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On the Importance of Institutions: Review of Arbitral Awards for Legal Errors

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One of the distinctive features of arbitration is the limited opportunity for judicial review of arbitral awards. Arbitration laws generally contain quite a narrow set of grounds upon which a reviewing court may vacate the arbitral award. Likewise, the major multilateral treaties governing the recognition and enforcement of foreign arbitral awards restrict the grounds for review. As one example, arbitral awards, unlike ordinary court judgments, are not reviewable for errors of law.

Against this tradition of limited judicial review and, specifically, non-reviewability for legal errors, the United States stands as an exception. The Federal Arbitration Act (FAA), governing virtually all international arbitrations conducted in the United States, does not explicitly authorize judicial review of arbitral awards for legal errors. Despite this textual gap, federal courts have developed a doctrine permitting vacatur of arbitral awards where the arbitrator has rendered an award in "manifest disregard of the law." In a similar vein, courts have generally enforced parties' efforts to provide for judicial review of awards for legal errors in their arbitration agreements. In a few instances, states have modified their own arbitration laws to provide for court review of such errors or to allow parties to opt into such systems of expanded judicial review.

In light of these exceptional features, judicial review of arbitral awards for legal errors has attracted substantial attention in both the case law and commentary. Many scholars and courts have vigorously defended some level of judicial policing in order to prevent gross legal errors from going uncorrected. Some have lauded the concept while proposing alternative standards of review. A few have questioned the wisdom or validity of judicial review for legal errors altogether.

Participants in this debate have ignored a second-order issue. The debate over the desirability of judicial review of arbitral awards for legal errors, or any system of secondary review, reflects a recognition about the trade-offs involved in providing a further avenue of relief from an adverse decision. Recourse may provide some heightened degree of assurance that the "right" result has been reached. At the same time, it unquestionably increases the overall costs of the system and decreases the

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speediness of the process, contrary to the purported virtues of arbitration. Recognizing that these trade-offs must inevitably occur, the question arises: who shall make them? Thus, quite apart from *whether* courts should review arbitral awards for legal errors, a separate question arises over *who* should define that role.[1] Shall courts spontaneously generate a doctrine of judicial review for legal errors in their own case law? Shall the burden fall to parties explicitly to provide for it in their arbitration agreements? Or is the decision about the scope of judicial review of arbitral awards a quintessentially legislative function? While some scholarship has touched on the edges of this issue, no one has provided a systematic treatment of this underlying institutional question. This article attempts to fill that gap.

In my view, legislatures, rather than courts or parties, should decide whether (and to what extent) courts should review arbitral awards for errors of law. The optimal legislative mechanism should not be compulsory but should offer parties the choice whether to "opt-in" to this regime of expanded review by inserting language to that effect in their arbitration agreement. A legislative solution with an "opt-in" feature has a sounder doctrinal foundation, better respects the distribution of power between various branches of government, involves a lower risk of error and minimizes transaction costs. From this position, two additional conclusions follow: first, courts should not review arbitral awards for manifest disregard of the law; secondly, courts should not enforce party-based expansions of the grounds for judicial review of arbitral awards.

The article develops this thesis in three sections. The first section introduces the law in the United States on judicial review of arbitral awards for legal errors. It focuses on the interpretation of the FAA by the federal courts, which have given the most complete treatment to this issue, and also draws on examples from other countries' arbitration laws and those of individual states. The second section analyses the relative advantages and disadvantages of vesting courts, parties or legislatures with the power to regulate judicial review of arbitral awards for legal errors. The final section explores the conclusions of this analysis and sketches a future research agenda.

I. BACKGROUND AND DOCTRINE

After an arbitral tribunal has rendered an award, three outcomes are possible. First, the losing party may (and most often does) comply voluntarily with the award.[2] Secondly, the prevailing party may seek confirmation, recognition or enforcement of the award; in international arbitration, this typically occurs in a jurisdiction where the

[1] A further institutional issue is the extent to which courts, rather than some other body such as an appellate arbitral tribunal, should conduct this review for legal error. *See, e.g.* Greek Code of Civil Procedure, art. 895 (allowing the parties to arrange for appellate arbitral panels); Arbitration Rules of ICSID (W. Bank) 50–55 (providing for substantive review of arbitral awards by a committee of arbitrators). That question, though interesting in its own right, is beyond the scope of this article.

[2] *See* Pierre Lalive, *Enforcing Awards, in* INTERNATIONAL ARBITRATION: 60 YEARS OF ICC ARBITRATION – A LOOK AT THE FUTURE 317, 319 (1984) (high rate of voluntary compliance with ICC awards).

losing party has assets. Thirdly, the losing party may seek to vacate the award; in international arbitration, this occurs almost always in the jurisdiction where the arbitral award has been rendered.[3]

In the latter case, the law of the arbitral situs identifies the grounds upon which an arbitral award can be vacated. A court reviews an arbitrator's award narrowly, in contrast to an appellate court's more comprehensive scrutiny of a trial court's judgment. For example, the UNCITRAL Model Law on International Arbitration (UNCITRAL Model Law), the source for many national arbitration laws, provides that awards may be set aside only due to a party's incapacity, invalidity of the arbitration agreement, inadequate notice or opportunity to be heard, determinations beyond those submitted by the parties, an improperly constituted tribunal, non-arbitrability of the subject matter or an award incompatible with the public policy of the arbitral forum.[4] Other laws, such as the Swiss Private International Law Act or the Austrian Code of Civil Procedure contain similarly narrow grounds upon which an award can be set aside.[5] One noteworthy feature of these systems of review, as with the arbitration laws of most countries, is that they do not explicitly provide for vacatur of the arbitral award in case of legal error.[6]

At first glance, the regime in the United States would appear to be no different. Like many national arbitration laws, the FAA contains extremely narrow grounds upon which an arbitral award can be set aside.[7] In the case of domestic awards (i.e., in arbitrations held in the United States exclusively between U.S. citizens and not involving property or performance abroad), chapter 1 of the FAA governs.[8] In relevant part, section 10(a) provides that, upon application by a party, an arbitral award may be vacated:

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[3] In certain cases of international arbitration, it may be possible to seek vacatur in more than one jurisdiction. Art. V(1)(e) of the New York Convention allows for this possibility by providing that enforcement may be denied if the award has been vacated "by a competent authority of the country in which, *or under the law of which*, that award was made." United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention"), June 10, 1958, 330 U.N.T.S. 3, 21 U.S.T. 2517, T.I.A.S. No. 6997 (emphasis added); *see also* Inter-American Convention on International Commercial Arbitration ("Panama Convention"), Jan. 30, 1975, O.A.S.T.S. No. 42, 14 I.L.M. 336 (1975), art. V(1)(e) (providing for the same); European Convention on International Commercial Arbitration ("European Convention"), April 21, 1961, 484 U.N.T.S. 364, No. 7041, art. IX.1 (similarly allowing for vacatur in either location). In practice, however, this choice has little consequence.

[4] UNCITRAL Model Law on International Commercial Arbitration, art. 34; on the widespread adoption of the UNCITRAL Model Law, *see* GARY BORN, INTERNATIONAL COMMERCIAL ARBITRATION 31 (2d ed., 2000).

[5] Swiss I.P.R.G., art. 190; Zivilprozessordnung [Z.P.O.] § 595(1) (Aus.).

[6] For examples of national arbitration laws providing for more intrusive judicial review of arbitral awards, *see, e.g.*, Argentine Code of Civil and Commercial Procedure, art. 758; Civil Procedure Code of Iraq Law No. 83 of 1969, art. 273; English Arbitration Act 1996, § 69 (permitting appeals on points of law under certain circumstances); Swiss Intercantonal Arbitration Convention, art. 36 (permitting annulment where an award based on erroneous factual findings or constitutes "a clear violation of law or equity"); *see generally* Born, *supra* note 4, at 795–814; Daniel M. Kolkey, *Attacking Arbitral Awards: Rights of Appeal and Review in International Arbitrations*, 22 INT'L L. 693 (1988).

[7] 9 U.S.C. §§ 2, 202. Some states have enacted their own international Arbitration Acts, which the parties may choose or which may be applicable in rare circumstances. *See* Born, *supra* note 4, at 40–41 and note 236.

[8] *See* 9 U.S.C. §§ 202, 302 (differentiating between domestic and non-domestic awards).

1) where the award was procured by corruption, fraud, or undue means;
2) where there was evident partiality or corruption in the arbitrators, or either of them;
3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehaviour by which the rights of any party have been prejudiced;
4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made[9]

Section 10(a) does not list legal error among the grounds for vacatur.

In international arbitrations, the legal regime in the United States is more complicated but fundamentally no different with respect to judicial review of arbitral awards for legal error. The United States is a signatory to several treaties governing the recognition and enforcement of foreign arbitration awards, including the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("the New York Convention") and the 1975 Inter-American Convention on International Commercial Arbitration ("the Panama Convention").[10] These treaties cover two types of awards: "foreign" awards (i.e., certain awards rendered by an arbitral tribunal sitting in a third country which is a signatory to a treaty) and "non-domestic" awards (i.e., certain awards rendered by an arbitral tribunal sitting in the United States in an arbitration involving at least one foreign party, property or performance abroad or otherwise, which have a "reasonable relation" to one or more foreign states).[11] Chapters 2 and 3 of the FAA, implementing the New York and Panama Conventions respectively, provide that, upon application, a court "shall confirm" an award "unless it finds one of the grounds for refusal or deferral of recognition or enforcement of the award specified in the said Convention."[12] That implementing legislation, however, further provides that chapter 1 (which includes section 10, quoted above) shall apply to actions and proceedings "to the extent that [it] is not in conflict with" the implementing legislation or the treaties themselves.[13] These two passages create an interpretive puzzle: are the broader grounds for vacatur under chapter 1 "in conflict with" the narrower ones contained in the Conventions? Or do they merely

[9] 9 U.S.C. § 10.

[10] 9 U.S.C. §§ 201-208 (New York Convention); *id.* §§ 301-307 (Panama Convention).

[11] *See* New York Convention, art. I.1; 9 U.S.C. §§ 202, 302. For background on the New York Convention, *see generally* ALBERT JAN VAN DEN BERG, THE NEW YORK CONVENTION OF 1958 *passim* (1981).

[12] Those grounds include, principally, a party's lack of capacity, the arbitration agreement's invalidity, inadequate notice, improperly constituted tribunal, improper determination by the tribunal, non-arbitrability and public policy. *See* 9 U.S.C. §§ 207, 302; *see also* New York Convention, art. V; Panama Convention, art. 5. On the relationship between the concepts of vacatur, confirmation, recognition and enforcement, *see* W. MICHAEL REISMAN *et al.*, INTERNATIONAL COMMERCIAL ARBITRATION 971–972 (1997).

[13] 9 U.S.C. §§ 208, 307.

supplement those grounds and, therefore, apply to awards falling under the Conventions? As a result of this interpretive puzzle, in the case of "non-domestic" awards made in the United States and falling under one of the Conventions, federal courts disagree over the grounds governing judicial review.[14] Some courts hold that the applicable treaty provides the exclusive grounds for review;[15] other courts hold that the grounds for review of such awards are identical to those governing domestic awards, described in the preceding paragraph.[16] Regardless of whether the Conventions provide the exclusive grounds for review or the FAA grounds are also available, neither regime explicitly permits judicial review of awards in international arbitrations for legal error.[17]

Despite the absence of a clear textual mandate, both courts and parties in the United States have developed various mechanisms to expand the grounds for judicial review of arbitral awards beyond those explicitly provided for in the FAA. Additionally, state law-makers have proposed and enacted some reforms incorporating some form of merits-based review.

From the judicial corner, federal courts have developed various non-statutory grounds upon which an award may be set aside. Most significantly, federal courts in the United States have developed a doctrine under which courts may vacate an arbitral award where the arbitrator has rendered the award in manifest disregard of the law.[18] This "manifest disregard of the law" standard first appeared in a Supreme Court decision following the enactment of the FAA as the court struggled to reconcile the FAA's pro-arbitration policy with federal statutory schemes apparently favoring dispute resolution in a judicial forum.[19] While adopting this common standard, the appellate

[14] *See* Born, *supra* note 4, at 727–728 (discussing the debate); for a thoughtful discussion in the case law, *see* Lander Co., Inc. v. MMP Inv., Inc., 107 F.3d 476, 480–482 (CA7 1997). This issue, moreover, is distinct from the issue of whether a convention provides the exclusive grounds for denying recognition or enforcement of an award rendered abroad and falling under it. On this point, the case law more consistently holds that the applicable convention's grounds are exclusive. *See, e.g.*, M & C Corp. v. Erwin Behr GmbH & Co., KG, 87 F.3d 844, 850–851 (CA6 1996). *But see* Abdullah E. Al-Harbi v. Citibank, N.A., 85 F.3d 680 (CADC 1996) (apparently applying chapter 1 of the FAA to award rendered in England in arbitration between foreign parties); *see generally* Born, *supra* note 4, at 792–793, 809; ANDREAS F. LOWENFELD, INTERNATIONAL LITIGATION AND ARBITRATION 363 (1993).

