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**SEEKING CONSISTENCY IN JUDICIAL REVIEW OF
SECURITIES ARBITRATION: AN ANALYSIS OF
THE MANIFEST DISREGARD OF THE
LAW STANDARD**

Michael P. O'Mullan

INTRODUCTION

Arbitration, and securities arbitration in particular, is commonly considered a quick and informal alternative to the court system.¹ A series of Supreme Court decisions in the last ten years has made arbitration an easily accessible route for resolving securities disputes.² While recent trends have led increasing numbers to seek this forum in

1. Philip J. Hoblin, Jr., *Securities Arbitration: Procedures, Strategies, Cases* 2-4 (2d ed. 1992); 1 Ian R. Macneil et al., *Federal Arbitration Law: Agreements, Awards, and Remedies under the Federal Arbitration Act § 3* (1995) [hereinafter Macneil]. See generally Gabriel M. Wilner, *Domke on Commercial Arbitration* (1991 & Supp. 1995) (discussing commercial arbitration as an alternative method of dispute settlement). While much of this Note applies to commercial arbitration in general, the issues addressed will be discussed in the context of securities arbitration due to the widespread use of arbitration as an alternative to the courts. See *infra* note 2.

2. See *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484-86 (1989) (finding broadly worded predispute arbitration agreements enforceable in nearly all cases, including those involving the Securities Act); *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220, 242 (1987) (finding predispute arbitration agreement enforceable in Securities Exchange Act cases). These cases overruled *Wilko v. Swan*, 346 U.S. 427 (1953), which had held predispute arbitration clauses in customer margin agreements unenforceable in securities disputes. *Id.* at 432-35. *McMahon* and *Rodriguez*, however, gave free reign to the predispute arbitration clause, allowing such clauses to require arbitration of nearly all disputes. See *New York Stock Exchange, Inc. Symposium on Arbitration in the Securities Industry*, 63 *Fordham L. Rev.* 1495, 1517-18 (1995) [hereinafter *N.Y.S.E. Symposium*] (discussing widespread use of arbitration in the securities industry); see, e.g., 2 *N.Y.S.E. Guide* (CCH) ¶ 2600, Rule 600(a) (1992) [hereinafter *N.Y.S.E. Guide*] (allowing arbitration for any "dispute, claim or controversy"); *N.A.S.D. Manual* (CCH) ¶ 3712, § 12(a) (1995) [hereinafter *N.A.S.D. Manual*] (providing similar language); *infra* note 15 (discussing Uniform Code of Arbitration). Due to the widespread use of such clauses throughout the securities industry, arbitration has become the rule rather than the exception. See *N.Y.S.E. Symposium, supra*, at 1519. Such a situation runs the risk of contract of adhesion type coercion. See 4 Macneil, *supra* note 1, § 40.7.2.5 & n.65 (discussing the shortcomings of arbitration in terms of contract of adhesion type lack of consent due to some parties' lack of sophistication); *N.Y.S.E. Symposium, supra*, at 1513 & n.29, 1517-20 (1995) (discussing the issue of contract of adhesion type lack of consent and explaining the current position that even if consent is lacking, the choice of arbitration is consistent with federal policy, and, therefore, not voidable). Some commentators are of the belief that if the industry uses predispute agreements to strip investors of their rights, the courts will revisit the issue. See Constantine N. Katsoris, *Mastrobuono Not the Last Word on Punitives*, 13 *Alternatives to the High Cost of Litig.* 144, 145 (1995) (focusing on punitive damages). While other areas of commercial arbitration are moving toward wide-spread use of arbitration clauses, the issue is most pronounced in the securities industry. Therefore, the possibility of coercion must be given special consideration in the securities context.

the hope of avoiding the crowded and costly judicial system,³ great confusion exists even among practitioners about the role of judicial review for legal error in arbitration awards.⁴ This confusion has resulted in division among the federal courts of appeals over the proper grounds for vacating an arbitration award when the award is inconsistent with established law.⁵

Arbitration is an attractive alternative to a court trial because it is faster, less formal, and less expensive.⁶ When arbitrators get the law

3. Reports prepared by the Securities Industry Conference on Arbitration show a pronounced rise in the number of securities arbitrations submitted over recent years. *N.Y.S.E. Symposium, supra* note 2, at 1507-08 (citing Securities Industry Conference on Arbitration, Report No. 8, at 29 (1994)). Between 1980 and 1986, the number of total arbitrations submitted to all self-regulatory organizations ("SROs") rose from 830 per year to 2837 per year. *Id.* at 1507. In 1987, the number doubled to 6097, in part due to the *McMahon* decision, making arbitration mandatory in many securities disputes. *Id.*

4. Compare *R.M. Perez & Assocs. v. Welch*, 960 F.2d 534, 539-40 (5th Cir. 1992) (finding no review of arbitration awards outside the statutory provisions of the Arbitration Act) and *Stephen H. Kupperman & George C. Freeman III, Selected Topics in Securities Arbitration: Rule 15c2-2, Fraud, Duress, Unconscionability, Waiver, Class Arbitration, Punitive Damages, Rights of Review, and Attorneys' Fees and Costs*, 65 Tul. L. Rev. 1547, 1620 (1991) (finding it debatable whether the manifest disregard standard applies in securities arbitration) with *Jenkins v. Prudential-Bache Sec., Inc.*, 847 F.2d 631, 633-34 (10th Cir. 1988) (finding no restriction to statutory basis for review) and *Bret F. Randall, The History, Application, and Policy of the Judicially Created Standards of Review for Arbitration Awards*, 1992 B.Y.U. L. Rev. 759, 765 (recognizing manifest disregard standard as an independent standard of review).

5. See *NCR Corp. v. Sac-Co.*, 43 F.3d 1076, 1079 (6th Cir.) (finding manifest disregard an appropriate basis for judicial review), *cert. denied*, 116 S. Ct. 272 (1995); *Remmey v. PaineWebber, Inc.*, 32 F.3d 143, 149-50 (4th Cir. 1994) (accepting manifest disregard standard), *cert. denied*, 115 S. Ct. 903 (1995); *McIlroy v. Painewebber, Inc.*, 989 F.2d 817, 820 & n.2 (5th Cir. 1993) (limiting judicial review of arbitration award to Federal Arbitration Act); *Robbins v. Day*, 954 F.2d 679, 683-84 (11th Cir.) (rejecting manifest disregard of the law standard of review, but accepting arbitrary and capricious standard), *cert. denied*, 113 S. Ct. 201 (1992); *Kanuth v. Prescott, Ball & Turben, Inc.*, 949 F.2d 1175, 1182 (D.C. Cir. 1991) (appearing to accept manifest disregard of the law standard); *Todd Shipyards Corp. v. Cunard Lines, Ltd.*, 943 F.2d 1056, 1060 (9th Cir. 1991) (accepting manifest disregard of the law and completely irrational standards); *Marshall v. Green Giant Co.*, 942 F.2d 539, 550 (8th Cir. 1991) (en banc) (refraining from adopting the manifest disregard of the law standard); *Chameleon Dental Prods. v. Jackson*, 925 F.2d 223, 226 (7th Cir. 1991) (rejecting manifest disregard of the law standard); *Advest, Inc. v. McCarthy*, 914 F.2d 6, 8-9 (1st Cir. 1990) (finding two categories of nonstatutory review); *Mutual Fire, Marine & Inland Ins. v. Norad Reinsurance*, 868 F.2d 52, 56 (3d Cir. 1989) (accepting completely irrational standard); *Jenkins v. Prudential-Bache Sec., Inc.*, 847 F.2d 631, 633-34 (10th Cir. 1988) (recognizing nonstatutory review); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 808 F.2d 930, 933-34 (2d Cir. 1986) (recognizing manifest disregard of the law standard).

