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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 decisionmaking.<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 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 arbitral interpretations of law when they are challenged before courts. The modern trend is to choose a fairly deferential level of review: most arbitration statutes<sup>2</sup> and the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards<sup>3</sup> do not allow judicial review for errors of law. Only particularly egregious arbitral errors lead to the setting aside or nonenforcement 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>4</sup> The basic issues of institutional design here are familiar across many areas of law, whenever superior decisionmakers discipline primary decisionmakers, such as factfinders, administrative agencies, or lower courts. Review by a second decisionmaker 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 decisionmakers who are more distant from the primary inquiry. On a spectrum of possible alternative regimes, ranging from de novo review to complete nonreviewability, any particular point

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<sup>1</sup> See, for example, Christopher R. Drahozal and Quentin R. Wittrock, *Is There a Flight from Arbitration?*, 37 Hofstra L Rev 71, 77–78 (2008).

<sup>2</sup> See, for example, Federal Arbitration Act, Pub L No 80-282, 61 Stat 669 (1947), codified at 9 USC § 1 et seq. See also *Nationwide Mutual Insurance Co v Home Insurance Co*, 429 F3d 640, 643 (6th Cir 2005) (describing the level of review under the Federal Arbitration Act as “one of the narrowest standards of judicial review in all of American jurisprudence”).

<sup>3</sup> 21 UST 2517, TIAS No 6997 (1970).

<sup>4</sup> See *Mitsubishi Motors Corp v Soler Chrysler-Plymouth, Inc*, 473 US 614, 631 (1985).

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 poor-quality decisions that undermine the attractiveness of arbitration as a whole. The law must choose a point somewhere on the spectrum, and it generally leans toward minimal review.

This Essay analyzes the standard of judicial review of arbitral awards from the perspective of principal-agent theory. Taking as a starting point Judge Frank Easterbrook's decision in *George Watts & Son, Inc v Tiffany and Co*,<sup>5</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 arbitral 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 that provided by current doctrine. Some positive level of judicial review may help arbitration by providing a minimum floor for 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 US Supreme Court decision of *Hall Street Associates v Mattel, Inc*,<sup>6</sup> which like the *Watts* case can be understood as limiting the grounds for vacating awards under the Federal Arbitration Act (FAA). 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 Essay 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.

## I. MANIFEST DISREGARD AS A BASIS FOR VACATUR OF ARBITRAL AWARDS UNDER THE FEDERAL ARBITRATION ACT

The FAA provides only limited grounds on which a judge can vacate an arbitral award.<sup>7</sup> These include four statutory bases: if the

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<sup>5</sup> 248 F3d 577 (7th Cir 2001).

<sup>6</sup> 552 US 576 (2008).

<sup>7</sup> 9 USC § 10(a).

award was procured by fraud, corruption, or undue means;<sup>8</sup> if the arbitrators exhibited evident partiality or corruption;<sup>9</sup> if the arbitrators violated norms of a fair hearing;<sup>10</sup> or if the arbitrators exceeded their powers.<sup>11</sup> 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>12</sup> This test can be traced back at least to dictum in the case of *Wilko v Swan*,<sup>13</sup> and has gone largely, if not entirely, unquestioned in the intervening several decades.<sup>14</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 a clear error in law, or even a gross error in law.<sup>15</sup> 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>16</sup> Another opinion says that error of law amounts to 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 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>17</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

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<sup>8</sup> 9 USC § 10(a)(1).

<sup>9</sup> 9 USC § 10(a)(2).

<sup>10</sup> 9 USC § 10(a)(3).

<sup>11</sup> 9 USC § 10(a)(4).

<sup>12</sup> There is also a judicially created exception that is utilized on occasion. See note 40 and accompanying text.

<sup>13</sup> 346 US 427, 436–37 (1953).

<sup>14</sup> But see Christopher R. Drahozal, *Codifying Manifest Disregard*, 8 Nev L J 234, 235 (2007) (suggesting that manifest disregard should be codified into the FAA); Marta B. Varela, *Arbitration and the Doctrine of Manifest Disregard*, 49 Disp Res J 64, 66 (June 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).