[15] *E.g.*, Industrial Risk Insurers v. M.A.N. Gutehonffnungshutte GmbH, 141 F.3d 1434, 1445–1447 (CA11 1998).

[16] *E.g.*, Yusuf Ahmed Alghanim & Sons W.L.L. v. Toys "R" Us, Inc., 126 F.3d 15, 18 (CA2 1997); In Re Arbitration Between Carte Blanche (Singapore) Pte., Ltd. v. Carte Blanche Int'l Ltd., 888 F.2d 260, 264–265 (CA2 1989); *see also* Bergesen v. Joseph Muller Corp., 710 F.2d 928, 932–934 (CA2 1983) (applying the New York Convention to arbitration held in New York between foreign parties).

[17] In the exceptional case of non-domestic awards not falling under either the New York or the Panama Conventions, chapter 1 of the FAA (and thus the vacatur grounds contained in § 10) would govern. *See* Born, *supra* note 4, at 887.

[18] *See, e.g.*, Flex-Foot, Inc. v. Phillips, No. 99–1489, 2001 U.S. App. LEXIS 1432, at *7–8 (CAFC Feb. 2, 2001); Apex Plumbing Supply, Inc. v. U.S. Supply Co., Inc., 142 F.3d 188, 193 (CA4 1998); *see generally* Born, *supra* note 4, at 810–812 (collecting cases).

[19] *See* Born, *supra* note 4, at 797–798; *see* text accompanying notes 40–49.

courts have elaborated on it in various ways.[20] Under the predominant view, an arbitrator manifestly disregards the law when (a) a case is governed by a clearly defined applicable legal principle and (b) the arbitrator consciously refused to heed it.[21] In cases where an arbitrator has not provided any reasons for his award, a reviewing court generally will not vacate it for manifest disregard of the law if there is any rational basis upon which the award can be sustained.[22] Scholars and practitioners have commented extensively on the merits, the formulation, and the basis for this "manifest disregard of the law" standard.[23]

Alongside the manifest disregard of the law doctrine, parties themselves sometimes provide in their arbitration agreements for judicial review of arbitral awards for legal errors. Such arbitration agreements may specify a more exacting standard of review than the "manifest disregard of the law" standard. For example, one arbitration agreement provided that, "The Court shall vacate, modify or correct any award: (i) based upon any of the grounds referred to in the Federal Arbitration Act, (ii) where the arbitrators' findings of fact are not supported by substantial evidence, or (iii) where the arbitrators' conclusions of law are erroneous."[24]

As a result of such clauses, an increasing number of appellate courts have begun to consider whether parties may legally expand the grounds upon which courts shall

[20] *See, e.g.*, Williams v. Cigna Fin. Advisors Inc., 197 F.3d 752, 761 n.2 (CA5 1999) (describing formulations); Cole v. Burns Int'l Sec. Servs., 105 F.3d 1465, 1487 n.20 (CADC 1997) (same).

[21] *E.g.*, Hoffman v. Cargill, Inc., 236 F.3d 458, 462 (CA8 2001); Dawahare v. Spencer, 210 F.3d 666, 669 (CA6 2000); DiRussa v. Dean Witter Reynolds, Inc., 121 F.3d 818, 821 (CA2 1997); National Wrecking Co. v. International Brotherhood of Teamsters, Local 731, 990 F.2d 957 (CA7 1993); Folkways Music Publishers, Inc. v. Weiss, 989 F.2d 108, 111–12 (CA2 1993); *see generally* Born, *supra note* 4, at 811.

[22] *E.g.*, Willemijn Houdstermaatschappij, BV v. Standard Microsystems Corp., 103 F.3d 9 (CA2 1997).

[23] Glower W. Jones, *Grounds for Confirming and Vacating Awards*, paper delivered at the Center for International Legal Studies' Superconference on International Commercial and Construction Arbitration (June 15–18, 2000) (copy on file with author); Paul Turner, *Preemption: The United States Arbitration Act, the Manifest Disregard of the Law Test for Vacating an Arbitration Award, and State Courts*, 26 PEPP. L. REV. 519 (1999); Norman S. Poser, *Judicial Review of Arbitration Awards: Manifest Disregard of the Law*, 64 BROOKLYN L. REV. 471 (Summer 1998); Hans Smit, *Is Manifest Disregard of the Law or the Evidence or Both a Ground for Vacatur of an Arbitral Award?*, 8 AM. REV. INT'L ARB. 341 (1997); Kenneth R. Davis, *When Ignorance of the Law is No Excuse: Judicial Review of Arbitration Awards*, 45 BUFF. L. REV. 49 (1997); Marcus Mungioli, Comment, *The Manifest Disregard of the Law Standard: A Vehicle for Modernization of the Federal Arbitration Act*, 31 St. MARY'S L. J. 1079 (2000); Adam Milam, Comment, *A House Built on Sand: Vacating Arbitration Awards for Manifest Disregard of the Law*, 29 CUMB. L. REV. 705 (1999); Mark B. Rees, Comment, Halligan v. Piper Jaffray: *The Collision Between Arbitral Autonomy and Judicial Review*, 8 AM. REV. INT'L ARB. 347 (1997); Michael P. O'Mullan, Note, *Seeking Consistency in Judicial Review of Securities Arbitration: An Analysis of the Manifest Disregard of the Law Standard*, 64 FORDHAM L. REV. 1121 (1995); Marta B. Varela, *Arbitration and the Doctrine of Manifest Disregard*, 49 DISP. RESOL. L. J. 64 (June 1994); Brad A. Galbraith, *Vacatur of Commercial Arbitration Awards in Federal Court: Contemplating the Use and Utility of the "Manifest Disregard" of the Law Standard*, 27 IND. L. REV. 241 (1993); Note, *Manifest Disregard of the Law in International Commercial Arbitration*, 28 COLUM. J. TRANS. L. 449 (1990); Note, *Judicial Review of Arbitration Awards on the Merits*, 63 HARV. L. REV. 681 (1950).

[24] Lapine Tech. Corp. v. Kyocera Corp., 130 F.3d 884 (CA9 1997).

review an arbitral award.[25] Until recently, though the cases strongly suggested some differences of opinion over the enforceability of such agreements, no clear conflict of authority had emerged among the federal appellate courts. As a result of a recent decision by the U.S. Court of Appeals for the Tenth Circuit, the federal courts of appeals are now divided explicitly over the enforceability of such party-based expansions of the grounds for judicial review.[26] Like the courts, both scholars and practitioners are divided over the enforceability and advisability of such clauses.[27]

Finally, apart from the judicial and party-driven developments, some legislative models and innovations provide a third means through which courts may be authorized to review arbitral awards for legal errors. For example, New Jersey has enacted an optional dispute resolution regime, into which parties may "opt-in" and thereby authorize judicial review of an award for legal errors.[28] Additionally, the drafters of the Revised Uniform Arbitration Act recently considered (though they ultimately rejected) such a proposal.[29] A few scattered examples also exist under specialized arbitration regimes.[30] These legislative models provide a third mechanism for authorizing judicial review of arbitration awards for legal error.

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[25] UHC Management Co., Inc. v. Computer Sciences Corp., 148 F.3d 992 (CA8 1998); Lapine Tech. Corp., 130 F.3d 884; Syncor Int'l Corp. v. McLeland, 1997 U.S. App. LEXIS 21248 (CA4 Aug. 11, 1997) (*per curiam*) (unpub. mem.); Gateway Technologies, Inc. v. MCI Telecommunications Corp., 64 F.3d 993 (CA5 1995); Chicago Typographical Union No. 16 v. Chicago Sun-Times, Inc., 935 F.2d 1501 (CA7 1991). *See also* New England Utils. v. Hydro-Quebec, 10 F.Supp.2d 53 (D. Mass. 1998); In re Arbitration between Fils et Cables d'Acier de Lens and Midland Metals Corp., 584 F. Supp. 240, 244 (S.D.N.Y. 1984). For state court decisions, *see, e.g.,* Northern Ind. Commuter Transp. Dist. v. Chicago Southshore and South Bend R.R., 661 N.E.2d 842 (Ind. Ct. App. 1996); Primerica Fin. Servs. v. Wise, 456 S.E.2d 631 (Ga. App. 1995); Dick v. Dick, 534 N.W.2d 185 (Mich. Ct. App. 1995); Tretina Printing, Inc. v. Fitzpatrick & Assocs., Inc., 640 A.2d 788 (N.J. 1994); NAB Constr. Corp. v. Metropolitan Trans. Auth., 579 N.Y.S.2d 375 (N.Y. App. Div. 1992); South Wash. Assocs. v. Flanagan, 859 P.2d 217 (Colo. Ct. App. 1992); Moncharsh v. Heily & Blasé, 832 P.2d 899 (Cal. 1992); Konicki v. Oak Brook Racquet Club, Inc., 441 N.E.2d 1333 (1982). *See generally* Sarah Rudolph Cole, *Managerial Litigants? The Overlooked Problem of Party Autonomy in Dispute Resolution*, 51 HASTINGS L.J. 1199, 1249 note 227 (Aug. 2000) (collecting cases); Stephen P. Younger, *Agreements to Expand the Scope of Judicial Review of Arbitration Awards*, 63 ALB. L. Rev. 241, 257–258 and notes 110–112 (1999); Edward Brunet, *Replacing Folklore Arbitration with a Contract Model of Arbitration*, 74 TUL. L. REV. 39, 60 note 108 (Winter 1999) (collecting cases).

[26] Bowen v. Amoco Pipeline Co., 254 F.3d 925 (CA10 2001).

[27] *See, e.g.,* Born, *supra* note 4, at 814; Cole, *supra* note 25, at 1232–1263 (Aug. 2000); Younger, *supra* note 25, at 241; Brunet, *supra* note 25, at 65–84; Andreas Lowenfeld, *Can Arbitration Coexist with Judicial Review? A Critique of* LaPine v. Kyocera, ADR CURRENTS 1 (Sept. 1998); Hans Smit, *Contractual Modification of the Scope of Judicial Review of Arbitral Awards*, 8 AM. REV. INT'L ARB. 147 (1997); Alan Scott Rau, *Contracting out of the Arbitration Act*, 8 AM. REV. INT'L ARB. 225 (1997); THOMAS E. CARBONNEAU, CASES AND MATERIALS ON COMMERCIAL ARBITRATION 174 (1997); Tom Cullinan, Note, *Contracting for an Expanded Scope of Judicial Review in Arbitration Agreements*, 51 VAND. L. REV. 395 (1998); Caroll E. Neesemann, *Contracting for Judicial Review: Good for Arbitration*, DISP. RESOL. MAG. 18, 19 (Fall 1998); Abby Cohen Smutny, *Comment on the Ninth Circuit Decision in* Lapine Technology Corp. v. Kyocera Corp., INT'L ARB. REP. 18, 22 (Feb. 1998).

[28] N.J. Stat. Rev. §§ 2A:23A–13 (1999).

[29] Report No. 4 of the Drafting Committee of the National Conference of Commissioners on Uniform State Laws relating to the Uniform Arbitration Act (Dec. 15, 1998) (*available at* <www.abanet.org/litigation/committee/alternative/arbrep6.html>). For a discussion of the legislative history of this proposal, *see* Brunet, *supra* note 25, at 59–61 and n. 107. Similar options include rent-a-judge programs available under various state laws. Under these programs, the parties may present their dispute to a private referee, often a retired state judge, whose decision is then subject to judicial review. *See* Cal. Civ. Proc. Code §§ 638–645; Tex. Civ. Prac. & Rem. Code Ann. §§ 151.001–151.013.

[30] *See, e.g.,* Cal. Pub. Cont. Code §10240.12 (permitting certain awards in public contracts disputes to be vacated where not supported by substantial evidence or not decided under or in accordance with Californian law).

Traditionally, the arbitration literature has treated these judicial, contractual and legislative models in isolation from one another.[31] This separate treatment is a mistake. Each of these models attempts to address, in different forms, a common issue: whether and how rigorously courts should review arbitral awards for legal error. What distinguishes the models from one another is the institution responsible for vesting courts with that power. When these models are considered alongside one another, the resulting analysis demonstrates the importance of the choice of institution for the development of a legal rule.[32] The next section of this article analyses the choice of institution.

II. COURTS, PARTIES OR LEGISLATURES?

Assuming that judicial review of arbitral awards for legal error is a good idea, who should decide the nature and scope of that review? At least three institutions are possible candidates: the courts, the parties and the legislature.[33] Focusing on the FAA, this section evaluates the consequences of allowing each of these institutions to decide whether and how courts should review arbitral awards for legal error. In order to accentuate the comparison between institutions, this article does not organize the analysis around the institutions themselves but, instead, around various factors. These factors include legitimacy, error costs and transaction costs. Each subsection first introduces the factor, then assesses how each institution fares relative to the others under it. The end of this section summarizes the results of the analysis.