6. See *Wilko v. Swan*, 346 U.S. 427, 431-32 (1953) (explaining FAA intended to avoid complications of delay and expense of litigation); *Folkways Music Publishers v. Weiss*, 989 F.2d 108, 111 (2d Cir. 1993) (explaining twin goals of arbitration are efficient settlement of disputes and avoidance of the delay and expense of litigation); *Sargent v. Paine Webber Jackson & Curtis, Inc.*, 882 F.2d 529, 533 (D.C. Cir. 1989) (finding that arbitration creates a balance between speed and efficiency, and rooting out possible error), *cert. denied*, 494 U.S. 1028 (1990); see also *Hoblin, supra* note 1, at

wrong, however, the losing party often turns back to the courts for relief.⁷ This creates a fundamental conflict between the speed and efficiency of arbitration and the more deliberate precision of the court system. The courts' attempts to balance these competing interests has resulted in great confusion over the appropriate basis for judicial review of arbitration awards.⁸

Surprisingly, the statutory relationship between the federal courts and private arbitration has remained virtually unchanged since originally defined in the 1920s.⁹ According to the Federal Arbitration Act ("FAA"),¹⁰ the basis for judicial review of arbitration decisions is extremely limited.¹¹ Under the FAA, the only acceptable basis for vacating an arbitration award arises from procedural unfairness.¹² According to 9 U.S.C. § 10, these grounds are: (1) the procurement of the award by corruption, fraud, or undue means; (2) evident partiality or corruption; (3) refusal to hear proper evidence or to postpone the hearing upon sufficient cause; or (4) conduct by the arbitrators in excess of their powers.¹³ Such limited grounds for review under the statute reflect an intent to safeguard the parties' forum selection and promote speed, cost savings, and finality.¹⁴

2-4 (listing advantages of arbitration); 1 Macneil, *supra* note 1, § 3 (explaining advantages of arbitration).

7. See 4 Macneil, *supra* note 1, § 40.1.1 (noting situations in which arbitration awards may be vacated).

8. See *supra* note 5 and accompanying text.

9. Compare United States Arbitration Act, Pub. L. No. 68-401, ch. 213, 43 Stat. 883 (1925) with 9 U.S.C. §§ 1-16 (1994).

In 1990 the statute underwent renumbering, which resulted in no substantive change. See Administrative Dispute Resolution Act, Pub. L. No. 101-552, § 5, 104 Stat. 2736, 2745 (1990). All references will be cited to the new numbering.

10. 9 U.S.C. §§ 1-16 (1994).

11. Sections 10, 11, & 12 of the FAA provide the exclusive statutory basis for judicial intervention in arbitration awards found in the FAA. This Note will focus on § 10, which provides the grounds for vacating an award. Sections 11 and 12 provide for modification of the award. *Id.* §§ 10-12.

12. See 9 U.S.C. § 10 (a)(1)-(4).

13. 9 U.S.C. § 10(a)(1)-(4) provides:

(a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—

(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.

(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.

14. For a discussion of the legislative intent behind the FAA, see *infra* notes 124-31 and accompanying text.

Despite this narrow grant of federal jurisdiction, the federal courts of appeals are sharply divided over when review of an arbitration award is appropriate—most notably in situations where the arbitrators¹⁵ have ignored or neglected the established law governing a particular issue. Some circuits refuse to recognize any grounds for vacating an arbitration award other than the four listed in § 10.¹⁶ Other, more aggressive circuits have carved out by their own creation additional grounds for judicial review of arbitral awards not found in § 10.¹⁷ A third group of circuits find such judicially-created standards consistent with § 10(a)(4)'s mandate against arbitrators exceeding their powers.¹⁸ Chief among these judicially-created standards is review for the arbitrators' "manifest disregard of the law."¹⁹ According to this standard, the federal courts may vacate an arbitration award when the arbitrators have clearly ignored an established principle of controlling law.²⁰ Although the bounds of this standard have never been fully defined,²¹ it appears that in order to qualify for vacatur under the manifest disregard of the law standard, the arbitrators must intentionally ignore what they know to be the obviously applicable

15. Typically, arbitration panels consist of three or more arbitrators. See *N.Y.S.E. Guide*, *supra* note 2, ¶ 2607, Rule 607(a)(1) (calling for three or more arbitrators per panel if more than \$10,000 is in controversy); *N.A.S.D. Manual*, *supra* note 2, ¶ 3719, § 19(b) (calling for between three and five arbitrators if the amount in controversy is greater than \$30,000).

Note that efforts by the Securities Industry Conference on Arbitration ("SICA") to propagate uniform rules for securities arbitration have been largely adopted by the SROs. See *Hoblin*, *supra* note 1, at 1-3 to 1-4 (discussing SICA's Uniform Code of Arbitration). Because slight variations exist, this Note will cite to the *N.Y.S.E. Guide* and *N.A.S.D. Manual*.

16. See *infra* part II.A.

17. See *infra* part II.B.

18. See *infra* part II.C.

19. Examples of such standards include the manifest disregard of the law standard. See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 808 F.2d 930, 933-34 (2d Cir. 1986) (defining the manifest disregard standard); *infra* part I (explaining manifest disregard of the law). For examples of similar standards such as the "arbitrary and capricious" standard, see *Robbins v. Day*, 954 F.2d 679, 683-84 (11th Cir.) (applying the arbitrary and capricious standard), *cert. denied*, 113 S. Ct. 201 (1992); *infra* note 77 (describing arbitrary and capricious); for the "completely irrational" standard, see *Mutual Fire, Marine & Inland Ins. v. Norad Reinsurance*, 868 F.2d 52, 56 (3d Cir. 1989) (applying completely irrational standard); *infra* notes 184-90 and accompanying text (discussing the completely irrational standard); and for the "draws its essence from the contract" standard, see *Jenkins v. Prudential-Bache Sec., Inc.*, 847 F.2d 631, 634-35 (10th Cir. 1988) (discussing "draws its essence from the contract" standard); *infra* part II.B.2 (same). Although this Note focuses on the manifest disregard of the law standard, these others, referred to as related or similar standards, are the product of similar considerations.

Additional grounds for vacating arbitration awards include the public policy and illegality exceptions, which are beyond the scope of this Note.

20. See *Advest, Inc. v. McCarthy*, 914 F.2d 6, 9 (1st Cir. 1990) (discussing manifest disregard of the law standard and similar standards).

21. *Bobker*, 808 F.2d at 933.

and clearly governing law, and, moreover, they must do so expressly on the record.²² The result is an unworkable standard.

The manifest disregard of the law exception to the limited FAA grounds for review finds its roots in the Supreme Court's decision in *Wilko v. Swan*.²³ There, the Court stated in dicta: "In unrestricted submissions . . . the interpretations of the law by the arbitrators in contrast to *manifest disregard* are not subject, in the federal courts, to judicial review for error in interpretation."²⁴ While *Wilko's* principal holding was later overturned,²⁵ the admonition found in dicta continues to be cited.²⁶

Broadly defined, arbitration is a completely private settlement in which the court does no more than enter the result into the docket, much like a consent decree. At the opposite extreme, arbitration can be seen as a short-form litigation process that attempts to skip the backlog of the trial court, but expects the same exhaustive review in the event that the law is misconstrued. If the former is more accurate, no amount of review is necessary other than that to which the parties consent. If the latter is more accurate, full judicial review is appropriate. Each of these possibilities presents a very different picture of how arbitration should function.

This Note examines the uneven and unpredictable application of the manifest disregard of the law standard and attempts to discover its practical meaning. The discussion focuses on securities arbitration, in which the prevalence of judicial intervention and wide variety of applications of the manifest disregard of the law standard are greatest. Further, it attempts to distinguish the various policy considerations underlying judicial review of arbitration, analyze the mandates of the FAA, and thus create a consistent picture of arbitration as a whole. For example, if an arbitrator's decision can be reviewed for legal error, written opinions, clearly stating the arbitrator's findings, should be required.²⁷

Part I attempts to define the manifest disregard of the law standard, focusing on various attempts to distinguish manifest disregard from ordinary judicial error. Part II examines the adoption or rejection of the manifest disregard of the law standard as a basis for review by the federal courts of appeals, as well as the various rationales used to justify the standard in relation to the FAA. Part III analyzes the policy issues involved in recognizing a substantive standard of review and its effect on arbitration by proposing two models to assist in conceptual-

22. See *infra* part I.

23. 346 U.S. 427 (1953).

24. *Id.* at 436-37 (emphasis added).

25. *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989) (overruling *Wilko*).

26. See, e.g., *First Options of Chicago v. Kaplan*, 115 S. Ct. 1920, 1923 (1995) (citing *Wilko*).

27. See *infra* text accompanying notes 84-86.

izing arbitration as a system of dispute resolution. The first model, based on the consent decree, analogizes arbitration to the private settlement of the parties' dispute, that the court must accept absent some procedural unfairness.²⁸ The second model, based on judicial litigation, analogizes arbitration to a private courtroom, complete with substantive appeals for legal error.²⁹ Part IV argues that the consent decree model most accurately reflects a consistent view of arbitration. This Note concludes that because the manifest disregard of the law standard, and all substantive judicial review beyond the grounds enumerated in § 10, are inconsistent with the arbitration process, the correct approach to arbitration is found in the consent decree model.

