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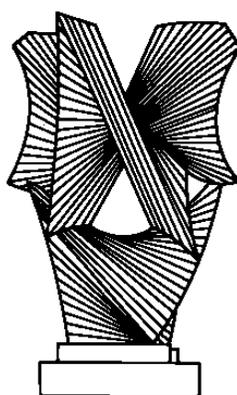
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## The Arbitrator as Agent: Why Deferential Review Is Not Always Pro-Arbitration

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## THE ARBITRATOR AS AGENT: WHY DEFERENTIAL REVIEW IS NOT ALWAYS PRO-ARBITRATION

Tom Ginsburg\*

Arbitration supplements the judicial system, it is often said, by providing relatively cheap, speedy and expert decision-making.<sup>1</sup> But arbitrators are not generalist judges, and so typically are not as expert in the law. They are thus prone to make mistakes, or at least presumptively more prone to do so than are judges. A legal system, like that of the United States, that has a policy of supporting arbitral dispute resolution must decide on a level of scrutiny to apply to arbitrator interpretations of law when they are challenged before courts. The modern trend is to choose a fairly deferential level of review: most arbitration statutes and the New York Convention on the Enforcement of Arbitral Awards do not allow judicial review for error of law. Only particularly egregious arbitral error will lead to the setting aside or non-enforcement of an award.

The overall policy of fairly deferential review of arbitral awards, like all standards of review, is calibrated to optimize the benefits of the arbitration regime, and is usually seen as being “pro-arbitration.”<sup>2</sup> The basic issues of institutional design here are familiar across many areas of law, whenever superior decision-makers discipline primary decision-makers such as fact-finders, administrative agencies or lower courts. Review by a second decision-maker provides substantial benefits, minimizing error costs and heightening uniformity across cases. But it introduces other costs, such as procedural delay and the shifting of power to decision-makers who are more distant from the primary inquiry. On a spectrum of possible alternative regimes, ranging from de novo review to complete non-reviewability, any particular point involves a tradeoff. If the standard of review is too rigorous, the benefits of arbitration in terms of speed, cost, and finality may be lost because parties will frequently appeal arbitral awards to the courts. On the other hand, if review is too limited, arbitrators might deliver very poor quality decisions that undermine the attractiveness of arbitration as a whole. The law must choose a point, and generally leans toward minimal review.

This article analyzes the standard of judicial review of arbitral awards from the perspective of principal-agent theory. Taking as a starting point Judge Easterbrook’s decision in *George Watts & Son v. Tiffany & Co.*,<sup>3</sup> it considers the implications of thinking about arbitrators as agents of the parties. In *Watts*, Judge Easterbrook used an agency perspective to argue for greater deference to arbitrator interpretations of law. While the agency perspective is usually seen as being consistent with a policy of minimal review, I argue that the optimal level of scrutiny is not zero, and is arguably higher than provided in current doctrine. Some positive level of judicial review may help arbitration by providing for a minimum floor for

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<sup>1</sup> See Christopher R. Drahozal and Quentin R. Wittrock, *Is There a Flight from Arbitration?* 37 HOFSTRA UNIV. L. REV. 71, 77-78 (2008).

<sup>2</sup> *Mitsubishi Motors v. Soler Chrysler Plymouth Inc.*, 473 U.S. 614, 631 (1985).

<sup>3</sup> 248 F.3d 577 (7th Cir. 2001).

quality. Most importantly, an agency perspective suggests that parties ought to be able to contract into review for errors of law. The argument thus uses Judge Easterbrook's framework to suggest that greater scrutiny of awards is appropriate under some circumstances.

The agency perspective also sheds light on the recent U.S. Supreme Court decision of *Hall Street Associates v. Mattel*,<sup>4</sup> which like the *Watts* case can be understood as limiting the grounds for vacating awards under the Federal Arbitration Act. Had the Supreme Court followed Judge Easterbrook's agency analysis in *Hall Street*, it might have come to a different conclusion than it did. In particular, it might have allowed parties to specify the standard of review by contract, as part of their delegation of power to the arbitrators.

The article is organized as follows. Part I describes the statutory and judicial framework governing vacatur of arbitral awards. Part II considers the *Watts* case, while Part III considers the implications of principal-agent theory in more depth. Part IV concludes.