Two methodological points should be made at the outset of the analysis. First, while I have tried to separate the question of the desirability of judicial review of arbitral awards for legal error from the question of which institution should authorize that review, those two questions can dovetail. Secondly, aspects of the critique may apply to more than one institution (i.e., critiques about judicial standards often apply to legislative ones). In order to avoid redundancy, I have located the relevant critique in the discussion of one institution and have identified any variations in the analysis of the other relevant institution.

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[31] For an exceptional effort to link these institutional alternatives, *see* Born, *supra* note 4, at 809–814.

[32] An added wrinkle, particularly in the United States, is the vertical division of power between Federal and state institutions. In order to address the topic at a level of generality useful to other jurisdictions, I do not discuss that issue in this article.

[33] Theoretically, one might argue that arbitration institutions such as the ICC or the AAA should make this determination. I do not give this possibility separate treatment. Though some institutions such as the ICC or the ICSID administrative body review the merits of the award, I am unaware of a major arbitration institution in which the institution itself decides whether to authorize such review by the national courts. *See* YVES DERAINS & ERIC A. SCHWARTZ, A GUIDE TO THE NEW ICC RULES OF ARBITRATION 291–292 (1998) (ICC review); MOSHE HIRSCH, THE ARBITRATION MECHANISM OF THE INTERNATIONAL CENTER FOR THE SETTLEMENT OF INVESTMENT DISPUTES 33–38 and n. 99 (1993). Moreover, in order for an arbitration institution to become involved at all, the parties ordinarily (with the exception of certain investment-related disputes) must invoke it in their arbitration agreement. Accordingly, delegating this decision to an arbitration institution would simply be an indirect form of party-based authorization. The dynamics might be distinctly different, but the practical remoteness of this possibility counsels against its separate and extended treatment in this article.

A. LEGITIMACY

The institution's legitimacy is a key criterion in evaluating its competence to authorize judicial review of arbitral awards for legal error. Legitimacy may be understood as the source of legal authority for the institution's action. Such questions appear frequently in the law. For example, judges often debate whether existing statutory language can be interpreted to support a particular legal result or whether a statute must first be amended to permit that result; this debate reflects competing views about whether a legislature or a court is the proper institution to make that decision. Legitimacy may take a variety of forms such as statutory authorization or authoritative judicial interpretation in common law jurisdictions. High legitimacy promotes confidence and stability in the legal regime. Low legitimacy sows doubt over the institution's action and subjects the legal regime to instability.

1. *Courts*

Court-based expansions of judicial review of arbitration awards suffer from a legitimacy problem. Apologists for the "manifest disregard of the law" standard have sought to anchor it either in the text of the FAA itself or in Supreme Court precedent. Contrary to their arguments, neither statute nor precedent supports a judicially created "manifest disregard of the law" standard.

Some courts and commentators have tried to fit the doctrine within one of the existing grounds under the FAA.[34] Certainly, a statutory hook for the "manifest disregard of the law" exception would strengthen substantially the doctrine's legitimacy. This view, moreover, draws some support from Justice Stevens' dissent in *Mitsubishi Motors v. Soler Chrysler-Plymouth* where he cited the FAA itself for the proposition that awards are reviewable for manifest disregard of the law.[35]

Despite these efforts, attempts to shoehorn the "manifest disregard of the law" doctrine within the text of section 10(a) of the FAA are unpersuasive. Section 10(a) of the FAA lists four subsections, quoted above, containing the grounds upon which a court may vacate an arbitral award.[36] The "manifest disregard of the law" doctrine clearly does not fit within the first two subsections of section 10(a), for the arbitrator's adherence to legal norms does not involve how the award was procured (corruption, fraud, undue means), nor the disposition of the arbitrators (partiality or corruption).

A slightly stronger argument can be made that it fits within section 10(a)(3), as an arbitrator's manifest disregard of the law might constitute "misbehaviour by which the rights of any party have been prejudiced." This argument, however, ultimately fails to persuade. The first part of section 10(a)(3) provides that an award may be vacated

[34] *See, e.g.*, George Watts & Sons, Inc. v. Tiffany and Co., No. 00–3231, (CA7 Apr. 16, 2001); *see generally* Mungioli, *supra* note 22, at 1099–1102 (collecting cases).
[35] 473 U.S. 614, 656 (1985) (Stevens, J., dissenting).
[36] *See* text accompanying note 9.

where the arbitrators were "guilty of misconduct in refusing to postpone the hearing ... or in refusing to hear evidence pertinent and material to the controversy." This language suggests that the term "misbehaviour" in section 10(a)(3) alludes to procedural errors in the conduct of the arbitration hearing, not substantive errors in the award itself.

By far the strongest and most prevalent textual argument is that an award rendered in manifest disregard of the law exemplifies a situation under section 10(a)(4). Section 10(a)(4) provides for vacatur where the arbitrators "exceeded their powers, or so imperfectly executed them that a mutual, final and definite award upon the subject matter submitted was not made."[37] Though defenders of the "manifest disregard of the law" doctrine are often content to cite section 10(a)(4) generally, the statutory language actually supports two different arguments. One might argue that the arbitrator who commits manifest disregard of the law "exceeds" his powers. Alternatively, one might argue that an arbitrator who manifestly disregards the law "imperfectly executes" his powers. On the face of the statute, either ground would suffice to justify the vacatur of the award.

An arbitrator who manifestly disregards the law does not "exceed" his powers. This variation of the argument cannot account for why the vacatur grounds should be limited to "manifest" disregard of the law rather than any legal error whatsoever. If the arbitration agreement empowers the arbitrators to render an award in accordance with the chosen legal regime, then the arbitrators exceed their powers as soon as they commit any error of law (or an erroneous application of law to fact) regardless of whether the error is egregious or the question is a "close one." Such an interpretation, however, contravenes the purposes of the FAA and clear Supreme Court precedent, holding that the FAA was designed to reverse judicial hostility toward arbitration.[38] It would render arbitration largely meaningless, for it would effectively expose any award to plenary judicial review. Any error, regardless of how "manifest" or not, would be an instance of the arbitrator "exceeding" his powers.

Though the question is closer, an arbitrator who manifestly disregards the law does not "so imperfectly execute" his powers under the second half of section 10(a)(4). In contrast to the "exceed" language, the "so imperfectly executed" language of section 10(a)(4) is a stronger candidate; the language "so imperfectly" connotes an idea of degree and, thus, could account for why manifest disregard of the law, but not normal errors, should constitute grounds for setting an award aside. This argument ultimately founders because it cannot account for the final section of the statute ("that a mutual, final and definite award upon the subject matter

[37] *See, e.g.*, United Transp. Union Local 1589 v. Suburban Transit Corp., 51 F.3d 376, 379–82 (CA3 1995); Federated Dep't Stores, Inc. v. J.V.B. Indus., Inc., 894 F.2d 862, 866 (CA6 1990); *see generally* Andrew M. Campbell, Annotation, Construction and Application of §10(a)(4) of Federal Arbitration Act (9 U.S.C. §10(a)(4)) Providing for Vacating of Arbitration Awards where Arbitrators Exceed or Imperfectly Execute Powers, 136 A.L.R. Fed. 183 §24 (1999) (collecting cases).

[38] *See, e.g.*, Circuit City Stores, Inc. v. Adams, 121 S.Ct. 1302, 1307 (2001); Allied-Bruce Terminix Cos., Inc. v. Dobson, 513 U.S. 265, 270–271 (1995); Gilmer v. Interstate Johnson/Lane Corp., 500 U.S. 20, 24 (1991).

submitted was not made"). An award rendered in manifest disregard of the law, despite the commission of error, still remains mutual, final and definite. It is directed at both parties to the arbitration ("mutual"), resolves the dispute ("final") and does so conclusively ("definite"). Read in context, the "so imperfectly executed" language would appear to be directed at the familiar situation where the arbitrator has failed to respond fully to the parties' submissions.[39] Thus, the "manifest disregard of the law" exception cannot fit within the existing statutory grounds under section 10 of the FAA.

Instead of relying on the FAA itself, most courts and commentators have grounded a judicially created "manifest disregard of the law" exception in existing Supreme Court precedent. Principally, they rely on the Supreme Court's decisions in *Wilko v. Swann*[40] and *First Options of Chicago, Inc. v. Kaplan.*[41] *Wilko* involved the arbitrability of claims under the Securities Act of 1933[42] brought by a purchaser of securities against partners in a securities firm. The Supreme Court held that an agreement to arbitrate future claims arising under that Act was invalid.[43] In its discussion, the court stated that in cases such as the one before it "interpretations of law by the arbitrators in contrast to manifest disregard are not subject, in the federal courts, to judicial review for error in interpretation."[44] Many courts embracing the "manifest disregard of the law" exception have read this passage to constitute an implicit endorsement of that exception.[45] In *First Options*, a unanimous court held, in relevant part, that a court must conduct a de novo review of an arbitrator's ruling on arbitrability unless the parties have agreed to submit that question to the arbitrator.[46] In that discussion, the court noted that a reviewing court will set aside an arbitrator's award "only in very unusual circumstances" and cited *Wilko* for the proposition that "parties (are) bound by (an) arbitrator's decision not in 'manifest disregard of the law' ").[47] Since the decision in *First Options*, courts and commentators have read it to reaffirm the principle extracted from *Wilko* that an arbitral award may be set aside for manifest disregard of the law.[48]

Contrary to these conclusions, there is absolutely no doctrinal basis for a judicially created "manifest disregard of the law" rule. *Wilko* does not support this view. The language from *Wilko* upon which courts rely is quintessential dictum. *Wilko* held that

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[39] *See, e.g.,* Swiss I.P.G., art. 190.2(c).

[40] 346 U.S. 427 (1953).

[41] 514 U.S. 938 (1995). In the Supreme Court's recent jurisprudence on arbitration law, in two dissenting opinions, Justices have expressed support for the "manifest disregard of the law" exception. *See* Shearson/American Express Inc. v. McMahon, 482 U.S. 220, 259 (1987) (Blackmun, J., dissenting); *Mitsubishi Motors*, 473 U.S at 657 (Stevens, J., dissenting).

[42] 15 U.S.C. §77 (1933).

[43] 346 U.S. at 438.

[44] *Id.* at 436–437.

[45] *E.g.,* Advest, Inc. v. McCarthy, 914 F.2d 6, 9 n.5 (CA1 1990); Jenkins v. Prudential-Bache Securities, Inc., 847 F.2d 631, 634 (CA10 1988).

[46] 514 U.S. at 943.

[47] *Id.* at 942.

[48] *E.g., Williams*, 197 F.3d at 759; *see generally* IV FEDERAL ARBITRATION LAW §40.7.1 (Ian R. MacNeil *et al*, Supp. 1999).

pre-dispute agreements to arbitrate customer-broker claims under the Securities Act of 1933 were unenforceable. Whether courts may review arbitral awards for manifest disregard of the law is neither logically necessary for that holding nor essential to the court's reasoning. Moreover, the doctrinal foundations of *Wilko*'s "manifest disregard of the law" dictum are themselves highly suspect.[49] Finally, the Supreme Court explicitly overruled *Wilko*. In *Rodriguez de Quijas v. Shearson/American Express, Inc.*, the Supreme Court held that pre-dispute agreements to arbitrate claims under the Securities Act of 1933 were enforceable and explicitly overruled *Wilko*'s contrary holding.[50] Thus, due to its vague dictum, questionable foundations and overruled holding, *Wilko* does not support a judicially created "manifest disregard of the law" doctrine.

First Options also does not support a judicially created manifest disregard of the law doctrine.[51] The question presented in *First Options* did not concern the manifest disregard of the law doctrine but concerned questions of arbitrability and the proper standard of review. Like the language from *Wilko*, the reference in *First Options* is neither logically anterior to the holding nor essential to the reasoning of the case.[52] Moreover, the claim in *First Options* that *Rodriguez du Quijas* had overruled *Wilko* "on other grounds" (and presumably thereby left undisturbed *Wilko*'s dicta concerning manifest disregard of the law) ignores at least two strands of reasoning in *Rodriguez de Quijas* that undermine *Wilko*'s dictum at least as much as *Wilko*'s holding.[53] *Rodriguez de Quijas* explained that it was necessary to overrule *Wilko*'s holding in order to correct an unjustified judicial hostility to arbitration.[54] A broad-based judicially created rule permitting judicial review of arbitral awards for legal error, such as the "manifest disregard of the law" doctrine, represents a form of hostility toward arbitration much like a judicially created non-arbitrability doctrine, carving out certain categories of

[49] For example, one of the Supreme Court decisions cited by the court in *Wilko* explicitly undercut the court's argument. In Burchell v. Marsh, the court explicitly stated that "[I]f 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." 58 U.S. 344, 349 (1855). *See* Born, *supra* note 4, at 798 n. 49.

[50] 490 U.S. 477, 481 (1989).

