

# CURBING THE RUNAWAY ARBITRATOR IN COMMERCIAL ARBITRATION: MAKING EXCEEDING THE POWERS COUNT

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## INTRODUCTION

Arbitration is in crisis. Under fire as an oppressive, claim-suppressing method of dispute resolution, imposed by businesses upon unsuspecting employees and consumers, arbitration is also becoming increasingly unpopular with its original designers—businesses in commercial disputes with other businesses.<sup>1</sup> While academic commentators spill considerable ink assessing the propriety of businesses imposing pre-dispute arbitration agreements on consumers and employees, to date they have paid scant attention to the reasons underlying business flight from arbitration as a preferred method for resolving disputes with other businesses.

The available empirical research, however, does shed at least some light on the issue. A 2011 RAND survey of U.S. corporate counsel found that most in-house counsel believed that arbitration was cheaper, faster and “better” than litigation, but worried about the risk of arbitrator compromise and the inability to appeal adverse arbitration awards to court.<sup>2</sup> A study by Stipanowich and Lamare of corporate counsel at Fortune 1,000

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1. Corporate disputes can manifest themselves in many ways—as disputes between shareholders and a business, challenging shareholder resolutions or questions about liability of management for its decisions. In this Article, the focus is on the classic form of commercial arbitration—disputes between two parties to a contract. In this area, arbitration clauses are common. See Thomas J. Stipanowich & J. Ryan Lamare, *Living with ADR: Evolving Perceptions and Use of Mediation, Arbitration, and Conflict Management in Fortune 1000 Corporations*, 19 HARV. NEGOT. L. REV. 1, 45 (2014); Michelle M. Leatham, *Making Arbitration Work: A Corporate User's View of the Future*, 32 ALTERNATIVES TO THE HIGH COST OF LITIG. (Int'l Inst. for Conflict Prevention & Resolution, New York, N.Y.), Mar. 2014, at 37, 37 (companies favor arbitration, among other reasons, because they can influence the selection of the expert decision-maker, enjoy low cost, speed, efficiency, and the ability to avoid discovery).

2. DOUGLAS SHONTZ ET AL., RAND CORP., INST. FOR CIVIL JUSTICE, BUSINESS-TO-BUSINESS ARBITRATION IN THE UNITED STATES: PERCEPTIONS OF CORPORATE COUNSEL 11–20 (2011) (right to appeal was the only factor cited by a majority of survey respondents discouraging them from using arbitration). In 1997, a survey of Fortune 1000 corporate counsel on their practices and attitudes regarding dispute resolution, mediation, and arbitration provided the first broad-based picture of conflict resolution processes within large companies. See DAVID B. LIPSKY & RONALD L. SEEBER, THE APPROPRIATE RESOLUTION OF CORPORATE DISPUTES: A REPORT ON THE GROWING USE OF ADR BY U.S. CORPORATIONS (1998). This survey showed that corporate counsel expressed positive views of many perceived benefits of these options and that a majority of respondents predicted that their companies would make use of both mediation and arbitration in the future. See *id.* In 2011, Cornell University's Scheinman Institute on Conflict Resolution, the Straus Institute for Dispute Resolution at Pepperdine University School of Law, and the International Institute for Conflict Prevention & Resolution (“CPR”) co-sponsored a survey of corporate counsel in Fortune 1000 companies. See Stipanowich & Lamare, *supra* note 1, at 24. The primary organizational representatives participating in the process of planning the survey were Professor David Lipsky (Scheinman Institute), Professor Thomas Stipanowich (Straus Institute) and CPR Institute President and CEO Kathleen Bryan. *Id.* at 23 n.164; see also David B. Lipsky et al., *The Strategic Underpinnings of Conflict Management in U.S. Corporations: Evidence from a Survey of Fortune 1000 Companies 1* (June 8, 2014) (unpublished manuscript) (on file with author). This study of American corporations revealed a common pattern to be a desire for maximum control of the dispute resolution process. See Stipanowich & Lamare, *supra* note 1, at 50–51. The 2011 study further reflected that, for many corporate counsel, concerns about the inability to overturn arbitration awards that do not comport with applicable law or proven fact, coupled with suspicions about the abilities or motivations of arbitrators, were paramount. See *id.* at 53.

Corporations, conducted both in 1997 and 2011, revealed similar concerns.<sup>3</sup> In 1997, they found that 85% of companies used arbitration in commercial or contract disputes; by 2011, that number fell to 62.3%.<sup>4</sup> The primary reasons counsel offered for abandoning arbitration as a means to resolve commercial disputes were the lack of appeal, fear of compromise awards, and concerns about the inability to require arbitrators to use legal rules.<sup>5</sup>

Disenchantment with arbitration in the business context stems at least in part, then, from parties' inability to constrain arbitrator discretion or obtain judicial correction of erroneous awards—what this Article refers to as the runaway-arbitrator problem.<sup>6</sup> Yet parties' efforts to obtain greater judicial involvement—for example, arbitral agreements calling for de novo review on legal issues—generally have not met with success. Although party autonomy in process design is an essential value of arbitration,<sup>7</sup> courts largely have rejected parties' attempts to design their own judicial review provisions, culminating in *Hall Street Associates v. Mattel, Inc.*, where the Supreme Court held that parties could not agree to expand judicial review of arbitration awards beyond the provisions set forth in the Federal Arbitration Act (FAA).<sup>8</sup> The *Hall Street* Court also arguably rejected the only other mechanism courts had developed to review the substance of an arbitral award, the “manifest disregard of the law” standard.<sup>9</sup> In short, the Supreme Court has adopted a strong arbitration

3. Stipanowich & Lamare, *supra* note 1, at 37.

4. *Id.* at 46.

5. *Id.* at 17. 51.6% of respondents reported that they were less interested in using arbitration for corporate or commercial disputes because arbitration awards are difficult to appeal. *Id.* at 53. 47% reported concern that arbitration results in compromised outcomes. *Id.* 44.1% of respondents were worried that arbitrators need not follow legal rules. *Id.* 44.9% of respondents cited reluctance of the opposing party as a reason not to use arbitration. *Id.*

6. Allen Blair, *Is Less Really More? Hall Street Associates, Private Procedural Ordering and Expanded Review of Arbitral Awards in State Courts*, 5 Y.B. ON ARB. & MEDIATION 74, 108–09 (2013) (recent empirical evidence establishes that commercial parties are moving away from arbitration because of arbitration's limited appeal rights); see also Christopher R. Drahozal, *Contracting Around Hall Street*, 14 LEWIS & CLARK L. REV. 905, 908 (2010). Blair cites an article in the Los Angeles Daily Journal from 2009, in which a corporate lawyer, whose client lost \$4 billion dollars in an arbitration case, said, “[w]e still like the benefits of arbitration . . . but boy, maybe we should think twice about having no safety net at all, no chance when things go wayward.” *Id.* at 74 n.1 (alteration in original) (quoting Joanna Lin, *\$4 Billion Award May Be Record in Arbitration Case*, L.A. DAILY J., June 5, 2009 (Verdicts and Settlements), at 2).

7. Thomas J. Stipanowich, *Arbitration: The “New Litigation,”* 2010 U. ILL. L. REV. 1, 51 (2010) (proffering that the primary value of arbitration is users' ability to make “key process choices to suit their particular needs”).

8. 552 U.S. 576, 592 (2008).

9. *Id.* at 585. Until 2008, every circuit court recognized manifest disregard of the law as a basis for challenging an arbitration award. See Michael H. LeRoy, *Are Arbitrators Above the Law? The “Manifest Disregard of the Law” Standard*, 52 B.C. L. REV. 137, 158–59 (2011). In *Hall Street*, the Court raised a question as to the continuing validity of manifest disregard of the law as a non-statutory basis for challenging an arbitration award, opining that the standard might be a separate basis for

deference regime that provides parties limited means to assuage their concerns about arbitrator incompetence or error.<sup>10</sup>

Yet, as noted above, if arbitration is to revive as a primary dispute resolution mechanism for commercial disputes, parties must have some means for securing effective review of arbitral awards—an escape hatch for the runaway-arbitrator problem.<sup>11</sup> This Article proposes one pathway courts could utilize to create a mechanism that is consistent with Supreme Court precedent while providing some limited means for judicial intervention to address the runaway-arbitrator problem.

This Article proceeds as follows. Part I briefly examines why businesses, the very parties that originally insisted upon extremely limited judicial review of arbitration awards, have now come to dislike narrow review and are moving away from arbitration as a result of this lack of review. Part I concludes that this change in viewpoint is largely a result of changed circumstances regarding the size and scope of business disputes—larger disputes lead to greater risk aversion. Part II examines the Supreme Court’s *Hall Street* decision, which rejected party efforts to expand judicial review of arbitration awards by party agreement and as a result, thwarted business efforts to alter arbitration to better suit their changing needs. This Part explains that the Court’s recommitment to narrow judicial review of arbitration awards prompts lower courts, when reviewing arbitration awards, to disregard or ignore terms contained in parties’ arbitration

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challenging an arbitration award or might be contained within Federal Arbitration Act § 10’s “exceeding the powers” provision. *Hall St.*, 552 U.S. at 584 (raising the question of the continuing viability of manifest disregard in dicta). The ambiguity of this Supreme Court dicta created confusion among the lower courts. See Citigroup Glob. Mkts. Inc. v. Bacon, 562 F.3d 349, 350 (5th Cir. 2009); Comedy Club, Inc. v. Improv W. Assocs., 553 F.3d 1277, 1290 (9th Cir. 2009); Coffee Beanery, Ltd. v. WW, L.L.C., 300 F. App’x 415, 418 (6th Cir. 2008). In 2010, the Supreme Court applied the manifest disregard standard in *Stolt-Nielsen S.A. v. AnimalFeeds Int’l Corp.*, 559 U.S. 662 (2010). In a footnote, the Court stated that it did not know if manifest disregard still existed. *Id.* at 672 n.3. However, the Court went on to note that if the manifest disregard standard did still exist, it was satisfied in the instant case, as the arbitrators relied upon their own view of public policy to interpret a silent arbitration clause to permit class arbitration. *Id.* The majority of circuit courts today continue to apply manifest disregard as they did before 2008. LeRoy, *supra*, at 180–81; see also Kenneth R. Davis, *The End of an Error: Replacing “Manifest Disregard” with a New Framework for Reviewing Arbitration Awards*, 60 CLEV. ST. L. REV. 87, 92 (2012) (noting that after the Supreme Court’s *Hall Street* decision, some courts hold that manifest disregard is no longer viable, while others hold that it is).

10. Christopher Drahozal suggests that parties seek greater judicial review in “bet the company” cases or to reduce risk of aberrational arbitration awards, sometimes known as “knucklehead,” “roll the dice,” or “Russian roulette” awards. See Drahozal, *supra* note 6, at 908. Expanded review makes arbitration more attractive to parties fearful of these kinds of results. *Id.*

11. Parties might use other mechanisms to manage the runaway arbitrator problem. For instance, parties could be more careful during the arbitrator selection process, require the arbitrator to conduct an early case management conference, or contract for the use of appellate arbitration panels. See Thomas J. Stipanowich, *Reflections on the State and Future of Commercial Arbitration: Challenges, Opportunities, Proposals*, 25 AM. REV. INT’L ARB. 297, 344–46 (2014) (reviewing means to ensure business users are able to obtain what they want from the arbitration process). This Article focuses on the legal mechanisms available to ensure enforcement of party limitations: the exceeding the powers provision included in the Federal Arbitration Act and in the vast majority of state arbitration acts.

agreements, including the commonly inserted provisions designed to circumscribe arbitrators' remedial authority.

Next, Part III describes how the Court's refusal to enforce parties' agreed upon language regarding judicial review and choice of law prompted parties to flee arbitration, often for less efficient and more expensive resolution processes.<sup>12</sup> Part IV proposes a new approach to evaluating arbitration agreements that constrains arbitrator remedial authority and choice of law.<sup>13</sup> Existing federal and state arbitration acts all contain an "exceeding the powers" provision for reviewing arbitration awards. Under this provision, a losing party may challenge an adverse arbitration award on the basis that the arbitrator rendered an award inconsistent with the limitations the parties included in their agreement. Unfortunately, courts haphazardly and inconsistently apply this provision, in part, perhaps, because the term "exceeding the powers" has no real definition. Using language adopted in other arbitration cases, this Article proposes providing some definition to the term and asserts that, in cases where an arbitrator ignores party limitations on remedies that are *clearly and unmistakably* articulated in the parties' agreement, the arbitrator has exceeded her powers. This proposal provides a mechanism for determining whether the parties actually intended to limit the arbitrator's remedial authority while still honoring the traditional deference due arbitration awards.

If the parties' limits are clear and unmistakable, the next question is whether the limits should be enforced. Thus, the Article explores whether the unconscionability test courts use to evaluate party limits on *judicial* remedial authority could be applied to evaluate party agreements to constrain *arbitrator* remedial authority. This Article also proposes that arbitration agreements containing choice of law clauses be evaluated in the same manner as choice of law provisions in traditional contracts, rather than under the heightened scrutiny test the courts currently use. Using this

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12. MyLinda K. Sims & Richard A. Bales, *Much Ado About Nothing: The Future of Manifest Disregard After Hall Street*, 62 S.C. L. REV. 407, 436 (2010) ("If arbitrators were free to make decisions outside the scope of the contract, then arbitration would become an unstable means of dispute resolution. Parties would have little assurance that arbitrators would recognize sound legal principles or controlling industry standards. Such a situation could be akin to Russian roulette, with parties never knowing what the end result would be.").

13. Of course, ensuring adequate judicial review of arbitration awards is likely to result in more arbitration award challenges. But, the fundamental nature of arbitration, which requires enforcement of party intent, as expressed through their agreement, must be assured, even if more challenges are a consequence. At first glance, the "slippery slope" argument may be overblown. In 2004, a ten-month study of arbitration award challenges in state and federal court revealed that only 182 awards were challenged in court. *See generally* Lawrence R. Mills, J. Lani Bader, Thomas J. Brewer & Peggy J. Williams, *Vacating Arbitration Awards*, DISP. RESOL. MAG., Summer 2005, at 23. A repeat of that study in 2008, over a nine-month period, showed that only 158 challenges were filed. *See* Thomas J. Brewer & Lawrence R. Mills, *When Arbitrators "Exceed Their Powers,"* DISP. RESOL. J., Feb.-Apr. 2009, at 46, 47.

approach, a court would find that the arbitrator exceeded her powers if she ignored the parties' choice of law, and that ignorance was apparent on the face of the award or through a review of the arbitrator's opinion. This approach would provide consistency when courts review these provisions and, at the same time, avoid placing an unnecessary burden on parties to prove that they really meant it when they adopted a choice of law provision.

## I. NARROW JUDICIAL REVIEW OF ARBITRATION AWARDS

Parties created arbitration to resolve disputes effectively, efficiently, and at a lower cost than they could achieve through litigation.<sup>14</sup> While arbitration is similar to litigation in that a neutral third party resolves the dispute, it differs in several important ways, including that the parties design the process and control (at least in theory) the issues and law the arbitrator may consider and the remedies she can order.<sup>15</sup> In addition, in a typical arbitration, parties trade the right to challenge the substance of the decision-maker's ruling in exchange for a fast and relatively final resolution of the issue.<sup>16</sup> For the most part, then, arbitration operates independently of the court system. Interactions between parties committed by agreement to arbitration and the court system are limited to challenges at the front end to the arbitration agreement (i.e., is the matter properly sent to arbitration?) and at the back end, after the arbitration process is over, a very deferential review of the arbitrator's award (i.e. is the arbitrator's award permissible?). Narrow judicial review of arbitration awards made sense historically because parties wanted their disputes resolved according to norms and customs, rather than laws.<sup>17</sup>

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14. See COMMERCIAL ARBITRATION AT ITS BEST: SUCCESSFUL STRATEGIES FOR BUSINESS USERS 173 (Thomas J. Stipanowich & Peter H. Kaskell eds., 2001) [hereinafter COMMERCIAL ARBITRATION AT ITS BEST] (traditional values of arbitration include speed, finality, and party autonomy); Leetham, *supra* note 1 (companies favor arbitration, among other reasons, because they can influence the selection of the expert decision maker, enjoy low cost, speed, efficiency, and the ability to avoid discovery).

15. See Murray S. Levin, *The Role of Substantive Law in Business Arbitration and the Importance of Volition*, 35 AM. BUS. L.J. 105, 106, 112 (1997) (arbitral parties design and control the arbitration process and may designate the decision-making principles the arbitrators must use); Matthew Savare, *Clauses in Conflict: Can an Arbitration Provision Eviscerate a Choice-of-Law Clause?*, 35 SETON HALL L. REV. 597, 598 (2005) (parties can structure arbitrations as they see fit). According to the American Arbitration Association (AAA), "[i]t is not uncommon for parties to specify the law that will govern the contract and/or the arbitration proceedings." AM. ARBITRATION ASS'N, DRAFTING DISPUTE RESOLUTION CLAUSES: A PRACTICAL GUIDE 9 (1992).

16. See Stephen L. Hayford, *Law in Disarray: Judicial Standards for Vacatur of Commercial Arbitration Awards*, 30 GA. L. REV. 731, 741 n.24 (1996).

17. See Jeffrey W. Stempel, *Asymmetric Dynamism and Acceptable Judicial Review of Arbitration Awards*, 5 Y.B. ON ARB. & MEDIATION 1, 6 (2013) (limited-scope review existed in commercial disputes because merchants wanted the ability to continue doing business in the future and operate according to informal norms unique to their field).

As arbitration evolved, though, courts ignored party attempts to circumscribe arbitrator authority in favor of maintaining limited judicial review of arbitration awards, reasoning that only narrow review would protect the values of arbitration—its speed, low cost, and efficient processing of disputes by a third party with expertise in the subject matter of the dispute.<sup>18</sup> Courts concluded that substantive review of arbitration awards would undermine the flexibility and independence of the arbitration process and render it a useless pre-litigation step.<sup>19</sup> In emphasizing these values, though, the courts ignore another core value that underlies arbitration: party autonomy.<sup>20</sup> By valuing finality and low cost over party autonomy, these rulings deprive parties of the benefit of designing and controlling the process that leads to the final award and discourages them from using the arbitral process.<sup>21</sup> If courts fail to enforce the parties' wishes, parties may conclude that they cannot control this private process and opt for some other form of dispute resolution.<sup>22</sup>

This Part traces the evolution of judicial review of arbitration awards and explains why, ironically, almost one hundred years after merchants sought the enactment of the FAA with its limited judicial review provisions, they are no longer enamored with limited judicial review of arbitration awards and, instead, seek a more flexible review process as a condition of their willingness to continue using arbitration as their primary means for resolving disputes.