## I.

The Federal Arbitration Act (FAA) provides only limited grounds on which a judge can vacate an arbitral award.<sup>5</sup> These include four statutory bases: if the award was procured by fraud, corruption or undue means; if the arbitrators exhibited evident partiality or corruption; if the arbitrators violate norms of a fair hearing; or if the arbitrators exceeded their powers. For many years, courts have also utilized the standard that arbitral awards are to be vacated if they exhibit "manifest disregard" for the law.<sup>6</sup> This test can be traced back at least to *dictum* in the case of *Wilko v. Swan*,<sup>7</sup> and has gone largely, if not entirely, unquestioned in the intervening several decades.<sup>8</sup>

Despite acceptance of manifest disregard of the law as a basis for vacatur, courts and scholars have argued over what exactly constitutes manifest disregard. In order to limit the scope of review, most agree that manifest disregard means more than an arbitrator making clear error in law, or even a gross error in law. Although there is wide agreement on what manifest disregard is *not*, it is not clear what exactly it is. There has been some convergence on the idea that disregard is manifest when "(1) the arbitrator knew of a governing legal principle yet refused to apply it or ignored it altogether, and (2) the law ignored by the arbitrator was well-defined, explicit and clearly applicable to the case."<sup>9</sup> Another opinion says that error of law is a manifest disregard only if the error is "obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator. Moreover the

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<sup>4</sup> 128 S. Ct. 1396 (2008).

<sup>5</sup> 9 U.S.C.A. § 10(a)(4)

<sup>6</sup> *Wilko v. Swan*, 346 U.S. 427, 436-37, 74 S.Ct. 182, 98 L.Ed. 168 (1953).

<sup>7</sup> *Wilko v. Swan*, 346 U.S. 427, 436-37, 74 S.Ct. 182, 98 L.Ed. 168 (1953)

<sup>8</sup> Marta B. Varela, *Arbitration and the Doctrine of Manifest Disregard*, 49 DISP. RESOL. J. 64, 66 (1994) (arguing that the Supreme Court used the term "manifest disregard" in *Wilko* casually, not intending the phrase to launch a new standard of review); Christopher Drahozal, *Codifying Manifest Disregard*, 8 NEV. L.J. 234 (2007) (manifest disregard should be codified into the FAA).

<sup>9</sup> Williams, *Watts* at 581-52, citing *Greenberg v. Bear, Stearns & Co.*, 220 F.3d 22, 28 (2d Cir.2000), *cert. denied*, 531 U.S. 1075, 121 S.Ct. 770, 148 L.Ed.2d 669 (2001); *Health Servs. Mgmt. Corp. v. Hughes*, 975 F.2d 1253, 1267 (7th Cir.1992).

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.”<sup>10</sup>

Judicial application of manifest disregard had been unstable. One commentator writes that although “it was nearly impossible, until about 1997, to find a case vacating an arbitration award in reliance on the “manifest disregard of law” doctrine, since that time some courts have begun to apply the doctrine more aggressively.”<sup>11</sup> Many of the post-1997 cases concern statutory claims. In the leading case, *Cole v. Burns International Security Services*<sup>12</sup> Judge Edwards held that arbitration agreements for statutory claims are enforceable only if the manifest disregard test is “sufficiently rigorous to ensure that arbitrators have properly interpreted and applied statutory law”,<sup>13</sup> essentially converting manifest disregard into a more searching inquiry close to de novo review for error of law. In another case, involving labor arbitration, *New York Telephone Co. v. Communications Workers of America Local 1100*,<sup>14</sup> an arbitrator was aware of the law, but believed that the law should change. The Second Circuit overturned the arbitrator, holding that his actions exhibited manifest disregard of the law.

Some have argued that manifest disregard of the law creates perverse incentives for arbitrators. Arbitrators might seek to minimize the legal reasoning in their awards to avoid being second-guessed by judges. In particular, they might obfuscate the grounds for their interpretation, so as to avoid appearing that they have misapplied statutes. Perhaps to ward off this pressure, courts have also been increasing the reasons requirement in some contexts.<sup>15</sup> A requirement to give reasons, however, increases the cost of arbitration. This is one illustration of how the level of scrutiny applied to awards will affect the viability of arbitration as an effective and efficient substitute for judicial dispute resolution.