[51] Prior to *First Options*, some courts of appeals had expressed a resistance to the manifest disregard of the law standard, *see, e.g.*, Baravati v. Josephthal, Lyon & Ross, Inc., 28 F.3d 704, 706 (CA7 1994); Brown v. Rauscher Pierce Refsnes, Inc., 994 F.2d 775, 779 n.3 (CA11 1993); McIlroy v. Painewebber Inc., 989 F.2d 817, 820 n.2 (CA5 1993) (per curiam); Marshall v. Green Giant Co., 942 F.2d 539, 550 (CA8 1991).

[52] By citing *Wilko*, the court was not necessarily endorsing the legal proposition contained therein. Rather, it may have done so to signal its awareness of a view among the lower courts that it wished to leave unresolved. This makes sense. The court cannot address every single issue in a legal opinion. Thus, it errs on the side of caution by leaving the issue for another day. Unfortunately, despite this cautionary language, the court regularly must correct lower courts' misreading of this language, even if repeated in multiple opinions, precisely on the ground that the language relied upon contains no holding on the proposition for which lower courts were citing it. *See, e.g.*, U.S. Bancorp Mortg. Co. v. Bonner Mall, 513 U.S. 18, 24 (1994); McCray v. Illinois, 386 U.S. 300, 312 n.11 (1967). Thus, it is far wiser to read decisions such as *First Options* for what they hold and not for what a particular isolated piece of language unessential to the court's holding might say.

[53] In the wake of the decision in *Rodriguez de Quijas*, particularly before *First Options*, it is surprising that lower courts did not undertake a more thoroughgoing re-examination of the doctrine permitting review of arbitral awards for manifest disregard of the law. For a few cases that recognized this problem, *see, e.g., Baravati*, 28 F.3d at 706; Rostad & Rostad Corp. v. Investment Management & Research, Inc., 923 F.2d 694, 697 (CA9 1991); *see generally* Born, *supra* note 4, at 810–811.

[54] 490 U.S. at 480.

rights from arbitration.[55] *Rodriguez de Quijas* also identified a congressional policy favoring arbitration, embodied in the FAA.[56] Limited grounds for judicial review of arbitral awards are part and parcel of that congressional policy; judicial expansion of those grounds undermines that policy by encouraging parties to relitigate the merits of their dispute before the courts. Thus, *First Options* merely layered more dictum onto *Wilko*'s already embattled dictum and, to the extent that it sought to reaffirm the manifest disregard of the law principle, cannot be squared with the more relevant and essential reasoning of *Rodriguez de Quijas*.[57] The over-reading of *Wilko*, the misreading of *First Options* and the cramped reading of *Rodriguez de Quijas* have combined to create a bizarre regime in which the dictum of an outdated decision explicitly overruled by the Supreme Court has received greater respect from the lower courts than the essential reasoning of more relevant decisions.

One might argue that Congress implicitly endorsed the judicially created concept of "manifest disregard of the law" review by failing to amend the statute after *Wilko* and its progeny. The court has regularly relied on this "acceptance by silence" argument to reaffirm various prior holdings.[58] In this context, however, that concept is unconvincing. The Supreme Court has never actually held that courts may review an arbitral award for manifest disregard of the law. Thus, whatever the merits of assuming congressional "acceptance by silence" of a judicial holding, it would be folly to expect Congress to busy itself with the dicta of Supreme Court decisions as well. Moreover, even if it could be assumed that Congress had embraced the concept expressed in *Wilko*, the court expressly overruled that decision, and the reasoning of *Rodriguez de Quijas* undermines the entire concept of judicially created review for manifest disregard of the law. The logic of the "acceptance by silence" theory of Congressional inaction cannot extend to dictum of a decision that the Supreme Court has explicitly overruled. Finally, the "manifest disregard of the law" doctrine has developed only in lower court decisions, and it would be unreasonable to read too much from Congress' inaction in response to such decisions which, unlike Supreme Court decisions, do not have uniform national application.

The judicially created doctrine of "manifest disregard of the law" does not find support either in the FAA or in Supreme Court precedent. The doctrine cannot be shoehorned into any of the existing grounds under the FAA. As a matter of judicial precedent, the Supreme Court has never explicitly embraced a judicially created ground for reviewing arbitral awards for legal errors. Arguments grounded on legislative acceptance by silence are equally unpersuasive. Accordingly, the judicially created review of arbitral awards for legal errors ranks low on the legitimacy scale.

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[55] *See Baravati*, 28 F.3d at 706.

[56] 490 U.S. at 483.

[57] *First Options* also casts doubt on the view, exemplified by Justice Stevens' dissent in *Mitsubishi*, that the "manifest disregard of the law" doctrine can fit into one of the existing vacatur grounds under the FAA. See text accompanying note 35.

[58] *See, e.g.*, Keene Corp v. United States, 508 U.S. 200, 212 (1993); Lorillard v. Pons, 434 U.S. 575, 580 (1978).

2. *Parties*

Party-based expansions also suffer from a legitimacy problem. Contrary to the arguments of some courts and commentators, such arrangements do not derive support from the FAA, nor from Supreme Court precedent.

As with the judicially created "manifest disregard of the law" doctrine, some defenders of party-based expansions of the vacatur grounds have attempted to fit them within the existing terms of the FAA. Under one theory, section 10 of the FAA consists of a set of default rules which are subject to alteration by the parties; expansions of the grounds for judicial review are exercises of the parties' right to supplement those default rules.[59] Under another theory, the text, history and structure of the FAA all support the principle of party autonomy; party-based expansions of judicial review track that principle and, thus, are consistent with the FAA.[60]

Party-created standards of review, however, cannot be squared with the text or structure of the FAA.[61] Several textual clues suggest that these grounds were meant to have been binding and exclusive. Section 9 of the FAA provides that, upon a party's application for an order to confirm an award, a court "*must* grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of [the FAA]."[62] The use of the imperative term "must" connotes a legislative preference for upholding the award. The use of this mandatory term contrasts sharply with the use of voluntary language in both sections 10 and 11. Both sections 10 and 11 provide that a court "may" vacate or, respectively, modify an award for any of the grounds specified therein.[63] The use of the volitional term "may" accords courts a modicum of discretion to decline to vacate or modify an award despite the presence of one of the statutorily specified grounds. Thus, the mandatory language of section 9 ("must") read alongside the optional language of sections 10 and 11 ("may") collectively create a strong presumption in favor of upholding arbitral awards. Party-based expansions of the grounds for vacatur undercut that scheme.

Moreover, the explicit reference to section 10 in section 9 suggests that the grounds contained in those sections, rather than those plus any others that parties might design, provide the exclusive grounds for vacatur. Had Congress intended to provide some space for parties to craft their own grounds for vacatur, it could easily have drafted a statute providing that a court "must grant such an order unless the award is vacated, modified or corrected." This would have de-coupled the issue of vacatur from section 10 and left more flexibility, as a textual matter, for the parties' creativity. Congress' failure to draft a statute along these lines, and instead to link vacatur with

[59] Rau, *supra* note 27, at 231–233; *Fils et Cables*, 584 F. Supp. at 244.

[60] Brunet, *supra* note 25, at 77–84.

[61] To the extent relevant to the question of statutory interpretation, the legislative history surrounding the FAA's enactment suggests that the drafters either intended to exclude substantive review altogether or did not consider the issue. *See* Turner, *supra* note 23, at 537–540 and n. 115–117 (discussing legislative history of the FAA).

[62] 9 U.S.C. §9.

[63] *Id.* §§ 10–11.

section 10, provides a strong textual clue that Congress intended the grounds in section 10 to be exclusive.[64]

Other textual evidence in the FAA strongly supports this interpretation. Elsewhere in the FAA, Congress has demonstrated its ability explicitly to authorize party-generated variations when it so chooses. Both with respect to the selection of arbitrators and the proper venue for confirmation actions, Congress has provided for default rules that the parties may override.[65] The venue provisions of section 9, the same section regulating the manner of vacatur, provide an especially probative example. In relevant part, section 9 of the FAA provides that the parties may specify the court responsible for confirming an arbitral award. In cases where the parties' agreement does not specify a court, section 9 provides that the venue shall be proper in the court in the district where the award was made. Had Congress intended for the vacatur grounds in section 10 to be similarly manipulable default rules, it could have drafted section 9's vacatur provisions along the same lines as it did section 9's venue provisions. Its failure to provide for party manipulation of the vacatur grounds, in precisely the same section of the statute where it provided for such manipulation in matters of venue, supplies strong evidence for the theory that the FAA does not permit party-initiated expansion of the grounds for vacatur.

If the statute does not support party-based expansions, what about the Supreme Court? As with the question whether courts may develop extra-statutory grounds for vacatur of arbitral awards, the Supreme Court has also not addressed whether parties may do so through the arbitration agreement. Appellate courts endorsing this practice have drawn support from the Supreme Court's decision in *Volt Info. Sciences v. Leland Stanford Jr. University*.[66] *Volt* held that where the parties specified a state choice-of-law clause in the arbitration agreement, the FAA did not pre-empt the provisions of the (California) state arbitration law governing when an arbitration would be stayed.[67] In reaching this conclusion, the court observed that:

> Arbitration under the [FAA] is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit. Just as they may limit by contract the issues which they will arbitrate, so too may they specify by contract the rules under which that arbitration will be conducted.[68]

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[64] One might also argue that the phrase "pursuant to" in § 9 should be read in procedural terms rather than substantive ones. In other words, the statute should be interpreted to mean: "a court must grant an order to confirm an arbitral award unless it undertakes the act of vacating the award as contemplated in Section 10." This counter-argument is slightly stronger than the previous one and is buttressed by the parallel reference to § 11's modification order, suggesting that the "pursuant to" language is referring to types of orders rather than the exclusive grounds upon which those orders may be granted. Neither § 10 nor § 11 contains many clues indicating which interpretation is the better one, but this "procedural" interpretation of § 9's language is also problematic. If the "pursuant to" language is meant in procedural terms, then the reference to § 10 is essentially superfluous. Section 10 does not really elaborate in any terms on how a court is to vacate an award; rather, it simply provides that an award may be vacated and then lists the grounds thereto (§ 11 is similarly structured). Thus, it would be rather odd to refer to another statutory section for the procedure for vacating an award when that section contains no elaboration or specification on that point.

[65] *See* 9 U.S.C. § 5 (appointment); *id.* § 9 (venue).

[66] 489 U.S. 468 (1989).

[67] *Id.* at 476–479.

[68] *Id.* at 479 (citation omitted).

Several appellate courts have relied on this language to support the proposition that parties may expand the grounds for judicial review of arbitration awards in their arbitration agreements.[69]

As a matter of precedent, post-*Volt* developments suggest that the opinion cannot support party-based expansions of the grounds for judicial review. In the aftermath of *Volt*, scholars widely criticized the decision for wreaking havoc on the doctrine concerning the FAA's pre-emption of state arbitration laws.[70] In a string of post-*Volt* decisions, the Supreme Court narrowed the reach of that case.[71] Most significantly, the court held that the FAA pre-empted both a state law forbidding prospective arbitration agreements and a state law regulating the placement and typeface of arbitration clauses.[72] Read together, *Volt* and its progeny stand for the proposition that the parties may adopt rules supporting the arbitral process but not undermining it.[73] This principle might support party-generated contractions of the grounds for the vacatur of arbitral awards, but it hardly supports party-based expansions. Party-based expansions undermine the arbitral process. They increase the likelihood that an arbitral award will be set aside and invite more intrusive judicial intervention into the arbitral process. Accordingly, the logic of *Volt*, read in light of its progeny, does not support party-based expansions of the grounds for vacatur of arbitral awards.

Even if *Volt*'s statement that "parties are generally free to structure their arbitration agreements as they see fit" survived the decision's burial, it does not authorize parties to expand the FAA's vacatur grounds. In holding that the FAA did not pre-empt Californian law referenced in the parties' agreement, the court was merely determining the applicable legal scheme. This is suggested by the very next sentence in the court's opinion: "Where, as here, the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA. ... "[74] Thus, when read in context, the language cited from *Volt* stands merely for the proposition that the FAA permits parties to opt for a particular arbitration law which results in an outcome other than that which would have been obtained under the FAA.[75] The choice between different arbitration laws or rules merely involves the parties' peculiar interests.

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[69] *Lapine*, 130 F.3d at 888; *Syncor*, 1997 U.S. App. LEXIS 21248 at *16–17; *Gateway Tech.*, 64 F.3d at 996–997.

[70] *See* Born, *supra* note 4, at 340–341, 358–380.

[71] *See* Doctor's Associates, Inc. v. Casarotto, 517 U.S. 681 (1996); Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52 (1995); Allied Bruce Terminix Co. v. Dobson, 513 U.S. 265 (1995).

[72] *Allied Bruce Terminix*, 513 U.S. 265 (FAA pre-empts Alabama statute prohibiting prospective arbitration agreements); *Doctor's Associates*, 517 U.S. 681 (FAA pre-empts Montana statute requiring arbitration clauses to appear in capital letters on first page of document).