I. DEFINING MANIFEST DISREGARD OF THE LAW

Perhaps the most puzzling questions for courts faced with apparent legal error in arbitration awards is when, if ever, they may intervene to vacate the award. In *Wilko v. Swan*,³⁰ the Court apparently distinguished "interpretations of law" from "manifest disregard" of the law,³¹ leading some circuits to adopt the latter as an independent basis of review.³² Long before *Wilko*, however, the Supreme Court, in *Burchell v. Marsh*,³³ distinguished mere errors of law from "gross mistake" in the arbitral context, describing the latter as error "made out to the satisfaction of the arbitrator" resulting in a different award than would have resulted through application of the correct rule of law.³⁴ Needless to say, courts have had a difficult time recognizing this dis-

28. See *infra* part III.A.

29. See *infra* part III.B.

30. 346 U.S. 427 (1953).

31. *Id.* at 436-37.

32. See *infra* II.B.1.

33. 58 U.S. (17 How.) 344 (1854).

34. *Id.* at 349-50. The Court explained:

Arbitrators are judges chosen by the parties to decide the matters submitted to them, finally and without appeal. As a mode of settling disputes, it should receive every encouragement from courts of equity. If the award is within the submission, and contains the honest decision of the arbitrators, after a full and fair hearing of the parties, a court of equity will not set it aside for error, either in law or fact. A contrary course would be a substitution of the judgment of the chancellor in place of the judges chosen by the parties, and would make an award the commencement, not the end, of litigation. In order, says Lord Thurlow, (*Knox v. Symmonds*, 1 Ves., 369.) "to induce the court to interfere, there must be something more than an error of judgment, such as corruption in the arbitrator, or gross mistake, either apparent on the face of the award, or to be made out by evidence; but in case of mistake, it must be made out to the satisfaction of the arbitrator, and that if it had not happened, he should have made a different award."

Courts should be careful to avoid a wrong use of the word "mistake," and, by making it synonymous with mere error of judgment, assume to themselves an arbitrary power over awards.

Id. Thus gross mistake is more than mere error of judgment, but what more, exactly, is unclear.

inction. Such continued uncertainty is captured in this typical statement of a modern court attempting to define the standard for manifest disregard of the law: "Although the bounds of this ground have never been defined, it clearly means more than error or misunderstanding with respect to the law."³⁵ What is required, other than mere error or misunderstanding, has yet to be determined.

The problem, then, consists of distinguishing such disregard of the law from ordinary legal error by the arbitrators, which most agree is beyond the scope of judicial review. In general terms, one court has explained this distinction by stating that the manifest disregard of the law standard "embraces instances where it is clear from the record that the arbitrator recognized the applicable law—and then ignored it."³⁶ This conception suggests three important considerations: first, what type of legal error is sufficient; second, what degree of awareness of this error must be demonstrated by the arbitrators; and, third, how must this be demonstrated to the reviewing court. The first question asks whether a given law is both sufficiently controlling and determinative of the ultimate issue. The second question asks what degree of intent must the arbitrators possess. The third question asks whether such disregard must be stated directly or may be inferred from the circumstances of the award. Each of these prongs of manifest disregard is discussed below.

A. *What Error?*

The first prong distinguishing manifest disregard of the law from ordinary judicial review is the degree of error. In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*,³⁷ the Second Circuit shed some light on this question by stating: "The error must have been obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator."³⁸ Moreover the error must involve a "clearly governing legal principle."³⁹

Thus, according to the Second Circuit, the error of law described by the first question must be one that is both "clearly governing" and "obvious" to a qualified arbitrator. While this determination must be made by a reviewing judge, it must be made not according to what law is "obvious" and "clearly governing" to a judge. Rather, it must be "obvious" to the average qualified arbitrator. This limitation is concededly significant, especially considering that most recognized arbi-

35. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 808 F.2d 930, 933 (2d Cir. 1986).

36. *Advest, Inc. v. McCarthy*, 914 F.2d 6, 9 (1st Cir. 1990) (citations omitted).

37. 808 F.2d 930 (2d Cir. 1986).

38. *Id.* at 933.

39. *Id.*

tration bodies do not require their arbitrators to be attorneys.⁴⁰ According to this limitation it is far from clear, which, if any, legal errors would be covered by the *Bobker* standard. The clearly governing legal principle in cases arising out of securities arbitrations, however, must be in the realm of what is obvious to an arbitrator, rather than a judge.⁴¹

The *Bobker* case, for example, involved a dispute over the ability of Bobker, a customer, to sell short 2000 shares of Phillips Petroleum stock, while simultaneously tendering all of his 4000 shares to a stock repurchase offer.⁴² Bobker hoped to take full advantage of the favorable repurchase offer, which was likely to be pro-rated based on shares tendered due to an anticipated oversubscription of the repurchase offer.⁴³ He also hoped to take advantage of the inflated repurchase price by selling short 2000 of his shares and later repurchasing on the market after the proration date to meet the short sale.⁴⁴ Bobker brought suit after Merrill Lynch cancelled his short sale because the broker believed it constituted a manipulative practice known as a "hedged tender."⁴⁵ According to Merrill Lynch, Bobker failed to maintain a "net long" position as required by Rule 10b-4 of the Securities Exchange Act.⁴⁶ Bobker argued that the short sale did not violate the "net long" requirement, which is not expressly defined by 10b-4.⁴⁷

The arbitrators heard arguments on this point and decided in favor of Bobker.⁴⁸ The district court vacated the award, holding the arbitra-

40. See *Stroh Container Co. v. Delphi Indus.*, 783 F.2d 743, 751, n.12 (8th Cir.) (finding "the results of arbitration by private and untrained 'judges' are distinctly remote from the . . . application of principled law found in the judicial process."), *cert. denied*, 476 U.S. 1141 (1986); 4 Macneil, *supra* note 1, § 40.7.2.5 (stating that the absence of legal training of arbitrators is a central theme of arbitration's critics); Stephen A. Hochman, *We Need A Lawyers Arbitration Forum For Commercial Arbitration*, C907 A.L.I.-A.B.A. 259, 262-65 (1994) [hereinafter Hochman] (explaining AAA's rules do not require arbitrators to be attorneys); see generally *N.Y.S.E. Symposium*, *supra* note 2, at 1679-93 (discussing training and selection of arbitrators).

41. Securities arbitrators are drawn from two pools: The first, labeled "securities industry" arbitrators, consist of current industry employees, retirees, and professionals, such as attorneys, who devoted at least 20% of their time to industry clients within the last two years; the second, labeled "public" arbitrators, have no such industry ties. *N.Y.S.E. Guide*, *supra* note 2, ¶ 2607, Rule 607(a)(2)-(3); *N.A.S.D. Manual*, *supra* note 2, ¶ 3719, § 19(c)-(d). Ordinarily, panels must consist of a majority of public arbitrators. *N.Y.S.E. Guide*, *supra* note 2, ¶ 2607, Rule 607 (a)(1); *N.A.S.D. Manual*, *supra* note 2, ¶ 3719, § 19(b).

42. *Bobker*, 808 F.2d 930, 931 (2d Cir. 1986).

43. See *id.*

44. *Id.*

45. *Id.* at 931-32. A "hedged tender," according to the SEC, occurs when a shareholder responding to a repurchase offer does not have a "net long" position both at the time the security is tendered and on the date the offer expires. See *id.* at 932.

46. *Id.* "Net long" position is not defined by the Securities Exchange Act or by Rule 10b-4.

47. *Id.*

48. *Id.* at 933.

tors had manifestly disregarded the law by rejecting the SEC definition of "net long" position.⁴⁹ The Second Circuit reversed,⁵⁰ rejecting the argument that it should "set aside an arbitration panel's award because of an *arguable* difference regarding the meaning or applicability of laws urged upon it."⁵¹

The Second Circuit explained that the governing law must be "well defined, explicit, and clearly applicable"⁵² to satisfy the manifest disregard standard. Under this standard, the court explained that the "net long" position in Rule 10b-4 is not defined by statute, but had been interpreted by the SEC.⁵³ Such interpretations, however, must be upheld only when they are consistent with the legislation's purpose and history, and are founded upon a rational basis.⁵⁴ Because Bobker was able to put forth an acceptable argument against application of the SEC interpretation, the SEC definition was not "clearly applicable."

The manifest disregard of the law standard masks many of the potential errors in customer complaint cases because the arbitrators are often called upon to interpret some aspect of the securities laws.⁵⁵ Moreover, even if the SEC definition had been part of the statute, the arbitrators still had to apply the law to their factual findings. Because arbitrators generally have no duty to make express findings of fact or legal analysis,⁵⁶ in many cases, courts are forced to conclude that the facts were open to multiple interpretations, preventing a clear application of the law.⁵⁷

A similar issue arises where arbitrators give lump sum awards for disputes presenting multiple legal theories with no explanation of their findings. In *Raiford v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,⁵⁸ for example, a customer brought claims for churning, unsuitability, and margin infractions under federal securities law and state

49. *Id.*

50. *Id.* at 937.