Perhaps because of its vagueness, manifest disregard has been often claimed by parties. One study of several hundred state and federal cases challenging employment arbitration awards over three decades found that manifest disregard of the law was the most frequently invoked grounds by a party seeking vacatur.<sup>16</sup> Though asserted in 35.1% of the trial court cases and 30.4% of the appellate cases in the sample, the challenges were only successful in 7.1% of trial cases and 8.2% of appellate cases in which it was claimed.<sup>17</sup> Other studies have found comparable results.<sup>18</sup>

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<sup>10</sup> *Merril Lynch Pierce Fenner and Smith, Inc. v. Bobker*, 808 F. 2d 930, 933 (2d Cir. 1986).

<sup>11</sup> Stephen Ware, *Interstate Arbitration: Chapter 1 of the Federal Arbitration Act* in Edward Brunet, et al, *Arbitration Law in America: A Critical Assessment* 116 n.90 (2006); see also Stephen Ware, *ALTERNATIVE DISPUTE RESOLUTION* 94 (2001).

<sup>12</sup> 105 F. 3d 1465 (DC Cir, 1997)

<sup>13</sup> 105 F 3d at 1487.

<sup>14</sup> 256 F.3d 89, 91 (2d Cir. 2001).

<sup>15</sup> *Halligan v Jaffray, Inc.* 148 F 3d 197,204 (2d Cir 2008) (labor arbitration).

<sup>16</sup> Michael H. LeRoy & Peter Feuille, *The Revolving Door of Justice: Arbitration Agreements that Expand Court Review of an Award*, 19 OHIO ST. J. ON DISP. RESOL. 861, 907 (2004).

<sup>17</sup> LeRoy and Feuille, at 907.

<sup>18</sup> Lawrence R. Mills et al., *Vacating Arbitration Awards*, DISP. RESOL. MAG., Summer 2005, at 23. Note that Mill et al find arbitrators acting in excess of authority is a more frequent claim.

Courts have also varied their own approach. The Seventh Circuit had long exhibited some suspicion about so-called non-statutory bases of judicial review of awards,<sup>19</sup> but had also occasionally utilized them.<sup>20</sup> Other circuits have adopted their own distinctive approaches, so that there appears to be profound regional variation in the availability of a manifest disregard grounds for vacating awards. These muddy legal waters have produced myriad calls for reform, and on occasion, a judicial decision that seeks to clarify the state of affairs. Both *Watts* and *Hill Street* fall into this category.

## II.

George Watts sold Tiffany's products in Wisconsin under a contractual arrangement. When Tiffany announced that it was terminating the arrangement, Watts sued for contract violation and a violation of Wisconsin's fair dealership law. The parties agreed to arbitrate, and the arbitrator delivered an award extending Watt's arrangement, but failing to award Watts' costs. Watts argued that the Wisconsin Fair Dealing Law provided that parties are entitled to attorney's fees in any case in which they prevail, and so the failure of the arbitrator to award fees constituted a manifest disregard of the law, requiring vacatur.<sup>21</sup>

In his majority decision, Judge Easterbrook rejected this claim wholly. He first reviewed some of the difficulties courts have had applying the "manifest disregard" standard by citing two alternative readings from Seventh Circuit cases.<sup>22</sup> He then proposed a new and novel reading of manifest disregard, namely that it would be found when an arbitral order requires the parties to violate the law or does not adhere to the legal principles specified by contract.<sup>23</sup> The latter condition would arguably render the award unenforceable under § 10(a)(4), which allows a court to vacate the award if the arbitrators exceeded their powers.<sup>24</sup> Thus we are left with a reading that the judicially created principle of manifest disregard would serve as an *independent* basis for setting aside an award only when an arbitrator directs parties to violate the law.

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<sup>19</sup> *Robbins v. Day*, 954 F.2d 679, 684 (11th Cir. 1992).

<sup>20</sup> *Chameleon Dental Prod. Inc. v. Jackson*, 925 F.2d 223, 226 (7th Cir. 1991)).

<sup>21</sup> See Williams opinion at 584-85, finding that Wisconsin law does not clearly state that recovery is mandatory.

