court stated that "[b]y agreeing to arbitrate a statutory claim, a party does not forego the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum."[332] The Court emphasized that "so long as the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function."[333] In *Cole v. Burns International Security Services*[334] the District of Columbia Circuit Court recently summarized the factors that must be satisfied according to *Gilmer*. The arbitration arrangement must provide for (1) neutral arbitrators, (2) more than minimal discovery, (3) a written award, (4) all of the types of relief that would otherwise be available in court, and (5) a fee arrangement that does not require employees to pay unreasonable costs, fees or expenses as a condition of access to arbitration.[335] While these fine attributes will undoubtedly contribute to a fairer proceeding, they do not assure adherence to principles of substantive law. There must be additional emphasis either on (a) providing awards in accordance with the law or (b) the voluntariness of the arbitration so that the agreement to arbitrate sufficiently signifies a genuine desire to relinquish a substantive legal right and opt instead for a more expedient decision potentially based on a broader sense of fairness and justice.

Unconstrained, unreviewable arbitral decision-making is worthy if it is truly agreeable to those who are significantly affected. The sweeping judicial support for arbitration has resulted, however, in the displacement of law under what seems to be an unsuitably broad range of circumstances. The extension of arbitration to new contexts characterized by significant circumstantial differences — such as disputing that is not focused merely on contract interpretation, arbitration that is not the product of a meaningful consentual agreement, and the absence of a shared commitment to common values — gives cause to consider a change.

Solutions

The problem may be summarized briefly as follows: the role of substantive law in arbitration is poorly defined; many participants misunderstand the role of law in arbitration; and in this environment of

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[332] 500 U.S. at 26 (*quoting* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, 473 U.S. 614, 628 (1985)).

[333] Id. at 28 (*quoting* Mitsubishi, 473 U.S. at 637 (1985)).

[334] 105 F.3d 1465 (D.C. Cir. 1997).

[335] *Id.* at 1482. For additional discussion of the *Cole* case see *supra* notes 268 and 312.

confusion and misunderstanding, some participants unwittingly agree to arbitration, or they are more or less forced to do so. There are a variety of potential fixes for this problem.

Obviously, arbitration laws could be revised to require that all awards be in accordance with substantive law. While this extreme measure takes care of all aspects of the problem, it is severely flawed. This approach would completely deny disputants the opportunity to enjoy the benefit of a bona fide dispute resolution alternative of arbitration. Law would drive all arbitration, and all arbitration would lack finality. This approach involves throwing the baby out with the bath water.

A similar but less drastic alternative would entail restructuring the relationship between law and arbitration so that arbitral decisions would be made in accordance with the law unless explicitly agreed otherwise (i.e. reversing the default mode). This change would serve to improve definition and understanding. It would not preclude the opportunity for use of the bona fide alternative of arbitration. However, it would likely greatly diminish the occurrence of arbitration as it now is constituted. Yet this reduction in the use of arbitration may not occur where one would like to see it occur — in the offensive adhesive transactions. Dominant parties could continue to impose lawless arbitration.

Both of the preceding approaches would open a Pandora's box of issues concerning mechanics and standards for judicial review, especially if arbitration was to offer some meaningful difference from private judging or adjudication in court. As an alternative to legislative impetus, the above changes could be fostered through the arbitration rules of organizations that are active in administering arbitration. It would appear that the most prominent arbitration organization, the American Arbitration Association, has no interest in such a rule change.[336] As a matter of candor, however, the AAA and other arbitration organizations should revise their arbitration rules to be more direct and clear in establishing and explaining the intended role of law in the arbitration process.

Another reaction might be to impose an obligation to decide arbitrations by law, but recognize that arbitration is a less perfect process, consequently allowing for certain kinds of or degrees of deviation from law. This would accomplish nothing in terms of definition, understanding or adhesion. Furthermore, such an effort to infuse some lesser degree of adherence to the law opens the door to appeal, virtually destroying the efficient finality of arbitration.[337] It

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[336] *See supra* text accompanying notes 33-53.

[337] *See Perini*, 610 A.2d at 384 (Wilentz, C. J., concurring).

would also likely produce a frustrating record of many inconsistent outcomes. The troubled attempts of some courts to draw distinctions between serious and minor errors of law suggest this is unworkable.[338]

Another approach would be to change the law so that pre-dispute arbitration agreements would no longer be enforced. This change would foremost serve to address the inadvertent or adhesive agreement aspect of the problem. Unless this would be applied in a very limited and selective way (e.g., only to employment discrimination claims),[339] it would constitute a rejection of a basic tenet of the modern arbitration and alternative dispute resolution movements, that people should be able to control their disputing destinies through contractual agreement. Furthermore, selective application would necessitate either identifying criteria for distinguishing among transactions or specifying a comprehensive list of non-enforceable contexts, and there would be associated problems of scope of coverage and uncertainty. Moreover, this reform would entail setting the clock back seventy-five years out of concern for a subset of troubling transactions.[340]

Indeed the problem with the law-centered and other radical reforms is that they effectively deny the use of arbitration, as it is presently constituted, to the many who legitimately value it. A superior approach would allow for recognition of differing needs for definition, understanding, and protection from coercion. What is needed is more judicial scrutiny — but not scrutiny for adherence to the law. The judiciary needs to evaluate more thoroughly the voluntariness of the agreement to arbitrate.[341] Some state legislatures have been thinking along these lines.[342] In light of the *Doctor's Associates* decision, however, it appears the impetus for change will have to come from either Congress, the federal courts, or state courts that are willing to subject a wide range of contracts to greater scrutiny for volition.[343]

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[338] *See supra* notes 131-42 and 157 and accompanying text.