51. *Id.* at 934 (emphasis added).

52. *Id.*

53. *Id.* at 932.

54. *Id.* at 936 (citations omitted).

55. See, e.g., *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 238 (1987) (allowing arbitration claims under the Securities Exchange Act); *Remmey v. PaineWebber, Inc.*, 32 F.3d 143, 149 (4th Cir. 1994) (raising churning and unsuitability claims), *cert. denied*, 115 S. Ct. 903 (1995); *FSC Sec. v. Freel*, 811 F. Supp. 439, 445 (D. Minn. 1993) (interpreting statute of limitations issue), *aff'd*, 14 F.3d 1310 (8th Cir. 1994).

56. See N.Y.S.E. Guide, *supra* note 2, ¶ 2627, Rule 627(e) (listing required contents of the award); N.A.S.D. Manual, *supra* note 2, ¶ 3741, § 41(e) (providing same list); see also *Hoblin*, *supra* note 1, 11-16 (explaining that arbitrators rarely explain their awards).

57. See, e.g., *Remmey*, 32 F.3d at 149-50 (finding that conflicting evidence justifies the panel's interpretations); *Freel*, 811 F. Supp. at 445 (refusing to vacate where arbitrators' decision does not clearly delineate the law); see also *Hoblin*, *supra* note 1, at 2-5 (stating that arbitrators' disregard of the law may not be clearly apparent from the record).

58. 903 F.2d 1410 (11th Cir. 1990).

breach of fiduciary duty theories.⁵⁹ Without explanation, the arbitrators awarded the Raifords a lump sum of \$10,000, an amount bearing no obvious relation to any particular claim.⁶⁰ The Eleventh Circuit explained that the award was sufficient because "the facts and claims in this case indicate that the arbitrators could have fashioned their award based on any number of valid reasons."⁶¹ In that case, the appellant could not possibly establish legal error, because no findings of fact facilitated the application of the correct law.⁶²

Other errors, on the other hand, might more easily qualify if they arise in a proper factual situation. One example of such gross error arose in *Ainsworth v. Skurnick*,⁶³ where an arbitration panel found a broker to have negligently handled Ainsworth's account in violation of Florida securities law, but found no damages.⁶⁴ The district court vacated the award, because the panel had ignored a related Florida statute which gave mandatory damages for such violations.⁶⁵ The Eleventh Circuit, in an unusual step, certified the question of the Florida damages statute to the Florida Supreme Court, which, in turn, confirmed its applicability.⁶⁶ The Eleventh Circuit therefore affirmed the district court's vacatur of the award.⁶⁷

With the exception of the need to certify the question to the Florida high court,⁶⁸ this example demonstrates a potentially gross error be-

59. *Id.* at 1411-12.

60. *Id.* at 1412.

61. *Id.* at 1413.

62. The court in *Raiford* did not apply the manifest disregard of the law standard because the Eleventh Circuit has not accepted such a standard, but instead applied the arbitrary and capricious standard. *Id.* at 1413. The *Raiford* court did, however, state that even if it did accept the manifest disregard of the law standard, it would have been inapplicable here. *Id.* at 1412; *see infra* note 77 (discussing the arbitrary and capricious standard); *see also* *Sargent v. Paine Webber Jackson & Curtis, Inc.*, 882 F.2d 529, 532 (D.C. Cir. 1989) ("We reject the idea that a lump-sum award can be rejected for want of explanation. . . ."), *cert. denied*, 494 U.S. 1028 (1990).

63. 960 F.2d 939 (11th Cir. 1992), *cert. denied*, 113 S. Ct. 1269 (1993).

64. *Id.* at 939-40.

65. *Id.* at 940. In fact, the district court sent the award back to the arbitrators in light of the damages statute, but the panel again returned an award without damages. *Id.*

66. *Id.*

67. The Court of Appeals for the Eleventh Circuit corrected the district court's application of the manifest disregard of the law standard, by applying the arbitrary and capricious standard. *Id.* at 940-41. In this situation, the court treated the distinction as irrelevant. *But see infra* note 77 (distinguishing arbitrary and capricious standard).

68. While the fact that the question was certified to the Florida Supreme Court makes certain the statute's applicability, the fact that it needed certification demonstrates that the court of appeals was uncertain of its application. In that case, it would be reasonable for the arbitration panel to have some doubt, justifying its initial award of no damages because the law was not clearly applicable. *See supra* notes 38-41 and accompanying text. Thus, under the *Bobker* analysis, the arbitration panel's first award would not have manifestly disregarded the established law. The same is not true, however, after remand from the Florida Supreme Court.

cause a finding of liability under one statute, which the panel clearly found, must necessarily lead to the imposition of mandatory damages under a related statute, which the panel refused to apply. What makes this error “gross” is the absence of any need for interpretation; that is, a finding of liability triggers mandatory damages. Still, in order for the court to establish the gross error, the panel had to make appropriate and clear findings.⁶⁹ Such a conception of the error prong seems most consistent with *Burchell v. Marsh*’s definition of a “gross mistake” as one which is more than mere error or misunderstanding of the law.⁷⁰

B. Deliberate Error

The second prong distinguishing manifest disregard of the law from ordinary legal error is the degree of the arbitrators’ intent to disregard the applicable law. This distinction suggests that the degree of error must not only be pronounced, but also that the correct law be consciously disregarded. In *Bobker*, the court stated: “Moreover, the term “disregard” implies that the arbitrator appreciates the existence of a clearly governing legal principle but decides to ignore or pay no attention to it.”⁷¹ This suggests intentional conduct.⁷² The court made its meaning more clear at a later point, explaining that to manifestly disregard the law, the arbitrators must have “understood the terms and applicability of [the laws] . . . and deliberately ignored them in making their award.”⁷³

Such a definition seems to exclude the situation in which the arbitrator should have known a given law was applicable, satisfying the first prong, but lacking such knowledge cannot *intentionally* ignore that law. Thus, it is not enough under the manifest disregard of the law standard for the arbitrators to be negligently grossly wrong, but rather they must be intentionally grossly wrong.⁷⁴

The Ninth Circuit has explained this distinction by stating that it must refuse to vacate an award despite legal error, “if the award contains the honest decision of the arbitrators, after a full and fair hearing

69. That is, the panel had to find on the record, that liability was based on the Florida securities law, which triggered the application of the damages provision.

70. See *supra* notes 33-34 and accompanying text (distinguishing “gross mistake”); accord *McIlroy v. Painewebber, Inc.*, 989 F.2d 817, 820 (5th Cir. 1993) (finding no evidence of gross mistake based solely upon the discrepancy between award and claim when the arbitration panel exercised discretion).

71. *Bobker*, 808 F.2d at 933.

72. In *Stroh Container Co. v. Delphi Indus.*, 783 F.2d 743, 749 (8th Cir.), *cert. denied*, 476 U.S. 1141 (1986), the court used the term “expressly flouted the law,” conveying the same intent.

73. *Bobker*, 808 F.2d at 934.

74. *Remmey v. PaineWebber, Inc.*, 32 F.3d 143, 149 (4th Cir. 1994) (“[A]ppellant is required to show that the arbitrators were aware of the law, understood it correctly, found it applicable to the case before them, and yet chose to ignore it in propounding their decision.”), *cert. denied*, 115 S. Ct. 903 (1995).

of the parties.”⁷⁵ Thus, if the arbitrators’ award unquestionably contains what would ordinarily be reversible error, but the error resulted from the arbitrators’ “honest mistake,” the court may not vacate the award. Therefore, in *Ainsworth*,⁷⁶ if the arbitrators genuinely misread the mandatory damages provision, the error would not be in manifest disregard of the law.⁷⁷

Such an interpretation removes arbitral review from the ranks of mere review of the merits and places it into the purview of procedural fairness. The court must not only be convinced of the critical legal error, but also that the arbitrators deliberately ignored the applicable law. The reversible award thus results from the arbitrators’ subjectively-reached decision.⁷⁸

C. *Demonstrating the Error*

The third prong distinguishing manifest disregard of the law from ordinary judicial review is how clearly the decision to ignore the controlling law must appear on the record.⁷⁹ Some appellate courts appear willing to infer this disregard of the law, while others require a clear showing of the previous two prongs on the face of the record.⁸⁰ If this prong is strictly enforced, the manifest disregard of the law standard requires the arbitrators to expressly admit that they are ignoring what they know to be the correct law. Such a case is unlikely.