<sup>15</sup> See, for example, *B.L. Harbert International v Hercules Steel Co*, 441 F3d 905, 911–12 (11th Cir 2006).

<sup>16</sup> *Watts*, 248 F3d at 581–82 (Williams concurring), citing *Greenberg v Bear, Stearns & Co*, 220 F3d 22, 28 (2d Cir 2000); *Health Services Management Corp v Hughes*, 975 F2d 1253, 1267 (7th Cir 1992).

<sup>17</sup> *Merrill Lynch, Pierce, Fenner & Smith, Inc v Bobker*, 808 F2d 930, 933 (2d Cir 1986).

have begun to apply the doctrine more aggressively.”<sup>18</sup> Many of the post-1997 cases concern statutory claims. In the leading case, *Cole v Burns International Security Services*,<sup>19</sup> Judge Harry 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>20</sup> essentially converting manifest disregard into a more searching inquiry close to de novo review for errors of law. In another case involving labor arbitration, *New York Telephone Co v Communications Workers of America Local 1100*,<sup>21</sup> the arbitrator was aware of the law but believed that the law should change.<sup>22</sup> The Second Circuit overturned the arbitrator, holding that his actions exhibited manifest disregard of the law.<sup>23</sup>

Some have argued that manifest disregard of the law creates perverse incentives for arbitrators.<sup>24</sup> 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 interpretations to avoid appearing like they have misapplied statutes. Perhaps to ward off this pressure, some courts now take into account arbitrators’ failures to explain the reasoning behind their awards.<sup>25</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 is often claimed by parties seeking to vacate an award. One study of several hundred state and federal cases challenging employment arbitration awards over three decades found that manifest disregard of the law was

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<sup>18</sup> Stephen J. Ware, *Interstate Arbitration: Chapter 1 of the Federal Arbitration Act*, in Edward Brunet, et al, *Arbitration Law in America: A Critical Assessment* 88, 116 & n 90 (Cambridge 2006) (noting that current case law applies the doctrine regardless of whether the ignored rule was default or mandatory). See also Stephen J. Ware, *Principles of Alternative Dispute Resolution* 120–21 (West 2d ed 2007) (outlining the recent expansion of the use of manifest disregard).

<sup>19</sup> 105 F3d 1465 (DC Cir 1997).

<sup>20</sup> *Id.* at 1487 (explaining that parties that agree to arbitrate a statutory claim do not forego their substantive statutory rights).

<sup>21</sup> 256 F3d 89 (2d Cir 2001) (per curiam).

<sup>22</sup> *Id.* at 91.

<sup>23</sup> *Id.* at 93.

<sup>24</sup> See, for example, Richard C. Reuben, *Process Purity and Innovation: A Response to Professors Stempel, Cole, and Drahozal*, 8 Nev L J 271, 306 (2007).

<sup>25</sup> See, for example, *Halligan v Piper Jaffray, Inc*, 148 F3d 197, 204 (2d Cir 1998) (inferring that manifest disregard occurred from the failure to explain the award and overwhelming evidence that the award was erroneous).

the most frequently invoked grounds by a party seeking vacatur.<sup>26</sup> Though asserted in 35.1 percent of trial court cases and 30.4 percent of appellate cases in the sample, the challenges were only successful in 7.1 percent of trial court cases and 8.2 percent of appellate cases in which they were raised.<sup>27</sup> Other studies have found comparable results.<sup>28</sup>

Courts have also varied their approaches. The Seventh Circuit has long exhibited some suspicion about so-called nonstatutory bases of judicial review of awards,<sup>29</sup> but has also occasionally utilized them.<sup>30</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.<sup>31</sup> These muddy legal waters have produced myriad calls for reform, and, on occasion, a judicial decision that seeks to clarify this state of affairs. Both *Watts* and *Hall Street* fall into this category.