[73] This is not the only possible reading of *Volt* consistent with subsequent Supreme Court case law. *Volt* might also stand for the proposition that parties may incorporate certain rules by reference to state law (e.g. Californian law in *Volt*, New York law in *Mastrobuono*). This alternative reading does not affect my thesis here. For the incorporated rule still would have to be enforceable in a system employing legitimacy as one of its criteria. On the other hand, in purely contractual models concerned solely with the parties' economic interests, the different interpretation of *Volt* might be significant. I am grateful to Professor Chris Drahozal and Jeffrey Greenblatt for their helpful observations on this point.

[74] 489 U.S. at 479.

[75] For a similar argument on this point, *see* Cole, *supra* note 25, at 1247–1248.

In contrast to the parties' choice of a legal scheme, their alteration of an existing one involves very different interests. Alterations of those laws or rules (as in the case of party-based expansions for vacatur beyond those expressly provided in the FAA) can upset the institutional interests of the body crafting those rules. A legislature may have valid reasons why it wishes to restrict the ground upon which arbitral awards may be vacated. For one thing, restricted grounds for review can conserve judicial resources.[76] Several of the grounds for vacatur of an award under section 10 of the FAA such as whether the award was procured by fraud or whether the arbitrator erroneously refused to hear evidence easily can be applied without substantial factual development or record review. Requiring a court to decide whether substantial evidence supports the arbitrator's factual findings or whether the arbitrator has committed legal error may require a much more time-consuming and exhaustive review of the arbitration.

Apart from the resource costs, a legislature may not want its courts to develop precedent on questions of law or applications of fact to law in cases arising out of arbitrations. Factual development, discovery rules and other procedural aspects may affect the record and the arguments presented to the tribunal and, subsequently, to the court. These findings may influence how the court resolves the case on review. Moreover, the court's review will depend on the grounds upon which an arbitrator resolves the case. Arbitrators can sometimes resolve a case on one of several grounds (e.g., the statute of limitations has run, the defendant is not liable as a matter of law, the defendant could be liable but not under these circumstances, etc.). Conversely, the arbitrator may overlook a particular basis for resolving a case that would obviate the need to deal with a certain legal question. The arbitrator's choice of grounds for resolving a dispute (or failure to choose grounds) will influence the legal questions that a court must address in order to conduct a substantive review of the award. In light of this risk of uncertain or unnecessary judicial pronouncements on questions of law, a legislature may understandably opt, instead, for a regime under which courts do not delve into the merits of the arbitrator's award. Unbridled enforcement of party-based expansions of vacatur grounds ignores these institutional interests and co-opts the judicial system, forcing courts to develop precedent on certain legal issues despite the absence of procedural safeguards attendant to an ordinary trial.

Some courts have suggested a separate reason why Congress might oppose party-based expansions of the grounds for judicial review. They argue that such arrangements constitute efforts to expand the "jurisdiction" of the federal courts, and that this prerogative belongs exclusively to Congress.[77] This argument is mistaken, at least in cases under chapter 1 of the FAA. The Supreme Court has specified that chapter 1 of the FAA does not provide an independent basis for federal jurisdiction.[78] Instead,

[76] *See* Smit, *supra* note 27, at 150.

[77] *E.g.*, *UHC*, 148 F.3d at 997–998; *Lapine*, 130 F.3d at 891 (Myer, J., dissenting); *Chicago Typographical Union*, 935 F.3d at 1505 (dicta).

[78] *See* Moses H. Cone Hospital v. Mercury Constr. Corp., 460 U.S. 1, 25 n.32 (1983); *Fils et Cables*, 584 F. Supp. at 244.

applications for orders under the FAA must have an independent jurisdictional basis such as diversity or alienage. Thus, expansion of the grounds for judicial review does not usurp Congress' prerogative to regulate the jurisdiction of the federal courts, at least in cases governed by section 10.[79] This jurisdictional objection may carry more weight in the case of awards falling under the conventions. Chapters 2 and 3 provide an independent basis for jurisdiction for cases falling under the New York and Panama Conventions.[80] Where one of those chapters provides the basis for jurisdiction of a review action, party-based expansions of the grounds for review could constitute attempts to expand the subject matter jurisdiction of the federal courts, contrary to prevailing principles of federal jurisdiction. Though this principle has not been tested at the federal level, several state courts have employed that theory to invalidate parties' efforts to expand the grounds for judicial review.[81]

Thus, party-based expansions of the grounds for judicial review of arbitral awards generally rank low on the scale of legitimacy. Neither the FAA nor Supreme Court precedent adequately supports these innovations. Party-based expansions trample on legislative prerogatives concerning the allocation of judicial resources and the manner in which precedent evolves.

3. *Legislatures*

Legislatively authorized judicial review of arbitral awards for legal error does not suffer from a legitimacy problem and warrants only brief comment. Little controversy exists over the power of the legislature to regulate the grounds upon which an arbitral award may be vacated. International norms, under which virtually all nations regulate the vacatur of arbitral awards in legislative enactments, support this view.[82] Within the United States, the predominant source of law on vacatur grounds is statutory, as exemplified by section 10 of the FAA. Accordingly, in the case of federal law, if Congress were to expand the FAA to permit judicial review of awards for legal error, as some state and other nations' legislatures provided in their own laws, there would be little doubt over the legitimacy of such a course.

Certain legislative regimes can reduce the legitimacy deficit associated with the party-developed expansions of the grounds for judicial review. Under such a regime, the legislature initially creates a separate system providing for judicial review of the arbitral award for factual or legal error; the parties then choose whether to opt into this alternative system. New Jersey has incorporated such an option into its arbitration laws.[83] In contrast to pure party-based regimes, these types of opt-in regimes preserve the legislative prerogative to decide whether, as an initial matter, its courts should busy themselves with

[79] *See* Rau, *supra* note 27, at 227–230.
[80] 9 U.S.C. §§ 203, 302.
[81] *See, e.g., Konicki*, 441 N.E.2d 1333.
[82] *See, e.g.*, Swiss I.P.R.G., art. 190; Austrian Z.P.O. § 595.
[83] N.J. Stat. Rev. 2A:23A–13 (1999).

the questions of law underpinning an arbitral award or should develop precedent on important questions of substantive law through their review of arbitral awards.

B. ERROR COSTS

Error costs represent a second important criterion in evaluating the proper institution to promulgate a rule. Error costs are a function of two variables: the rate of error and the consequences of the error. Important in this regard is the ease with which errors can be corrected; if the institution can correct errors easily or at little cost, total error costs will be lower. Under this criterion, the optimal institution would be that institution whose rule yields the lowest error costs.

In the specific context of judicial review of arbitral awards, one methodological point should be made here. The term "error" might have at least two definitions. On the one hand, "error" might be a situation in which a court misapplies an institution's rule (e.g., where a court finds manifest disregard of the law to exist where none exists or vice versa). On the other hand, "error" might be a situation in which a court correctly applies an institution's rule but reaches the wrong legal result (e.g., where a court concludes that the arbitrators did not render an award in manifest disregard of the law even though the award is legally erroneous). In my view, "error" is properly understood in the former sense – i.e., misapplication of the rule. If it were to be used in the latter sense, that would ignore the institutional interests that might counsel in favor of more limited judicial review of an arbitral error and largely eviscerate the value of arbitration as a dispute resolution mechanism. Thus, in the section *infra*, I use the term "error" to describe situations where the courts misapply an institution's standard rather than situations where the courts reach the wrong result on the law.

1. *Courts*

Judicially created standards yield potentially high error costs. The rate of error may be high due to several difficulties in its application: non-workability in cases where arbitrators have not given reasons for their award, inconsistency between articulation and application in a particular case, inconsistent application across cases, and unclear elaboration of a general standard.

A judicially generated standard for reviewing arbitral awards for legal error risks high error costs due to difficulties in applying it when the arbitrators have failed to give reasons for their award. Unless required by the parties' agreement or the applicable institutional rules, arbitrators in the United States are not required to give reasons for their decision.[84] This norm complicates application of the "manifest disregard of the

[84] *E.g.*, United Steelworkers of Am. v. Enterprise Wheel & Car Corp., 363 U.S. 593, 598 (1960); Prudential-Bache Sec., Inc. v. Tanner, 72 F.3d 234, 240 n.9 (CA1 1995); Sobel v. Hertz, Warner & Co., 469 F.2d 1211, 1214–1215 (CA2 1972); *see generally* Born, *supra* note 4, at 794.

law" standard.[85] As described above, the standard generally requires proof that the arbitrators consciously disregarded the applicable legal principle.[86] Evidence of this conscious disregard, however, will be hard to come by in situations where arbitrators have not given reasons for their decisions.[87] This dilemma forces courts to react in one of two ways. They must comb the entire record to ascertain whether there is any rational basis for the award.[88] Alternatively, they must conclude that no manifest disregard of the law occurred due to the absence of record evidence.[89] In either case, the absence of record evidence complicates the courts' review and enhances the risk that the reviewing court will reach an erroneous decision.[90]

Application of the judicially created "manifest disregard of the law" standard can also be internally inconsistent. The Second Circuit's decision in *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Bobker* ("*Bobker*") exemplifies this sort of problem.[91] That case arose from a district court order setting aside an award in a securities-related dispute on the grounds that the arbitrators had manifestly disregarded the law. It involved whether an investor was entitled to recover damages from a stockbroker, who had refused to carry out a short-sale on the grounds that it would have violated a Rule of the Securities and Exchange Commission (Rule 10b-4).[92] In *Bobker*, the Second Circuit reversed the district court's judgment and held that the arbitrators had not manifestly disregarded the law.[93] The Second Circuit began its opinion by articulating the most widely used general principles of review for manifest disregard of the law: (a) that a patently obvious legal principle governed the case and (b) that the arbitrators consciously disregarded that principle.[94] After reciting these principles, the court delved into the merits and engaged in an extensive analysis of the tribunal's and the

[85] *See, e.g.,* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Jaros, 70 F.3d 418, 421 (CA6 1995) ("Where, as here, the arbitrators decline to explain their resolution of certain questions of law, a party seeking to have the award set aside faces a tremendous obstacle."); O.R. Sec. v. Professional Planning Assoc, 857 F.2d 742, 747 (CA11 1988) ("Where the arbitrators do not give their reasons, it is nearly impossible for the courts to determine whether they acted in disregard of the law."); *see also* In re I/S Stavborg v. National Metal Converters, Inc., 500 F.2d 424, 429 (CA2 1974) ("It seems rather anomalous, but had the arbitral majority failed to render a written opinion in this case, our ability – ignoring the question of our power – to review that decision would be greatly limited."). For a thoughtful discursus on the problem, *see Willemijn*, 103 F.3d at 12–13.

[86] *See* text accompanying note 21.

[87] *See* Dawahare v. Spencer, 210 F.3d 666, 670 (CA6 2000); *Federated Department Stores, Inc.*, 894 F.2d at 871 (Martin, Chief Judge concurring)

[88] *E.g.,* Montes v. Shearson Lehman Brothers, Inc., 128 F.3d 1456, 1461 (CA11 1997) (concluding that the tribunal manifestly disregarded the law because "[i]n the absence of any stated reasons for the decision and in light of the marginal evidence presented to it, we cannot say that this is not what the panel did."); Robbins v. Day, 954 F.2d 679, 684 (CA11 1992).

[89] *E.g.,* Raiford v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 903 F.2d 1410, 1413 (CA11 1990) ("Since nothing on the face of the record indicates that the arbitrators were aware of some legal standard which they ignored in fashioning the award, we certainly cannot say that the district court abused its discretion in confirming the award."); Pyle v. Securities U.S.A., Inc., 758 F. Supp. 638 (D. Colo. 1991).

[90] Admittedly, the analysis on this point depends also on the substantive standard. One could imagine a regime whereunder courts would presume manifest disregard of the law where arbitrators have failed to give reasons for their award. Whatever the other consequences of such a rule, it at least would reduce these error costs by providing a clear standard and encouraging arbitrators to give reasons for their awards.

[91] 808 F.2d 930 (CA 2 1986).

[92] *See* 17 CFR § 240.10b–4.

[93] 808 F.2d 930 at 937.

[94] *See* text accompanying note 21.

district court's applications of Rule 10b–4. It then went so far as to intimate that the SEC's Rule governing the case might be invalid.[95]

This analysis ignored the very framework that the court had just articulated. The court simply should have asked either whether the tribunal's application of Rule 10b–4 was an obvious error or, alternatively, whether the arbitrators consciously disregarded that error. Had it conducted such an analysis (the one that it claimed to be conducting), the opinion would have read quite differently and been far narrower.[96] It was clear from the record in the case that the arbitrators had extensively considered the applicability of Rule 10b–4: they had dedicated an entire hearing and set of briefings to the matter. Moreover, it was highly doubtful whether there was a clearly applicable legal principle governing the case. The district court saw the necessity to order supplemental briefing on the subject from the SEC, and the arbitrators themselves admitted that the case was a close one, describing the state of the law as "indeterminate." Thus *Bobker* illustrates how, under the judicially created "manifest disregard of the law" standard, the standard actually applied by the courts may be far more rigorous than the standard that they purport to be applying.