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18. See *Willemijn Houdstermaatschappij, BV v. Standard Microsystems Corp.*, 103 F.3d 9, 12 (2d Cir. 1997); *J.D. Shehadi, L.L.C. v. U.S. Maint., Inc.*, No. 11-224, 2011 WL 4632484, at \*4 (E.D. Pa. Oct. 5, 2011); *Harper Ins. Ltd. v. Century Indem. Co.*, 819 F. Supp. 2d 270, 275 (S.D.N.Y. 2011).

19. *Hall St. Assocs. v. Mattel, Inc.*, 552 U.S. 576, 588 (2008) (limited judicial review of arbitration awards is “needed to maintain arbitration’s essential virtue of resolving disputes straightaway”); *Garrity v. McCaskey*, 612 A.2d 742, 745 (Conn. 1992) (judicial review of arbitration awards should be designed to avoid “interference with an efficient and economical system of alternative dispute resolution”); *Ancor Holdings, LLC v. Peterson, Goldman & Villani, Inc.*, 294 S.W.3d 818, 826 (Tex. App. 2009) (judicial review of an arbitration award increases expenses and causes delays, which undermines arbitration as an efficient and economical means of resolving disputes).

20. See *infra* Part II(A).

21. See *infra* Part II(A).

22. The flight from arbitration has been a long time coming. Users, providers, and scholars strongly encourage parties to tailor the arbitral process to fit their needs, assuring parties that the arbitrator will follow their dictates. As parties increasingly included choice of law provisions along with their arbitration agreements and, in addition, asked arbitrators to decide legal issues, they expected greater scrutiny of arbitration awards to ensure that the arbitrator complied with their rules. Yet courts, by and large, have been reluctant to expand judicial review of arbitration awards, even under the exceeding the powers provisions, for fear of undermining arbitration’s finality. The irony is that providers and others continue to tell parties that arbitration is the parties’ process and that the parties can control the outcome through design. Between the judicial rejection of party attempts to expand judicial review of arbitration awards and the unwillingness of courts to ensure enforcement of party limits—either through choice of law provisions or explicit instructions—parties are finally realizing that arbitration is not going to provide them what they want, at least in major disputes.

### A. *Traditional Arbitration*

Originally conceived as a means to resolve commercial disputes among merchants during the medieval period,<sup>23</sup> arbitration thrived as the preferred dispute resolution mechanism in specialized, self-regulating communities.<sup>24</sup> In the earliest days of arbitration's development, merchants traveled to fairs where they could meet and conduct business with other merchants.<sup>25</sup> Because these fairs occurred far from the merchants' homes, and because the merchants did not stay at any particular fair very long, it was important for the merchants to create a system to resolve the disputes that would inevitably arise from the business conducted at the fair.<sup>26</sup> Unfortunately, the common law court system was not an appropriate venue for the resolution of these disputes because of its complex and drawn out procedures.<sup>27</sup> Moreover, the common law courts had little understanding of the customary norms the merchants followed.<sup>28</sup>

Merchants were interested in a system that would resolve disputes (1) quickly (so they could leave the fairs) and (2) in accordance with industry standards (to facilitate relationships among the parties).<sup>29</sup> Thus, self-regulating communities, like merchants in the seventeenth and eighteenth centuries, adopted an arbitral system to resolve disputes.<sup>30</sup> Traditional arbitration, unlike litigation, empowered these disputants to appoint a disinterested third party who was an expert in the industry to resolve the dispute in accordance with understood customary norms.<sup>31</sup> The arbitral process, with its lack of formalism, provided the swift results the parties

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23. Arbitration was created to resolve disputes long before English merchants began to use it. Roman merchants utilized arbitration to resolve disputes, as did the seventh century Ecclesiastical courts. Paul L. Sayre, *Development of Commercial Arbitration Law*, 37 YALE L.J. 595, 597-98 (1928).

24. See TOM E. CARBONNEAU, CASES AND MATERIALS ON COMMERCIAL ARBITRATION 10 (1st ed. 1997) (noting that the arbitral procedures used in commercial, labor, maritime, and construction disputes are very similar); Jeffrey W. Stempel, *Reflections on Judicial ADR and the Multi-Door Courthouse at Twenty: Fait Accompli, Failed Overture, or Fledgling Adulthood?*, 11 OHIO ST. J. ON DISP. RESOL. 297, 334 (1996) (describing traditional arbitration as part of "old" ADR which confines disputes to a subset of an industry).

25. See Stempel, *supra* note 17 and accompanying text.

26. See Stempel, *supra* note 24, at 334.

27. See Thomas E. Carbonneau, *The Reception of Arbitration in United States Law*, 40 ME. L. REV. 263, 268 (1988) (emphasizing that commercial relationships fared much better under a system that focused on salvaging relationships among the parties rather than on ensuring that stringent procedural safeguards were followed).

28. As Blackstone emphasized, arbitration was useful in settling mercantile transactions that were "almost impossible to be adjusted on a trial at law." 2 WILLIAM BLACKSTONE, COMMENTARIES \*17.

29. See *id.*

30. See *id.*; see also Carbonneau, *supra* note 27, at 268.

31. Jeffrey W. Stempel, *Pitfalls of Public Policy: The Case of Arbitration Agreements*, 22 ST. MARY'S L.J. 259, 270 (1990).

desired.<sup>32</sup> Moreover, the arbitral system ensured finality, also essential to facilitating continuing relationships, by obtaining the parties' agreement to abide by the arbitrator's resolution of the claim.<sup>33</sup> Judicial review of arbitration awards was unwanted both because the timetable for such review was inconsistent with the parties' need for immediate resolution, and because parties believed that application of purely legal rules was likely to result in a high error rate in a custom or norm-driven system.<sup>34</sup>

Interestingly, even if the parties had not agreed that the arbitrator's decision was final, judicial involvement would nevertheless have been unnecessary to ensure enforcement of most arbitration agreements or awards because both parties had an incentive to avoid self-serving behavior.<sup>35</sup> The amount in controversy tended to be relatively small, meaning that the value of the parties' ongoing relationship, as well as the reputational interest of each party within the industry, vastly outweighed the stakes at issue in any particular case.<sup>36</sup> Thus, parties willingly abided by arbitration agreements and decisions in order to preserve their relationship and their respective reputations, and accordingly, to protect their livelihoods.<sup>37</sup>

It is not surprising then that the structure of traditional arbitration was entirely contractual. Allocation of important issues was left to the parties, in part because the governmental powers were not interested in regulating the arbitration process,<sup>38</sup> and in part because informal marketplace sanctions served the enforcement role that regulation often plays today.<sup>39</sup> Yet, largely for the reasons noted above, market sanctions work best when markets consist of relatively few players with frequent business

32. Edward Brunet, *Replacing Folklore Arbitration with a Contract Model of Arbitration*, 74 TUL. L. REV. 39, 45 (1999) ("In the historic folklore arbitrations, informal procedures dominated. There was little or no discovery. Evidence rules were inapplicable . . ." (footnotes omitted)).

33. *Id.* at 43–44; see also Randy Linda Sturman, *House of Judgment: Alternate Dispute Resolution in the Orthodox Jewish Community*, 36 CAL. W. L. REV. 417, 418 (2000) (recognizing that Bet Din, a form of ADR that allows Jews to resolve disputes between themselves, requires parties to sign a contract stating that they agree to abide by the decision).

34. See Brunet, *supra* note 32, at 45.

35. Avery Katz, *The Strategic Structure of Offer and Acceptance: Game Theory and the Law of Contract Formation*, 89 MICH. L. REV. 215, 280 (1990).

36. See Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115, 149–50 (1992) (noting that the diamond industry ensures obedience to arbitral awards through reputational sanctions).

37. See Brunet, *supra* note 32 and accompanying text.

38. The English courts in the medieval period had little interest or expertise in commercial disputes. Robert B. von Mehren, *From Vynior's Case to Mitsubishi: The Future of Arbitration and Public Law*, 12 BROOK. J. INT'L L. 583, 583–84 (1986) (suggesting that merchants preferred arbitration to litigation because they believed the King's courts were not well-versed in commercial matters).

39. See Bernstein, *supra* note 36 and accompanying text.

interactions, thus maximizing the importance of reputational concerns.<sup>40</sup> When the market grew wider and more impersonal, market sanctions became less effective. The growth of the market in the late nineteenth and early twentieth centuries played a major role in the development of law regulating arbitration in the commercial context. Initially, the commercial community was quite manageable. Yet as commerce grew beyond local fairs to national and then international venues, the informal marketplace sanctions that accompanied the failure to abide by an arbitral award were no longer sufficient alone to preserve the commercial community.<sup>41</sup>

Confronted by hostile courts<sup>42</sup> and an expanding marketplace, the commercial community in America turned to Congress to assist it in its efforts to bypass the traditional legal system in favor of a more efficient system of arbitration.<sup>43</sup> The commercial community pushed the adoption of

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40. Bruce Mann, in his extensive study of arbitration in pre-revolutionary Connecticut, emphasized the same phenomenon. According to his study, the success of arbitration is dependent on the existence of a community. Once community bonds weaken, community norms are no longer sufficient to ensure compliance with arbitration decisions. See Bruce H. Mann, *The Formalization of Informal Law: Arbitration Before the American Revolution*, 59 N.Y.U. L. REV. 443, 457–58 (1984). When that weakening occurs, the inability of parties to obtain enforcement of arbitral awards in court becomes problematic. *Id.* Jeffrey Stempel offers alternative reasons: he suggests that business people abided by agreements to arbitrate because it was honorable to do so. See Stempel, *supra* note 31, at 273. Alternatively, he contends that merchants may have complied with such agreements because they were fearful of informal business sanctions. *Id.* He also theorizes that some merchants might simply have preferred arbitration to traditional litigation. *Id.*

41. See Stempel, *supra* note 31, at 277 (explaining that increased commercialization of the community tended to render informal market-based coercion less effective).

42. Common law judges were hostile toward arbitration because they believed that merchants could systematically circumvent common law court procedures by agreeing to submit their disputes to arbitration, which would result in a reduction of the judges' salaries. *Kill v. Hollister* (1746), 95 Eng. Rep. 532; 1 Wils. 129. The judges' theory was that the increased use of arbitration had diminished judges' salaries because the amount a judge was paid depended on the number of cases he heard. *Scott v. Avery* (1856), 111 Rev. Rep. 392; 25 L.J. Ex. 308, 313. To avoid losing fees to arbitrators, the judges developed what came to be known as the "ouster doctrine." Applying this doctrine, common law courts invalidated executory agreements to arbitrate in a series of cases during the eighteenth century. Sarah Rudolph Cole, *Incentives and Arbitration: The Case Against Enforcement of Executory Arbitration Agreements Between Employers and Employees*, 64 UMKC L. REV. 449, 461–62 (1996). The ouster doctrine became well known as well as widespread and ultimately had to be addressed through legislation, like the Federal Arbitration Act, which guaranteed the enforceability of arbitration agreements and awards. See *id.* at 464–65.

43. Julius H. Cohen reported that the New York statute was necessary because merchants, who preferred to settle their disputes through a process other than litigation, were in the best position to know what that process should look like. Julius Henry Cohen, *The Law of Commercial Arbitration and the New York Statute*, 31 YALE L.J. 147, 150 (1921). As Cohen said,

Presumably men of commercial experience today need no guardianship for determining, at the time of making a contract, whether they prefer the opinion of their own trade upon technical questions, or the hazardous judgment of a jury of the vicinage. They know whether the contract is of a kind under which disputes can better be disposed of by trade committees or by twelve inexpert strangers to the trade. They know whether or not they prefer to have judicial selection of arbitrators, and the statute leaves them free either to provide their own method for selection or to leave it to the court.

*Id.*

the New York Arbitration Act in 1920, which ultimately became the model for the 1925 FAA.<sup>44</sup> The FAA's passage was an acknowledgment that a purely private approach was no longer workable in light of the developing concerns about enforceability that the market was no longer addressing and that the courts were exacerbating.

Discussion surrounding the FAA's adoption focused primarily on § 2, which governed enforceability of arbitration agreements.<sup>45</sup> Section 10(a), governing judicial review, unlike § 2, was not a significant departure from common law or state statutory arbitration as it existed prior to the FAA's passage.<sup>46</sup> According to Professor Ian MacNeil, the leading expert on the FAA's enactment, the adoption of § 10 was, for practical reasons, an unnecessary step, as the existing common law already limited the bases upon which a court could vacate an arbitral award.<sup>47</sup> In fact, the 1921 draft of the FAA did not include any provisions governing judicial review of arbitral awards.<sup>48</sup> This is not surprising because the 1921 draft mirrored the 1920 New York arbitration law, which also failed to include any provisions dealing with the process for reviewing awards.<sup>49</sup>

In adding judicial review provisions, FAA drafters were likely attempting to codify what they perceived to be the existing consensus regarding judicial review of arbitral awards—that review should be limited to reversal on procedural irregularity grounds. It is quite probable that the drafters simply did not contemplate that parties would be interested in any other form of judicial review of arbitration awards.<sup>50</sup> Nothing in the legislative history challenges this assumption.

The bare bones structure of the FAA provided a process for ensuring enforcement of pre-dispute arbitration agreements and reviewing arbitration awards, but little guidance regarding the arbitral process itself. While imperfect, the limited governance scheme the FAA created was

44. Proposed by the American Bar Association (ABA) and corporate lawyers, the law used arbitration statutes in New York and New Jersey as models. Michael H. LeRoy, *Misguided Fairness? Regulating Arbitration by Statute: Empirical Evidence of Declining Award Finality*, 83 NOTRE DAME L. REV. 551, 560–61 (2008).

45. The FAA's legislative history focuses almost entirely on the enforceability of pre-dispute arbitration agreements. IAN R. MACNEIL, *AMERICAN ARBITRATION LAW: REFORMATION–NATIONALIZATION–INTERNATIONALIZATION* 103–21 (1992).

46. 9 U.S.C. § 10(a) (2012).

47. MACNEIL, *supra* note 45, at 104.

48. *Id.* at 86.

49. *Id.*

50. Alternatively, the drafters may have believed that parties who wanted arbitrators to follow the law would contract for that result. At the time the FAA was enacted, courts routinely enforced such agreements. Philip G. Phillips, *Rules of Law or Laissez-Faire in Commercial Arbitration*, 47 HARV. L. REV. 590, 603 (1934) (citing numerous state cases). See generally Amy J. Schmitz, *Ending a Mud Bowl: Defining Arbitration's Finality Through Functional Analysis*, 37 GA. L. REV. 123, 139 (2002) (explaining that if the arbitration agreement so provided, common law courts were willing to reverse inconsistent arbitration awards).

designed to protect party autonomy in designing arbitral systems. In other words, if parties wanted to limit remedies, discovery, or other facets of traditional litigation, Congress would make no attempt to prohibit them from doing so.<sup>51</sup> Following the FAA's adoption, then, parties had a means for ensuring that arbitration, as they designed and planned it, would take place and that the award, once rendered, would be final.

### B. *Modern Commercial Arbitration*

By the early 1990s, however, commercial entities began amending their arbitration agreements to expand judicial review beyond the limits outlined in FAA § 10(a).<sup>52</sup> Several justifications may explain merchants'

51. Courts continue to interpret the FAA primarily as a tool designed to ensure enforcement of arbitration agreements. *E.g.*, *Doctor's Assocs. v. Casarotto*, 517 U.S. 681 (1996); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995); *Southland Corp. v. Keating*, 465 U.S. 1 (1984). When an agreement specifies the procedures under which the arbitration will be conducted, however, courts hold that the FAA has no impact. *E.g.*, *Volt Info. Scis., Inc. v. Bd. of Trs. of the Leland Stanford Junior Univ.*, 489 U.S. 468 (1989).