## II. WATTS AND ITS CRITICS

George Watts sold Tiffany products in Wisconsin under a contractual arrangement. When Tiffany announced that it was terminating the arrangement, Watts sued for breach of contract and a violation of Wisconsin's Fair Dealership Law. The parties agreed to arbitrate, and the arbitrator delivered an award extending Watts's arrangement, but failing to award Watts his costs. Watts argued that the Wisconsin Fair Dealership Law provided that parties are entitled to attorneys' fees in any case in which they prevail, so the failure of the arbitrator to award fees constituted a manifest disregard of the law, requiring vacatur.<sup>32</sup>

In his majority opinion, 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

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<sup>26</sup> Michael H. LeRoy and Peter Feuille, *Happily Never After: When Final and Binding Arbitration Has No Fairy Tale Ending*, 13 Harv Neg L Rev 167, 189–90 (2008) (finding that manifest disregard was claimed in 84 out of 239 cases argued to district courts).

<sup>27</sup> *Id.*

<sup>28</sup> See, for example, Lawrence R. Mills, et al, *Vacating Arbitration Awards: Study Reveals Real-World Odds of Success by Grounds, Subject Matter and Jurisdiction*, Disp Res Mag 23, 25 (Summer 2005) (finding that only 4 percent of appeals where “manifest disregard” was asserted were successful). Note that this study finds that arbitrators acting in excess of their authority is a more frequently successful claim. See *id.* at 25 (determining that 20.8 percent of these claims proved fruitful).

<sup>29</sup> See, for example, *Chameleon Dental Products, Inc v Jackson*, 925 F2d 223, 226 (7th Cir 1991) (refusing to recognize “manifest disregard” as grounds for appeal).

<sup>30</sup> See, for example, *Hughes*, 975 F2d at 1267.

<sup>31</sup> See *Baravati v Josephthal, Lyon & Ross, Inc*, 28 F3d 704, 706 (7th Cir 1994) (collecting cases).

<sup>32</sup> See *Watts*, 248 F3d at 578–79.

from Seventh Circuit cases.<sup>33</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>34</sup> The latter condition would arguably render the award unenforceable under 9 USC § 10(a)(4), which allows a court to vacate an award if the arbitrators exceeded their powers.<sup>35</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.

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's legal fees, the law could scarcely intervene.<sup>36</sup> When the arbitrator-agent issues a decision to the same effect, why should the law revisit that decision? As Easterbrook succinctly puts it, "[W]hat the parties may do, the arbitrator as their mutual agent may do."<sup>37</sup>

On its face, this claim seems to overreach. 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

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<sup>33</sup> Id at 579–80. One line of cases held that arbitrators manifestly disregard the law when they treat it as an obstacle to their preferred result. See *National Wrecking Co v International Brotherhood of Teamsters, Local 731*, 990 F2d 957, 962 (7th Cir 1993) (holding there was no manifest disregard because the arbitrator “carefully weigh[ed] the evidence”); *Health Services Management Corp v Hughes*, 975 F2d 1253, 1267 (7th Cir 1992). Another line of cases sharply departed and held that arbitrators need not apply rules outside the parties' agreement. See *Baravati v Josephthal, Lyon & Ross, Inc*, 28 F3d 704, 711 (7th Cir 1994) (holding that manifest disregard is not an independent reason for overturning an award); *Flender Corp v Techna-Quip Co*, 953 F2d 273, 280–81 (7th Cir 1992) (approving an arbitrator's refusal to hear evidence regarding mitigation of damages); *Chameleon Dental Products, Inc v Jackson*, 925 F2d 223, 225 (7th Cir 1991) (holding that arbitrators need not apply rules outside the parties' agreement).

<sup>34</sup> See *Watts*, 248 F3d at 580–81.

<sup>35</sup> I use the term “arguably,” though the opinion seems clear that it would indeed be unenforceable. See id at 581. 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 and Western Railway Co*, 814 F2d 1192 (7th Cir 1987), the standard is simply whether the arbitrator did interpret the contract. Id at 1194–95 (emphasizing that “[i]f they did, their interpretation is conclusive”). 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 as not to be considered interpretation at all. See id at 1195.

<sup>36</sup> See *Watts*, 248 F3d at 580.