Related to the problem of internal inconsistency between the articulation of a standard and its application, is how the standard is applied across cases. Judicially created standards run the risk that divergences will develop between various courts attempting to apply those standards. A comparison of two decisions applying the doctrine to similar types of cases, *Halligan v. Piper Jaffray*[97] and *Williams v. Cigna Financial Advisors, Inc.*[98] demonstrates the point.

Halligan involved a securities dealer's claim of age discrimination against his employer. Reversing a district court judgment confirming a panel's award in favor of the employer, the Second Circuit held that the award reflected a manifest disregard of the law.[99] The court began with a general articulation of the principles governing review under the judicially created "manifest disregard of the law" standard. It then launched into an extensive tirade against securities-industry arbitration, particularly in the context of federal civil rights claims. Concluding that "strong evidence that Halligan was fired because of his age" established the "clear principle" that the tribunal should have used to decide the case, the court then implicitly concluded that the arbitrators had consciously disregarded this principle. This conclusion was especially odd in light of the fact that no evidence in the record actually established that the panel had consciously disregarded the "clear principle" or even that the applicable legal standard had been explained to the panel. Instead, the court appeared to infer their

[95] 808 F.2d 930 at 934–937.

[96] Judge Meskill's concurring opinion provides a model for how an opinion actually applying the standards that the majority had articulated might have looked. *Id.* at 937–938.

[97] 148 F.3d 197 (CA11 1998).

[98] 197 F.3d 752 (CA5 1999).

[99] 148 F.3d at 204.

conscious disregard from the fact that the tribunal declined to explain their award though no applicable rule had required them do to so.[100]

In *Williams v. Cigna Financial Advisors, Inc.*, the Fifth Circuit confronted the identical issue. There, a district court confirmed a tribunal's award denying relief to a securities dealer on his claims of age discrimination against his employer. Conducting a highly deferential review, the court found that the evidence "solidly supported a reasonable finding" that Williams had lost his active agent status not on the basis of his age but on the basis of ineffective performance unrelated to his age. The court, therefore, declined to set aside the award.

A comparison of the decisions in *Halligan* and *Williams* demonstrates how the judicial "manifest disregard of the law" standard can yield inconsistent application across cases. In both cases, the appellate courts were presented with conflicting explanations from the ex-employee and the employer about the grounds for the dismissal; moreover, in both cases, the district court had entered factual findings supporting the tribunal's conclusion dismissing the age discrimination claim. Nonetheless, on review, the Second Circuit in *Halligan* essentially overrode the district court's (and the tribunal's) findings to conclude that the tribunal had manifestly disregarded the law, while the Fifth Circuit in *Williams* engaged in a far more deferential review, declining to disturb the district court's holding or to find that the tribunal had committed error warranting vacatur. While the precise amount of evidence of age discrimination reported in the two opinions differed, the different analysis conducted by the two courts suggests that, at a minimum, the Fifth Circuit might have reached a different result on the facts of *Halligan*.[101] Under the deferential review conducted by the court in *Williams*, the Fifth Circuit might well have affirmed, on the basis of the district court's finding in *Halligan*, that the record supported the arbitrators' conclusions in that case.[102] Thus, a comparison between the decisions in *Halligan* and *Williams* demonstrates that, even where circuit courts purport to be applying the same general "manifest disregard of the law" standard, vast differences in how they actually apply that standard breed inconsistency and uncertainty in the doctrine.[103]

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[100] *Halligan* exemplifies a judicially manufactured doctrine, unconstrained by legislative standards, run amok. The decision has been widely criticized for, among other reasons, the fact that the opinion dramatically expands review under the "manifest disregard of the law" standard, for the fact that it implicitly imports a requirement that an arbitral tribunal give reasons for its decision notwithstanding any such explicit requirement in the text or rules and for the fact that it arguably expands the "manifest disregard of the law" doctrine to permit vacatur for "manifest disregard of the evidence." *See, e.g.*, Rees, *supra* note 23, at 365–366.

[101] In the interest of completeness, it should be noted that the National Association of Securities Dealers has modified its rules governing the mandatory arbitration of employment discrimination claims. *See Williams*, 197 F.3d at 764.

[102] *See also Jaros*, 70 F.3d at 421 ("Yet even a misapplication of well defined and explicit legal principles does not constitute manifest disregard."); *Willemijn*, 103 F.3d at 14 ("We cannot say that the law as applied to the facts of this case is so clear and obvious that there was an error that an average person qualified to serve as an arbitrator should have instantaneously perceived and corrected.").

[103] For a recent interesting discussion of the tensions in application of the "manifest disregard of the law" standard which suggested this tension between *Halligan* and *Williams*, see Mungioli, *supra* note 23, at 1103–1106.

A final flaw in a judicially developed rule such as the "manifest disregard of the law" doctrine is that it can easily mutate into a more searching form of merits-based review. The D.C. Circuit's decision in *Cole v. Burns International Security Services (Cole)*[104] provides a good example. Like *Halligan* and *Williams*, *Cole* involved an employee's claims under federal civil rights laws. While the appellate court affirmed a district court order compelling arbitration of such claims, the interesting aspect of its opinion is its discussion of the "manifest disregard of the law" standard. Recognizing that the Supreme Court had never defined this standard, the court reasoned that "this type of review must be defined by reference to the assumptions underlying the Court's endorsement of arbitration."[105] Elaborating on this fuzzy notion, the court in *Cole* distinguished between statutory claims and non-statutory ones, reasoning that in the former case the plaintiff must not be forced to forego the rights afforded by the statute and the judicial review must be sufficient to ensure that the arbitrators comply with the requirements of the statute at issue. Moreover, in cases where the arbitration presents a novel or difficult question of law, the court emphasized that courts "are empowered to review an arbitrator's award to ensure that its resolution of public law issues is correct."[106]

While commendable for its effort to provide some elaboration on the "manifest disregard of the law" standard, *Cole* illustrates how a judicially crafted rule can wreak havoc on the doctrine. Other circuits have applied the same "manifest disregard of the law" review to arbitral awards without providing the special *Cole* scrutiny to statutory claims; thus developments, such as decisions in *Cole*, ensure further non-uniformity in the case law.[107] Furthermore, *Cole* provides no basis for applying a special type of "manifest disregard of the law" review to statutory claims. Both *Wilko* and *First Options*, the only Supreme Court majority decisions to mention the concept, arose in the context of statutory claims. Neither, however, suggested that the type of analysis conducted by a reviewing court should turn on the type of claim being reviewed. Finally, even if its questionable origins are put to one side, the distinction drawn by *Cole* between statutory and non-statutory claims may easily prove untenable. Plaintiffs often lump both statutory and non-statutory claims into a single case, and arbitrators, not being required to provide reasons for their award, may render an award without specifying whether it is based in the statutory or non-statutory claims made by the plaintiff.[108] The upshot of a decision such as *Cole* is that it creates further uncertainty among the circuits about the state of the "manifest disregard of the law" rule and pushes the doctrine closer toward a de novo review of arbitral awards for legal errors.

Thus, a judicially designed standard of reviewing arbitral awards for legal errors risks potentially high error costs. It encounters workability problems due to the lack of

[104] 105 F.3d 1465 (1997).
[105] *Id.* at 1487.
[106] *Id.*
[107] *E.g.*, *Jaros*, 70 F.3d at 420.
[108] *Id.* at 422 (finding that state common law claims support arbitrators' lump-sum award even if arbitrators manifestly disregarded the law on statutory claims).

a general requirement that the tribunal give reasons for its award, risks internally inconsistent application expanding the scope of review beyond its purported boundaries, suffers from inconsistent inter-jurisdictional application and generates inconsistent elaboration of the general standard. The case law method by which judicial rules evolve might limit these costs. Subsequent courts might interpret prior precedents more narrowly or otherwise generate a more refined and uniform standard for review of arbitral awards for errors of law. At the same time, principles of *stare decisis* restrict the lower courts' ability to adjust meaningfully the standard and, absent a clear signal from the Supreme Court, lower courts seem reluctant to overthrow the "manifest disregard of the law" standard. As a result, the inconsistencies that plague it and the resulting error costs are likely to persist.

2. *Parties*

Party-authorized review for legal errors also entails error costs. However, those error costs are not as significant as with judicially crafted standards. Error rates can be high due to judicial misinterpretation of the parties' standards. However, total error costs should be lower, due to the more limited consequences of an erroneous decision.

Error rates in the case of party-authorized review of arbitral awards for legal errors can be high. Even where parties have explicitly inserted expanded grounds for judicial review in their arbitration agreements, reviewing courts must still undertake the task of interpreting those agreements in light of the language and the parties' intentions. Those intentions may not always be clear, and the record of judicial treatment of such party-based expansions demonstrates the pitfalls.

The decisions in *Gateway* and *Syncor* are illustrative. In *Gateway*, the relevant language in the arbitration clause provided that "errors of law" should be subject to appeal; in *Syncor*, the agreement provided that an award could be corrected for "errors of law or legal reasoning."[109] Both courts took the rather bold step of interpreting this language to authorize de novo review of legal conclusions.[110] But this move was far from obvious. Both courts might have interpreted the language to import a variety of different standards such as harmless error review (as the district court in *Gateway* had done), a "manifest disregard of the law" standard (as the district court in *Syncor* had done) or a standard such as whether reasonable minds could disagree over the subject. As a result of their expansive interpretation, the courts adopted a course not evident from the language in the agreements.

Even where there is no ambiguity about the meaning of the standard of expanded review, *Gateway* and *Syncor* illustrate that the court's actual application of that standard may depart sharply from the parties' intentions. In *Gateway*, the court held that the

[109] *Gateway*, 64 F.3d at 995; *Syncor*, 1997 U.S. App. LEXIS 21248 at *15.
[110] *Gateway*, 64 F.3d at 997; *Syncor*, 1997 U.S. App. LEXIS 21248 at *17.

appeal with respect to the prevailing party's attorneys' fees had been waived.[111] While on the surface this argument might appear plausible, it is actually quite striking in the context of the case, as the court had interpreted the agreement to provide for de novo review of legal errors, and an erroneous award of attorneys' fees obviously qualified as a type of legal error. Moreover, the agreement did not provide that the errors had to be properly preserved; instead, the court effectively read a preservation requirement into the agreement in order to reach its "waiver" conclusion. The court in *Gateway* made a similar move in evaluating the punitive damages award in that case. The basis for the punitive damages was not especially clear from the arbitrator's award. After concluding that an award of punitive damages had to be grounded in a tort claim and that Gateway had not waived its tort claim for breach of fiduciary duty, the court vacated the award of punitive damages on the ground that "the facts do not sustain a claim for breach of fiduciary duty," the existence of which was "a question of fact."[112] This review, however, departs radically from the standard under which the parties had authorized appellate review, namely review for "errors of law." By the court's own admission, however, the court was revisiting the factual findings or, at best, the application of law to fact – neither of which it was explicitly authorized to review under the parties' agreement. Though its analysis was far more conclusory and less probing, the court in *Syncor* took similar liberties with the standard after interpreting it to permit de novo review of legal conclusions. After reviewing the record and the award, the appellate court concluded that the arbitrator "did not commit error, either legal or factual, in issuing his award."[113] Though perhaps merely a case of sloppy draftsmanship, the court's very suggestion that the arbitrator had not committed "factual" error suggested that the court in *Syncor*, like the court in *Gateway*, had exceeded the bounds of review contemplated by the parties.

In contrast to judicially developed standards, however, party-developed standards can reduce the error rate by linking a requirement to give reasons with judicial review for legal errors. As explained above, one of the difficulties of a judicially developed standard of review of arbitral awards for legal error is that it is difficult to apply in countries such as the United States, where arbitrators are usually not required to give reasons for their decisions. Party-based expansions of the grounds for review can avoid this collision of norms. Parties can easily require in the arbitration agreement that the arbitrators give reasons for their decision. This requirement may be inserted either directly, in the form of an explicit clause in the arbitration agreement,[114] or indirectly, through adoption of a particular set of arbitral rules requiring the arbitrators to give reasons for their decision.[115] A requirement that arbitrators give reasons for their decision facilitates the process of judicial review; courts are more easily able to evaluate

[111] 64 F.3d at 998.
[112] 64 F.3d at 1000–1001.
[113] 1997 U.S. App. LEXIS 21248 at *18.
[114] *E.g., Lapine*, 130 F.3d at 886–887.
[115] *E.g.*, UNCITRAL Rules, art. 32(3); ICC Rules, art. 25(2); LCIA Rules, art. 26(1); AAA Int'l Rules, art. 27.2.

whether the arbitrators committed a (manifest) legal error in arriving at the award.[116] As a result, error rates decline.