52. 9 U.S.C. § 10(a) lists four bases upon which a party may challenge an arbitral award:

- (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 misbehavior by which the rights of any party have been prejudiced; or
- (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. § 10(a) (2012); *see also* *P.R. Tel. Co. v. U.S. Phone Mfg., Corp.*, 427 F.3d 21 (1st Cir. 2005) (contract provides judicial error as basis for review); *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*, 341 F.3d 987 (9th Cir. 2003) (en banc); *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925 (10th Cir. 2001); *Syncor Int'l Corp. v. McLeland*, No. 96-2216, 1997 WL 452245, at \*6 (4th Cir. Aug. 11, 1997) (pointing out that parties agreed that arbitration decision would be reviewed for "errors of law"); *Gateway Techs., Inc. v. MCI Telecomm. Corp.*, 64 F.3d 993 (5th Cir. 1995); *Westinghouse Elec. Corp. v. N.Y.C. Transit Auth.*, 14 F.3d 818, 822 (2d Cir. 1994) (explaining that parties agree to judicial review of arbitral award under "arbitrary and capricious" standard); *W. Emp'rs Ins. Co. v. Jefferies & Co.*, 958 F.2d 258, 259 (9th Cir. 1992) (parties agree to permit arbitrator to make findings of fact and conclusions of law); *New England Utils. v. Hydro-Quebec*, 10 F. Supp. 2d 53, 61 (D. Mass. 1998) (stating that parties agreed to judicial review of arbitral award for errors of law); *S. Wash. Assocs. v. Flanagan*, 859 P.2d 217, 219 (Colo. App. 1992) (pointing out that parties agree to same standard of review as is used to review findings of fact and conclusions of law by a Colorado District Court); Edward Brunet, *The Core Values of Arbitration*, in *ARBITRATION LAW IN AMERICA: A CRITICAL ASSESSMENT* 3, 6 (2006) ("There is evidence that sophisticated, repeat users of arbitration are willing to pay higher transactions costs for a more complicated and judicialized style of arbitration."). Brunet suggested that the National Arbitration Forum's (NAF) increased prominence as an arbitral service provider is evidence that supports this theory. *Id.* Unlike other providers, in the early 2000s, NAF advertised its requirement that its arbitrators follow the law. *Id.*; *see also* Edward Brunet, *Toward Changing Models of Securities Arbitration*, 62 *BROOK. L. REV.* 1459, 1460 (1996). Brunet noted elsewhere that companies in the 1990s were more interested in ensuring that an arbitrator correctly applies the law in order to "reduce the risk of an arbitrator deciding the case 'equitably' or arbitrarily." EDWARD BRUNET & CHARLES B. CRAVER, *ALTERNATIVE DISPUTE RESOLUTION: THE ADVOCATE'S PERSPECTIVE* 427 (1997).

changed approach to judicial review. Merchants' interest in expanding judicial review of arbitrators' decisions may have been a response to society's increased skepticism of arbitration.<sup>53</sup> Alternatively, merchants might have been concerned that an arbitrator who is primarily an expert in industry customs would be incapable of providing an acceptable resolution to more complex commercial disputes.<sup>54</sup> Moreover, modern commercial disputes might have purely commercial aspects, or purely legal aspects, or a combination of both. If legal questions are at issue, merchants would have an interest in obtaining expanded judicial review of arbitration awards because arbitrators are generally considered experts in particular industries but not in the law. In other words, merchants might want to increase the predictability of results where legal issues are central to the dispute while still taking advantage of some of arbitration's benefits, such as speed and efficiency.<sup>55</sup>

Yet under FAA § 10(a), parties did not have the power to cabin arbitrator discretion in any meaningful way. Under § 10(a), as courts traditionally interpret it, a court may reverse an arbitral award only under very limited circumstances.<sup>56</sup> Limited review was initially perceived as a

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53. Society has grown increasingly suspicious of arbitration as a means for resolving disputes, at least under certain circumstances. Mandatory binding arbitration, particularly of statutory claims, has caused increasing controversy. Much attention has been focused on whether the existing arbitral procedures provide sufficient procedural safeguards to ensure that parties will be able to vindicate their statutory rights effectively. *See, e.g., Fact Finding Report Issued by the Commission on the Future of Worker-Management Relations*, 105 DAILY LAB. REP. (BNA) D-34 (June 2, 1994); U.S. DEP'T OF LABOR, DUNLOP COMMISSION ON THE FUTURE OF WORKER-MANAGEMENT RELATIONS, FINAL REPORT 31 (1994). In a 1997 Policy Statement, the Equal Employment Opportunity Commission (EEOC), an administrative agency created by Congress to administer the federal employment discrimination laws, declared that compulsory employment arbitration agreements usurp the judicial role of interpreting and applying the federal discrimination laws, thereby limiting civil rights provided by those laws. *See EEOC Policy Statement on Mandatory Arbitration*, 133 DAILY LAB. REP. (BNA) E-4 (July 11, 1997). Bills have also been introduced in Congress to ensure that pre-dispute arbitration agreements of employment discrimination claims would no longer be permissible. *See Arbitration Fairness Act of 2011*, H.R. 1873, 112th Cong. (2011); *Arbitration Fairness Act of 2009*, S. 931, 111th Cong. (2009); *Civil Rights Act of 2008*, H.R. 5129, 110th Cong. (2008).

54. *See* COMMERCIAL ARBITRATION AT ITS BEST, *supra* note 14, at 288 (stating that changes in corporate philosophy, bad arbitration experiences and/or high stakes may lead a party to seek greater judicial review of arbitration awards); David Rudenstine, *The Impact on the Arbitration Process of Arbitrating Statutory Claims*, in CONTEMPORARY ISSUES IN LABOR AND EMPLOYMENT LAW: PROCEEDINGS OF NEW YORK UNIVERSITY 46TH ANNUAL NATIONAL CONFERENCE ON LABOR 249, 260 (Bruce Stein ed., 1994) (stating that as the kinds of issues submitted to arbitrators become more complex, parties' arbitrator selection process may be affected because knowledge of industry norms will no longer be sufficient to justify selection of an arbitrator).

55. In 1996, Stephen Hayford predicted that, "[w]ith the increasing use of arbitration as a means for adjudicating complex, high-stakes commercial disputes involving difficult questions of law, fact, and contract interpretation, it is likely that substantive, reasoned awards will become . . . common," as will greater judicial scrutiny of those decisions. Hayford, *supra* note 16, at 842.

56. 9 U.S.C. § 10(a) (listing four bases upon which a party may challenge an arbitral award). In addition to the four statutory grounds set out in § 10(a), many of the federal appeals courts permit challenge to an arbitral award based on one or more of the following grounds: manifest disregard of the law by the arbitrator; the award is arbitrary and capricious; the award violates a clear public policy; the

benefit of the arbitral process, enhancing decision-making efficiency as well as ensuring that the arbitrator, often an expert in the subject matter of the dispute, was able to render a final decision that a judge, who is ignorant of industry customs, would not disturb.<sup>57</sup> As disputes grew in size and importance, and began to involve more legal issues, however, parties no longer considered arbitrators as infallible as they once did—arbitrators who are experts in the subject matter of the dispute they arbitrate may not be able to lend the same expertise to disputes involving statutory and legal claims rather than claims that can be resolved by examining industry customs.<sup>58</sup>

As a result, many parties believed that the limited review outlined in FAA § 10(a) created an unacceptable risk of arbitrary and capricious decision-making. This concern, together with the expansion in the kind of disputes that may be submitted to arbitration, may have triggered an increase in parties' desires for greater predictability in outcomes that more expansive judicial review may achieve.

Still another possibility exists. As commercial transactions grew in size and amount, the disputes that arose from those transactions similarly increased in magnitude. Under the single-tier system of traditional arbitration, parties were not overly concerned about any single result because results would even out over time (i.e., parties were risk neutral over the course of multiple disputes).<sup>59</sup> As the stakes in a given case become higher, however, merchants who might be risk neutral with respect to small disputes may become risk averse and want more predictable results.<sup>60</sup> Thus, the parties' desire to expand judicial review may simply be seen as a way to constrain the uncertainty inherent in a single-tier or limited multi-tier system.

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award fails to draw its essence from the parties' contract; and the award is completely irrational. See Stephen L. Hayford, *A New Paradigm for Commercial Arbitration: Rethinking the Relationship Between Reasoned Awards and the Judicial Standards for Vacatur*, 66 GEO. WASH. L. REV. 443, 450–51 (1998).

57. Viewed this way, the reluctance of judges to revisit arbitral decisions is not unlike the deference awarded to corporate directors under the business judgment rule. See LEWIS D. SOLOMON ET AL., *CORPORATIONS LAW AND POLICY: MATERIALS AND PROBLEMS* 40 (4th ed. 1998). The common notion underlying each is that a judge should hesitate to substitute his judgment for that of a person more qualified either by expertise or by the fact that the parties chose the alternate decision-maker. Similar notions underlie the *Chevron* doctrine in administrative law, which cautions against judicial intervention into agency decisions about statutory meaning. See *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 865–66 (1984).

58. *A Due Process Protocol for Mediation and Arbitration of Statutory Disputes Arising Out of the Employment Relationship*, 91 DAILY LAB. REP. (BNA) A-8, E-11 (May 11, 1995).

59. This conclusion assumes unbiased errors in the decision-making process. So long as arbitral errors are unbiased, parties have no cause for alarm over any single decision. See Julius G. Getman, *Labor Arbitration and Dispute Resolution*, 88 YALE L.J. 916, 922–23 (1979).

60. COMMERCIAL ARBITRATION AT ITS BEST, *supra* note 14, at 288.

## II. JUDICIAL REJECTION OF PARTY AGREEMENTS TO EXPAND JUDICIAL REVIEW OF ARBITRATION AWARDS

Courts initially divided over the propriety of agreements to expand judicial review of arbitration awards. Some courts enforced the parties' judicial review provisions on the ground that parties should control the arbitration process even if that meant that courts would have to more carefully scrutinize arbitration awards, such as by reviewing the award to determine if the arbitrator committed legal error.<sup>61</sup> Other courts were skeptical of these arrangements, concerned that they demand greater judicial oversight of arbitration than Congress provided in the FAA.<sup>62</sup> Ultimately, the Supreme Court, in *Hall Street Associates v. Mattel, Inc.*, held that parties could not agree to increased judicial scrutiny of an arbitrator's decision beyond those bases expressly provided in the FAA.<sup>63</sup>

In *Hall Street*, the Court also raised a question in dicta about the continuing viability of the manifest disregard of the law doctrine, a doctrine that federal and state courts had been using since the 1950s to review arbitration awards.<sup>64</sup> The manifest disregard doctrine permitted courts to evaluate an arbitration award to determine if the arbitrator knew what the law was but failed to follow it. Although application of the manifest disregard standard did not result in frequent reversal of arbitration awards, it was, nevertheless, an outlet for parties who believed the arbitrator's decision was the result of an abject misunderstanding of the law.

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61. The First Circuit held that when "explicit contractual language . . . specific[s] the precise nature of the intended judicial review," a court should enforce the parties' agreement to "displace the FAA standard of review." *P.R. Tel. Co. v. U.S. Phone Mfg. Corp.*, 427 F.3d 21, 31 (1st Cir. 2005). The Third Circuit followed suit, holding that parties should be able to contract around the FAA. *See Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287, 297 (3d Cir. 2001). *Roadway* confirmed that parties have a right to "opt out of the FAA's off-the-rack vacatur standards and fashion their own." *Id.* at 293. Similarly, the Fifth Circuit held that when a "contract expressly and unambiguously provides for review" on standards different than those in the FAA, refusing to enforce the contractual provisions "would frustrate the mutual intent of the parties." *See Gateway Techs., Inc. v. MCI Telecomms. Corp.*, 64 F.3d 993, 997 (5th Cir. 1995). The *Gateway* court then reviewed an arbitration award de novo for "errors of law," as the parties had specified in their contract. *Id.*

62. *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*, 341 F.3d 987 (9th Cir. 2003); *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925 (10th Cir. 2001). Prior to *Hall Street*, the Ninth and Tenth Circuits read the standards of review in § 10 as restrictions on the parties' freedom of contract rather than as mechanisms designed to ensure the security of their agreements. *See Kyocera*, 341 F.3d at 1000. The courts expressed concern that enforcing judicial review provisions in arbitration agreements would frustrate the efficiency of the arbitration process and undermine the independence of private dispute resolution. *See id.* at 998; *Bowen*, 254 F.3d at 935. In dicta, the Seventh and the Eighth Circuits also indicated their reluctance to enforce agreements for judicial review on terms other than those in FAA § 10. *See UHC Mgmt. Co. v. Comput. Scis. Corp.*, 148 F.3d 992, 998 (8th Cir. 1998); *Chi. Typographical Union No. 16 v. Chi. Sun-Times, Inc.*, 935 F.2d 1501, 1504-05 (7th Cir. 1991).

63. 552 U.S. 576, 586 (2008).

64. *Id.* at 585.

Following *Hall Street*, courts may be limited to the language of § 10 as the sole basis for challenging an arbitration award. But the Court did not shut the door entirely on either manifest disregard of the law review or other substantive review of arbitration awards. The Court stated that manifest disregard may exist as a separate basis for challenging an arbitration award or it may simply be part of § 10(a)(4), the provision permitting reversal of an arbitral award when the arbitrator exceeds his powers in issuing the award.<sup>65</sup> Little cited prior to *Hall Street*, the Court's discussion of § 10(a)(4) prompted commentators, litigants, and courts to consider the meaning of this phrase and whether it authorizes any kind of substantive review of arbitration awards.<sup>66</sup>

The *Hall Street* ruling was a surprise to many.<sup>67</sup> The Court's rejection of party autonomy in arbitration process design, in favor of award finality, was inconsistent with its previous arbitration rulings<sup>68</sup> and undermined the

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65. *Id.*

66. Prior to *Hall Street*, courts did not utilize § 10(a)(4) to permit substantive review of an arbitrator's legal rulings; rather, § 10(a)(4) was only applied to cases where the arbitrator had decided an issue not properly before her or where she directed a remedy that was not within her power to order. A number of courts and commentators posited that manifest disregard of the law continues to exist, but now as part of § 10(a)(4). In other words, an arbitrator may exceed her powers when she manifestly disregards the law. The Supreme Court has not revisited the question of how broad the exceeding the powers exception is. According to the general counsel of the AAA, Eric Tuchman, the continuing viability of manifest disregard of the law and the scope of exceeding the powers are issues that are very important to commercial arbitration. ABADisputeResolution, *Arbitration Update*, YOUTUBE (Aug. 19, 2015), <https://www.youtube.com/watch?v=UmlmFKcnmAI&list=PLFS9Uh2ndTfw-ra3gH0rA7iWbaxPQ1d5A&index=11> (ABA Section on Dispute Resolution 17th Annual Spring Conference).

67. Blair, *supra* note 6, at 95–96; Sarah R. Cole, *Hall Street Decision Today: Parties Cannot Expand Judicial Review of Arbitration Awards*, INDISPUTABLY: LINKING DISPUTE RESOLUTION SCHOLARSHIP, EDUCATION, AND PRACTICE (Mar. 25, 2008) [www.indisputably.org/?p=92](http://www.indisputably.org/?p=92) (“I find this decision surprising from an allegedly ‘pro-business’ court.”).

68. In *Hall Street*, the Court favored finality over party autonomy. This choice, Richard Reuben notes, is inconsistent with the Court's earlier decision in *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985), in which the Court expressed preference for autonomy over efficiency. See Richard C. Reuben, *Personal Autonomy and Vacatur After Hall Street*, 113 PENN ST. L. REV. 1103, 1130 (2009) (institutional efficiency does not trump party autonomy when parties agreed to arbitrate state law claims but litigate federal law claims). In *Byrd*, the Court refused to “allow the fortuitous impact of the [FAA] on efficient dispute resolution to overshadow the underlying motivation [of enforcing party agreements].” 470 U.S. at 220. The decision is also inconsistent with other Supreme Court decisions. In *First Options of Chi. v. Kaplan*, the Court said, “the basic objective . . . is not to resolve disputes in the quickest manner possible, no matter what the parties’ wishes, but to ensure that commercial arbitration agreements, like other contracts, ‘are enforced according to their terms,’ . . . .” 514 U.S. 938, 947 (1995) (citation omitted) (quoting *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 54 (1995)); see also *Volt Info. Scis., Inc. v. Bd. of Trs. of the Leland Stanford Junior Univ.*, 489 U.S. 468, 478 (1989) (stating that “[w]hile Congress was no doubt aware that the Act would encourage the expeditious resolution of disputes, its passage was motivated, first and foremost, by a congressional desire to enforce agreements into which parties had entered.”) (quoting *Byrd*, 470 U.S. at 220); *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 20 (1983) (enforcing an agreement to arbitrate that inefficiently led to dual proceedings because “federal law requires piecemeal resolution when necessary to give effect to an arbitration agreement”).

frequently stated precept that arbitration is a “creature of contract.”<sup>69</sup> With expanded review provisions off the table, commercial parties began to flee arbitration, too fearful of narrow review to continue using the process.<sup>70</sup>

Yet the movement of commercial parties away from arbitration may be premature. Before abandoning arbitration as the preferred dispute resolution vehicle of business, commercial entities should examine what remains of the FAA structure to determine whether there may yet be a mechanism for providing the efficient dispute resolution process they desire while reducing the risk of the “runaway arbitrator” award. Following *Hall Street*, the precise contours of the expressly identified categories in FAA § 10 take on increased significance as parties attempt to control the arbitration process in two of the few ways still available to them—express limitations on arbitrator authority and the use of choice of law provisions.

### III. CONSEQUENCES OF IGNORING LIMITATIONS ON ARBITRATOR REMEDIAL AUTHORITY AND CHOICE OF LAW PROVISIONS

*Hall Street* eliminated one approach business entities adopted to constrain arbitrator discretion—contractual terms expanding judicial review. But, both before and since *Hall Street*, parties have routinely tailored arbitration agreements to limit arbitrator discretion.<sup>71</sup> In a well-

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69. As Stempel notes, “*Hall Street* devalues the ‘freedom of contract’ concept that animated passage of the Act as well as the sentiment of the commercial community that fueled passage of the Act.” Stempel, *supra* note 17, at 36.

70. Several *Amici Curiae* Briefs in the *Hall Street* case warned that parties would abandon arbitration if expanded review were not permissible. See *Hall St.*, 552 U.S. at 588–89; see also David K. Kessler, *Why Arbitrate? The Questionable Quest for Efficiency in Arbitration After Hall Street* Associates, 8 FLA. ST. U. BUS. REV. 77, 92 (2009) (“The most drastic result of the *Hall Street* decision could be a flight from arbitration in the United States.”); Maureen A. Weston, *The Other Avenues of Hall Street and Prospects for Judicial Review of Arbitral Awards*, 14 LEWIS & CLARK L. REV. 929, 950 (2010) (“After *Hall Street*, will parties accept arbitration’s benefits, risks, and finality? A likely answer in many high-stakes cases is probably not.”).

71. Stephen D. Houck, *Complex Commercial Arbitration: Designing a Process to Suit the Case*, ARB. J., Sept. 1988, at 3 (describing how the parties’ careful tailoring of an arbitration process in a complex commercial dispute, including limitations on damages, helped the parties successfully resolve the case); Alan Scott Rau, *Punitive, Exemplary, “Vindictive,” “or Edifying Damages of Whatever Nature,”* (UNIV. OF TEX. AT AUSTIN, KAY BAILEY HUTCHISON CTR. FOR ENERGY, LAW & BUS., Research Paper No. 2015-11), [http://papers.ssrn.com/sol3/Papers.cfm?abstract\\_id=2633653](http://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2633653) (explaining that “[f]or commercial parties in high-stakes cases, the appropriate trade-off between litigation and informal justice may sometimes call for reducing the risk of excessive damage awards.”); see also Theodore J. St. Antoine, *Judicial Review of Labor Arbitration Awards: A Second Look at Enterprise Wheel and Its Progeny*, 75 MICH. L. REV. 1137, 1151 (1977) (“Arbitrators are subject to the mandate of the parties not only with regard to ‘subject matter’ jurisdiction, but also with regard to the capacity to fashion a particular remedy”); Kermit L. Kendrick & Julie W. Pittman, *Dreaming the Nearly Impossible Dream: Vacatur of Arbitration Awards in Commercial Arbitration*, BRIEF, Winter 2014, at 34, 36 (“Arbitration agreements often contain clauses that limit the scope of arbitral authority both substantively and procedurally.”). Of course, most arbitration agreements confer on the arbitrator expansive power to award remedies. COMMERCIAL ARB. RULES (AM. ARB. ASSOC. 2013). Rule 47 states that “[t]he arbitrator may grant any remedy or relief that the arbitrator deems just and equitable

known text for users of commercial arbitration, the authors advise business parties that

[t]here are a number of things [they] can do to try to ensure that arbitration awards are well reasoned and consistent with the norms the parties consider important. These options include:

...