[339] *See supra* note 281 and accompanying text.

[340] One of the major purposes of the FAA "was to reverse the longstanding judicial hostility to arbitration agreements that had existed at English common law and had been adopted by American courts . . . ." Gilmer, 500 U.S. at 24. For a historical perspective on the enforceability of business arbitration agreements, see Philip G. Phillips, *The Paradox in Arbitration Law: Compulsion as Applied to a Voluntary Proceeding*, 46 HARV. L. REV. 1258 (1933).

[341] This would be a more probing evaluation than the traditional contract law assessment of fraud, duress or unconscionability. *See supra* notes 306-12 and accompanying text. For a discussion of evidence supporting the view that the original intent of the drafters of the FAA was that the courts should only enforce arbitration agreements that are voluntary and the product of bargaining among relative equals in arms length transactions and that the FAA was intended to apply only in federal courts, see Sternlight, *supra* note 272, at 647-51.

[342] *See supra* notes 319-23 and accompanying text.

[343] *See supra* notes 324-27 and accompanying text.

Although greater scrutiny of the genuineness of assent would potentially cloud the enforceability of arbitration agreements, it need not be deleterious. The onus would shift to the contract preparer, and it would be relatively easy for parties interested in arbitration to construct arbitration clauses or agreements that would unambiguously display volition, at least in an objective way. For example, any contract that might be considered adhesive could include a dispute resolution clause that calls for the non-preparer to signify a choice between arbitration or trial (or other ADR processes) by checking (and initialing) an accompanying box. To promote an informed choice, such a clause should include language appropriately descriptive of each of the alternatives.[344] One might expect that a great many preparers of form contracts would prefer to structure their contracts in such a way rather than face uncertainty of enforceability. Also, responsible businesses, out of concern for an ethical approach to dispute resolution, ought to prefer an approach that emphasizes understanding and volition, rather than trickery and abuse of power. Though a bit cumbersome, this approach promotes mutual agreement and provides a much-improved indicator of

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[344] One may look to the securities industry for guidance. Functioning under the influence of several self regulatory organizations, and the watchful eye of the Securities and Exchange Commission, the securities industry has made major advances in improving arbitration clause language. *See supra* notes 328-30 and accompanying text. Clauses now in use in the industry have evolved to include language such as the following:

> ARBITRATION DISCLOSURES:
> ARBITRATION IS FINAL AND BINDING ON THE PARTIES.
> THE PARTIES ARE WAIVING THEIR RIGHT TO SEEK REMEDIES IN COURT, INCLUDING THE RIGHT TO JURY TRIAL.
> PRE-ARBITRATION DISCOVERY IS GENERALLY MORE LIMITED THAN AND DIFFERENT FROM COURT PROCEEDINGS.
> THE ARBITRATOR'S AWARD IS NOT REQUIRED TO INCLUDE FACTUAL FINDINGS OR LEGAL REASONING AND ANY PARTY'S RIGHT TO APPEAL OR TO SEEK MODIFICATION OF RULINGS BY THE ARBITRATORS IS STRICTLY LIMITED.
> THE PANEL OF ARBITRATORS WILL TYPICALLY INCLUDE A MINORITY OF ARBITRATORS WHO WERE OR ARE AFFILIATED WITH THE SECURITIES INDUSTRY.

Agreement of Pershing, Division of Donaldson, Lufkin & Jenrette Securities Corporation, 1996 (emphasis in original).

This language is essentially dictated by Rule 21(f), NASD Rules of Fair Practice (1989). *See also* The Ruder Report, *supra* note 328, at 14-15. It is interesting to note that the Pershing statement which includes the above arbitration disclosures and the arbitration agreement and a number of other "Terms and Conditions" also includes the following statement: "If any of the above Terms and Conditions are unacceptable to you, please notify Pershing immediately in writing by certified mail to Pershing . . . [address] Attention: Compliance Department." From this, it appears that some of these terms of agreement may be negotiable. If that is the case, this represents a step in the direction that this author is advocating.

genuine consent. In other words, it takes care of the problems of definition, understanding, and adhesion.