<sup>22</sup> *National Wrecking Co. v. Teamsters, Local 731*, 990 F.2d 957 (7th Cir.1993); *Health Services Management Corp. v. Hughes*, 975 F.2d 1253 (7th Cir.1992) (arbitrators manifestly disregard the law when they treat it as an obstacle to the desired result); *Baravati v. Josephthal, Lyon & Ross*, 28 F.3d 704 (1994) (manifest disregard not an independent reason for overturning an award); *Flender Corp. v. Techna-Quip Co.*, 953 F.2d 273 (7th Cir.1992); *Chameleon Dental Products, Inc. v. Jackson*, 925 F.2d 223 (7th Cir.1991) (arbitrators need not apply rules outside the parties' agreement); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 942, 115 S.Ct. 1920, 131 L.Ed.2d 985 (1995) (manifest disregard is a reason to overturn an award).

<sup>23</sup> *George Watts & Son v. Tiffany & Co.*, 248 F.3d 577 (7th Cir. 2001)

<sup>24</sup> I use the term arguably, though the opinion seems clear that it would indeed be unenforceable. The reason is that the implementation of this element of the Easterbrook test does seem to require interpretation of the contract. Under *Hill v. Norfolk*, the standard is simply whether the arbitrator did interpret the contract. Hypothetically, an arbitrator could interpret a contract stipulating New York law as allowing New Jersey law to be applied in the dispute. That would be an act of interpretation, however implausible. So under the older standard it might seem to be immune from review. The solution is to hold that some interpretations are so implausible that so as not to be considered interpretation at all. *Hill v. Norfolk & Western Ry. Co.*, 814 F.2d 1192, 1195 (7th Cir.1987).

Easterbrook rests his opinion on agency theory. Arbitrators are agents of the parties, hired to resolve a dispute, and hence ought to be able to exercise powers delegated to them by their principals. So long as the principals have the ability to exercise a certain power, they can delegate the power by contract to an agent. As Easterbrook points out, if Watts and Tiffany had agreed to settle their differences without Tiffany paying Watts' legal fees, the law could scarcely intervene. When the arbitrator-agent issues a decision to the same effect, why should the law revisit that decision? As Easterbrook succinctly put it, "What the parties may do, the arbitrator as their mutual agent may do."<sup>25</sup>

On its face, this claim seems to over-reach. The arbitrators are creatures of contract, exercising powers delegated by the parties, but they are also to some degree operating under state authority. Courts supervise the arbitration, supporting and constraining it in various ways, including appointing arbitrators when one party refuses to do so. For this reason, arbitrators are not pure agents of parties, and parties may be able to get away with more in a settlement than an arbitrator could in the award. Parties can resolve to decide their disputes by coin flip, but a court would hardly appoint an arbitrator to do so, even if a contract so stipulated. Parties in a settlement might produce an agreement that violates public policy, which is a basis for non-enforcement of arbitral awards in some jurisdictions. These examples illustrate that arbitrators are limited in their ability to act purely as agents of the parties.

As Judge Williams argued in concurrence, the majority opinion seemed to effectively end the doctrine of manifest disregard as an independent basis for setting aside arbitral awards in the Seventh Circuit.<sup>26</sup> For it is difficult to imagine an arbitrator ordering parties to violate existing rules of law, and earlier cases had held that arbitrators could not do so anyway.<sup>27</sup> As a general matter, the law seeks to avoid regulatory traps, situations in which upholding one legal obligation requires a violation of another. So the universe of cases in which manifest disregard might serve as an independent basis for setting aside the award shrunk dramatically. The only remaining analytic issue was whether it had shrunk to zero.

Easterbrook's opinion was subject to scholarly critique at the time.<sup>28</sup> Some commentators pointed out that, as Judge Williams had argued in concurrence, any award ordering a party to violate the law would already be unenforceable. Indeed, Easterbrook's agency framework helps to illuminate this point: if arbitrators can do what parties can do, surely arbitrators cannot do what the parties cannot, including creating a binding agreement to violate the law.<sup>29</sup> Later, the Seventh Circuit clarified that manifest

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<sup>25</sup> Watts at 581.

<sup>26</sup> Williams is probably correct that the case could have been decided in Tiffany's favor by *applying* the manifest disregard standard, in that Watts had not showed that the arbitrator had affirmatively disregarded what he knew to be the law. So there may have been no need to reach as far as Easterbrook did.