- (2) set clear, specific standards for the arbitrators' decision,
- (3) place limits on awards of damages or on the kinds of relief that arbitrators may grant,
- (4) require that the arbitrators include a statement of reasons for their award . . . .<sup>72</sup>

Evidence suggests that parties routinely follow this advice by capping damages, removing categories of remedies available (e.g., punitive damages), or requiring the arbitrator to choose either one party or the other's proposed ruling and remedy.<sup>73</sup> In addition, parties frequently

and within the scope of the agreement of the parties." *Id.* at R. 47. The rule acknowledges that the parties' agreement is the source for limitations on the arbitrator's remedial authority. *Id.*

72. COMMERCIAL ARBITRATION AT ITS BEST, *supra* note 14, at 277. Other articles providing drafting advice are consistent with these statements. See John M. Townsend, *Drafting Arbitration Clauses: Avoiding the 7 Deadly Sins*, DISP. RESOL. J., Feb.–Apr. 2003, at 28, 34–36 (parties may want to specify limits on authority of arbitrators to award punitive damages or similar damages); AM. ARB. ASSOC., DRAFTING DISPUTE RESOLUTION CLAUSES: A PRACTICAL GUIDE 29–30 (2013), [https://www.adr.org/aaa/ShowPDF?doc=ADRSTG\\_002540](https://www.adr.org/aaa/ShowPDF?doc=ADRSTG_002540) (providing examples of clauses addressing limitations on remedies; including a sample clause precluding arbitrator from awarding punitive damages). Judicial Arbitration and Mediation Services (“JAMS”) provides a model limitation on liability clause that states: “In any arbitration arising out of or related to this Agreement, the arbitrator(s) may not award any incidental, indirect or consequential damages, including damages for lost profits.” JAMS CLAUSE WORKBOOK, A GUIDE TO DRAFTING DISPUTE RESOLUTION CLAUSES FOR COMMERCIAL CONTRACTS 5 (2015), <http://www.jamsadr.com/files/Uploads/Documents/JAMS-Rules/JAMS-ADR-Clauses.pdf>; see also Stephen L. Hayford, *Building a More Perfect Beast: Rethinking the Commercial Arbitration Agreement*, 7 DEPAUL BUS. & COM. L.J. 437, 443 (2009) (explaining that the scope clause can be used to limit the remedial authority of the arbitrator, either by barring or limiting certain remedies).

73. AAA's clause builder for commercial disputes provides mechanisms for parties to limit the arbitrator's remedial authority including clauses limiting the arbitrator's power to award punitive damages or consequential damages. See *Alternative Dispute Resolution ClauseBuilder Tool*, AM. ARB. ASSOC., [https://www.clausebuilder.org/cb/faces/welcome?\\_adf.ctrl-state=167rxx7h7z\\_9&\\_afzLoop=2360117259676627](https://www.clausebuilder.org/cb/faces/welcome?_adf.ctrl-state=167rxx7h7z_9&_afzLoop=2360117259676627) (last visited Jan. 3, 2016) [hereinafter “AAA ClauseBuilder”]; see also Thomas J. Stipanowich, *Arbitration and Choice: Taking Charge of the “New Litigation,”* 7 DEPAUL BUS. & COM. L.J. 383, 404, 412 (2009) (describing this latter approach, adopted by Abbott Labs, as a variant on traditional baseball arbitration. Stipanowich also suggests precluding arbitrators from awarding punitive damages or capping damages.). In a recent article focused on construction arbitration, the author recommended providing specific limitations on consequential, punitive, and other types of damages, but provided no advice on how to ensure that a court enforces such limitations. See Charles M. Sink, *Negotiating Dispute Clauses that Affect Damage Recovery in Arbitration*, CONSTRUCTION LAW., Summer 2002, at 5, 5 (parties may be able to limit their exposure in arbitration by specifying and limiting damages because the arbitrators are “more likely” to follow those instructions and the courts are “more likely” to find that the arbitrator exceeded his authority if he ignores these provisions).

include a choice of law provision along with, or as part of, the arbitration clause. This Article will first consider how courts evaluate explicit party-imposed limitations on arbitrator remedial authority and then how courts treat parties' choice of law provisions when appearing in a contract containing an arbitration agreement.

#### A. Enforcement of Arbitrator Remedial Authority Limitations

If parties expressly articulate limits on arbitrator remedial authority, it is generally accepted that courts *should* step in and vacate or modify an award when an arbitrator exceeds those limitations.<sup>74</sup> Unfortunately, though, courts do not always satisfy parties' expectations because they do not provide the necessary backstop to ensure enforcement of the parties' agreed terms.<sup>75</sup> A closer examination of cases involving challenges to arbitration awards reveals that courts are, at best, ambivalent toward arbitration awards granting relief beyond the limits articulated by the parties in their underlying contract.<sup>76</sup>

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74. IAN R. MACNEIL, RICHARD E. SPEIDEL & THOMAS J. STIPANOWICH, *FEDERAL ARBITRATION LAW: AGREEMENTS, AWARDS, AND REMEDIES UNDER THE FEDERAL ARBITRATION ACT* § 40.5.2.3 (Aspen Law & Bus. 1995); Jessica T. Martin, *Advanced Micro Devices v. Intel Corp. and Judicial Review of Commercial Arbitration Awards: When Does a Remedy 'Exceed' Arbitral Powers?*, 46 *HASTINGS L.J.* 1907, 1918 (1995) (explaining that if parties limit the arbitrators' ability in any way, such as by limiting relief to money damages or no punitive damages, arbitrators going beyond those limits exceed their powers and should have their awards vacated). Even courts suggest that they will vacate an arbitration award if the arbitrator ignores the parties' limitations on remedial authority. *Advanced Micro Devices, Inc. v. Intel Corp.*, 885 P.2d 994, 1007 (Cal. 1994) ("It follows that parties entering into commercial contracts with arbitration clauses, if they wish the arbitrator's remedial authority to be specially restricted, would be well advised to set out such limitations explicitly and unambiguously in the arbitration clause.").

75. In fact, courts are extraordinarily reluctant to vacate arbitration awards. This reluctance may lead courts to incorrect results in cases where parties have provided limitations on arbitrator power. In other words, the overly cautious judicial approach to reviewing arbitration awards results in enforcement of improperly adjudicated awards. For example, in *J.D. Shehadi, L.L.C. v. U.S. Maintenance, Inc.*, No. 11-224, 2011 WL 4632484, at \*3 (E.D. Pa. Oct. 5, 2011), the court explained that courts should vacate arbitration awards only under "exceedingly narrow" circumstances and apply an "extremely deferential" standard of review. *Accord*, *Harper Ins. Ltd. v. Century Indem. Co.*, 819 F. Supp. 2d 270, 275 (S.D.N.Y. 2011); *U.S. Energy Corp. v. Nukem, Inc.*, 400 F.3d 822, 830 (10th Cir. 2005) (to give full effect to the parties' contractual agreement, arbitration awards may be vacated by a court only on extremely limited grounds); *Willemijn Houdstermaatschappij, BV v. Standard Microsystems Corp.*, 103 F.3d 9, 12 (2d Cir.1997) (it is well-settled that "[a]rbitration awards are subject to very limited review in order to avoid undermining the twin goals of arbitration, namely, settling disputes efficiently and avoiding long and expensive litigation" (alteration in original) (quoting *Folkways Music Publishers, Inc. v. Weiss*, 989 F.2d 108, 111 (2d Cir. 1993))); *see also* *Hollern v. Wachovia Secs., Inc.*, 458 F.3d 1169, 1172 (10th Cir. 2006) ("Once an arbitration award is entered, the finality of arbitration weighs heavily in its favor and cannot be upset except under exceptional circumstances."); *Carll v. Terminix Int'l Co.*, 793 A.2d 921 (Pa. Super. Ct. 2002) (parties' agreement precluded arbitrator from awarding indirect, special, incidental, consequential or punitive damages).

76. Levin, *supra* note 15, at 157 (courts are ambivalent toward arbitrator shortcomings); *see also* *Evans Indus., Inc. v. Int'l Bus. Machs. Co.*, No. Civ.A. 01-0051, 2004 WL 241701, at \*10 (E.D. La. Feb. 6, 2004) (court rejected challenge to arbitration award even though arbitrators awarded substantial

Existing empirical evidence establishes how rare it is for a party to convince a court to vacate an arbitration award under any circumstances, even when the parties explicitly limited arbitrator authority.<sup>77</sup> Two arbitrators, Thomas J. Brewer and Larry Mills, reviewed all reported cases in federal and state courts in which a party who lost in arbitration sought to vacate the arbitration award over an eight-month sample period in 2004, a nine-month period in 2008, and a twelve-month period from mid-2011 to mid-2012.<sup>78</sup> Mills and Brewer found that parties used FAA § 10(a)(4), which allows a court to overturn an award when the arbitrator exceeded his powers, more frequently than any other FAA-based challenge.<sup>79</sup> Yet the authors also found that challenges to awards, much less successful challenges, were infrequent. For example, during the one-year period from 2011 to 2012, federal and state courts decided only forty-seven exceeded the powers cases.<sup>80</sup> Of those cases, courts vacated the arbitration award only *twenty percent* of the time.<sup>81</sup> Of that twenty percent (nine cases), only four of the cases where vacatur was granted involved challenges based on the arbitrator disregarding the contract's terms or rewriting the parties' contract in the award.<sup>82</sup> Parties' limited success in challenging arbitration awards on exceeding the powers grounds, even when they attempted to limit by contract the arbitrator's authority, may discourage them from bringing future challenges and cause them to rethink their choice of arbitration as a primary means of dispute resolution.

Examples of arbitrators ignoring plain language limiting remedial authority demonstrate the difficulties companies face in containing the runaway arbitrator.<sup>83</sup> Recently, in *Cedar Fair, L.P. v. Falfas*, a company

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amounts of damages inconsistent with parties' agreement that the exclusive remedies would be cure, refund of any fees paid, and termination); Kendrick & Pitman, *supra* note 71, at 37 ("[F]or every vacatur granted under § 10(a)(4), there are far more petitions denied under the same ground [exceeding the powers]—even where an arbitrator[']s decision clearly exceeds [his] contractual authority.").

77. "The chances for a successful appeal of an arbitration award are not particularly good. . . . [J]udicial review of arbitration awards is extremely limited." Chameleon Dental Prods., Inc. v. Jackson, 925 F.2d 223, 225 (7th Cir. 1991).

78. Lawrence R. Mills & Thomas J. Brewer, 'Exceeded Powers': Exploring Recent Trends in Cases Challenging Tribunal Authority, 31 ALTERNATIVES TO THE HIGH COST OF LITIG. (Int'l Inst. for Conflict Prevention & Resolution, New York, N.Y.), Sept. 2013, at 113, 113; see also discussion *supra* Part II.

79. Mills & Brewer, *supra* note 78 (exceeding the powers is both the most common and most successful basis for challenging an arbitration award but that a successful exceeding the powers challenge is rare); Brewer & Mills, *supra* note 13 at 46; Mills, Bader, Brewer & Williams, *supra* note 13, at 23.

80. Mills & Brewer, *supra* note 78, at 121.

81. *Id.* at 121.

82. *Id.* at 122.

83. Interestingly, courts reviewing labor arbitration awards seem more willing to vacate arbitration awards when the arbitrator's award conflicts with the express terms of the agreement or is without rational support or cannot rationally be derived from the agreement. See, e.g., *Ohio Office of Collective Bargaining v. Ohio Civil Serv. Emps. Ass'n, Local 11*, 572 N.E.2d 71, 73-74 (Ohio 1991).

and its chief operating officer (“the COO”) entered an employment contract with clauses that spelled out exactly what compensation the COO was to receive if terminated with or without cause.<sup>84</sup> Section 7 of the parties’ agreement stated that if the COO was terminated other than for cause, the COO was to receive his base salary and insurance for the longer of one year or the remaining employment term.<sup>85</sup> If the COO was found to have resigned, he would be entitled to no additional compensation and benefits. Another provision of the agreement, § 19(c), stated that, if the parties were in dispute,

[t]he arbitration panel shall have authority to award any remedy or relief that an Ohio or federal court in Ohio could grant in conformity with applicable law on the basis of the claims actually made in the arbitration. The arbitration panel shall not have the authority either to abridge or change substantive rights available under the existing law.<sup>86</sup>

The arbitral panel determined that the COO had been terminated other than for cause.<sup>87</sup> Yet, despite guidelines for compensation of the COO if the panel determined that he was terminated other than for cause, the arbitral

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In labor arbitration, it is well understood that arbitrators may construe ambiguous contract language but are “without authority to disregard or modify plain and unambiguous provisions.” *Id.* at 74. Instead, arbitrators are “confined to interpreting the provisions of [an agreement] as written and to construe the terms used in the agreement according to their plain and ordinary meaning.” *Int’l Ass’n of Firefighters, Local 67 v. City of Columbus*, 766 N.E.2d 139, 141 (Ohio 2002); *see also Muskegon Cent. Dispatch 911 v. Tiburon, Inc.*, 462 F. App’x 517, 525 (6th Cir. 2012) (court may vacate arbitration award when there is only one fair reading of the contract language, “which makes it clear that the parties intended a mutual obligation to carry out the escalation process”); *Town of Newburgh v. Civil Serv. Emps. Ass’n, Inc.*, 204 A.D.2d 464, 466 (N.Y. App. Div. 1994); *Manhattan & Bronx Surface Transit Operating Auth. v. Transp. Workers Union of Am.*, 180 A.D.2d 798, 799 (N.Y. App. Div. 1992) (if an arbitrator exceeds a specifically enumerated limitation set forth in the arbitration clause, the award may be vacated). Although most labor arbitrations involve considerably lower stakes than commercial arbitrations, a more well developed process for reviewing arbitration awards when the parties negotiate language to limit the arbitrator’s authority may have emerged because of the volume of cases in labor arbitration, the routine use of written reasoned awards so that it is easier to determine if the arbitrator ignored the parties’ directives, and the carefully negotiated language limiting arbitrator authority that is present in many collective bargaining agreements (collective bargaining agreements seem to escape concerns about the sticky nature of contract language). In one other context, courts seem willing to vacate arbitration awards on exceeding the powers grounds—arbitration awards in excess of uninsured motorists’ coverage policy limits. *See, e.g., Brijmohan v. State Farm Ins. Co.*, 699 N.E.2d 414, 415 (N.Y. 1998) (court may vacate an arbitration award when the arbitration clause of the policy incorporates by reference the rules of the American Arbitration Association, which in turn provide that the arbitrator “shall render a decision not in excess of the applicable policy limits”); *Spears v. N.Y.C. Transit Auth.*, 262 A.D.2d 493, 494 (N.Y. App. Div. 1999) (New York courts have interpreted CPLR § 7511(b)(1)(iii) to forbid arbitrators from exceeding their powers by exercising authority beyond that granted to the arbiter by either statute or the arbitration agreement).

84. 140 Ohio St. 3d 447, 2014-Ohio-3943, 19 N.E.3d 893.

85. *Id.* ¶ 9, 19 N.E.3d at 896–97.

86. *Id.*

87. *Id.* ¶ 11, 19 N.E.3d at 897.

panel directed the company to reinstate the former COO.<sup>88</sup> Not only did the arbitral panel order reinstatement, but it also awarded back pay and benefits as though the employment relationship had not been severed.<sup>89</sup>

In awarding this relief, the arbitral panel clearly modified or ignored the plain and unambiguous contractual provisions limiting its remedial authority. Yet the appellate court, reviewing the trial court's decision to reverse the arbitral panel's holding, found that the arbitrators' interpretation of the contract was a permissible one. The reviewing court explained that the contractual provision in § 7 limiting the compensation the COO could receive conflicted with § 19 of the contract, which allowed the arbitrators the full extent of remedial authority allowed under Ohio law.<sup>90</sup> The court's view was that the arbitrators could resolve this conflict as they saw fit.<sup>91</sup> As a practical matter, however, no reasonable interpretation of these two sections revealed either a conflict or an ambiguity. Instead, the first section, placing limits on damages for a particular circumstance (termination without cause) is consistent with the second section, providing limitations on damages for any other circumstance surrounding termination (i.e., providing guidance for circumstances the parties did *not* anticipate). In other words, the first section addressed damages for a specific situation, termination without cause.

The second clause was intended to apply in other circumstances. Yet a strong arbitration deference principle carried the day until this dispute reached the Ohio Supreme Court. The court deferred to the arbitration panel as the fact-finder, holding that the panel's finding that the COO was terminated without cause was largely unreviewable.<sup>92</sup> But, the court noted, § 7 of the contract included a liquidated-damages provision designed to set forth the compensation and benefits to which the COO was entitled in such circumstances. The court concluded that because the record showed that the parties "envisioned precisely what happened here," the arbitrators could not reasonably conclude otherwise and ignore the provision that specifically addressed what was to happen if the employee was terminated without cause.<sup>93</sup> In short, the parties' agreed remedy served as the outer bounds on the arbitrators' remedial authority.

Similarly, in *Guardian Builders, LLC v. Uselton*, the Supreme Court of Alabama reversed the lower court's decision to deny Guardian's motion to vacate an arbitration award which, among other things, awarded arbitration

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88. *Id.*

89. *Id.* ¶ 18, 19 N.E.3d at 899–900.