CONCLUSION

This article has explored the role of substantive law in arbitration. As in the case of adjudication in the courts, disputants in arbitral tribunals commonly argue their case by explaining how the law supports their position. The role of law in judicial and arbitral forums can be very different, however. Law is central to judicial proceedings since error of law serves as the basis for seeking an appeal and securing the reversal of a trial court decision. A judge is duty bound to follow the law in reaching a decision. In contrast, the role that law plays in arbitration typically is ill defined and may vary from case to case according to context. Ordinarily, error of law does not serve as a basis for appeal or vacation of an arbitration award. Given the nature of the adversarial process and the character of the lawyer's vigorous dedication to the client's cause, it is easy to appreciate how even arbitrators who intend to decide by law make honest errors. Professor James J. White has written, "[I]t is the lawyer's right and probably his responsibility to argue for plausible interpretations of cases and statutes which favor his client's interests, even in circumstances where privately he has advised his client that those are not his true interpretations of the cases and statutes."[345] Furthermore, in arbitration it would seem that the lawyer may be justified in arguing, and the arbitrator may be appropriately persuaded, that the arbitrator should consider compromising the law and ruling on other principles of fairness.[346]

A leading textbook on dispute resolution describes most arbitration systems as providing for the following: joint selection and payment of the arbitrator, procedural rules to be applied by the arbitrator, and objective standards on which the arbitrator's decision is to be based.[347] The latter is described as consisting of "the terms of an agreement between the parties, the customs of the trade in which they conduct business, the *applicable law*, or some combination of these."[348] This textbook model anticipates that the combination of arbitration statutes and implied and express terms of the contractual agreement (including contractual incorporation of governing rules promulgated by arbitration organizations) will establish the necessary framework for the arbitration. Since the typical arbitration statutes and rules do not speak

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[345] James J. White, *Machiavelli and the Bar: Ethical Limitations On Lying In Negotiation*, AM. B. FOUND. RES. J. 926, 931-32 (1980).

[346] *See supra* notes 87-100 and accompanying text.

[347] GOLDBERG ET AL., *supra* note 5, at 200.

[348] *Id.* (emphasis added).

to the role of substantive law, the subject is primarily left to the agreement of the parties. Far more often than not the agreement to arbitrate does not address the matter either. Thus, the role of substantive law is regularly slighted in this defining process. The result is that most arbitrators are not obligated to decide cases in accordance with principles of substantive law, and their awards are not appealable or vacatable simply because they are not supported by law.

The role of substantive law in arbitration has failed to garner much attention. It has primarily drawn notice in connection with attempts to vacate arbitration awards. One may conjecture that many lawyers fail to fully appreciate that error of law ordinarily is not a ground for vacation, that other variations on the deviation from law theme offer little if any promise for overturning arbitration awards, and that arbitrators typically are not obligated to apply principles of substantive law. It is likely that laymen are even more confused about these attributes of arbitration. The notion that arbitration awards may significantly deviate from the law does not sit well with some members of the judiciary. This is apparent in the strained and sometimes combative attempts to resolve the error of law issue. The prevailing view allows a relatively standardless form of arbitral decision-making and fails to assure successful arbitral prosecution of valid legal claims. This runs counter to the judicial sense of justice.

The legal research presented in this article shows that our laws do not direct that substantive law be an essential determinant of awards in ordinary arbitration. It also shows that there is some degree of confusion about the particulars of this approach and also some level of discomfort with it. The scant empirical research points to favorable levels of participant satisfaction with this arrangement, or at least with the general process and the product it ordinarily produces. Additional empirical research designed to enhance our understanding of how arbitrators actually relate to the law in the process of rendering arbitration awards would be beneficial in the achievement of a better understanding of the relationship between law and arbitration. Nevertheless, additional research is not needed as a prerequisite to the change proposed in this article.

If one embraces the rule of law, then the elementary proposition of this article needs no support beyond simple logic and a common sense of fairness. This article has emphasized a view that focuses on the role of arbitration as a meaningful dispute resolution alternative. If arbitration is to serve as a significant alternative to litigation, devotion to the law need not be a chief concern. It is useful to permit an alternative process that is not devoted to the law. Because arbitration does not assure legal rights, however, voluntariness ought to be of

foremost importance. Arbitration, without devotion to the law, should only pertain when arbitration is knowledgeably and freely selected.

Potential arbitrants should understand the nature of arbitration, and should be afforded a genuine opportunity to decide whether they want dispute resolution in the form of arbitration. This is the case for most commercial context arbitrations, especially those exclusively involving parties that have experience with arbitration. In marked contrast, some business arbitrations involve agreements to arbitrate that have been entered into by laymen under adhesive circumstances. The courts have evaluated these transactions according to traditional contract law analysis for fraud, duress, and unconscionability. All but the most extraordinarily abusive arbitration "agreements" withstand such scrutiny.

Lack of adherence to the law should dictate that the entry to arbitration be more carefully guarded. Judicial scrutiny ought to focus on the voluntariness of the agreement, and not the correctness of the arbitration award. This article proposes a solution that emphasizes improved contract language and format and a genuine choice. Arbitration clauses can easily be structured to display that the potential disputants were truly offered a choice, and they chose arbitration. This approach allows arbitration to survive as a meaningful alternative dispute resolution process that will be utilized only when it is truly the product of mutual volition.