75. *Coast Trading Co. v. Pacific Molasses Co.*, 681 F.2d 1195, 1198 (9th Cir. 1982) (quoting *Burchell v. Marsh*, 58 U.S. 344, 349 (1854)).

76. *Ainsworth v. Skurnick*, 960 F.2d 939 (11th Cir. 1992), *cert. denied*, 113 S. Ct. 1269 (1993).

77. In *Ainsworth*, the Eleventh Circuit corrected the district court, finding the award arbitrary and capricious, rather than in manifest disregard of the law. This appears to be the difference between the Eleventh Circuit’s arbitrary and capricious standard and the manifest disregard of the law standard. The arbitrary and capricious standard applies only if the basis for the arbitrators’ award cannot be inferred from the facts of the case. *Raiford v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 903 F.2d 1410, 1413 (11th Cir. 1990). Under this standard, the arbitrators’ decision does not have to be willful, only wrong. Thus in *Ainsworth*, the district court’s remand was unnecessary to vacate the award as arbitrary and capricious, but might have been required for vacatur under the manifest disregard of the law. The former requires no subjective intent.

78. One court has stated, “manifest infidelity to what the arbitrators know to be the law, but deliberately disregard might well be regarded as the use of ‘undue means’ within the meaning of subdivision (a)[(1)] of 9 U.S.C. § 10, or amount to ‘partiality’ within the meaning of subdivision [(a)(2)] thereof.” *San Martine Compania De Navegacion v. Saguenay Terminals Ltd.*, 293 F.2d 796, 801 (9th Cir. 1961). Thus, such a situation may be deemed procedurally unfair, making an independent basis for review unnecessary.

79. *Robbins v. Day*, 954 F.2d 679, 683 (11th Cir.) (“There is inconsistency among courts throughout the United States on the degree of the ‘showing in the record’ required to satisfy the manifest disregard of the law standard.”), *cert. denied*, 113 S. Ct. 201 (1992).

80. *Michigan Mut. Ins. v. Unigard Sec. Ins.*, 44 F.3d 826, 832 (9th Cir. 1995) (“It must be clear from the record that the arbitrators recognized the applicable law and then ignored it.”).

Therefore, some circuits have adopted a slightly less strict requirement.

1. Requiring an Express Showing on the Record

O.R. Securities, Inc. v. Professional Planning Associates,⁸¹ is an example of the most extreme requirement of a clear showing of manifest disregard of the law on the record. There, O.R. Securities contested its inclusion in the arbitration of a dispute between financial services firms after it had procured substantially all the assets of one of the disputing parties.⁸² Without explaining its decision, the arbitration panel found O.R. Securities to be jointly and severally liable with the losing disputant, despite O.R. Securities's motion to dismiss based on the law of successor liability.⁸³ Later, on appeal before the Eleventh Circuit, the court rejected O.R. Securities's argument that manifest disregard of the law could be inferred from the panel's failure to address their legal arguments, explaining that the manifest disregard of the law standard required "some showing in the record, other than the result obtained, that the arbitrators knew the law and expressly disregarded it."⁸⁴ Such a showing will be particularly difficult where the arbitrators do not write an opinion.

The court recognized this dilemma, stating that such a showing of manifest disregard of the law would be "nearly impossible" to prove where the arbitrators have opted not to state their reasons.⁸⁵ Moreover, the court went on to explain that the lack of any requirement that arbitrators explain their reasoning is "a strong argument in support of not recognizing manifest disregard of the law as a basis for vacating an arbitration award."⁸⁶ Subsequently, the Eleventh Circuit has rejected manifest disregard of the law as a basis for review of arbitral awards.⁸⁷

*Wilko v. Swan*⁸⁸ appears to require such an extreme showing on the record. There the Court stated "[w]hile it may be true . . . that a failure of the arbitrators to decide in accordance with the provisions of the Securities Act would 'constitute grounds for vacating the award

81. 857 F.2d 742 (11th Cir. 1988).

82. *Id.* at 744.

83. *Id.* at 747.

84. *Id.*

85. *Id.* No such requirement exists. *Id.*; see, e.g., N.Y.S.E. Guide, *supra* note 2, ¶ 2627, Rule 627 (explaining required contents of award); N.A.S.D. Manual, *supra* note 2, ¶ 3741, § 41(e) (providing same requirements).

86. *O.R. Securities*, 857 F.2d at 747 & n.4.

87. See *Robbins v. Day*, 954 F.2d 679, 683-84 (11th Cir.) (rejecting the manifest disregard of the law standard), *cert. denied*, 113 S. Ct. 201 (1992); see also *Brown v. Rauscher Pierce Refsnes, Inc.*, 994 F.2d 775, 779 n.3 (11th Cir. 1993) ("This Circuit, however, has declined to adopt the manifest disregard of the law standard. . . .").

88. 346 U.S. 427 (1953).

pursuant to section 10 of the Federal Arbitration Act,' *that failure would need to be made clearly to appear.*"⁸⁹

2. Inferring Manifest Disregard from the Record

A slightly less strict showing on the record is demonstrated in *Jenkins v. Prudential-Bache Securities, Inc.*⁹⁰ There, the Tenth Circuit refused to overturn a panel's award where it was unable to state "with positive assurance that the contract is not susceptible to a [contrary] interpretation."⁹¹ Accordingly, the Tenth Circuit will vacate the award only if the appellant can prove no possible justification. Thus, the Tenth Circuit appears willing to infer any rationale that might justify the award whether or not addressed by the panel. In this situation, the arbitrators' silence insures against review unless the appellant can show no possible justification for the award.⁹² Such review is only slightly more lenient than a strict reading of the third prong, where nothing may be inferred from the award, but rather the arbitrators apparently must expressly state an intention to disregard clearly controlling law.

Similarly, other circuits which recognize a more generalized non-statutory basis for judicial review appear more willing to infer a disregard of the law, without the need for a direct showing. The Eleventh Circuit's "arbitrary and capricious" standard, for example, allows review where no legal justification can be inferred from the award.⁹³ Thus, even if the arbitrators do not expressly state the error on the record, if the absence of legal justification may be inferred from the case, the award may be vacated. This represents a less restrictive approach to the third prong.⁹⁴

89. *Id.* at 436 (emphasis added) (quoting lower court opinion, 201 F.2d 439, 445 (2d Cir. 1953)); *see also* *Stroh Container Co. v. Delphi Indus.*, 783 F.2d 743, 750 (8th Cir.) (refusing to find manifest disregard where it does not directly appear on the record or in the award), *cert. denied*, 476 U.S. 1141 (1986).

90. 847 F.2d 631 (10th Cir. 1988).

91. *Id.* at 635. Note that in *Jenkins* the panel was faced with the interpretation of a contract, *id.*, which may be distinguishable from application of statutory law. *See infra* notes 167-76 and accompanying text.

92. *See* *Mutual Fire, Marine & Inland Ins. v. Norad Reinsurance*, 868 F.2d 52, 56 (3d Cir. 1989) (explaining the completely irrational basis for vacating an arbitration award).

93. *See supra* note 77 (explaining arbitrary and capricious).

94. The First Circuit seems to allow review where: "[T]he governing law may have such widespread familiarity, pristine clarity, and irrefutable applicability that a court *could assume* the arbitrators knew the rule and, notwithstanding, swept it under the rug." *Advest, Inc. v. McCarthy*, 914 F.2d 6, 10 (1st Cir. 1990) (emphasis added). This suggests that if the reviewing judge could not have justified an award, the arbitral award may be vacated based only upon a consideration of the award itself.

D. *Summary of the Manifest Disregard of the Law Standard*

In sum then, arbitrators manifestly disregard the law when the award is contrary to the obviously applicable and clearly governing law. Moreover, arbitrators must be subjectively aware of such law and decide to ignore it nonetheless. Finally, manifest disregard must be expressly clear from the record. Thus, a genuine mistake by nonlawyer arbitrators, although plainly clear to the reviewing judge, may not be overturned. Further, because arbitrators are not required to explain the award, the arbitrators can circumvent the law completely by granting a lump sum award which is nearly impossible to review.