90. *Id.*

91. *Id.* ¶ 15, 19 N.E.3d at 898.

92. *Id.*

93. *Id.* ¶ 18, 19 N.E.3d at 899–900.

fees to the winning party.<sup>94</sup> The parties, a consumer and a builder, had agreed to arbitration under the auspices of the North Alabama Better Business Bureau (BBB). The BBB rules state that the “arbitration fees shall be based upon the current rate of the BBB . . . and shall be paid by both parties.”<sup>95</sup> The arbitrator found in favor of the Useltons, awarding them both the fees they paid for arbitration, as well as attorney’s fees.<sup>96</sup> On appeal, the Alabama Supreme Court held that the language requiring that arbitration fees be paid by both parties was unambiguous.<sup>97</sup> Thus, the arbitrator exceeded his authority when he ordered Guardian to pay the Uselton’s arbitration fees.<sup>98</sup> As in *Falfas*, the arbitrator ignored express contractual language.<sup>99</sup> The judicial system compounded the mistake by initially refusing to vacate the arbitration award despite an obvious conflict between the award and the parties’ chosen language.<sup>100</sup> While both the Ohio and Alabama Supreme Courts ultimately resolved these cases correctly, it is cases like these that cause prospective arbitration participants to lose faith in the arbitration process. Judicial unwillingness to enforce the explicit limitations parties articulate in their arbitration agreements causes parties to abandon the arbitration process.<sup>101</sup>

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94. 154 So. 3d 964 (Ala. 2014).

95. *Id.* at 969.

96. *Id.* at 968. The Alabama Supreme Court also reversed the arbitrator’s decision to award attorney’s fees to the Useltons. *Id.* According to the parties’ agreement, the arbitrator was empowered to “award any remedy that is permitted under applicable law.” *Id.* at 970. Since the applicable law in this case was the law of the state of Alabama, and Alabama follows the American rule regarding attorney’s fees, an arbitrator could not award attorney’s fees to a successful party because a similarly situated court could not. *Id.* In the absence of a statutory mandate or a contractual provision stating otherwise, an arbitrator could not award attorney’s fees to the winning party in an arbitration. *Id.* at 972.

97. *Id.* at 974.

98. *Id.* at 975.

99. *Id.*; see also *Cedar Fair, L.P. v. Falfas*, 140 Ohio St. 3d 447, 2014-Ohio-3943, 19 N.E.3d 893.

100. *Guardian Builders*, 154 So. 3d at 975.

101. In a similar case, the losing party had to appeal to the South Dakota Supreme Court to overturn an arbitrator’s award, previously confirmed by a state circuit court, where the plain language of the arbitration agreement precluded an award of attorney’s fees and, yet, the arbitrator had awarded the winning party its attorney’s fees. *Black Hills Surgical Physicians, LLC v. Setliff*, 855 N.W.2d 407, 410–11 (S.D. 2014). The language of the agreement stated, “[a]ny dispute or difference arising between a Member and [BHSP] whether as a result of this Agreement or otherwise, shall be subject to binding arbitration. . . . B. *The Member and [BHSP] agree to equally divide the cost and expense of the arbitration except that each shall pay their own attorney’s fees.*” *Id.* (alteration in original). One commentator criticized both the outcome in *Setliff* and *Falfas* on the basis that the two state supreme courts deciding these cases relied on “decades old” labor law cases that should have been ignored in light of recent cases like *Hall Street* and *Sutter*. Liz Kramer, *Five Tips for State Courts Considering Whether to Vacate Arbitration Awards (Ahem, South Dakota, Ohio)*, JDSUPRA BUS. ADVISOR (Oct. 3, 2014), <http://www.jdsupra.com/legalnews/five-tips-for-state-courts-considering-w-17810/>. The commentator must misunderstand *Hall Street* and *Sutter*, as neither would apply to a motion to vacate an arbitration award on the ground that the arbitrator ignored the parties’ limitations on remedies, unless the parties attempted to expand the scope of judicial review. Principles of deference are not extended so far as to preclude parties from negotiating limits on what law an arbitrator may apply or how much damages she can award. *Hall Street* only precludes party attempts to expand judicial review of

In California, courts have inconsistently handled explicit limitations on the arbitrator's authority in the context of attorney's fees. In *DiMarco v. Chaney*, the parties' arbitration agreement included an attorney's fees provision stating that the prevailing party shall recover his or her attorney's fees.<sup>102</sup> The arbitrator ruled in the plaintiff's favor on the underlying claim and found the plaintiff was the prevailing party, but refused to award the plaintiff his attorney's fees because the arbitrator found he had the discretion to deny fees to the prevailing party.<sup>103</sup> The trial court rejected the plaintiff's effort to correct the arbitration award to include attorney's fees.<sup>104</sup> Following reversal by the Court of Appeal, the California Supreme Court found the arbitrator exceeded his powers by denying the plaintiff attorney's fees because the parties' contract required a fee award for the prevailing party.<sup>105</sup>

In a subsequent California case, *Safari Associates v. Superior Court*,<sup>106</sup> however, a California Court of Appeal limited the reach of *Dimarco*. In *Safari*, the arbitrator was confronted with a conflict between a party agreement that defined prevailing party as the "party, if any, that obtains substantially the relief sought in the arbitration"<sup>107</sup> and a California statute that defined prevailing party somewhat differently, as the party who recovers *greater* relief in the action on the contract.<sup>108</sup> The dispute over attorney's fees involved Safari Associates and Tarlov, its former managing general partner.<sup>109</sup> Safari and Tarlov entered into a settlement agreement to resolve a number of claims related to Tarlov's management of Safari.<sup>110</sup> The agreement did not address the question of whether money Safari paid to Tarlov and his family for personal expenses should be returned to Safari.<sup>111</sup> The parties, unable to settle these claims, turned to arbitration.<sup>112</sup> Safari claimed that Tarlov should return \$768,228 to Safari.<sup>113</sup> Following a hearing, the arbitrator ordered Tarlov to repay only \$152,611.<sup>114</sup> Tarlov

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arbitration awards. Limits on remedies are not an end-run around *Hall Street* (as a clause telling the arbitrator to "follow the law" might be) and are therefore enforceable.

102. 37 Cal. Rptr. 2d 558, 559 (Cal. Ct. App. 1995). The clause stated: "Attorney's Fees: In any action, proceeding or arbitration arising out of this agreement, the prevailing party *shall* be entitled to reasonable attorney's fees and costs." *Id.* at n.1 (emphasis added).

103. *Id.*

104. *Id.* at 560.

105. *Id.* at 561.

106. 182 Cal. Rptr. 3d 190 (Cal. Ct. App. 2014).

107. *Id.* at 193.

108. CAL. CIV. CODE § 1717(b)(1) (West 2012).

109. *Safari*, 182 Cal. Rptr. 3d at 192.

110. *Id.* at 192-93.

111. *Id.*

112. *Id.* at 193.

113. *Id.*

114. *Id.*

claimed that application of the parties' agreement required that he be named the prevailing party because Safari did not obtain "substantially" the relief it sought.<sup>115</sup> Instead, Safari obtained only about one-fifth of what it claimed.<sup>116</sup> Thus, Tarlov was the prevailing party and entitled to attorney's fees.<sup>117</sup> Safari claimed that the statute applied and, under the statute, it was entitled to attorney's fees because the relief it obtained in the arbitration was "greater" than the amount Tarlov obtained (zero).<sup>118</sup> Thus, the arbitrator was required to choose between the contractual definition of "prevailing party" and the statutory one in determining the attorney fee issue.<sup>119</sup> The arbitrator decided to follow the statute, holding that the statute trumped the parties' agreement.<sup>120</sup> Accordingly, the arbitrator named Safari the prevailing party and awarded it substantial attorney's fees and costs.<sup>121</sup> The trial court reversed the arbitrator's ruling, holding that the arbitrator should have followed the terms of the agreement and awarded attorney's fees to the prevailing party, once it determined that one of the parties had prevailed.<sup>122</sup> The California Court of Appeal reversed, however, finding that, at most, the arbitrator's decision to ignore the parties' agreement in favor of the law was a "legal error," one that could not be reversed by a reviewing court.<sup>123</sup> The court stated that, "even [a decision] that 'explicitly contradict[s]' the parties' agreement . . . is not subject to correction by a trial court."<sup>124</sup>

As in *Falfas* and *Useton*, the arbitrator ignored the parties' explicit limitations on arbitrator authority in favor of his own view that the statute should trump the parties' contractual language. The arbitrator's decision ignores the fundamental notion that arbitration is a process of the parties' design. If the parties adopt specific provisions, arbitrators should follow them, at least absent an express finding that the provision is unconscionable. If arbitrators fail to comply with parties' explicit directives, courts should do more than rubber stamp the arbitrators' decisions.<sup>125</sup> To ensure continued use of a process that commercial parties

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115. *Id.* at 193–94.

116. *Id.*

117. *Id.*

118. *Id.*

119. *Id.* at 193.

120. *Id.*

121. *Id.*

122. *Id.* at 194.

123. *Id.* at 199–200.

124. *Id.* at 199 (second alteration in original).

125. See also *Silverman v. Benmor Coats, Inc.*, 461 N.E.2d 1261, 1268 (N.Y. 1984) (although conceding that arbitrators' awards exceeded limits articulated in the parties' agreement, the court nevertheless confirmed the award). In *Silverman*, the dissent articulately described the runaway arbitrator problem:

value highly, courts should ensure that parties' explicit limitations are enforced.<sup>126</sup>

### B. Enforcement of Parties' Choice of Law Provisions

Another device parties use to limit arbitrator authority and control the arbitration process is the contractual choice of law provision, which identifies the jurisdiction's law that should govern the arbitration.<sup>127</sup> Rules

The award may contravene principles of substantive law and rules of evidence, it may exceed the remedy requested by the parties, it may disregard the plain meaning of the arbitration agreement, and still it will be confirmed. Short of a violation of public policy or totally irrational result, yet to be found by this court, an award will not be set aside. While the majority recognizes that under CPLR 7511 an award may be vacated if the arbitrator exceeds a specifically enumerated limitation on his power, that relief too has been circumscribed, and is even further circumscribed today.

*Id.* (Kaye, J., dissenting).

126. Some courts properly analyze parties' explicit limitations on damages. For example, an Ohio appellate court correctly applied the exceeding the powers doctrine in *H.C. Nutting Co. v. Midland Atlantic Development Co.*, 2013-Ohio-5511, 5 N.E.3d 125 (1st. Dist.). There the contract at issue required arbitration, but precluded recovery in that arbitration for "consequential damages," which expressly included "loss of profits or revenue." *Id.* ¶ 8 (emphasis removed). The arbitrator nevertheless awarded "lost revenue." *Id.* ¶ 16. The court held that the arbitrator's award must be vacated because it did not reflect an interpretation of the contract:

Here . . . the arbitrator failed to discuss the probative terms of the contract and offered no clear basis for how he construed the contract. Without such consideration, and with an award, which on its face awards Midland consequential damages, damages which are expressly precluded by the parties' contract, we cannot conclude that the award was based upon the four corners of the contract or that it drew its essence from the parties' agreement.

*Id.* ¶ 18. Although the *Nutting* court reached the right conclusion, it suggested that it would have affirmed the award had the arbitrator offered some explanation for deviating from the parties' express language. The court stated, "Had the arbitrator discussed the contract language or provided some basis for the award, his decision might have at least rested upon an interpretation of the parties' contract." *Id.* In this respect, the court's analysis is problematic. If the language the parties use is clear and unambiguous, the arbitrator should not be able to override it by "interpreting" it. In *LHO New Orleans LM, L.P. v. MHI Leasco New Orleans, Inc.*, 2003-1283, p. 14 (La. App. 4 Cir. 3/3/04); 869 So. 2d 304, 312, a Louisiana Court of Appeals ordered a hotel owner, LaSalle, and hotel operator, MHI Leasco, to arbitrate a dispute over the fair market value of the operator's interest in the hotel. *Id.* at p. 12; 869 So. 2d at 311. The arbitrators did not do that, instead ordering the hotel owner to pay a specific amount to the hotel operator. *Id.* The court reversed the arbitrators' decision, stating that, "[a]s can be readily seen, the award is not a determination of FMV, but instead orders LaSalle to pay sums certain to MHI/MHI Leasco." *Id.* at p. 14; 869 So. 2d at 312. In that regard, "the panel exceeded its authority and imperfectly executed its powers under the arbitration agreement." *Id.*

127. Choice of law clauses are ubiquitous in commercial agreements, and with good reason. Contract law is mostly state law, and it varies from state to state. As a result, parties to commercial agreements often care a great deal about which state's law will govern their association. And because modern choice of law doctrines tend to place great weight on intent, contracting parties have an incentive to include choice of law clauses in their agreements. Commercial parties often also bargain for arbitration clauses, hoping to benefit from arbitration's purported advantages over litigation. As a result, many commercial contracts include both choice of law and arbitration clauses. Sometimes choice of law provisions are in the arbitration clause. See AAA ClauseBuilder, *supra* note 73 (indicating that many commercial parties identify the law they want the arbitrator to apply). Other times, the choice of law provision is a separate clause. 1 LAW AND PRACTICE OF INSURANCE COVERAGE LITIGATION § 11:45 (2008); Levin, *supra* note 15, at 119.

governing whether an arbitrator can award attorney's fees, or punitive damages, and in what amount, as well as how long a party may have to file a claim, differ from state to state.<sup>128</sup> Aware of these differences, commercial parties often care about which state's law will be applied to control the outcome of their dispute. In the absence of concerns about unequal bargaining power, courts should give meaning to the parties' choice of law by ensuring that their arbitrator follows the parties' directive. But, like limits on arbitrator remedial authority, courts inconsistently enforce these provisions even when it becomes clear that the arbitrator ignored them.<sup>129</sup>

*Mastrobuono v. Shearson Lehman Hutton, Inc.* presents a well-known example of judicial reluctance to enforce choice of law provisions contained in an arbitration agreement.<sup>130</sup> In *Mastrobuono*, securities investors signed an agreement with a broker that contained an arbitration clause and a choice of law provision selecting New York as the governing law.<sup>131</sup> New York law prohibited arbitrators, but not courts, from awarding punitive damages to the investors.<sup>132</sup> A panel of three NASD arbitrators

128. Professor Jeffrey Stempel provides an excellent example of the consequences choice of law might have in arbitration:

Consider a charitable pledge with an arbitration clause on which the donor fails to make the promised contribution. Currently, nearly 80 percent of the states provide that promises to make charitable gifts are enforceable even if they lack consideration by the recipient. If the arbitration clause provided for application of the law of one of these states, an arbitration award refusing to order payment because of lack of consideration would be clearly incorrect - and would clearly create a different result in arbitration than what would have been obtained in either state or federal court subject to that state's law.

Stempel, *supra* note 17, at 48 (footnotes omitted). Another example is that in New York, attorney's fees are not recoverable absent a contrary contractual provision or legal basis for recovery. *A.G. Ship Maint. Corp. v. Lezak*, 503 N.E.2d 681 (N.Y. 1986). But in South Carolina, they are. S.C. CODE ANN. § 35-1-1490 (1987). Ignoring parties' New York choice of law provision in a South Carolina arbitration could potentially alter an attorney's fee award.

129. Cindy G. Buys, *The Arbitrators' Duty to Respect the Parties' Choice of Law in Commercial Arbitration*, 79 ST. JOHN'S L. REV. 59, 77 (2005) (noting that courts are unlikely to overturn an arbitrator's decision even when the arbitrators disregard the parties' choice of law); Rachel Engle, *Party Autonomy in International Arbitration: Where Uniformity Gives Way to Predictability*, 15 TRANSNAT'L LAW. 323, 325 (2002) ("[M]ost national courts defer to the arbitrators' rulings on the subject [of choice of law].") (citing GARY B. BORN, *Choices of Law in International Arbitration*, in INTERNATIONAL COMMERCIAL ARBITRATION IN THE UNITED STATES, COMMENTARY AND MATERIALS 98, 99-100 (1994)); Levin, *supra* note 15, at 119 ("In the arbitration context, the choice-of-law clause presents an enigma."). *But see* Lybrand v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 467 S.E.2d 745, 747 (S.C. Ct. App. 1996) (vacating arbitrator's attorney's fee award because parties chose to apply New York substantive law, which does not permit an arbitrator to award attorney's fees in the absence of a contractual provision or legal basis).

130. 514 U.S. 52 (1995). *Mastrobuono* involved a standard form securities brokerage contract imposed on customers. *Id.* at 52. Yet *Mastrobuono's* holding was not limited to cases involving parties with unequal bargaining power. *See id.* at 54. Thus, it is relevant to the analysis of commercial party choice of law provisions in contracts also containing arbitration agreements.

131. The choice of law and arbitration clauses both appeared in paragraph 13 of the parties' agreement. *See id.* at 54-55.

132. *Id.* at 53-54.

awarded the investors compensatory damages and \$400,000 in punitive damages for claims arising out of the broker's alleged mishandling of the investors' accounts.<sup>133</sup> Shearson Lehman moved to vacate the arbitration award on the ground that New York law prohibited arbitrators from awarding punitive damages.<sup>134</sup>

The Supreme Court held that the parties could not preclude an award of punitive damages simply by agreeing to application of a particular state's law.<sup>135</sup> Rather, such an agreement could be enforced only if the parties expressly agreed to preclude the arbitrator from awarding punitive damages.<sup>136</sup> The Court further explained that even if the parties wanted New York law to apply, the law included in the choice of law provision should be New York's substantive law, not a procedural rule that allocates power between alternative tribunals.<sup>137</sup> Moreover, the Court concluded that the choice of law provision was ambiguous in light of the NASD Code of Arbitration Procedure, also applicable to the case, which authorized arbitrators to award "damages and other relief."<sup>138</sup> The Court concluded that this language may have authorized arbitrators to award punitive damages.<sup>139</sup> In light of this "ambiguity," the Court concluded that the arbitral award of punitive damages was enforceable.<sup>140</sup>

Despite paying lip service to the notion that arbitration is a process "parties are generally free to structure . . . as they see fit" and pursuant to whatever rules they select to govern the process,<sup>141</sup> the Court, in a tortured analysis,<sup>142</sup> ultimately determined that the parties' agreement to use New

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133. *Id.* at 54–55.