Apart from potentially lower error rates, party-based expansions of the grounds for judicial review also carry less powerful consequences in case of error. In the case of party-based expansions, the significance of the expanded review is limited to the particular case because its authorization is anchored in the arbitration agreement itself. By contrast, court-based expansions have a greater impact because they apply across all cases within a given jurisdiction. This milder effect of party-based expansions may, however, decline over time. As such clauses are employed more frequently and evaluated by courts, certain model clauses may develop and be replicated in multiple agreements, generating a stream of doctrine on their scope and application. Over time, repeat use of these model clauses might even result in a fairly stable equilibrium. The phenomenon of party-based expansions of vacatur grounds is too recent for this effect to be evaluated, but the potential exists that a body of law will develop around certain types of common clauses as it has around other types of model arbitration clauses.[117] For now, at least, it would appear that party-based expansions have less drastic consequences.

Thus, the error costs associated with party-based standards are relatively low but not non-existent. Party-based standards still suffer from interpretive inconsistencies as evidenced by the decisions in *Gateway* and *Syncor*. Parties, however, can reduce error rates by explicitly linking expanded judicial review with a requirement that arbitrators give reasons for their award. Moreover, the consequences of an erroneous interpretation of party-based expansions are less drastic across all cases than the consequences of judicial rules.

3. *Legislatures*

The analysis of error costs of a legislative rule largely tracks that of a judicial one. A legislative standard is subject to problems of internally inconsistent application, and unclear elaboration. Moreover, so long as the governing arbitration law does not require arbitrators to provide reasons for their decisions, it may be equally difficult for courts applying a legislative standard to ascertain whether the arbitrators committed legal error. In at least three respects, however, the dynamics of the analysis of a legislative rule differ from those of a judicial one.

First, when interpreting a legislative rule, courts will rely on a different set of sources that may influence how the court elaborates on the rule. In interpreting the judicially created "manifest disregard of the law" standard, courts are forced to look to

[116] Moreover, an arbitrator's failure to provide reasons for the award, despite such a requirement, can be grounds for vacating the award. *See* Western Employers Ins. Co. v. Jeffries & Co., 958 F.2d 258 (CA9 1992); *see also Fils et Cables*, 584 F. Supp. at 246–247 (remanding for arbitrators' failure to provide factual findings despite such a requirement in the arbitration agreement).

[117] *See* GARY B. BORN, INTERNATIONAL ARBITRATION AND FORUM SELECTION AGREEMENTS 82–83 (1999) (discussing clauses for expanding the vacatur grounds and noting the enforceability concerns).

the rationale underlying the standard's development and evolution in the case law. In contrast, when interpreting a legislative "manifest disregard of the law" standard, they would appeal to different sources of authority such as the plain language of the statute, the statutory structure or the legislative history (putting aside the question of the legitimacy or order of priority of these sources).[118] Depending on what those sources reveal, it may be possible to arrive at a more definitive and firm conviction about the meaning of legislative language. The analysis may yield different results, especially in areas involving potentially conflicting legislative policies, such as those the *Cole* court grappled with in trying to reconcile the "manifest disregard of the law" standard with a potential legislative interest in proper resolution of statutory claims. Where appeal to the statutory sources yields firmer conclusions, error costs decline.

Secondly, a legislative standard may increase error costs due to its relative inflexibility and the difficulty of correcting errors. A legislative standard is less easily corrected than a judicial or a party-based one. Enacting legislation is difficult and expensive; it involves a substantial investment of time and resources. By contrast, standards developed through other institutions will be relatively easier to adjust. A judicial standard can be adjusted, at least partly, through case law. A party-based standard can be adjusted even more easily through modifications of agreements. The legislature, however, may be able to hedge against this risk through the use of "opt-in" mechanisms in its Arbitration Act.[119] Through such mechanisms, the parties can regulate the error costs associated with the legislative standard by deciding whether they wish to employ the review mechanism. Moreover, in contrast to pure party-based expansions, opt-in mechanisms offer some of the advantages of uniformity and greater predictability in interpretation, thereby avoiding some of the interpretive pitfalls demonstrated by decisions such as *Gateway* and *Syncor*.

Thirdly, a legislature can reduce error costs in the application of its rule by tying it to a requirement that arbitrators give reasons for their award. Many legislative regimes providing for judicial review of arbitral awards for legal errors couple that requirement with a requirement that arbitrators provide reasons for their award.[120] Through this coupling of requirements, courts reviewing the award after it has been rendered are better able to discern whether the tribunal committed a legal error in its decision. The greater workability of this standard yields relatively lower error costs than a judicially generated one which cannot automatically impose an *ex ante* requirement that arbitrators give reasons for their decisions.

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[118] Here, it should be noted that a differently phrased legislative standard could reduce error costs generated by uncertainty. If the standard provided that the arbitrator's legal conclusions were to be reviewed de novo, then there would be relatively less uncertainty over how to apply the standard. However, a residual uncertainty might linger over whether to classify a particular premise of the arbitral award as a legal conclusion, a factual finding or a mixed question of fact and law (an uncertainty suggested by the decisions in *Gateway* and *Syncor* applying party-developed standards of judicial review).

[119] *See* text accompanying notes 28–30.

[120] *See, e.g.*, Cal. Pub. Cont. Code § 10240.8; New Jersey Stat. Rev. § 2A:23A–12 (1999).

Thus, error costs associated with a legislative rule providing for expanded judicial review of an arbitral award seem to fall somewhere between those for court-based and party-based rules. Legislative rules risk many of the same errors of application that plague judicial rules. Moreover, legislative rules, in contrast to judicial rules or party-based ones, are relatively more difficult to fix due to the costs of enacting legislation. On the other hand, costs may be lower depending on the extent to which general methods of statutory interpretation yield clearer results. By linking substantive review of arbitral awards with a requirement to give reasons, a legislature can avoid some of the difficulties that complicate application of a judicial rule.

C. TRANSACTION COSTS

Transaction costs comprise another important factor in evaluating an institution's competence as the source of a legal rule. Transaction costs may be understood as the costs borne by the parties in effecting an exchange as a result of the legal rule. They may come in a variety of forms, such as costs of negotiating a particular term of the agreement. High transaction costs promote undesirable inefficiency in the commercial system. Low transaction costs yield relatively greater efficiency.

1. *Courts*

Judicially based rules involve relatively lower transaction costs in some respects and higher ones in others. In the case of review of arbitral awards for legal errors, a judicially crafted rule permitting review for legal errors reduces the parties' costs insofar as they do not need to negotiate over its inclusion in the arbitration agreement. On the other hand, it increases the transaction costs insofar as parties must investigate the choice of forum more closely.

Judicially crafted rules for review of arbitral awards involve some lower transaction costs. In this case, a judicial rule that awards will be reviewed for manifest disregard of the law essentially provides an implied term to the parties' agreement. In cases where one of the parties desires such review, the pre-existing judicial rule, automatically applicable to the agreement, avoids the need to negotiate over that term. Thereby, the rule reduces transaction costs.[121]

While a pre-existing judicial rule may reduce transaction costs with respect to the parties' negotiation over the scope of review for legal errors, it increases transaction costs in other respects, most notably with respect to the choice of forum. Specifically, uncertainty associated with the judicial rule and variations across jurisdictions require

[121] These cost savings associated with the judicial rule will, of course, depend on the rule's formulation. If the judicial rule provides for review only for "manifest disregard" of the law and the parties desire a broader review for legal or factual errors, the savings on transaction costs are lower. In regimes permitting party-based expansions, such a judicial default rule will still require the parties to negotiate over whether they wished to expand review beyond that provided by the judicial standard.

parties, with particular preferences about the scope of judicial review, to examine variations among jurisdictions and determine which jurisdiction's set of rules supplies the optimal regime.[122] These transaction costs have two causes: variations across jurisdictions over the application of the "manifest disregard of the law" standard and variations across jurisdictions over the grounds for setting aside an award.

Variations among jurisdictions over the application of the "manifest disregard of the law" standard increase the parties' transaction costs. As noted above, one of the difficulties of a judicially crafted rule is that courts in different jurisdictions generate inconsistent applications of that rule.[123] For example, a court in one jurisdiction may apply a much less exacting version of the standard than courts in other jurisdictions, or courts in different jurisdictions may apply the standard differently to certain types of claims such as statutory ones. These differences impact the choice of forum. Under the FAA, the choice of arbitral forum significantly influences the venue of any post-award review. In case of awards in domestic arbitrations or international arbitrations where the award does not fall under the New York or Panama Conventions, the court in the district wherein the award was made decides both whether to vacate the award and, unless the parties have specified otherwise in the agreement, whether to confirm the award.[124] If a party knows that one jurisdiction applies the doctrine in a manner more favorable to that party's interests, it will seek to negotiate more aggressively for that choice of forum in the arbitration clause. For example, a company may seek not to arbitrate claims with its employees in the District of Columbia due to the particularly aggressive rule articulated by the D.C. Circuit in *Cole*. As a result, differences across jurisdictions in the application of the "manifest disregard of the law" rule increase transaction costs by raising the stakes with respect to the choice of forum and forcing the parties to investigate closely the consequences of opting for a particular situs for the arbitration.

Variations among jurisdictions over the scope of extra-statutory grounds for setting aside an arbitration award also increase the parties' transaction costs. As noted above, most courts and commentators have grounded the "manifest disregard of the law" doctrine in federal common law rather than the FAA itself.[125] This methodology has spawned not just the "manifest disregard of the law" doctrine but a host of other non-statutory grounds for vacatur of arbitral awards. A sampling of reported opinions reveals a plethora of other judicially crafted grounds including when the award

[122] Admittedly, the parties may not bear these costs directly. Instead, lawyers may bear them, either passing them onto the parties directly or internalizing them as part of an effort to market their services in competition with other lawyers. Even in the latter case, however, the parties (broadly understood) still bear these costs, as lawyers attempt to recoup their investment through higher fees. I am grateful to David Kershaw for his discussions on this point.

[123] *See* text accompanying notes 95–106.

[124] *See* 9 U.S.C. §§ 9, 10 (specifying that an application to vacate an arbitral award may be brought in the Federal district court "in and for the district wherein the award was made"); *see also* Cortez Byrd Chips, Inc. v. Bill Harbert Constr. Co., 529 U.S. 193 (2000) (an award may be reviewed in any district proper under the general venue statute). In cases of arbitrations whose awards fall under the New York or Panama Conventions, generous venue rules reduce this problem. *See, e.g.*, 9 U.S.C. §§ 204, 302.

[125] *See* text accompanying notes 40–57.

(a) conflicts with strong public policy, (b) is arbitrary and capricious, (c) is completely irrational, (d) fails to draw its essence from the underlying contract, (e) is fundamentally unfair or (f) is arbitrary and capricious.[126] These grounds are not uniform across the federal circuits but, instead, vary widely. As a result, these variations further compound the significance of the choice of forum and force the parties to investigate variations among different forums over their setting aside grounds.

Moreover, these non-statutory doctrines effectively serve as one-way ratchets. Under basic principles of *stare decisis*, a future court is unlikely to limit the non-statutory grounds upon which a court may vacate an award once such grounds have been recognized in a prior decision. Rather, relying on the existence of such grounds, a court is much more likely to expand them to fashion additional ones as cases arise containing arbitral awards with which a court is uncomfortable for one reason or another. Over time, one would expect to see an increase in the number of and a growing variation across circuits in the non-statutory grounds for review of arbitral awards.

As a result, the transaction costs associated with a judicially crafted rule are decidedly mixed. A judicial rule may reduce the transaction costs insofar as it spares the parties the need to regulate the matter of judicial review explicitly in the agreement. However, a judicial rule also increases the parties' transaction costs insofar as it heightens the importance of the choice of forum due to inter-jurisdictional variations in the application of the standard and in the uneven growth in analogous non-statutory grounds for vacating an award.

2. *Parties*

Like other institutional rules, party-based expansions of judicial review generate a mixed array of transaction costs. Party-generated rules involve higher transaction costs with respect to negotiations over the terms of expanded review itself. On the other hand, some of the costs associated with the choice of forum generated by the judicially crafted "manifest disregard of the law" standard are less dominant in cases of contractually expanded judicial review. The size of this cost difference will depend, however, on the larger system within which the parties are operating.

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[126] *See, e.g., Cargill*, 236 F.3d at 461–462 (vacatur where an award is completely irrational or in manifest disregard of the law, recognizing possibility of "fundamental unfairness"); *Williams*, 197 F.3d at 757–758 (recognizing five non-statutory grounds); Scott v. Prudential Sec. Inc., 141 F.3d 1007, 1017 (CA11 1998) (vacatur where an award is arbitrary and capricious, contrary to public policy, or in manifest disregard of the law); *Montes*, 128 F.3d at 1458–1459 (same); *Tanner*, 72 F.3d at 239–242 (manifest disregard of the law or public policy); Ainsworth v. Skurnick, 960 F.2d 939, 940 (CA11 1992) (per curiam) (vacating an arbitral award for being "arbitrary and capricious"); Jenkins v. Prudential-Bache Sec., Inc., 847 F.2d 631, 633–634 (CA10 1988) (vacatur if an award is an abuse of discretion); *see generally*, Poser, *supra* note 23, at 512–513 and n. 185–190; Stephen L. Hayford & Scott B. Kerrigan, *Vacatur: The Non-Statutory Grounds for Judicial Review of Commercial Arbitration Awards*, 51 DISP. RESOL. J. 22, 23–26 (Oct. 1996) (collecting cases). For the suggestion that these doctrines are merely different formulations of a single ground for vacatur, *see Advest*, 914 F.2d at 8–9.