This attempt to define the manifest disregard of the law standard demonstrates that, even if Congress added this as a basis for vacatur under the FAA, the standard is too limited to be meaningful. Furthermore, such appeals result in undue expense and delay in the arbitration process.⁹⁵ Thus, despite the temptation to believe that substantive review of arbitration awards, restricted to the limited circumstances of manifest disregard of the law, will help protect the parties from abuse and gross mistake without the substantial side effects of undue expense and delay, a closer look at such review in practice reveals its ineffectiveness in both respects. The continued existence of this ground for review allows parties to plead ordinary legal error, thereby causing undue expense and delay, without the probability of meaningful review.⁹⁶

Some commentators believe that arbitrators should be free from the constraints of the law and should be able to decide cases based on pure equity.⁹⁷ Moreover, even if a limited substantive review is necessary, it should be one which is uniformly dictated by federal law. To further these ends, the standard must either be eliminated or redesigned and incorporated into the FAA. Before such a step is taken,

95. See *Sargent v. Paine Webber Jackson & Curtis, Inc.*, 882 F.2d 529, 533 (D.C. Cir. 1989) (stating that in the "balance between the interest in rooting out possible error and the interest in assuring that judgment be swift and economical . . . the latter must generally prevail"), *cert. denied*, 494 U.S. 1028 (1990).

96. In *Jenkins v. Prudential Bache Sec., Inc.*, 847 F.2d 631, 636 (10th Cir. 1988), for example, despite dismissing the request to vacate the award, the court refused to grant Rule 11 sanctions because the basis for review was "colorable." Thus, it is hard to find any incentive not to raise such an appeal. Moreover, in *FSC Sec. v. Freel*, 811 F. Supp. 439, 446 (D. Minn. 1993), *aff'd*, 14 F.3d 1310 (8th Cir. 1994), the court found that no award of attorneys' fees was warranted where the challenge to the award was not frivolous, but based on existing law. Given the state of this area of the law, it is unlikely that any challenge would meet such a burden. Cf. *Quick & Reilly, Inc. v. Jacobson*, 126 F.R.D. 24, 28 (S.D.N.Y. 1989) (awarding sanctions for a frivolous appeal).

97. See, e.g., Brad A. Galbraith, Note, *Vacatur of Commercial Arbitration Awards in Federal Court: Contemplating the Use and Utility of the "Manifest Disregard" of the Law Standard*, 27 Ind. L. Rev. 241, 263-64 (1993) (discussing the notion that arbitrators may not be bound by the law); see also *supra* note 4 (citing examples of the confusion over the manifest disregard standard).

however, it is useful to examine the confusion among the circuits over the justification for the various standards of substantive review.

II. CONFUSION AMONG THE CIRCUITS

Despite the noted absence of any reference to manifest disregard of the law as an enumerated basis for vacating an arbitration award under § 10 of the FAA, it has nonetheless been endorsed by a number of federal courts. What began as an offhand statement in *Wilko v. Swan*⁹⁸ has become a widely cited justification for expansion of § 10. To say, however, that such a standard is not based on the statute is an oversimplification because even among those circuits that recognize such judicially-created standards of review,⁹⁹ disagreement persists over the justification for such review.

A general survey of the courts of appeals reveals three prevailing approaches to the FAA. Some circuits, including the Fifth,¹⁰⁰ Seventh,¹⁰¹ and Eighth,¹⁰² refuse to recognize any grounds for vacating an award not specifically listed in § 10. A second approach accepted by some circuits, including the First,¹⁰³ Second,¹⁰⁴ Fourth,¹⁰⁵ Sixth,¹⁰⁶

98. 346 U.S. 427, 436-37 (1953) (stating that "[t]he interpretations of the law by the arbitrators in contrast to manifest disregard are not subject, in the federal courts, to judicial review for error in interpretation").

99. See *supra* note 19.

100. See *McIlroy v. Painewebber, Inc.*, 989 F.2d 817, 820 n.2 (5th Cir. 1993) ("[W]e disregard [appellant's] argument to the extent that they rely upon standards of review outside the scope of the Arbitration Act."); *R.M. Perez & Assocs. v. Welch*, 960 F.2d 534, 539 (5th Cir. 1992) ("[T]his circuit never has employed a 'manifest disregard of the law' standard in reviewing arbitration awards."). But see *Anderman/Smith Operating Co. v. Tennessee Gas Pipeline Co.*, 918 F.2d 1215, 1218 (5th Cir. 1990) (accepting the "draw its essence from the contract" standard), *cert. denied*, 501 U.S. 1206 (1991).

101. See *Chameleon Dental Products v. Jackson*, 925 F.2d 223, 226 (7th Cir. 1991) ("[T]he exclusive grounds for vacating or modifying a commercial arbitration award are found in §§ 10 and 11 of the Arbitration Act."); *Moseley, Hallgarten, Estabrook & Weeden, Inc. v. Ellis*, 849 F.2d 264, 267 (7th Cir. 1988) ("Sections 10 and 11 of the Act set forth the exclusive grounds for vacating or modifying a commercial arbitration award."). But see *Health Servs. Mgmt. v. Hughes*, 975 F.2d 1253, 1267 (7th Cir. 1992) (stating that Seventh Circuit has applied manifest disregard of the law).

102. See *Marshall v. Green Giant Co.*, 942 F.2d 539, 550 (8th Cir. 1991) (en banc) (declining to apply manifest disregard of the law standard); *FSC Sec. v. Freel*, 811 F. Supp. 439, 445 (D. Minn. 1993) ("The Eighth Circuit, however, has on two occasions explicitly refused to adopt the manifest disregard standard."), *aff'd*, 14 F.3d 1310 (8th Cir. 1994). But see *Osceola County Rural Water Sys. v. Subsurfco*, 914 F.2d 1072, 1075 (8th Cir. 1990) (accepting "draws essence from the contract" standard).

103. See *Advest, Inc. v. McCarthy*, 914 F.2d 6, 8 (1st Cir. 1990) ("Courts do, however, retain a very limited power to review arbitration awards outside of section 10.").

104. See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 808 F.2d 930, 933-34 (2d Cir. 1986) (applying manifest disregard of the law).

105. See *Remmey v. PaineWebber, Inc.*, 32 F.3d 143, 149-50 (4th Cir. 1994) (accepting manifest disregard of the law), *cert. denied*, 115 S. Ct. 903 (1995). But see *Miller v. Prudential Bache Sec., Inc.*, 884 F.2d 128, 130 (4th Cir. 1989) (stating that "contract misconstruction is an insufficient basis for vacating an arbitration award" under the FAA).

Ninth,¹⁰⁷ Eleventh,¹⁰⁸ and D.C. Circuits,¹⁰⁹ does not rely on any statutory justification, but is content with a judicially-created standard. A third group of those who accept such extra-statutory standards, including the Third¹¹⁰ and Tenth¹¹¹ Circuits, seeks to justify such review as an interpretation of § 10(a)(4), which allows relief where arbitrators "exceeded their powers."¹¹²

A. Section 10 As the Exclusive Grounds for Review of the Law

The first group, perhaps the most straightforward, stalwartly rejects any basis for review that is not found in § 10 of the FAA. The Fifth Circuit provides the clearest example of this approach. In *R.M. Perez & Associates v. Welch*,¹¹³ the Fifth Circuit explained, "this circuit never has employed a 'manifest disregard of the law' standard in reviewing arbitration awards."¹¹⁴ The court went on to hold that "judicial review of a commercial arbitration award is limited to Sections 10 and 11 of the Federal Arbitration Act."¹¹⁵ In a subsequent case, the

106. See *NCR Corp. v. Sac-Co.*, 43 F.3d 1076, 1079 (6th Cir. 1995) ("[A] court may vacate an award if the conduct of the arbitrator constitutes "'manifest disregard'" of applicable law."), *cert. denied*, 116 S. Ct. 272 (1995).

107. See *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056, 1060 (9th Cir. 1991) (appearing to accept manifest disregard of the law standard as a judicially-created standard); *French v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 784 F.2d 902, 906 (9th Cir. 1986) (accepting the completely irrational or manifest disregard of the law standard); see also *Michigan Mut. Ins. v. Unigard Sec. Ins.*, 44 F.3d 826, 832 (9th Cir. 1995) (relying on *Bobker*, *Advest*, and *Green Giant* cases for manifest disregard standard).

108. See *Robbins v. Day*, 954 F.2d 679, 683-84 (11th Cir.) (rejecting manifest disregard of the law standard, but recognizing arbitrary and capricious standard as judicially-created basis for review), *cert. denied*, 113 S. Ct. 201 (1992).

109. See *Kanuth v. Prescott, Ball & Turben Inc.*, 949 F.2d 1175, 1182 (D.C. Cir. 1991) (appearing to accept manifest disregard standard); *Sargent v. Paine Webber Jackson & Curtis, Inc.*, 882 F.2d 529, 532 (D.C. Cir. 1989) (appearing to allow review for manifest disregard of the law, based, inter alia, on Second Circuit precedent), *cert. denied*, 494 U.S. 1028 (1990).