134. *Id.* Both the federal district court and the Seventh Circuit held that the arbitral panel had no power to award punitive damages because New York law limits the power to award punitive damages to judicial tribunals. *Id.* at 55.

135. *Id.* at 62.

136. *Id.* at 62–63.

137. *Id.* Traditional choice of law analysis results in application of the chosen state's substantive law, not its procedural rules. Thus, if the choice of law requires application of Ohio law, but the case is brought in New York, the New York courts would apply New York procedural law and Ohio substantive law. In the arbitration context, however, the answer is less clear, because the arbitrator is not bound to apply the procedural law of the state in which she sits. Moreover, the FAA provides some procedural guidance to arbitrators, further complicating the question of what procedural rules to apply. The Court, in *Volt Information Sciences, Inc., v. Board of Trustees of the Leland Stanford Junior University*, 489 U.S. 468, 468 (1989), offered assistance on this question, permitting the choice of law provision to direct both the application of substantive and procedural law of the identified state, as long as the procedural law did not conflict with the FAA. According to the *Volt* Court, parties may specify the rules governing the conduct of the arbitration. *Id.* at 476–77.

138. *Mastrobuono*, 514 U.S. at 61.

139. *Id.* at 62–64.

140. *Id.*

141. *Id.* at 57.

142. Tom Carbonneau, a noted arbitration scholar, describes the Court's interpretation of the parties' agreement as pointing only to New York substantive law, rather than both New York

York law was not what they really intended and thus should not bind them.<sup>143</sup> In addition, the Court's conclusion that the choice of law provision was ambiguous in light of an NASD Code of Arbitration Procedure section that authorized arbitrators to award damages and "other relief" was highly suspect.<sup>144</sup> The Court's interpretation of the code provision suggests as much. The Court said, "this provision *appears* broad enough at least to contemplate such a remedy."<sup>145</sup> To take the rule permitting "other relief" and conclude that "other relief" includes punitive damages seems like quite a stretch.<sup>146</sup> Moreover, it is difficult to describe that provision as creating ambiguity since the New York law the parties chose was clear—arbitrators do not have the authority to award punitive damages.<sup>147</sup>

Not only is the majority's choice of law analysis strained, but it also is at odds with Supreme Court precedent from only a few years earlier.<sup>148</sup> In *Volt*, the Court permitted parties to choose procedural rules for arbitration so long as those rules did not interfere with the parties' contractual right to

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procedural and substantive law, as "strained" and an attempt "to justify a foregone conclusion." THOMAS E. CARBONNEAU, *ARBITRATION LAW AND PRACTICE* 236–37 (6th ed. 2012).

143. It may well be that the Court's ruling was motivated more by sympathy toward the one-shot player investors rather than a broader pronouncement about the ability of a court to vacate an arbitration award when the arbitrator ignores the parties' choice of law. A subsequent decision suggested as much. "Underlying the holding in *Mastrobuono* was the Court's concern that the noncommercial customers of brokerage firms, like the *Mastrobuonos*, would not know that they were waiving their right to punitive damages when they signed a standard-form contract with a New York choice of law clause." Dean Witter Reynolds, Inc. v. Trimble, 631 N.Y.S.2d 215, 218 (N.Y. Sup. Ct. 1995).

144. See *Mastrobuono*, 514 U.S. at 68 (Thomas, J., dissenting).

145. *Id.* at 61 (majority opinion) (emphasis added).

146. *Id.* Carbonneau makes this point as well, stating that the NASD Code of Arbitration Procedure "does not establish a clear institutional rule on that score" (namely, that the NASD rules provide justification for permitting arbitrators to award punitive damages). CARBONNEAU, *supra* note 142, at 237. Carbonneau also suggests that the Court's refusal to vacate the punitive damages award stemmed from sympathy toward the investors. *Id.* Justice Thomas's *Mastrobuono* dissent makes this point as well. See *Mastrobuono*, 514 U.S. at 65–72 (Thomas, J., dissenting).

147. Moreover, this was a rule that was well-known: "[T]he longstanding rule in this State is that '[a]n arbitrator has no power to award punitive damages, even if agreed upon by the parties.'" *Trimble*, 631 N.Y.S. 2d at 217 (alteration in original) (quoting *In re Dreyfus Serv. Corp.*, 584 N.Y.S.2d 446, 446 (N.Y. App. Div. 1992)). Standard choice of law jurisprudence should have prompted the opposite result—choice of law incorporates into the parties' contract the law of the named jurisdiction, including the rule precluding arbitrators from awarding punitive damages. This approach does not conflict with the rule, it simply limits arbitrator authority.

148. See *Volt Info. Scis., Inc., v. Bd. of Trs. of the Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989). In *Volt*, the parties to a construction contract agreed to use arbitration to resolve all disputes arising out of their contract. *Id.* at 468. The contract also contained a choice of law provision that stated that the laws of the state where the project took place, California, would govern the contract. *Id.* When a dispute arose, *Volt* demanded arbitration. Stanford filed suit against *Volt* and two other contractors and moved to stay the arbitration under California law, which permits a stay of arbitration pending resolution of related litigation between a party to the arbitration agreement and a third party not bound by the agreement. *Id.* The Court held that parties could freely incorporate state arbitration rules or develop their own procedural rules to govern their arbitration as long as those rules do not undermine the federal policy favoring arbitration. *Id.* at 468–69.

arbitrate.<sup>149</sup> This ruling, applied to the facts of *Mastrobuono*, should have resulted in enforcement of New York procedural law, because the rule prohibiting arbitrators from awarding punitive damages does not interfere or abridge the parties' right to arbitrate. Instead, sympathy for the investors may have led the *Mastrobuono* Court to create confusion on the issue of whether commercial parties should be permitted to incorporate state rules that provide guidance to an arbitration procedure, as long as those rules do not interfere with the parties' right to arbitrate. Problematically, if broadly applied, *Mastrobuono* precludes parties from designing the arbitral process as they see fit, including the use of choice of law provisions. This conclusion is directly at odds with the fundamental principle that parties control arbitration process design. As the drafters of the Revised Uniform Arbitration Act explained, post-*Volt* and *Mastrobuono*, when "parties elect to govern their contractual arbitration mechanism by the law of a particular State" they limit "the procedures under which the arbitration will be conducted, [and] their bargain will be honored – as long as the state law principles invoked by the choice-of-law provision do not conflict with the FAA's prime directive that agreements to arbitrate be enforced."<sup>150</sup> If limits on damages do not interfere with the enforcement of the agreement to arbitrate, then, courts should enforce them.

Yet *Mastrobuono* suggests a different conclusion—that parties' choice of law provisions should not routinely be enforced when appearing in a contract that also contains an arbitration agreement. Following *Mastrobuono*, courts refuse to enforce choice of law provisions in contracts also containing arbitration agreements in two situations. First, some courts fail to enforce the parties' choice of law provision unless the choice of law provision clearly evidences the parties' intent to be bound by one state's rules.<sup>151</sup> This approach places an unnecessary and unjustified burden on parties to identify precisely the state arbitration rules they would like to have applied, or their choice of law will be ignored. While there might be some reason for imposing this burden in a *Mastrobuono* type of case, when the parties did not have equal bargaining power in negotiating the choice of law or arbitration provisions, it makes little sense in a case where the parties had an opportunity to negotiate their choice of law provision and

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149. *Id.* at 477–78.

150. UNIF. ARBITRATION ACT prefatory note, at 3 (NAT'L CONFERENCE OF COMM'RS OF UNIF. STATE LAWS 2000).

151. See Lawrence A. Cunningham, *Rhetoric Versus Reality in Arbitration Jurisprudence: How the Supreme Court Flaunts and Flunks Contracts*, 75 LAW & CONTEMP. PROBS. 129, 134–35 (2012) (arguing that *Mastrobuono* requires "crystal clarity" on terms limiting arbitrator authority despite the lack of such a requirement in the common law); see also *Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287, 293 (3d Cir. 2001) (stating that parties must evidence a "clear intent" to incorporate state law rules for arbitration); *Chiron Corp. v. Ortho Diagnostic Sys., Inc.*, 207 F.3d 1126, 1131 (9th Cir. 2000); *Wolsey, Ltd. v. Foodmaker, Inc.*, 144 F.3d 1205, 1213 (9th Cir. 1998).

either chose not to, or purposely chose to, use a traditional choice of law provision.

Imagine a case like *Mastrobuono*, but with parties of relatively equal bargaining strength. The parties include in their agreement a New York choice of law provision, which would preclude their arbitrator from awarding punitive damages. Under *Mastrobuono*, this general choice of law provision (even absent the existence of the NASD Code of Arbitration Procedure) would be interpreted to direct the arbitrator to follow New York substantive law, but not its procedural law (which precludes arbitrators from awarding punitive damages). Thus, the reviewing court could not vacate an arbitration award even if the arbitrator decided to award punitive damages because New York substantive law does not address this issue—only New York procedural law does. Only if the parties specifically indicate that they wish to use New York *procedural* law will the New York ban on arbitrators awarding punitive damages be enforced.<sup>152</sup> Requiring parties to anticipate and articulate the particular procedural law of the state they want to use is overly burdensome and inconsistent with choice of law analysis generally.<sup>153</sup> Nevertheless, courts apply the *Mastrobuono* requirements in a variety of cases without regard to whether the parties are relatively equal in negotiating strength.<sup>154</sup>

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152. *Revson v. Hack*, 657 N.Y.S.2d 51, 51 (N.Y. App. Div. 1997) (refusing to vacate an arbitration award on the grounds that the explicit New York choice of law provision was not contained in the arbitration clause).

153. See *infra* text accompanying notes 154–158. In one set of circumstances, requiring an affirmation from the parties that they prefer state arbitration rules to federal arbitration law makes sense: judicial review. Both before and after *Hall Street*, some state statutes provide for more invasive judicial review than the FAA provides. As I have stated elsewhere, the FAA provides clear rules on only two issues: enforceability of arbitration agreements and review of arbitral awards. Some states provide greater review for arbitration awards than does the FAA. Thus, in the context of judicial review, a party must clearly indicate that they want the application of a state judicial review provision; otherwise, § 10 of the FAA should apply. *Hall Street* dictates this result. If a state refused to enforce arbitration agreements, the parties would have to opt in to that state procedural rule as well, since the FAA explicitly addresses enforceability of arbitration agreements. On virtually every other issue, though, the FAA does not provide guidance. Under the FAA, parties may limit the award of damages in their arbitration agreement. Thus, they could be able to do it indirectly, by contracting for a choice of law provision that limits the arbitrator’s power to award a certain category of damages.

154. Following *Mastrobuono*, courts require parties to clearly evidence their intent to be bound by state rules or the FAA default rules will apply. See *Chiron Corp.*, 207 F.3d at 1131; *Wolsey*, 144 F.3d at 1213; see also *Roadway*, 257 F.3d at 293 (stating that parties must evidence a “clear intent” to incorporate state law rules for arbitration); *Jung v. Ass’n of Am. Med. Colls.*, 300 F. Supp. 2d 119, 152 (D.D.C. 2004) (parties who wish to apply state arbitration rules to arbitration cannot rely on a general choice of law provision but must explicitly so indicate in their agreement). For example, in *Sovak v. Chugai Pharmaceutical Co.*, 280 F.3d 1266, 1269–70 (9th Cir.), *amended on denial of reh’g* by 289 F.3d 615 (9th Cir. 2002), the court rejected the moving party’s effort to have Illinois law applied to determine whether the other party had waived its right to compel arbitration, stating, “[following *Mastrobuono*] we will interpret the choice-of-law clause as simply supplying state substantive, decisional law, and not state law rules for arbitration. Therefore, we must conclude that the Agreement incorporates the FAA’s rules for arbitration, but Illinois substantive law applies in all other respects.”

Second, some courts evaluate a claim that the arbitrator ignored the parties' choice of law provision under the manifest disregard of the law standard rather than the exceeding the powers standard.<sup>155</sup> This approach is problematic because *Hall Street* questioned the continuing viability of manifest disregard of the law as a basis for challenging an arbitration award.<sup>156</sup> Using manifest disregard of the law in a choice of law case is also troubling because it ignores the nuances of an equally problematic situation—where the parties articulate which law they want the arbitrator to use and it is apparent on the face of the award that the arbitrator made no effort to implement the parties' choice. This fact pattern should result in vacatur of the award because the arbitrator exceeded her powers when she chose to apply the wrong state's law. Unfortunately, though, when this situation is evaluated under the manifest disregard standard, the arbitrator's decision will not be vacated because courts either no longer reverse for manifest disregard of the law or because courts do not view application of incorrect law as sufficient to satisfy the manifest disregard of the law standard.<sup>157</sup>

*C. How the Wrong Standard of Review Can Impact Judicial Review of Arbitrators' Decisions*

Two Seventh Circuit cases, *Edstrom Industries, Inc. v. Companion Life Insurance Co.*<sup>158</sup> and *Affymax, Inc. v. Ortho-McNeil-Janssen Pharmaceuticals, Inc.*,<sup>159</sup> illustrate how application of the wrong standard of review may impact the result. The outcome of the cases turns on whether the court reviewing the arbitrator's decision treats that decision as one where the arbitrator may have exceeded his powers by ignoring the parties' explicit choice of law provision (apparent on the face of the award), or whether the arbitrator applied the law the parties directed her to use, but in a manner the parties did not expect—arguably a manifest disregard of the law.

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155. See *supra* Part II.

156. See discussion *supra* Part II.

157. The distinction between manifest disregard of the law and exceeding the powers is not clear in arbitration law and may have become more opaque following *Hall Street* when the Court suggested that manifest disregard may now be contained with the exceeding the powers provision. Exceeding the powers should be reserved for those cases where the arbitrator goes beyond the authority granted by the parties or the operative document, not where the arbitrator may have manifestly disregarded the law. See *Evans Indus., Inc. v. Int'l Bus. Machs. Co.*, No. Civ.A. 01-0051, 2004 WL 241701, at \*6 (E.D. La. Feb. 6, 2004) (holding that failure to uphold contractual damage limitation was not manifest disregard of the law); *Visiting Nurse Ass'n of Fla., Inc. v. Jupiter Med. Ctr., Inc.*, 154 So. 3d 1115, 1136–38 (Fla. 2014), *cert. denied*, 135 S. Ct. 2052 (2015).

158. 516 F.3d 546, 550 (7th Cir. 2008).

159. 660 F.3d 281, 284–85 (7th Cir. 2011).

This Article proposes that when the parties explicitly identify the law the arbitrator is to apply, the question is not whether the arbitrator manifestly disregarded the law, an inquiry *Hall Street* arguably precludes, but instead whether the arbitrator exceeded her powers by failing to follow the parties' directions regarding choice of law. Choosing the correct approach would result in vacatur of arbitration awards only when it is clear on the face of the arbitrator's decision that the arbitrator ignored the parties' choice of law. It would not allow vacatur when the arbitrator chose the correct law and then incorrectly applied it.<sup>160</sup> Although an argument can be made that a court may vacate such an award because the arbitrator manifestly disregarded the law, for purposes of this Article, the focus is on whether the arbitrator exceeded his authority by ignoring party directives regarding the rules available for his decision-making.

In *Edstrom*, the sponsor of an employee health insurance plan, Edstrom, failed to notify Companion, its stop-loss insurer for claims over \$65,000, that it had an employee covered by the plan whose child was reasonably expected to incur more than \$32,500 in medical expenses during 2004.<sup>161</sup> Edstrom ultimately provided \$890,000 in medical expenses to the employee's family for the child's treatment.<sup>162</sup> Companion refused to reimburse Edstrom for this expenditure on the ground that Edstrom failed to properly notify Companion of the child's condition. Edstrom proceeded to arbitration, seeking reimbursement.<sup>163</sup>

The arbitration clause explicitly required the arbitrator to apply Wisconsin law.<sup>164</sup> Wisconsin law provided that an insured's misrepresentation does not affect an insurer's obligation unless the insured "knew or should have known that the representation was false."<sup>165</sup> Edstrom claimed that this law precluded a decision in favor of Companion because Edstrom did not know and should not have known of the child's condition at the time it made its representations to Companion.<sup>166</sup> The arbitrator did not apply this provision of Wisconsin law, holding that the insurance policy

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160. This approach would only be applied in cases where arbitrators wrote opinions. Although historically, opinion writing was atypical in commercial arbitration cases, today, more and more commercial arbitrators report that they write reasoned opinions. If the arbitrator failed to write a reasoned opinion, the award could not be vacated on the ground that the arbitrator exceeded her powers by ignoring the parties' choice of law because it would not be clear whether the arbitrator followed the parties' directive or not. In that situation, it would be inappropriate to vacate the arbitration award because it would not be clear that the arbitrator disregarded the parties' choice. When there is ambiguity about what rules the arbitrator followed, her opinion cannot be disturbed (as long as the award appears rational or drawn from the essence of the agreement).

161. 516 F.3d at 546.

162. *Id.* at 549.

163. *Id.*

164. *Id.*

165. *Id.* at 549–50 (quoting WIS. STAT. ANN. § 631.11(1)(b) (West 2006)).

166. *Id.* at 550.

gave Companion the right to raise the deductible for Edstrom “when it became aware of [the child’s] medical condition. . . . It is of no moment whether omission of” the information “was, in the word[s] of Edstrom’s counsel, ‘an honest mistake,’ or the product of Edstrom’s failure to exercise due care or worse.”<sup>167</sup> The Seventh Circuit vacated the arbitration award, emphasizing that it was not doing so because of the arbitrator’s error of law.<sup>168</sup> Instead, the court stated that “because arbitration is a creature of contract, the arbitrator cannot disregard the lawful directions the parties have given them. If they tell him to apply Wisconsin law, he cannot apply New York law.”<sup>169</sup> The court explained that the arbitrator’s job was to interpret Wisconsin law, not ignore it.<sup>170</sup> Because the arbitrator ignored Wisconsin law, he acted inconsistently with the parties’ directive; thus, the Seventh Circuit held that the arbitrator’s award should be vacated.<sup>171</sup>

Using the exceeding the powers analysis proposed in this Article, the court correctly vacated the arbitrator’s decision, which ignored the parties’ contractual choice of law. In a subsequent case challenging an arbitration award, the Seventh Circuit stated that an interpretation of *Edstrom* that permits vacation of an arbitration award on the ground that the arbitrator manifestly *violated* the law cannot be correct because, following *Hall Street*, “‘manifest disregard of the law’ is not a ground on which a court may reject an arbitrator’s award under the Federal Arbitration Act.”<sup>172</sup> The court then discussed the exceeding the powers basis for vacating an arbitration award and clarified that if the arbitrators had “defied the contract by making a decision on a ground other than the (contractual) principle that ownership follows inventorship,” the award could have been vacated because the contract required application of that rule.<sup>173</sup>

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167. *Id.* (alteration in original).