<sup>37</sup> Id at 581.

appointing arbitrators when one party refuses to do so.<sup>38</sup> 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 an 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.<sup>39</sup> Parties in a settlement might produce an agreement that violates public policy, which is a basis for nonenforcement of arbitral awards in some jurisdictions.<sup>40</sup> These examples illustrate that arbitrators are limited in their ability to act purely as agents of the parties.

As Judge Ann Claire Williams argued in concurrence, the majority opinion seems effectively to end the doctrine of manifest disregard as an independent basis for setting aside arbitral awards in the Seventh Circuit.<sup>41</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>42</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 shrank 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>43</sup> Some commentators pointed out that, as Judge Williams argued, any award ordering a party to violate the law would already be unen-

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<sup>38</sup> See, for example, *Compania Espanola de Petroleos, S.A. v Nereus Shipping, S.A.*, 527 F2d 966, 975 (2d Cir 1974).

<sup>39</sup> See *Advanced Bodycare Solutions v Thione International*, 524 F3d 1235, 1239 n 3 (11th Cir 2008).

<sup>40</sup> See, for example, *Eastern Associated Coal Corp v United Mine Workers of America, District 17*, 531 US 57, 62–63 (2000).

<sup>41</sup> *Watts*, 248 F3d at 581 (Williams concurring) (maintaining that “the majority has effectively rejected the manifest disregard doctrine”). Judge 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 shown that the arbitrator affirmatively disregarded what he knew to be the law. So there may have been no need to reach as far as Easterbrook did.

<sup>42</sup> See *Hill*, 814 F2d at 1195 (limiting the judicial review of arbitral decisions to when the arbitrator does not interpret the contract, engages in fraud or corruption, or orders a party to engage in illegal behavior).

<sup>43</sup> See, for example, Michael A. Scodro, *Deterrence and Implied Limits on Arbitral Power*, 55 Duke L J 547, 577–78 (2005); Bonnie Roach, *Recent Development: George Watts & Son v Tiffany & Co.*, 17 Ohio St J Disp Res 503, 512 (2002) (asserting that Easterbrook's approach “essentially ousted manifest disregard as a non-statutory method for vacatur”); Noah Rubins, “*Manifest Disregard of the Law*” and *Vacatur of Arbitral Awards in the United States*, 12 Am Rev Intl Arb 363, 379 (2001) (condemning *Watts*'s “somewhat faulty reasoning”). But see Paul J. Krause, *Disregarding Manifest Disregard: Watts Shifts Standard for Vacating Arbitrators' Decisions*, 72 Defense Counsel J 79, 84 (2005) (“*Watts* appears to provide many benefits and few drawbacks.”).



forceable.<sup>44</sup> 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>45</sup> Later, the Seventh Circuit clarified that manifest 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 § 10(a)(4).<sup>46</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.<sup>47</sup> 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 acted as an effective agent of the parties.<sup>48</sup> The *Watts* framework, then, turns the focus away from how well the arbitrators apply the law *per se* and looks at whether they effectively carry out the wishes of their principals in doing so.<sup>49</sup>

Manifest disregard continues to sputter along. In 2008, the United States Supreme Court decided *Hall Street*, in which it stated that the grounds for vacatur under the FAA were exclusive.<sup>50</sup> Some commentators argued that this decision overturned the manifest disregard standard.<sup>51</sup> But the Supreme Court was not explicit on this point, and a circuit split has emerged on whether "manifest disregard" survives *Hall*

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<sup>44</sup> See Rubins, 12 Am Rev Intl Arb at 379–80 (cited in note 43) (arguing that § 10(a)(4) itself prohibits awards that violate the law).

<sup>45</sup> See *id.*

<sup>46</sup> See *Wise v Wachovia Securities*, 450 F3d 265, 268–69 (7th Cir 2006).

<sup>47</sup> See *Watts*, 248 F3d at 579.

<sup>48</sup> Consider *Hill*, 814 F2d at 1194–95 (emphasizing that the question for a reviewing court to consider is whether the arbitrator interpreted the contract).