110. See *Mutual Fire, Marine & Inland Ins. v. Norad Reinsurance*, 868 F.2d 52, 56 (3d Cir. 1989) (accepting completely irrational standard based on § 10(a)(4)); *Swift Indus. v. Botany Indus.*, 466 F.2d 1125, 1130 & n.11 (3d Cir. 1972) (recognizing "draws essence from the contract" standard based on § 10(a)(4) and labor cases).

111. See *Jenkins v. Prudential-Bache Sec., Inc.*, 847 F.2d 631, 633-34 (10th Cir. 1988) (allowing review "either as an inherent appurtenance to the right of judicial review or as a broad interpretation of subsection [10(a)(4)] prohibiting arbitrators from exceeding their powers. . ."); see also *Kelley v. Michaels*, 830 F. Supp. 577, 578-79 (N.D. Okla. 1993) (premising review on § 10(a)(4)), *aff'd*, 59 F.3d 1050 (10th Cir. 1995).

112. 9 U.S.C. § 10(a)(4) (1994).

113. 960 F.2d 534 (5th Cir. 1992).

114. *Id.* at 539 (footnote omitted).

115. *Id.* at 539-40; see also *McIlroy v. Painewebber, Inc.*, 989 F.2d 817, 820 & n.2 (5th Cir. 1993) ("During the pendency of the appeal, we declined to adopt 'manifest disregard,' or any other standard, as an addendum to section 10.").

Fifth Circuit refused to consider arguments for review which were not based on a ground enumerated in § 10.¹¹⁶

Other circuits have adopted similar approaches. The Seventh Circuit, in *Chameleon Dental Products v. Jackson*,¹¹⁷ has stated: "We have not adopted exceptions to the exclusivity of §§ 10 and 11 [of the FAA] and see no reason to do so in this case."¹¹⁸ The Eighth Circuit, without explaining its rationale, has consistently refused to accept the manifest disregard of the law standard.¹¹⁹

Such a stance is consistent with a plain reading of the statute, which enumerates a finite list of grounds for vacating an award. Section 10(a) states: "In any of the following cases the [district court] may make an order vacating the award upon the application of any party to the arbitration . . ." ¹²⁰ Notably absent from that list is any mention of manifest disregard of the law, or, for that matter, any substantive review.¹²¹ According to the common law maxim of contract and statutory interpretation *expressio unius est exclusio alterius*,¹²² such a list should be read as exclusive. Moreover, the plain meaning rule of statutory interpretation suggests that because the language, when given its ordinary meaning, suggests a clear and unambiguous result, that result should be applied without the need to look beyond the text.¹²³ Thus, such a reading of § 10 indicates that the statute plainly limits the court's ability to review arbitral awards.

116. *McIlroy*, 989 F.2d at 820.

117. 925 F.2d 223 (7th Cir. 1991).

118. *Id.* at 226; see also *Moseley, Hallgarten, Estabrook & Weeden, Inc. v. Ellis*, 849 F.2d 264, 272 (7th Cir. 1988) ("Judicial review has been thus restricted in order to . . . resolve disputes promptly and inexpensively, without resort to litigation and often without any requirement that the arbitrators state the rationale behind their decision. . . ." (quoting *Office of Supply v. New York Navigation Co.*, 469 F.2d 377, 379 (2d Cir. 1972) (footnotes and citations omitted))). But see *Health Servs. Mgmt. v. Hughes*, 975 F.2d 1253, 1267 (7th Cir. 1992) ("[T]o vacate an arbitration award for manifest disregard of the law, there must be something beyond and different from mere error in law. . . ." (citing *Shearson Hayden Stone, Inc. v. Liang*, 493 F. Supp. 104 (D.C. Ill.), *aff'd*, 653 F.2d 310 (7th Cir. 1980))).

119. See *Marshall v. Green Giant Co.*, 942 F.2d 539, 550 (8th Cir. 1991) (en banc) ("This circuit has never adopted manifest disregard as a basis for vacating an arbitrator's award. . . ."); see also *FSC Sec. v. Freel*, 811 F. Supp. 439, 445 (D. Minn. 1993) (explaining the Eighth Circuit's continued refusal to adopt the manifest disregard of the law standard), *aff'd*, 14 F.3d 1310 (8th Cir. 1994).

120. 9 U.S.C. § 10(a) (1994). The provision goes on to list four grounds for review. *Id.* § 10(a)(1)-(4).

121. See *supra* note 13 (quoting § 10(a)(1)-(4)).

122. Meaning "the expression of one thing is the exclusion of another." See E. Allan Farnsworth, *Contracts* § 7.11, at 496 (2d ed. 1990).

123. See *Hamilton v. Rathbone*, 175 U.S. 414, 419 (1899).

The general rule is perfectly well settled that, where a statute is of doubtful meaning and susceptible upon its face of two constructions, the court may look into prior and contemporaneous acts, the reasons which induce the act in question, the mischiefs intended to be remedied, the extraneous circumstances, and the purpose intended to be accomplished by it, to determine its proper construction. But where the act is clear upon its face, and when

Even if the language of § 10 is seen as ambiguous, the existence of a finite list is consistent with the purpose of the FAA. The Supreme Court has recognized that the purpose "was to assure those who desired arbitration . . . that their expectations would not be undermined by federal judges."¹²⁴ Moreover, the congressional committee reports give no allowance for review of the merits of an award.

The legislative history of the FAA makes it clear that a general review of the merits of arbitral awards is outside the role of the federal judiciary. In fact, the House report describing the Act states that the award "may . . . be entered as a judgment, subject to attack by the other party for fraud and corruption and similar undue influence, or for palpable error in form."¹²⁵ This limitation of review to procedural fairness is supported by the explanation that mistakes must be "evident" and "not affecting the merits."¹²⁶ Thus, Congress apparently envisioned no substantive review for commercial arbitration awards.

Similarly, the Senate report explains that the legislation was necessary to overturn the common law "jealousy" of courts over their jurisdiction.¹²⁷ In enacting the FAA, "Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration."¹²⁸ Thus, the desire of courts to exercise jurisdiction beyond the limited scope granted by Congress appears reminiscent of this common law "jealousy" and represents an attempt to undermine the FAA.

Both the House and Senate reports unequivocally indicate congressional confidence in the ability of arbitrators to give parties' disputes "full or proper redress."¹²⁹ The scope of this redress does not appear to be limited to specific types of disputes, such as those over contracts, but rather appears to be modeled after various trade associations' arbitral bodies.¹³⁰ Nonetheless, the prevalence and enforceability of

standing alone it is fairly susceptible of but one construction, that construction must be given to it.

Id. (citations omitted). While modern courts are less apt to blindly apply the plain meaning rule, its application in this situation may be worth noting, because nothing in the statute suggests a manifest disregard of the law basis for review.

124. *Southland Corp. v. Keating*, 465 U.S. 1, 13 (1984) (quoting *Metro Indus. Painting v. Terminal Constr.*, 287 F.2d 382, 387 (2d Cir. 1961) (Lumbard, C.J., concurring)).

125. H.R. Rep. No. 96, 68th Cong., 1st Sess. 2 (1924).

126. *Id.*

127. S. Rep. No. 569, 68th Cong., 1st Sess. 2 (1924); see also *Red Cross Line v. Atlantic Fruit Co.*, 264 U.S. 109, 120-21 (1924) (explaining that at common law courts refused to give specific performance to arbitration clauses).

128. *Southland Corp.*, 465 U.S. at 10.

129. See S. Rep. No. 569, *supra* note 127, at 2.

130. See *id.* at 3 (stating that "'arrangements for . . . referring a dispute to friends or neutral persons are a natural practice of which traces may be found in any state of society'" (citation omitted)). For example, the Senate report referred particularly to the Arbitration Society of America. *Id.* Moreover, the bill which became the FAA had strong support from commercial interests. H.R. Rep. No. 96, *supra* note 125, at 2.

predispute arbitration agreements and the expansion of federal regulatory legislation may prompt Congress to limit arbitration, absent substantive review, either by subject area or dollar amount.¹³¹ No such limitation, however, is evident in the FAA. Thus, it appears that Congress envisioned arbitration, absent procedural unfairness, to be a final resolution of parties' disputes.

B. Judicially-Created Review of the Law

Despite Congress' intent to prohibit substantive review of arbitral awards, some courts justify such review based on grounds that are not expressly enumerated in § 10. Two separate lines of Supreme Court precedent are cited to justify their existence.