168. *Id.* at 552.

169. *Id.*

170. *Id.*

171. *Id.* at 553. The *Edstrom* court noted that had the arbitrator not written an opinion, the result would have been different because the court could not have determined what law the arbitrator used. *Id.* Under the analysis proposed in this Article, an arbitrator’s opinion in the choice of law cases would be a prerequisite to a claim that the award should be vacated. In the absence of evidence that the arbitrator ignored the parties’ choice of law, the deference principle would force the court to affirm the award. While theoretically such a rule might discourage arbitrators from writing reasoned opinions, in fact, the number of written opinions should actually increase because of the significant benefits associated with reasoned opinion writing.

172. *Affymax, Inc. v. Ortho-McNeil-Janssen Pharm., Inc.*, 660 F.3d 281, 285 (7th Cir. 2011).

173. *Id.* The court explained,

[t]he 1992 contract called for the arbitrators to decide who invented the technology reflected in the patents; ownership tracks inventorship. If the arbitrators resolved the dispute on some other ground—for example, a belief that one of the inventions is not patentable, or a conclusion that ownership should be shared so that all parties make a profit—the award would be set aside under § 10(a)(4)

on the ground that the arbitrators disregarded the contract, not the law. *Id.*

Unfortunately for *Affymax*, however, the arbitrators did not explain how they reached their decision.<sup>174</sup> The Seventh Circuit correctly concluded that it could not presume that the arbitrators' silence meant that they had used an extra-contractual ground for their decision.<sup>175</sup> "Silence is just silence" in an arbitration award.<sup>176</sup>

*Affymax* correctly refused to vacate an arbitration award on the ground that the arbitrators exceeded their powers because it was not apparent from the award that the arbitrators ignored the parties' contract. But *Affymax*'s assertion that *Edstrom* is a case that permits vacation of an arbitration award on the ground that the arbitrator manifestly violated the law is unfortunate because it muddies the two bases for challenging an arbitration award.<sup>177</sup> To maintain the integrity of arbitration, and remain consistent with *Hall Street*, courts must be careful to assess whether the challenging party's claim is based on the arbitrator ignoring the parties' choice of law entirely, or, instead, simply misapplying the law the parties chose. In *Edstrom*, the arbitrator committed the former sin, not the latter one. Unfortunately, subsequent cases continue to treat challenges that the arbitrator misapplied the parties' choice of law provisions as manifest disregard of the law challenges, rather than exceeding the powers challenges. Until courts understand which standard they should apply when reviewing the arbitrator's application of law, parties will be discouraged from using contracts containing both an agreement to arbitrate and a choice of law provision.<sup>178</sup>

#### IV. USING "EXCEEDING THE POWERS" TO EVALUATE PARTIES' LIMITATIONS ON ARBITRATOR REMEDIAL AUTHORITY AND CHOICE OF LAW

An arbitrator should apply explicitly articulated limitations on her remedial authority or choice of law provisions in parties' arbitration agreements.<sup>179</sup> If the arbitrator fails to do so, the losing party should not be

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174. *Id.*

175. *Id.*

176. *Id.*

177. The misapplication of manifest disregard of the law standard to a case where the arbitrator ignored a contractual provision happened in a case involving limitations on arbitrator remedial authority, too. *See Jacada (Europe), Ltd. v. Int'l Mktg. Strategies, Inc.*, 401 F.3d 701, 714–15 (6th Cir. 2005) (court refused to vacate arbitration award on manifest disregard grounds even though the arbitrators ignored a clause in the parties' distribution agreement limiting monetary damages).

178. *See Paul Green Sch. Of Rock Music Franchising, L.L.C v. Smith*, 389 F. App'x 172, 178 (3d Cir. 2010) (applying manifest disregard of the law standard when reviewing whether arbitrator's decision properly applied parties' choice of law provision).

179. Courts may step in and vacate or modify awards when arbitrators exceed their powers. *See* 9 U.S.C. § 10(a)(4) (2012).

precluded by principles of arbitration deference from obtaining vacatur of the arbitration award. Yet parties have mixed results when using the exceeding the powers challenge to obtain vacatur of such arbitration awards.<sup>180</sup> Rarely successful, it is also quite difficult to distinguish those parties who are likely to succeed in obtaining vacatur under these circumstances and those who will fail.<sup>181</sup> The inconsistent application of the exceeding the powers doctrine presents a problem for commercial parties drafting agreements to arbitrate. If the parties are not confident that the courts will uniformly apply the doctrine to ensure that their choice of law or explicit limitations on the arbitrator's remedial authority are enforced, they are unlikely to continue to use arbitration.<sup>182</sup>

The next part of this Article, therefore, proposes a structured process for analysis of an arbitration award that could be applied in those cases where the parties' arbitration agreement limited arbitrator remedial authority or identified choice of law for the arbitrators to apply. As we have seen, following *Hall Street*, the primary remaining basis for challenging an arbitration award is that the arbitrator exceeded her powers. A party with an arbitration agreement tailored to limit the arbitrator's remedial authority would challenge an award on exceeding the powers grounds if the award was inconsistent with the parties' pre-dispute limitations. A court would then analyze the arbitration award to determine whether the parties' language was clear and unmistakable in its limitation of arbitrator remedial authority. If so, the court would determine whether the limitation(s) were unconscionable. If the limits were clear and unmistakable, and conscionable, the court would ensure that the arbitration award followed them. If the limits were either unconscionable or vague, the court would vacate the award. Courts could also use the exceeding the powers ground when reviewing awards where the arbitrator ignored the parties' choice of law provision. Using traditional choice of law analysis, a court would

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180. Kendrick & Pittman, *supra* note 71, at 37 (although courts will vacate awards on exceeding the powers grounds, "there are far more petitions denied under the same ground—even where [the] arbitrators' decision clearly exceeds their contractual authority").

181. See Mills, Bader, Brewer & Williams, *supra* note 13, at 23; Brewer & Mills, *supra* note 13, at 46; Mills & Brewer, *supra* note 78, at 113. In the 2013 article, the authors described three cases where the losing party obtained vacatur of the arbitration award because the arbitrator disregarded the parties' contract. *Id.* at 121–22. But the article also cited three cases in which a party's challenge to the arbitration award failed even though it made a virtually identical argument in similar circumstances. See *id.* The absence of a standard governing what constitutes exceeding the powers may be to blame.

182. One might suggest, as Lawrence Cunningham did in a recent article, that the Court's arbitration jurisprudence has little to do with contract law and everything to do with a national policy favoring arbitration. See Cunningham, *supra* note 151, at 159. In his view, the Court should either abandon its arbitration policy and act consistently with freedom of contract or "come clean about its national policy's real implications." *Id.* This Article proposes that, in an area where there is little current attention to judicial review of arbitration awards under the exceeding the powers doctrine, it may not be tilting at windmills to provide courts a framework that enables them to walk the line between traditional deference toward arbitration awards and parties' freedom of contract.

review the arbitration award and assess whether the arbitrator ignored the parties' choice of law provision. If the arbitrator's disregard of the parties' selection was apparent from the face of the award or through examination of the arbitrator's opinion, the court would vacate the award on exceeding the powers grounds.<sup>183</sup>

#### A. *Clear and Unmistakable Agreement to Limit Arbitrator Authority*

In the world of arbitration jurisprudence, certain phrases have become ubiquitous. One of those phrases is "clear and unmistakable."<sup>184</sup> The phrase first emerged in the context of arbitrability doctrine, which states that there is a presumption that a court, not an arbitrator, will decide the question of whether the parties' dispute is arbitrable. In the late 1980s, the Supreme Court articulated a limit on this presumption, holding that only if the parties "clearly and unmistakably" waive their right to have a court decide arbitrability, could the arbitrator decide the question.<sup>185</sup> In 2009, in the context of labor arbitration, the Court again utilized this standard to assess whether a court should enforce the union's agreement to arbitrate employees' statutory claims.<sup>186</sup> As with arbitrability, the presumption is that statutory claims will not be arbitrated in labor arbitration pursuant to a collective bargaining agreement. Only if the parties clearly and unmistakably indicate they wish to arbitrate statutory claims in labor arbitration will this presumption be rebutted. In the context of judicial review, as in the arbitrability and union waiver situations, courts invoke a strong presumption in favor of the narrow judicial review of arbitration awards.<sup>187</sup> To reverse that presumption, then, it makes sense to adopt the

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183. In addition to challenging the award on the back end, parties could make an effort to ensure that the arbitrator does not ignore their choice of law by carefully selecting the arbitrator who will decide their case and stating in the agreement that said arbitrator is not authorized to enter an equitable award. *See Savare, supra* note 15, at 609.

184. I propose the clear and unmistakable test even though this standard is foreign to traditional contract law. While traditional contract analysis would apply a plain and unambiguous language test, the application of the clear and unmistakable test to limits on arbitrator remedial authority requires both evidence of the parties' intent, together with the familiarity of this language, frequently used in arbitration cases. In addition, it acknowledges the high burden parties face when drafting language to limit arbitrator remedial authority. The limits must be clear, or the courts' traditional deference to the arbitration award will trump. *See Kendrick & Pittman, supra* note 71, at 41 ("Any hint of ambiguity in a limitation on arbitration—even something as subtle as using the word 'shall' instead of the stronger word 'must'—will be aggressively construed in favor of arbitration."). Another approach would be to analyze the parties' agreement to determine if the arbitrator "manifestly disregarded" the terms of the agreement. *See Sims & Bales, supra* note 12, at 436.

185. *AT&T Techs., Inc. v. Commc'ns Workers of Am.*, 475 U.S. 643, 649 (1986) ("Unless the parties clearly and unmistakably provide otherwise, the question of whether the parties agreed to arbitrate is to be decided by the court, not the arbitrator.").

186. *14 Penn Plaza, L.L.C v. Pyett*, 556 U.S. 247 (2009).

187. In *J.D. Shehadi, L.L.C. v. U.S. Maintenance, Inc.*, No. 11-224, 2011 WL 4632484, at \*3 (E.D. Pa. Oct. 5, 2011), the court stated that courts should vacate arbitration awards only under

high standard of clear and unmistakable before permitting more invasive review. Adoption of a clear and unmistakable standard to evaluate parties' limitations on arbitrator remedial authority enables parties seeking greater judicial review to avoid the presumption of narrow review only where there is virtually no question that the parties intended for their limitations to be enforced.

Of course, understanding the contours of the clear and unmistakable standard is essential if courts are to apply it correctly when reviewing party limitation on arbitral authority. In the arbitration context, the Court first applied the phrase clear and unmistakable in *First Options of Chicago, Inc. v. Kaplan*.<sup>188</sup> In American arbitration, the presumption is that courts, not arbitrators, decide arbitrability issues. An arbitrability issue is the question of whether the parties agreed to arbitrate a particular dispute. If one party contends that it did not agree to arbitrate the dispute, it may attempt to convince the court that the arbitration agreement does not require arbitration of the particular issue or to challenge the existence of an arbitration agreement in its entirety. But parties, seeking efficiency in dispute resolution, began to include clauses in arbitration agreements requiring that the arbitrator decide issues of arbitrability, thus reversing the traditional presumption. In *First Options*, the Court considered whether the parties' agreement to arbitrate substantive issues was also an agreement to arbitrate arbitrability. Ultimately, the Court concluded that the parties had not agreed to arbitrate but also held that if the parties want the arbitrator, rather than the court, to decide issues of arbitrability, they must use clear and unmistakable language to achieve that goal.<sup>189</sup> In other words, if the parties were silent or the agreement contained ambiguous language regarding who was to make arbitrability decisions, the presumption would be that the court would make the decision. In the Kaplans' case, the parties did not clearly and unmistakably agree to arbitrate arbitrability simply

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"exceedingly narrow" circumstances and apply an "extremely deferential" standard of review. *Accord*, *Willemijn Houdstermaatschappij, BV v. Standard Microsystems Corp.*, 103 F.3d 9, 12 (2d Cir.1997) (it is well-settled that arbitration awards are "subject to very limited review in order to avoid undermining the twin goals of arbitration, namely, settling disputes efficiently and avoiding long and expensive litigation") (quoting *Folkways Music Publishers, Inc. v. Weiss*, 989 F.2d 108, 111 (2d Cir. 1993)); *Hosier v. Citigroup Glob. Mkts., Inc.*, 835 F. Supp. 2d 1098, 1101 (D. Colo. 2011) ("To give full effect to the parties' contractual agreement, arbitration awards may be vacated by a court only on extremely limited grounds."); *Harper Ins. Ltd. v. Century Indem. Co.*, 819 F. Supp. 2d 270, 275 (S.D.N.Y. 2011); *see also Hollern v. Wachovia Sec., Inc.*, 458 F.3d 1169, 1172 (10th Cir. 2006) ("Once an arbitration award is entered, the finality of arbitration weighs heavily in its favor and cannot be upset except under exceptional circumstances." (quoting *Ormsbee Dev. Co. v. Grace*, 668 F.2d 1140, 1146-47 (10th Cir. 1982))).

188. 514 U.S. 938 (1995). *First Options* involved several parties: Kaplan, his wife, his wholly owned investment company (MKI), and First Options. First Options moved to arbitrate a dispute. Kaplan objected on the ground that he did not agree to arbitrate, only MKI did. The arbitrators decided they had the power to decide the case and did so, in favor of First Options. Kaplan appealed. *Id.*

189. *Id.* at 944.

because the Kaplans “forcefully” objected to arbitrating in front of the arbitrators, or because the Third Circuit had indicated that the Kaplans could object to the arbitrators’ deciding arbitrability without forgoing their rights to challenge on this issue again in court.<sup>190</sup>

Subsequent arbitrability jurisprudence offers further elucidation of the “clear and unmistakable” language. Courts find that parties clearly and unmistakably waive their right to have a court decide arbitrability when the language used to delegate this decision to the arbitrator is plain and unambiguous,<sup>191</sup> and when the parties explicitly incorporate rules that empower the arbitrator to decide issues of arbitrability.<sup>192</sup>

The phrase “clear and unmistakable” has also played a starring role in labor arbitration. In *Alexander v. Gardner-Denver Co.*, the Supreme Court held that an employer may not compel a union-represented employee to arbitrate a statutorily based claim.<sup>193</sup> In labor arbitration, a potential conflict of interest exists between the union and the employee during an arbitration because the union might be more concerned about the impact of the employee’s claim on the entire group of employees it represents than on the fate of the complaining employee.<sup>194</sup> Moreover, the union’s agreement to waive access to court that is implicit in its execution of the arbitration clause in the collective bargaining agreement cannot be attributed to the individual employee.<sup>195</sup> The *Gardner-Denver* Court thus permitted the employee to bring his Title VII claim in federal court despite the arbitration clause.<sup>196</sup> A little over twenty years later, the Court retreated from the *Gardner-Denver* holding, concluding that a unionized employee’s statutory claim, based on alleged violations of Title VII and the ADA, could be arbitrated but only if the union-negotiated waiver of the employee’s statutory right was clear and unmistakable.<sup>197</sup> The Court held that basic arbitration agreement language (i.e., “we agree to arbitrate all disputes arising out of this relationship”) did not satisfy the clear and unmistakable waiver requirement.<sup>198</sup>

190. *Id.* at 946–47. MKI, the Kaplans’ investment company, signed the arbitration agreement, not the Kaplans as individuals.

191. *Rent-A-Ctr., W., Inc. v. Jackson*, 561 U.S. 63, 68–70 (2010) (holding that parties rebut the presumption that courts should decide arbitrability questions when they explicitly delegate arbitrability questions to the arbitrator).

192. *Contec Corp. v. Remote Sol., Co.*, 398 F.3d 205, 208 (2d Cir. 2005) (involving an agreement to arbitrate according to AAA Commercial Arbitration Rules, which require that the arbitrator decides arbitrability issues).

193. 415 U.S. 36 (1974).

194. *Id.* at 51.

195. *Id.*

196. *Id.* at 59–60.

197. *See Wright v. Universal Mar. Serv. Corp.*, 525 U.S. 70 (1998).

198. *Id.* Following *Wright*, the question became, when does an employee make a clear and unmistakable waiver of her right to bring statutory claims in court? What if the collective bargaining

In 2009, the Court discussed the issue of what constitutes a clear and unmistakable waiver of a unionized employee's right to take a statutory claim to court in *14 Penn Plaza LLC v. Pyett*.<sup>199</sup> In that case, the collective bargaining agreement required union members to submit all claims of employment discrimination to binding arbitration under the grievance and dispute resolution procedures. The clause stated:

§ 30 NO DISCRIMINATION. There shall be no discrimination against any present or future employee by reason of race, creed, color, age, disability, national origin, sex, union membership, or any other characteristic protected by law, including, but not limited to, claims made pursuant to Title VII of the Civil Rights Act, the Americans with Disabilities Act, the Age Discrimination in Employment Act, the New York State Human Rights Law, the New York City Human Rights Code, . . . or any other similar laws, rules, or regulations. All such claims shall be subject to the grievance and arbitration procedures (Articles V and VI) as the sole and exclusive remedy for violations. Arbitrators shall apply appropriate law in rendering decisions based upon claims of discrimination.<sup>200</sup>

The *Pyett* Court concluded that this waiver clearly and unmistakably required union members to arbitrate ADEA claims (the claim at issue in *Pyett*).<sup>201</sup> Thus, the clause was enforceable as a matter of law.