<sup>49</sup> Judge Easterbrook's later decision in a case that arose under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 21 UST 2517, TIAS No 6997 (1970), illustrates the hands-off approach. In *Baxter International, Inc v Abbott Laboratories*, 315 F3d 829 (7th Cir 2003), the court affirmed an award that was alleged to violate the Sherman Act. *Id.* at 833. The court found that so long as the arbitrator had construed the Sherman Act and found no violation, the court could not inquire further. *Id.* at 832 (noting that judicial review only extends so far as to ensure that the arbitrator actually decided the issues). See also Kai Wantzen, *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 729, 739–42 (2004).

<sup>50</sup> 552 US at 585–86.

<sup>51</sup> See Justin Kelly, *Confusion about "Manifest Disregard" after Hall Street v. Mattel: Supreme Court Returns "Manifest Disregard" Ruling to 9th Circuit*, 63 Disp Res J 4, 4 (Nov 2008) (surveying the disagreement over the impact of *Hall Street*).

*Street*.<sup>52</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>53</sup> On this point, there is some tension between *Hall Street* and the agency logic of *Watts*.

### III. A DEFENSE OF AGENCY THEORY

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>54</sup> The canonical problem is that the agent might ignore the wishes of her principal. Agents may impose their own preferences, act in their own interests, or simply fail to exert appropriate effort in carrying out their assigned tasks. 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 high-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 and for vindicating other systemic interests in uniform and accurate decisionmaking.

Consider screening first. Assume that there are two types of arbitrators, good and bad. Good arbitrators always interpret the law accurately (with a probability  $p = 1$ ), while bad ones do so only with a probability  $p < 1$ .<sup>55</sup> A party evaluating a potential arbitrator will seek to determine if the arbitrator is good or bad, and will look for costly

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<sup>52</sup> See J.P. Duffy, *Hall Street One Year Later: The Manifest Disregard Debate Continues*, 19 *Am Rev Intl Arb* 193, 196–98 (2008). The Fifth Circuit struck manifest disregard, while the Second, Fourth, Sixth, and Ninth Circuits continue to allow manifest disregard challenges. See id.

<sup>53</sup> 552 US at 583 & n 5.

<sup>54</sup> See generally Eric A. Posner, *Agency Models in Law and Economics*, in Eric A. Posner, ed, *Chicago Lectures in Law and Economics* 225 (Foundation 2000).

<sup>55</sup> This simple example assumes that judges always interpret the law accurately, and that parties do not want arbitrators to make *better* law than judges. In some contexts, parties might want to contract into private law that is of higher quality than that applied by judges. See Ware, *Interstate Arbitration* at 116 n 89 (cited in note 18).

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 adequately to 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 mandatory 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 abilities 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>56</sup> There will thus be certain informational asymmetries in the market for arbitrators, allowing bad arbitrators to remain in the market.<sup>57</sup>

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 instructions *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 possibility 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, 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

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<sup>56</sup> Another relevant consideration is mandatory disclosure rules that require arbitrators to reveal past work. See Cal Code Civ Pro § 1281.9 (“[W]hen a person is to serve as a neutral arbitrator, the proposed neutral arbitrator shall disclose all matters that could cause a person aware of the facts to reasonably entertain a doubt that the proposed neutral arbitrator would be able to be impartial.”).

<sup>57</sup> I mean bad in the sense of having a propensity to misapply the law.

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. 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 decisionmakers. 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>58</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>59</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>60</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 arbitral interpretations of law, *Hall Street* may end up reducing the number of cases sent to arbitration and, perversely, shift-

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<sup>58</sup> The agency framework might thus be consistent with the views of those who have advocated less deferential review than the “manifest disregard” standard. See Samuel Estreicher, *Predispute Agreements to Arbitrate Statutory Employment Claims*, 72 NYU L Rev 1344, 1350–51 n 22 (1997) (arguing that arbitration of public law claims should be confirmed only where it is not “clearly repugnant to the purposes and policies” of the relevant statutes). See also Richard E. Speidel, *Arbitration of Statutory Rights under the Federal Arbitration Act: The Case for Reform*, 4 Ohio St J Disp Res 157, 206–12 (1989) (arguing that statutory rights may raise public law issues that cannot be solved by arbitration). The reason is that, in public law claims, judges are agents with two principals: the parties and the public. Less deferential review is a form of balancing the competing interests of multiple principals.