<sup>27</sup> *Hill v. Norfolk & Western Ry. Co.*, 814 F.2d 1192, 1195 (7th Cir.1987).

<sup>28</sup> Bonnie Roach, *Recent Development: George Watts & Son v. Tiffany & Co.* 17 OHIO ST. J. ON DISP. RESOL. 503, 510 (2002) (approach "essentially ousted manifest disregard as a non-statutory method for vacatur"); Michael A. Scodro, *Deterrence And Implied Limits On Arbitral Power*, 55 DUKE L.J. 547, 577 (2005) (Watts effectively defined manifest disregard out of existence without statutory or supreme court grounding); Noah Rubins, "*Manifest Disregard of the Law*" and *Vacatur of Arbitral Awards in the United States*, 12 AM. REV. INT'L ARB 363, 379 (Watts' "somewhat faulty reasoning."); but see Paul J. Krause, *Disregarding Manifest Disregard: Watts Shifts Standard for Vacating Arbitrators' Decisions*, 72 DEF. COUNS. J. 79 (2005) (Watts "appears to provide many benefits and few drawbacks").

<sup>29</sup> Rubins, *id.*

disregard would not provide an independent basis for review even in the hypothetical case, because the purported order to violate the law would constitute an arbitrator exceeding her powers, and thus would already fall within the statutory grounds of Section 10(a)(4).<sup>30</sup>

Note that the hypothetical requires the court to scrutinize the contract at some minimum level. As Easterbrook points out, an arbitration clause that requires application of Wisconsin law would not be satisfied by an arbitrator explicitly applying New York law. An arbitrator who *did* apply New York law would be exceeding her powers under the contract. Thus the excess of powers prong of the FAA requires some scrutiny of the award, essentially to determine whether the arbitrator has acted as an effective agent of the parties.<sup>31</sup> The *Watts* framework, then, turns the focus away from how well the arbitrators apply the law *per se*, but whether they effectively carry out the wishes of their principals in doing so.<sup>32</sup>

Manifest disregard continues to sputter along. In 2008, the United States Supreme Court decided *Hall Street Associates v. Mattel*,<sup>33</sup> in which it stated that the grounds for vacatur under the FAA were exclusive. Some commentators argued that this decision overturned the manifest disregard standard.<sup>34</sup> But the Supreme Court was not explicit on this point, and a circuit split has emerged on whether “manifest disregard” survives *Hall Street*.<sup>35</sup> *Hall Street* also states that the parties cannot contract into higher levels of review by courts: they cannot for example, state that the award will be unenforceable if “the arbitrator’s conclusions of law are erroneous.”<sup>36</sup> On this point, there is some tension between *Hall Street* and the agency logic of *Watts*.

### III.

Judge Easterbrook’s characterization of the arbitrators as agents of the parties implicates basic principal-agent theory. This theory is concerned with situations in which one party (the principal) hires another that is more expert (the agent) in order to carry out a given task.<sup>37</sup> The canonical problem is that the agent may ignore the wishes of their principal. Agents may impose their own preferences, act in their

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<sup>30</sup> *Wise v. Wachovia Sec., LLC*, 450 F.3d 265, 268 (2006).

<sup>31</sup> Cf. *Hill v. Norfolk*, supra note \_\_ (discussed above.)

<sup>32</sup> Judge Easterbrook’s later decision in a case that arose under the New York Convention for the Enforcement of Arbitral Awards illustrated the hands-off approach. In *Baxter International Inc v. Abbott Laboratories* 315 F.3d. 829 (7<sup>th</sup> Cir., 2003) the court confirmed an award that was alleged to violate the Sherman Antitrust Act. The court found that so long as the arbitrator had construed the Sherman Act and found no violation, the Court could not inquire further. See Kai Wintzen, *Baxter International, Inc. v. Abbott Laboratories: Enforcement of Arbitration Awards in the Seventh Circuit—Re-interpretation of the Supreme Court’s Mitsubishi Case?* 5 EUR. BUS. ORG. L. REV. 720 (2004).

<sup>33</sup> 128 S. Ct. 1396

<sup>34</sup> Justin Kelly, *Confusion About Manifest Disregard” After Hall Street v. Mattel*, 63-Jan Disp. Resol. J 4 (2009).