In both *Kaplan* and *Pyett*, the Court held that the clear and unmistakable test required explicit language mandating the particular action (i.e., an arbitrator deciding arbitrability or an employee agreeing to have the arbitrator hear his or her statutory discrimination claims).<sup>202</sup> Lower

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agreement provides that all employees submit all federal causes of action arising out of their employment to arbitration? What if the agreement specifically incorporates statutory antidiscrimination claims into the arbitration clause? *Compare* *Carson v. Giant Food, Inc.*, 175 F.3d 325 (4th Cir. 1999) (although a clear and unmistakable waiver is possible, it did not exist because general arbitration clause makes no mention of disputes arising under federal law); *Robinson v. Healthtex, Inc.*, No. 99-2023, 2000 WL 691053, at \*14 (4th Cir. May 30, 2000) (requirements for clear and unmistakable waiver not satisfied); *Rogers v. N.Y. Univ.*, 220 F.3d 73 (2d Cir. 2000) (both arbitration and nondiscrimination clauses too broad and general to constitute clear and unmistakable waiver), *abrogated by* *14 Penn Plaza L.L.C v. Pyett*, 556 U.S. 247 (2009); *Bratten v. SSI Servs. Inc.*, 185 F.3d 625 (6th Cir. 1999) (no clear and unmistakable waiver even though agreement contained specific language from Title VII), *with* *Safrit v. Cone Mills Corp.*, 248 F.3d 306, 307 (4th Cir. 2001) (collective bargaining agreement contains clear and unmistakable waiver of employee's right to bring statutory discrimination claim to court where CBA stated that parties would "abide by all the requirements of Title VII" and that "[u]nresolved grievances arising under this Section are the proper subjects for arbitration").

199. 556 U.S. 247.

200. *Id.* at 252 (alteration in original).

201. *Id.* at 274.

202. *See id.*; *First Options of Chi., Inc. v. Kaplan*, 514 U.S. 938, 944 (1995).

courts continue to require an explicit statement of agreement before they will reverse the presumption that courts decide arbitrability issues and labor arbitrators do not decide employee's statutory claims.<sup>203</sup> In the arbitrability context, this requirement typically manifests itself as a statement contained in the arbitration clause that the "parties agree that the arbitrator will resolve arbitrability questions."<sup>204</sup> In the labor arbitration context, the non-discrimination language specifically identifies those statutory claims that will be subject to the collective bargaining agreement's grievance and arbitration procedures.<sup>205</sup> In other words, the parties need specific language such as "claims made pursuant to Title VII, the ADA, etc. shall be subject to the grievance and arbitration procedures."<sup>206</sup>

Applying the clear and unmistakable test to determine whether the arbitrator exceeded her powers in entering an award where the agreement contained limits on arbitrator remedial authority is consistent with arbitration jurisprudence. In arbitration, the default rules contained in the FAA or equivalent state acts, which govern agreement enforceability and award review, are only overridden in exceptional circumstances.<sup>207</sup> In both arbitrability and labor arbitration, courts require clear and unmistakable waivers because of the strong presumption in favor of the expected result—in arbitrability, that the court, not the arbitrator, will decide arbitrability, and, in labor arbitration, that an employee's statutory claims will not proceed through the collective bargaining agreement's grievance process. Thus, it makes sense to use this approach in the judicial review context, where deference to the arbitrator's decision is the default rule. To override that presumption, parties must clearly state their intent to limit the arbitrator's remedial authority, as well as ensure that their agreement contains no conflicting provisions—if the limits on arbitrator authority are ambiguous due to a lack of careful drafting, the language will not be viewed as clear and unmistakable and the presumption will not be rebutted.

In practice, following the issuance of the arbitration award, the objecting party would move the court to vacate the arbitration award on the ground that the arbitrator exceeded her powers when issuing the award because it was inconsistent with the parties' remedy limitations.<sup>208</sup> The

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203. See discussion *supra* Part II(A).

204. See MACNEIL, *supra* note 45 and accompanying text.

205. See discussion *supra* Part IV(A).

206. See *supra* note 151 and accompanying text.

207. See, e.g., *Hollern v. Wachovia Sec., Inc.*, 458 F.3d 1169, 1172 (10th Cir. 2006) ("Once an arbitration award is entered, the finality of arbitration weighs heavily in its favor and cannot be upset except under exceptional circumstances." (quoting *Ormsbee Dev. Co. v. Grace*, 668 F.2d 1140, 1146–47 (10th Cir. 1982))).

208. During the arbitration, the dissatisfied party should also object to any attempt by the other side to put in evidence that would permit a ruling inconsistent with the parties' agreement. Thus, if the agreement does not permit the arbitrator to award punitive damages, a party should object on the record,

moving party would submit the arbitration agreement, together with the arbitrator's ruling and/or written reasoned opinion. This approach would not necessarily require the arbitrator to write a reasoned opinion, however, because the face of the arbitration award would almost certainly reveal whether or not the award was consistent with the parties' limitations.<sup>209</sup>

The court would review the terms of the arbitration agreement together with the award and/or opinion. Rather than cite the mantra of narrow judicial review that is ubiquitous in judicial opinions confirming arbitration awards, the court would, instead, assess whether the parties used sufficiently precise and unequivocal language limiting the arbitrator's ability to award remedies so that the court could declare that the arbitrator violated limitations that satisfy the clear and unmistakable test. This approach is familiar to courts, which must routinely evaluate contract language in breach of contract cases to determine whether the parties understood the language they adopted when drafting the contract. Because commercial parties have relatively equal bargaining power when negotiating the terms of a contract, it would be exceedingly rare for a reviewing court to affirm an arbitration award that ignored the parties' explicit limits on the arbitrator's remedial authority. Creating a clear and unmistakable inquiry for examination of this issue would help courts avoid concerns about deferring to an arbitration award and provide a useful framework for parties planning for the possibility of a dispute resolution event.

After ensuring that the arbitrator's award is consistent with the language of the parties' agreement, the only remaining question would be whether the parties' limitations on the arbitrator's authority in a particular case should be enforceable. Fortunately, outside the arbitration agreement context, considerable guidance regarding evaluation of such provisions is available. It is commonplace for contracting parties to limit remedies or alter traditional rules governing damages and even exclude categories of

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if there is a record, to any testimony or evidence that seems intended to elicit such an award. See Kendrick & Pittman, *supra* note 71, at 43.

209. In both *Falfas* and *Guardian*, a review of the parties' agreement and the arbitrator's award (not opinion) would reveal the arbitrator's failure to follow the parties' limitations. In the remedial context, the limitations would typically be plain and unambiguous because the limits usually focus on categories of damages such as "the arbitrator may not award punitive damages or consequential damages" or "the arbitrator may not award attorney's fees." Brewer and Mills also found that challenges to arbitration awards worked best when the award "involved a fairly blatant disregard for, or rewriting of, the parties' underlying contract." See Mills & Brewer, *supra* note 78, at 121. Courts may state that they take this approach but, unfortunately, do not always apply it. For example, the appellate court in *American Federation of State, County and Municipal Employees, Council 4, Local 1303-119 v. Town of East Haven*, 951 A.2d 21, 25 (Conn. App. Ct. 2008) held that a challenge to an arbitration award on exceeding the powers ground required only a comparison of the award with the submission.

damages, such as consequential damages, entirely.<sup>210</sup> Courts impose few limits on sophisticated parties' ability to control risk, precluding only those remedy limitations that fail to provide the nonbreaching party with "at least minimum adequate remedies."<sup>211</sup> Particularly when the provision limiting damages is not accompanied by a limited remedy provision, it is unlikely that a court will find the damages limiting provision unconscionable.<sup>212</sup> In other words, if both parties are sophisticated, of relatively equal bargaining power, and participate in the drafting of the agreement, it is highly unlikely that a court will determine that a damages limitation provision is unconscionable.<sup>213</sup> If these requirements are satisfied, the provision is very likely to be enforced.<sup>214</sup>

### B. A Framework for Choice of Law Analysis in Arbitration Agreements

The analysis for choice of law provisions would also be straightforward. Following issuance of the award, the disappointed party would challenge the award on the ground that the arbitrator exceeded her powers when she did not follow the parties' directives regarding choice of law. Rather than a discussion of deference to the arbitrator's decision, the reviewing court would examine the parties' agreement to determine whether they included language indicating that they wanted a particular

210. Michael Pillow, *Clashing Policies or Confusing Precedents: The "Gross Negligence" Exception to Consequential Damages Disclaimers*, 4 WM. & MARY BUS. L. REV. 493 (2013) (commercial parties routinely disclaim consequential damages from their agreements). Section 2-719 of the UCC provides that courts may enforce contractual consequential damages disclaimers absent a finding of unconscionability. U.C.C. § 2-719 (AM. LAW INST. & UNIF. LAW COMM'N 1977).

211. Joel D. Applebaum & Linda M. Watson, *Drafting Liability-Limiting Clauses: A Study in Unintended Consequences*, MICH. BAR J., June 2013, at 36, 38 (quoting MICH. COMP. LAWS ANN. § 440.2718 (2015)).

212. Courts void a limitation on or exclusion of consequential damages only if it is unconscionable. Kathryn I. Murtagh, Note, *UCC Section 2-719: Limited Remedies and Consequential Damage Exclusions*, 74 CORNELL L. REV. 359, 361 (1989).

213. Although unlikely, it could happen. See *Jacada (Europe), Ltd. v. Int'l Mktg. Strategies, Inc.*, 401 F.3d 701, 712–13 (6th Cir. 2005) (refusing to vacate an arbitration award when the arbitrators disregarded the following limited liability provision because they deemed it unconscionable: "[n]otwithstanding anything herein to the contrary, the maximum aggregate amount of money damages for which [Jacada] may be liable to IMS under this Agreement, resulting from any cause whatsoever other than for a breach by [Jacada] of any of its representations and warranties under paragraph 5(a), shall be limited to the amounts actually paid by IMS to [Jacada] under this Agreement" (alteration in original)). This result seems surprising since the parties reached a negotiated agreement following arms-length bargaining.

214. Courts typically find unconscionability only when the contract terms are grossly unfair and one of the parties to the agreement is a consumer or unsophisticated buyer. See Pillow, *supra* note 210, at 495. The court could make an exception to this rule if the limit or exclusion of consequential damages "fails of its essential purpose." See Applebaum & Watson, *supra* note 211, at 38. A provision fails of its essential purpose when it results in depriving either party of the "substantial value of the bargain." *Id.* Under these circumstances, the U.C.C.'s general remedy provisions substitute for the parties' limited remedy provisions. U.C.C. § 2-719(2).

state's law to govern the outcome of the arbitration. This review would not require commercial parties to specify that they intended to use particular state procedural rules. Instead, the review would take the parties at their word, only inquiring as to whether the parties agreed on a particular state's law to apply. This approach would limit *Mastrobuono* to its facts,<sup>215</sup> applying its principles only when the stronger party imposes a non-negotiable agreement on the weaker party.<sup>216</sup> The choice of law approach

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215. Justice Thomas suggested in his dissent that *Mastrobuono* should be limited to its facts because the case, though wrongly decided, was simply a federal court applying Illinois and New York contract law to an agreement between parties in Illinois. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 71–72 (1995) (Thomas, J., dissenting). Most commentators agree that *Mastrobuono* is inconsistent with traditional contract law principles and inconsistent with *Volt*, a decision the Supreme Court decided only six years earlier. In *Volt*, the Court held that the FAA requires enforcement of the parties' choice of law provision in a contract also containing an arbitration agreement even though the state law required different treatment of the arbitration process than would the FAA. *Volt Info. Scis., Inc., v. Bd. of Trs. of the Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989); see also CARBONNEAU, *supra* note 142, at 236–37 (decrying *Mastrobuono*'s treatment of choice of law provisions in arbitration agreements); Heather J. Haase, Note, *In Defense of Parties' Rights to Limit Arbitral Awards Under the Federal Arbitration Act*: *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 31 WAKE FOREST L. REV. 309, 334–35 (1996) (explaining that the better view of choice of law clauses is that they incorporate all of the laws of the chosen state because parties will not value or use choice of law provisions if some provisions of state law can be stricken if not specifically referred to in the parties' agreement). *But see* Rau, *supra* note 71, at 20 (*Mastrobuono* rightly decided and preference for state arbitration law in an arbitration agreement must be very explicit in order to override federal default rule favoring arbitrability).

216. Alternatively, courts could continue to follow *Mastrobuono*. This approach would incentivize parties to negotiate around the default rule, which currently directs an arbitrator to apply only state substantive law, not its procedural rules, when rendering the arbitration award. Some contracts scholars believe that default rules better preserve the concept of freedom of contract by allowing parties to opt out of them in favor of a regime they prefer. See Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 88 (1989); Raymond T. Nimmer, *Services Contracts: The Forgotten Sector of Commercial Law*, 26 LOY. L.A. L. REV. 725, 733 (1993); J. Hoult Verkerke, *An Empirical Perspective on Indefinite Term Employment Contracts: Resolving the Just Cause Debate*, 1995 WIS. L. REV. 837, 869 (1995). Courts expect commercial parties to be aware of default rules and negotiate around them if they are not desired. This Article advocates limiting *Mastrobuono* to its facts, however, in light of the “sticky” nature of contract drafting, particularly when it comes to dispute resolution clauses. See Peter B. Rutledge & Christopher R. Drahozal, “Sticky” Arbitration Clauses? *The Use of Arbitration Clauses After Concepcion and Amex*, 67 VAND. L. REV. 955, 987–1001 (2014) (wholesale adoption of arbitration clauses with class arbitration waivers did not occur in the two years after *AT&T v. Concepcion* because of the sticky nature of contracts). Federal Express General Counsel Rush O’Keefe explained that inclusion of dispute resolution clauses in commercial contracts is more difficult than an outsider might imagine:

One of the obstacles that the inclusion of ADR provisions must overcome is the practical limitation on the number of issues and provisions that parties can include in agreements and timely negotiate to execution. An important factor working against inclusion of ADR provisions, is the fact that without one, there is a legal framework for resolving disputes and enforcing rights. Thus it is not a required component of an agreement.

Since it is improbable that inclusion of ADR in contracts would ever be required by statute, it would be necessary to convince counsel for transacting parties to choose to include one, at the expense of other issues that could otherwise be covered.

E-mail from Rush O’Keefe, Gen. Couns., Fed. Express, to Gary Doernhoefer, Former Gen. Couns., Orbitz (Jan. 15, 2015) (on file with author).

advocated in this Part is consistent with standard contract law principles, which permit commercial parties to select the law of the jurisdiction they want to apply.<sup>217</sup>

If a party believed that the arbitrator did not apply the parties' choice of law, the approach would be similar to the challenge for failure to follow the parties' remedial limitations discussed above. As long as the parties' choice of law is clear, the court would then ask whether, from the face of the award, it is apparent that the arbitrator followed the parties' choice of law. In other words, if the agreement directed the arbitrator to apply Ohio law, and the arbitrator applied New York law instead, the court should vacate the arbitration award. If, however, the arbitration agreement directed the arbitrator to apply Ohio law and the arbitrator incorrectly applied Ohio law, the award could not be vacated. This approach permits vacatur on the ground that the arbitrator exceeded her powers when she ignored the party directives but not when she arguably manifestly disregarded the law (or, at the least, misinterpreted it).

## V. CONCLUSION

Deference to arbitration decisions and party autonomy are both essential principles of arbitration. One of the primary benefits of using arbitration is that parties are able to tailor their arbitration clause to suit their needs. When parties choose to structure the arbitration process, they expect arbitrators to act consistently with their directives. Parties also expect that courts will review arbitration awards to ensure that they comport with parties' expectations. Without courts as a backstop, parties will eventually abandon attempts to tailor their agreements and stop using arbitration as their preferred dispute resolution process. Together with growing concerns about the risk of erroneous awards, a belief that courts will not enforce party limitations on arbitral authority will only speed party flight from arbitration.

This Article proposes that courts adopt a specific inquiry when confronted with cases where parties drafted limitations on arbitrator remedial authority or included a choice of law provision along with an

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217. See 7 RICHARD A. LORD, WILLISTON ON CONTRACTS § 15.11 (4th ed. 2007); Strausberg v. Laurel Healthcare Providers, LLC, 2013-NMSC-032, 304 P.3d 409 (parties may choose the law to be applied in a dispute through a contractual choice of law provision); Brown v. MHN Gov't Servs., Inc., 306 P.3d 948 (Wash. 2013) (Supreme Court generally enforces choice of law provisions unless in violation of state public policy). Courts strongly favor enforcement of choice of law provisions, particularly among commercial parties. Courts only invalidate the choice of law provision when it is unreasonable under the circumstances. 17A AM. JUR. 2D *Contracts* § 259 (2007). Conflicts of laws principles are in accord. RESTATEMENT (SECOND) OF CONFLICTS OF LAWS §§ 187, 207 (AM. LAW INST. 1969) (the parties' chosen law governing their contractual rights and obligations determines the measure of recovery).

arbitration clause. Courts would use this inquiry when a party challenged an arbitration award on the ground that the arbitrator exceeded her powers in rendering the award. With remedial limitations, the court should assess first whether the parties' limitations are clearly and unmistakably articulated. This high standard requires that the parties leave no ambiguity in their directions to the arbitrator, which is typical when parties choose to limit damages categorically. If the reviewing court finds that the parties' language clearly and unmistakably limits the arbitrator's remedial authority, it would vacate the award that transgressed those limits unless it found that the parties' limits were unconscionable, the traditional judicial approach to questions about the enforceability of damages limitations. Since these rules apply only to commercial parties, a court would be very likely to enforce the parties' remedial limitations.

A similar approach would apply in the choice of law context. If parties identified which state law should apply to the arbitration, it would be incumbent upon the arbitrator to apply both that state's procedural and substantive law during the arbitration. Because the parties are capable of negotiating around this default rule, they would have to do so if they wished to avoid application of the chosen state's rules.

This structured approach to the exceeding the powers basis for challenging an arbitration award would acknowledge the essential role party autonomy plays in arbitration. The approach would ensure that parties would receive their negotiated-for arbitration process. Arbitration is a party-designed process that parties will continue to use only if their negotiated limitations on arbitral authority, whether in the form of limits to remedial authority or choice of law, are enforced. Deference to arbitration awards, when unjustified, serves only to hasten party flight from a useful and efficient dispute resolution process.