<sup>59</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>60</sup> Parties can, however, continue to contract for expanded review under state arbitration laws that have not followed the *Hall Street* approach. See, for example, NJ Stat Ann § 2A:23B-4 (West) (allowing “a party to an agreement to arbitrate or to an arbitration proceeding” to waive “the requirements of this act to the extent permitted by law”). See also *Cable Connection, Inc v DIRECTV, Inc*, 190 P3d 586, 599 (Cal 2008) (determining that the *Hall Street* decision interpreted federal law in a federal case and did not preempt state arbitration law), discussed in John J. Barceló, III, *Expanded Judicial Review of Awards after Hall Street and in Comparative Perspective*, in Peter Hay, et al, eds, *Resolving International Conflicts: Liber Amicorum Timor Várady* 1, 10–11 (Central European University 2009).

ing contract disputes to the courts, precisely because there is no alternative way for parties to ensure that arbitrators *do* follow the law. The *Hall Street* logic may end up sacrificing judicial economy in an attempt to preserve it, and hurting arbitration in the name of helping it.

An agency perspective would allow the parties more freedom in stipulating legal grounds for review.<sup>61</sup> If parties want a decision that is accurate, they could require that arbitrators not make clear errors of law.<sup>62</sup> High quality arbitrator-agents could trade on their ability to interpret law by promising not to 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, could in fact enhance arbitration. It might thus allay concerns about a possible “flight from arbitration.”<sup>63</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 resulted in higher overall costs for arbitration. And the good-type arbitrator might be concerned with the judicial error associated with intensive review. Such errors

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<sup>61</sup> See *Hall Street*, 552 US at 594–95 (Stevens dissenting) (maintaining that the FAA does not mandate “a reading that is flatly inconsistent with the overriding interest in effectuating the clearly expressed intent of the contracting parties”). See generally Alan Scott Rau, *Fear of Freedom*, 17 Am Rev Intl Arb 469 (2006) (criticizing *Hall Street*). Note that an alternative way of reaching the same result would be to allow parties to agree to submit any determination of law by the first arbitrator to a second arbitrator. See *Chicago Typographical Union v Chicago Sun-Times, Inc.*, 935 F2d 1501, 1505 (7th Cir 1991) (suggesting that parties could use this approach). For a discussion, see Paul Bennett Marrow, *A Practical Approach to Affording Review of Commercial Arbitration Awards: Using an Appellate Arbitrator*, 60 Disp Res J 10, 15 (Aug 2005).

<sup>62</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, 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 Fennell for this point.

<sup>63</sup> See Drahozal and Wittrock, 37 Hofstra L Rev at 74, 114–15 (cited in note 1) (finding very little evidence that arbitration is on the decline). Consider also Perry A. Zirkel and Andriy Krahmal, *Creeping Legalism in Grievance Arbitration: Fact or Fiction?*, 16 Ohio St J Disp Res 243, 258–59 (2001).

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, because 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 do so either, but it surely provides a clearer conceptualization of how to think about it: arbitrators are agents of the parties, so we need a strong theory to interfere with the delegation by the party-principals. *Hall Street* does not provide such a theory.

## CONCLUSION

*Watts* was a transitional case, foreshadowing the highly restrictive view of manifest disregard of the law as an independent basis for vacatur.<sup>64</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 nontrivial 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 decisionmaking. 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

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<sup>64</sup> See Christopher R. Drahozal, *The Future of Manifest Disregard*, 2009:1 *Stockholm Intl Arb Rev* 1, 10 (finding the Seventh Circuit approach narrower than others).

affairs, under the manifest disregard standard, had the opposite effect.<sup>65</sup> As Noah 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>66</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>65</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 Res 117, 126 (characterizing the manifest disregard standard as a “nullity” in the absence of a reasoned opinion).

<sup>66</sup> Rubins, 12 Am Rev Intl Arb at 384 (cited in note 43).