<sup>35</sup> J.P. Duffy, *Hall Street One Year Later: The Manifest Disregard Debate Continues*, 19 AM. REV. INT’L ARB. 193 (2008). The Fifth Circuit has struck manifest disregard, while the Second, Fourth, Sixth and Ninth Circuits have continued to admit manifest disregard challenges. See generally Christopher A. Drahozal, *The Future of Manifest Disregard*, forthcoming \_\_ STOCKHOLM INT’L ARB. REV. \_\_ (2010)

<sup>36</sup> *Hall Street*, 128 S. Ct. at \_\_.

<sup>37</sup> Eric Posner, *Agency Models in Law and Economics*, in *Chicago Lectures on Law and Economics* (Eric Posner, ed., 2000).

own interest, or simply fail to exert appropriate effort in carrying out their assigned task. In the arbitration context, an arbitrator may simply decide a case in accordance with her own whims and conceal that basis from the parties. Or an arbitrator might not expend significant energy in trying to examine the chosen law governing the contract, leading to an error in interpretation.

Principal-agent theory has identified a variety of mechanisms to reduce agency slack. One such mechanism is screening in the labor market: parties can hire agents who have established a reputation for good quality service. In the arbitration context, good agents will be arbitrators with a reputation for issuing sound decisions accurately interpreting the law. Another mechanism to control agents is to hire a second agent to monitor the first. This is a way of gaining information on the accuracy of the decision. Review of decisions becomes a device for agency control as well as other systemic interests in uniform and accurate decision-making.

Consider screening first. Assume that there are two types of arbitrators, good and bad. Good arbitrators always interpret the law accurately, while bad ones do so only with a probability  $p < 1$ . A party evaluating a potential arbitrator will seek to determine if the arbitrator is a good or bad one, and will look for costly signals of quality: the arbitrator might, for example, have taken a leading position in an arbitral institution or have written articles and books on arbitration. Will screening serve to adequately reduce the agency problem of arbitrators? If the market for arbitrators is sufficiently robust, it might. But the market for arbitrators has certain imperfections. For example, there are no public records of arbitrator performance. Arbitrators need not produce publicly available opinions, and parties generally have no incentive to allow them to reveal the basis for the award. Only when an arbitrator makes an egregious error leading to a vacatur petition (such as manifestly disregarding the law outside the Seventh Circuit) will there be a public record of performance. Hence it is difficult for the parties to a contractual dispute to evaluate potential arbitrators in terms of their ability to interpret law. Reputational considerations are, of course, a factor, but in the absence of reasoned decisions, even past users of a particular arbitrator cannot be sure their favorable outcome resulted from skilled arbitration or a combination of lazy arbitration and luck.<sup>38</sup> There will thus be certain informational asymmetries in the market for arbitrators, allowing bad arbitrators to remain in the market.

If screening does not mitigate all agency problems, what about hiring a second agent to evaluate the first? Judges might be viewed as helping to minimize agency problems in this way. But judges are not really hired by the parties. Rather they are hired by the public to provide general judicial services.

Suppose, for a moment, that judges *could* be given instruction *ex ante* from the parties as to how closely to examine arbitral awards. If parties were able to contract into higher levels of judicial scrutiny, the judges could help to minimize arbitrator slack. The parties would be free to choose greater scrutiny, accepting the probability of greater expense that would come with more extensive and frequent judicial review. Presumably such a system would allow potential arbitrators to trade on their knowledge of the relevant law, and thus improve the *ex ante* screening function in arbitrator selection. Experts in legal interpretation would be able to market themselves as appropriate for the higher level of scrutiny,

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<sup>38</sup> Another relevant consideration are mandatory disclosure requirements that require arbitrators to reveal past work. See California Code of Civil Procedure Sec. 1281.9

providing an effective signal of their skill, while less effective arbitrators would be hired for the default position of the FAA, in which scrutiny is minimal. An agency perspective, in short, would allow the standard of review to itself be subject to contract, in no case falling below the floor set by the FAA.