A regime of party-based expansions increases some transaction costs. In contrast to judicial expansions (or legislative expansions described below), a regime of party-based expansions does not automatically insert an implied term of judicial review for legal errors into the parties' arbitration agreement. As a result, the parties are required to negotiate over matters such as whether to allow expanded judicial review for legal errors and, if so, under what substantive standard. Negotiations over these matters require the parties to assess the desirability of such review and the appropriate substantive standard. These sorts of assessments require an investment of time and costs by the parties. As a result, transaction costs rise.

In other respects, however, transaction costs under a regime of party-based expansions of judicial review are not as high as in the case of judicial rules. Party-generated rules are less likely to generate costs associated with the choice of forum than judicial regimes. Since the parties control the extent to which the grounds for review of the arbitral award may exceed those provided under the FAA, inter-jurisdictional variations do not arise, and analogous non-statutory grounds are less likely to develop. Moreover, the current case law on party-based expansions of judicial review does not reveal sharp inter-jurisdictional variations in the application of the parties' standard in contrast to the chaos under the judicially generated "manifest disregard of the law" doctrine.

Party-based expansions, however, are not costless with respect to the choice of forum. The parties must still investigate how courts have interpreted the language in other arbitration agreements expanding judicial review. Furthermore, in light of the explicit disagreement between courts over the enforceability of party-based expansions, choice-of-forum considerations are now crucial.

In summary, the transaction costs associated with party-based expansions of judicial review of arbitral awards are essentially the mirror image of those associated with judicially crafted rules. In a regime permitting parties to expand judicial review of arbitral awards to include legal errors, the parties must negotiate over whether to include such review and, if so, the substantive standard that the court should apply. On the other hand, the parties encounter relatively lower transaction costs with respect to the choice of forum due to relatively narrower variations between courts in applying such provisions. Legislatively authorized opt-in regimes may further reduce the costs associated with party-based expansions by narrowing the choices available to the parties.

3. *Legislatures*

For legislative rules, the analysis of transaction costs largely tracks that of court-generated rules. Like a judicial rule, a legislative rule automatically implied into the agreement may decrease transaction costs with respect to party negotiations over the scope of judicial review. Likewise, a legislative rule may increase transaction costs with respect to the choice of forum insofar as application of the legislative standard does not

develop uniformly across jurisdictions. In at least two respects, however, the transaction cost analysis of a legislative rule differs from that of a judicial rule.

First, the transaction costs associated with the legislative rule will depend partly on whether the regime automatically imposes a standard of judicial review or, instead, permits parties to opt into that regime. In regimes automatically requiring judicial review of an award for legal error, transaction costs would be relatively low. As with a judicial rule, such a legislative rule would effectively be implied into the parties' agreement, thereby sparing the parties the need to dicker over the term. By contrast, in regimes permitting the parties to opt into a system of judicial review of arbitral awards for legal error, transaction costs may actually be higher. By according the parties a modicum of choice, opt-in regimes expand the range of issues over which the parties may negotiate in formulating their agreement. This forces the parties to assess whether review of future awards for legal errors would be in their strategic interest. In cases where the parties' assessments diverge, opt-in regimes will require additional negotiation over the terms of the agreement and, thereby, increase overall transaction costs.

Secondly, the transaction costs associated with a legal rule will be lower than those associated with a judicial rule with respect to negotiations over the choice of forum. While the transaction costs caused by inconsistent applications of a legislative standard would not differ from those caused by a judicial standard, overall costs should be lower due to a reduced risk of expansion of the vacatur grounds by analogy. As noted above, judicial expansions of the grounds for vacatur are not confined to manifest disregard of the law.[127] A regime of legislative rules cuts out the methodological basis for non-statutory grounds for vacating an arbitral award and, thereby, reduces the risk that additional grounds will be created by analogy; variations across jurisdictions over the grounds for setting aside an award, therefore, should decline. This reduced variation lowers the costs entailed in investigating the choice of forum. As a result, overall transaction costs should decline in a regime where the legislature decides whether to authorize judicial review of arbitral awards for legal error.[128]

Thus, as with error costs, the transaction costs associated with a legislative rule providing for expanded judicial review of an arbitral award seem to fall somewhere between those for court-based and party-based rules. Like judicial rules, legislative rules mandating substantive review of arbitral awards reduce transaction costs by sparing the parties the need to bicker over the terms. Opt-in regimes may slightly increase costs by requiring parties to decide whether opting into the regime is in their

[127] *See* text accompanying notes 40–57.

[128] At a broad level of generality, this account of transaction costs is incomplete. A legislative rule, unlike a judicial one, involves "start-up" costs in terms of the systemic costs involved in enacting the legislation. Moreover, the model ignores certain biases in a legislative system where small, well-organized groups influence the process to obtain a result favorable to their interests but sub-optimal across all cases. I am grateful to Chris Bowers for his discussions on this point.

strategic interest. Due to inter-jurisdictional variations in the application of the standard, legislative costs should entail some transaction costs in the choice of forum. These costs, however, are likely to be less severe than in the case of judicial rules due to the reduced risk that variations in the non-statutory grounds for vacatur will develop.

4. *Summary*

This section considers whether courts, parties or legislatures serve as the optimal institution for the source of a rule permitting judicial review of arbitral awards for errors of law. It evaluates their relative competencies in three areas: legitimacy, error costs and transaction costs.

With respect to legitimacy, courts and parties rank relatively low due to the dearth of statutory or precedential support. Legislatures, by contrast, rank high due to the prevailing norms, both internationally and domestically, of statutes setting forth the grounds for vacating an arbitral award.

With respect to error costs, the record is more mixed. Judicial and, to a lesser extent, legislative rules risk relatively higher error costs due to the difficulties in application. Legislative rules risk slightly lower costs due to the legislature's ability to link expanded judicial review with a requirement to give reasons. On this criterion, party-based rules fare most favorably due to the comparatively lower risks of misapplication, the less substantial consequences of a misapplication and the parties' ability to link expanded review with a requirement to give reasons.

With respect to transaction costs, again the results are mixed. Judicial and legislative rules reduce up-front transaction costs by sparing the parties the need to investigate whether to include a term in the arbitration agreement providing for judicial review of the award for legal errors. On the other hand, both institutions, especially courts, generate high transaction costs related to the choice of forum due to inter-jurisdictional variations in the rule's application. Party-based expansions display the mirror image of the transaction costs associated with judicial and legislative rules. Transaction costs are high insofar as the parties are required to negotiate over the desirability of and terms governing expanded judicial review; they are lower insofar as slimmer inter-jurisdictional variations reduce the need to investigate the choice of forum. The following section of this article synthesizes the results of this analysis.

III. CONCLUSIONS

Having analyzed the various institutional models for extending judicial review of arbitral awards to encompass legal errors, I offer four conclusions; three concerning the future directions in the doctrine and one concerning a future research agenda.

First, legislatures should decide whether to expand judicial review of arbitral awards to encompass legal errors. In the case of the FAA, this responsibility falls to

Congress, not the federal courts or the parties. Entrusting that decision to the legislature avoids the legitimacy deficit associated with judicially crafted or party-based expansions of the grounds for review. It also respects institutional interests such as controlling the development of precedent and conserving judicial resources that underpin a legislature's desire *not* to permit judicial review of arbitral awards for legal error in certain circumstances. Court-based and party-based expansions of the grounds for review ignore these interests. Compared to a judicial rule, a legislative rule involves relatively lower error costs and ensures initial uniformity, at a certain level of generality, across jurisdictions. In order to avoid some of the workability problems associated with a judicial rule, the legislative rule can be crafted so as to couple substantive review with a requirement that arbitrators provide reasons for their decision. Finally, the legislative rule involves low to moderate transaction costs, sparing the parties the need to bicker over the terms of the arbitration agreement and, in contrast to a judicial rule, involving relatively less inter-jurisdictional variation such as the uneven growth of non-statutory grounds for vacatur.

To be sure, a legislative rule is not optimal along every factor. Many of the shortcomings associated with judicially crafted rules might also apply in the case of a legislative rule authorizing judicial review of arbitral awards for legal errors. Like judicial rules, legislative rules may generate substantial error costs due to misapplication or inconsistent application. Moreover, these error costs may be widespread due to the universal applicability of a legislative rule. Error costs may also be difficult to reduce due to the comparative difficulty of changing legislative rules. Inter-jurisdictional variations in the application of the rule may generate transaction costs associated with the choice of forum.

In order to decrease these costs while still capturing the benefits of the legislative solution, the legislative rule should not be compulsory but, like New Jersey's regime, should accord the parties the decision whether to opt into the system of expanded review for legal error. An opt-in feature entrusts legislatures with the prerogative to decide, in the first instance, whether to authorize substantive review of arbitration awards by courts. It overcomes the difficulty of changing the rule by effectively enabling the parties to decide whether to adopt the regime of expanded review in their particular case. Of course, an opt-in feature will involve slightly higher transaction costs than a mandatory legislative rule insofar as the parties themselves must decide whether to opt into the system of expanded judicial review. However, savings in error costs should outweigh these additional transaction costs.[129]

[129] A similar set of benefits could be obtained by an "opt out" regime, under which the legislature provides for substantive review of the award unless the parties "opt out" of the expansive review and, instead, choose minimal or no review. Several international arbitration laws from other countries supply examples of "opt out" regimes. For example, under the Swiss Private International Law Act, setting aside proceedings may be excluded or limited in arbitrations involving only non-Swiss parties. *See, e.g.*, Swiss I.P.R.G., art. 192.1. For a thoughtful discussion of these types of regimes, *see* Christopher R. Drahozal, *Enforcing Vacated International Arbitration Awards*, 11 AM. REV. INT'L ARB. (2000) (forthcoming, copy on file with author).

Secondly, courts should not enforce party-based expansions of the grounds for review. In the federal context, this means that cases such as *Gateway* and *Syncor* were wrongly decided. Party-based expansions impinge on certain institutional interests that might underpin a legislative decision not to permit judicial review of arbitral awards for legal error. Where the applicable Arbitration Act also supplies the basis for the court's subject matter jurisdiction, party-based expansions also collide with prohibitions on parties manufacturing the courts' subject matter jurisdiction. Party-generated expansions of the grounds for review also entail substantial risks exemplified by *Syncor* and *Gateway* that the courts will conduct a far more scrutinizing review than the parties ever intended.[130]

Thirdly, courts should curtail their spontaneously generated use of the manifest disregard of the law doctrine. In the federal context, this means that the development of the "manifest disregard of the law" doctrine in the case law following the dicta in *Wilko* has been entirely misguided. Court-based expansions, like party-based ones, intrude on legislative prerogatives that might underpin a decision not to permit judicial review of arbitral awards for legal errors. They undermine stability in the arbitration regime by creating uncertainty about the scope of the exception and creating the conditions under which additional non-statutory grounds can be developed by analogy. Decisions such as *Halligan* and *Cole* demonstrate that the purportedly narrow review of awards for "manifest disregard of the law" can easily evolve into a more intrusive full-scale review of the award for legal errors.

To set the stage for this reform agenda, the U.S. Supreme Court should send a strong signal that Congress controls the grounds upon which an arbitral award may be set aside under the FAA. In matters such as this one, involving the proper interpretation of the FAA, review is only likely where a clear division of authority emerges among the federal courts of appeals.[131] Under that rule, the current split over the enforceability of party-based expansions provides the most promising area for Supreme Court intervention. In other areas, although sharp disagreements have not emerged, review is not out of the question. Though appellate courts superficially recite the same "manifest disregard of the law" standard, a comparison of cases such as *Cole*, *Halligan* and *Williams* suggest that, beyond this abstract formulation, their applications of the standard differ sharply. The latent dissensus among the courts of appeals over the grounds for vacatur of "non-domestic" awards made in the United States provides another ripe area for Supreme Court intervention.

Fourthly, beyond these specific doctrinal conclusions, this article points to several additional directions for future research into an institutional account of arbitration law. Future study should provide a more systematic account of various institutions'

[130] Conversely, however, under a model not taking legitimacy into account, the case for party-based control, on purely economic grounds, is strong. This would particularly be true in a party-based regime in which the parties coupled review for legal error with a requirement that arbitrators give reasons for their decisions.

[131] *See* S.Ct. R. 10 (describing the grounds upon which a petition for a writ of certiorari may be granted).

respective competencies and an objective system for measuring their capacities.[132] The account should consider not just courts, parties and legislatures but also other actors, particularly arbitral institutions such as the International Chamber of Commerce and appellate arbitral tribunals.

[132] For a scholarly effort to consider one level of the institutional debate, *see* Stephen Walt, *Decision by Division: The Contractarian Structure of Commercial Arbitration*, 51 RUTGERS L. REV. 369 (1999).