This is the position that the *Hall Street* decision explicitly rejects: the judges cannot expand their monitoring of the arbitrator-agents simply because the party-principals want them to. In this view, judges are not second agents hired to monitor primary decision-makers. They might more properly be considered agents of the legislature or the public as a whole, and these principals might suffer if parties to a particular contract could freely call on judges' limited time.<sup>39</sup> But this means the law essentially limits the ability to use monitors (or at least to use the best possible monitors, expert judges) to watch the arbitrator-agents in their interpretation of law.<sup>40</sup>

One perverse result of the *Hall Street* decision might be *greater* pressure on courts to resolve full contract disputes. One rationale for not allowing parties to contract into higher levels of judicial scrutiny (though not fully articulated in the *Hall Street* decision which relied on a textual analysis of the FAA) would be to enhance judicial economy—the public should not have to subsidize private dispute resolution. But after *Hall Street*, parties who want a legally proper decision cannot submit to arbitration, or at least will be less likely to do so, because there can be only minimal ex post monitoring of arbitral awards.<sup>41</sup> Like *Watts*, *Hall Street* limits the scope of review. But unlike *Watts*, it does not follow an agency perspective. By preventing courts from policing arbitrator interpretations of law, *Hall Street* may end up *reducing* the number of cases sent to arbitration and, perversely, shifting contract disputes to the courts, precisely because there is no alternative way for parties to ensure that arbitrators *do* follow the law. The *Hall Street* logic may end up sacrificing judicial economy in an attempt to preserve it, and hurts arbitration in the name of helping it.

An agency perspective would allow the parties more freedom in stipulating legal grounds for review.<sup>42</sup> If parties want a decision that is accurate, they could require that arbitrators not make clear errors of law.<sup>43</sup> High quality arbitrator-agents could trade on their ability to interpret law by promising not to

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<sup>39</sup> The agency framework might thus be consistent with the views of those who have advocated less deferential review than the “manifest disregard” standard. Samuel Estreicher, *Predispute Agreements to Arbitrate Statutory Employment Claims*, 72 NYU L. Rev 1344, 1375 n. 22(1997); Richard E. Speidel, *Arbitration of Statutory Rights Under the Federal Arbitration Act: The Case for Reform*, 4 Ohio St. J. Disp. Resol. 157 (1989). The reason is that, in public law claims, the judges are agents with two principals: the parties and the public. Less deferential review is a form of balancing competing interests of multiple principals.

<sup>40</sup> Note that judges are in some sense competing agents, as well as monitors of arbitration. For cases that do not go to arbitration stand a good chance of ending up in the courts.

<sup>41</sup> Parties can, however, continue to contract for expanded review under state arbitration laws that have not followed the *Hall Street* approach. See New Jersey Statutes Annotated 2A:23B-4; *Cable Connection, Inc. v. DIRECTV, Inc.*, 44 Cal. 4<sup>th</sup> 1334; 190 P. 3d 586 (2008), discussed in John J. Barceló III, *Expanded Judicial Review of Awards after Hall Street and in Comparative Perspective*, in *RESOLVING INTERNATIONAL CONFLICTS: LIBER AMICORUM TIMOR VÁRADY* 1, 10-11 (Peter Hay et al. eds 2009);

<sup>42</sup> *Hall Street* at 1409 (Stevens, J., dissenting). See generally Alan Scott Rau, *Fear of Freedom*, 17 American Review of International Arbitration 469 (2006).

<sup>43</sup> It should be noted that parties negotiating over a standard of review will themselves be signaling information, and this might have perverse effects on the chosen level. For example, a party asking for the low-cost,

make clear errors. Low quality arbitrator-agents would not want to make such enforceable promises and so might be driven from the market. The *Hall Street* approach limits contractual freedom; the *Watts* approach might expand it, and in doing so, may in fact enhance arbitration. It might thus allay concerns about a possible “flight from arbitration.”<sup>44</sup>

As a thought experiment, consider what level of review would be attractive for arbitrators themselves. Presumably not all arbitrators would prefer the same standard. The good arbitrator who is confident in her abilities will not fear a high level of judicial scrutiny, which will not catch any errors except for those produced by bad-type competitors. An arbitrator who is not skilled, however, might prefer a lower level of judicial scrutiny. Mistakes by the “bad-type” arbitrator will not be easily identified under such a regime. (To be sure, even a good-type would want a level of scrutiny lower than de novo review: few would turn to arbitration if high scrutiny results in higher overall costs for arbitration. And the good type arbitrator might be concerned with judicial error associated with intensive review. Such errors would hurt the reputation of the good arbitrator more than the bad one. But all in all, the good type would probably not fear a moderate level of review.)

The point is that the standard of review will affect the mix of agents in the labor pool. A policy of no scrutiny will draw bad types. A policy of minimal scrutiny, such as under the FAA, will keep some bad types out: it will prevent arbitrators, for example, from applying New York law when they are instructed to apply Wisconsin law. But it will do nothing to hinder an arbitrator who applies Wisconsin law so poorly as to produce an obvious error. Given the existence of agency problems, the hands-off approach of the FAA after *Hall Street* may end up undermining the arbitration regime by drawing bad arbitrators. Letting parties designate the standard of review, on the other hand, would improve the functioning of the market for arbitrators by allowing good arbitrators to signal their status.

The problem of the standard of review is one of calibration. Parties will always be unwilling to arbitrate under a regime of de novo review, since it confers no advantages over going directly to court. But they will also be reluctant to arbitrate if the arbitrator is unlikely to resolve their dispute according to agreed-upon law. While the ideal point on the spectrum of standards is not completely clear, it seems fairly clear that *Hall Street* has not produced the right level of review. *Watts* may not have done so either, but it surely provides a clearer conceptualization of how to think about it: arbitrators are agents of the parties, and so we need a strong theory to interfere with the delegation by the party-principals. *Hall Street* does not provide a theory.

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minimal review form of arbitration might be seen as signaling an intention to violate the contract. This could lead parties to choose a higher level of review than they would otherwise prefer. On the other hand, a party asking for high-cost, intensive review might be signaling a fear that the contract will break down. It is hard to say which effect would dominate. Thanks to Lee Fennel for this point.

<sup>44</sup> Drahozal and Wittrock, *supra* note 1. See also Jerry A. Zirkel & Andriy Krahmal, *Creeping Legalism in Grievance Arbitration: Fact or Fiction*, 16 OHIO ST. J. ON DISP. RESOL. 243 (2001).

#### IV.

*Watts* was a transitional case, foreshadowing the highly restrictive view of "manifest disregard of the law" as an independent basis for vacatur.<sup>45</sup> But its implications are much larger. Arbitrators who are faithful agents will have little to fear from a regime in which parties can demand non-trivial review of their interpretations of law. Allowing more rigorous review might lead to *less* frequent litigation of arbitral awards, because it may improve the quality of decision-making. It might also lead to better-reasoned awards, as arbitrators seek to demonstrate that they have not made a clear error. The earlier state of affairs, under the manifest disregard standard, had the opposite effect.<sup>46</sup> As Rubins put it "A rule that allows extra-statutory vacatur only where arbitrators explicitly acknowledge the proper law to be applied and proceed to ignore it simply encourages silence on the part of the arbitrators. . . Under such an interpretation of 'manifest disregard,' the arbitrator has free rein to apply whatever rules of law he sees fit, as long as he keeps his mouth shut about the choice he has made, or states plainly that he is unaware of any contrary rule of law."<sup>47</sup> This can hardly be desirable from the point of view of the party-principals, or for arbitration as a whole.

Arbitration is contractual dispute resolution, and this means that arbitrators are agents. The standard of review of arbitral awards sets the level of monitoring of the agents' interpretation of law. Some agents will prefer not to be subject to monitoring of their performance, and these are the agents who are happy with *Hall Street*. Other agents have no fear of monitoring. While specifying a universal standard of review applicable for all cases may be an inherently unstable venture, it seems clear that allowing the parties to set the standard, and to choose higher levels of monitoring by contract, will reduce agency slack and allow parties to determine what type of arbitrator they are hiring. Deferential review, in short, is not always pro-arbitration.

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<sup>45</sup> Drahozal, *The Future of Manifest Disregard*, supra n. 35 at 8 (Seventh Circuit approach narrower than others).

<sup>46</sup> Stephen L. Hayford, *Reining in the "Manifest Disregard" of the Law Standard: The Key to Restoring Order to the Law of Vacatur*, 1998 J. DISP. RESOL. 117, 126 (1998).

<sup>47</sup> Rubins, supra note 28.

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