1. The *Wilko v. Swan*¹³² Precedent

The first approach is that taken by the Second Circuit. In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*,¹³³ the Second Circuit stated unequivocally, "[m]anifest disregard of the law' . . . is a judicially-created ground for vacating [an] arbitration award."¹³⁴ According to this approach, such review was created directly by the Supreme Court in *Wilko v. Swan* and therefore needs no statutory justification in the FAA.¹³⁵ In *Kanuth v. Prescott, Ball & Turben, Inc.*,¹³⁶ the D.C. Circuit stated directly that "[t]his formulation comes from dicta in *Wilko v. Swan*."¹³⁷ The First Circuit, in *Advest, Inc. v. McCarthy*,¹³⁸ the Fourth Circuit in *Remmey v. PaineWebber, Inc.*,¹³⁹ the Sixth Circuit in *NCR Corp. v. Sac-Co.*,¹⁴⁰ the Ninth Circuit in *Todd Shipyards*

131. See *Revere Copper & Brass Inc. v. Overseas Private Inv. Corp.*, 628 F.2d 81, 84 (D.C. Cir.) (explaining that Congress has the power to exempt certain types of contracts or regulatory schemes from the FAA), *cert. denied*, 446 U.S. 983 (1980).

132. 346 U.S. 427 (1953).

133. 808 F.2d 930 (2d Cir. 1986).

134. *Id.* at 933.

135. *Id.*

136. 949 F.2d 1175 (D.C. Cir. 1991).

137. *Id.* at 1178 (citation omitted).

138. 914 F.2d 6, 9 & n.5 (1st Cir. 1990) (finding the manifest disregard language derived directly from *Wilko*). In *Advest*, the First Circuit reviewed the various standards of review accepted by the circuits and concluded that despite semantical differences they were fungible. See *id.* at 9. As a result, the court divided arbitral review into two categories. One category, involving labor disputes, is not reviewable unless the "award is contrary to the plain language of the collective bargaining agreement." *Id.*; see *infra* part II.B.2 (discussing interpretations of the contract). The second category, including the manifest disregard of the law standard, allows review "where it is clear from the record that the arbitrator recognized the applicable law—and then ignored it." *Advest*, 914 F.2d at 9.

139. 32 F.3d 143, 149-50 (4th Cir. 1994), *cert. denied*, 115 S. Ct. 903 (1995).

140. 43 F.3d 1076, 1079 (6th Cir. 1995) (relying on judicial creation), *cert. denied*, 116 S. Ct. 272 (1995).

Corp. v. Cunard Line, Ltd.,¹⁴¹ and the Eleventh Circuit in *Robbins v. Day*,¹⁴² appear to rely on this basis for their related standards. The Tenth Circuit goes even further, stating "federal courts have *never* limited their scope of review to a strict reading of this statute."¹⁴³

Much has been made of the brief excerpt from *Wilko*, turning it from an unexplained comment into a widely-cited authority with no support in the statutory scheme. This is true despite the unquestionable fact that the comment is pure dictum.¹⁴⁴ Moreover, the very issue decided in *Wilko*, that predispute arbitration agreements are not enforceable for claims arising under the federal securities statutes, has been definitively overruled.¹⁴⁵ In addition, the Court followed the commonly quoted excerpt from *Wilko* with an effort to explain that the FAA, unlike English law, does not provide for judicial determination of legal issues in arbitration.¹⁴⁶ In the absence of such a provision the Court concluded that the FAA was insufficient to safeguard the federal protection afforded to the market by the securities laws.¹⁴⁷

Supreme Court precedent is used to justify not only the manifest disregard of the law standard, but also as a basis for similar and related standards.¹⁴⁸ In addition, an entirely different line of precedent governing the review of an arbitrators' interpretations of the contract has emerged in labor arbitration.

2. The *Enterprise Wheel* Precedent¹⁴⁹

A related line of Supreme Court precedent used as authority for nonstatutory review emerged in *United Steelworkers v. Enterprise*

141. 943 F.2d 1056, 1060 (9th Cir. 1991) (citing *San Martine Compania De Navegacion v. Saguenay Terminals, Ltd.*, 293 F.2d 796, 800-01 (9th Cir. 1961) (interpreting *Wilko*)).

142. 954 F.2d 679, 683 (11th Cir.) (finding arbitrary and capricious standard exists outside the FAA and is created by courts), *cert. denied*, 113 S. Ct. 201 (1992).

143. *Jenkins v. Prudential-Bache Sec., Inc.*, 847 F.2d 631, 633 (10th Cir. 1988) (emphasis added).

144. *See, e.g.*, *Kanuth v. Prescott, Ball & Turben, Inc.*, 949 F.2d 1175, 1178 (D.C. Cir. 1991) ("[A]n award may be vacated if the arbitrators made the award in 'manifest disregard of the law.' This formulation comes from *dicta* in *Wilko v. Swan*. . . ." (emphasis added) (citation omitted)).

145. *See supra* note 2.

146. The passage states:

In unrestricted submissions, such as the present margin agreements envisage, the interpretations of the law by the arbitrators in contrast to manifest disregard are not subject, in the federal courts, to judicial review for error in interpretation. The United States Arbitration Act contains no provision for judicial determination of legal issues such as is found in the English law.

Wilko v. Swan, 346 U.S. 427, 436-37 (1953) (footnotes omitted).

147. *Id.*

148. *See, e.g.*, *Robbins v. Day*, 954 F.2d 679, 683-84 (11th Cir.) (defining the arbitrary and capricious standard with same justification), *cert. denied*, 113 S. Ct. 201 (1992).

149. The *Enterprise Wheel* line of cases is often recognized as an interpretation of § 10(a)(4), which governs arbitrators' exceeding their powers. For this reason, the

*Wheel & Car Corp.*¹⁵⁰ In *Enterprise Wheel*, a labor case, the Supreme Court stated:

[A]n arbitrator is confined to interpretation and application of the collective bargaining agreement; he does not sit to dispense his own brand of industrial justice. He may of course look for guidance from many sources, yet his award is legitimate only so long as it *draws its essence* from the collective bargaining agreement.¹⁵¹

This deference to the arbitrators' interpretation of the collective bargaining agreement reflects a fundamental hallmark of arbitration—by including an arbitration clause, the parties have agreed to be bound by the arbitrators' view of their agreement. *Enterprise Wheel* recognizes that in labor arbitration, the only boundary to the arbitrators' determination is that it must be anchored in the agreement itself.¹⁵² In the context of labor arbitration, this collective bargaining agreement defines the very relationship between the parties and thus it essentially becomes the law of the dispute.¹⁵³ So long as the award is based on some interpretation of that agreement, even if a judge might disagree, the arbitrators' award must stand.¹⁵⁴

Although it is especially significant in labor arbitration, the collective bargaining agreement is essentially an all-encompassing contract between the parties.¹⁵⁵ Labor cases are not, therefore, unlike many contractual disputes decided by arbitration. A further similarity is that in such contract disputes, the arbitrators' interpretation of the contract is bargained for by the parties and ultimately definitive of the issues. Thus, many courts have expanded the "draws its essence from the collective bargaining agreement" standard outside the labor context to apply in to all types of contract disputes.¹⁵⁶

In *Swift Industries v. Botany Industries*,¹⁵⁷ the Third Circuit applied this portion of *Enterprise Wheel* to commercial arbitration cases, and

Enterprise Wheel line may often overlap with the analysis under part II.C. Nonetheless, it forms a judicially-created basis for review which is distinct from the manifest disregard of the law standard. In fact, properly applied, it cannot review the applicable law, but rather is limited to interpretations of contracts. See *infra* notes 167-76 and accompanying text (distinguishing review of the contract from the law).

150. 363 U.S. 593 (1960); see also *United Paper Workers Int'l Union v. Misco, Inc.*, 484 U.S. 29 (1987) (developing further the *Enterprise Wheel* analysis).

151. *Enterprise Wheel*, 363 U.S. at 597 (emphasis added).

152. *Id.* at 597; see *Misco*, 484 U.S. at 38 (explaining that the only limit on the arbitrator is that he may not ignore the plain meaning of the collective bargaining agreement).

153. See *Misco*, 484 U.S. at 38 (finding that arbitration is an important part of the collective bargaining process whereby labor parties' relationships are defined).

154. *Id.*; *Enterprise Wheel*, 363 U.S. at 599.

155. See *Misco*, 484 U.S. at 36-37 (finding labor arbitrators' role as essentially one of contract interpretation) (citing *Enterprise Wheel*, 363 U.S. at 597).

156. See, e.g., *Osceola County Rural Water Sys. v. Subsurfco*, 914 F.2d 1072, 1075 (8th Cir. 1990) ("[A] court may set aside an award if it fails to draw its essence from the contract." (citations omitted)).

157. 466 F.2d 1125 (3d Cir. 1972).

articulated a related standard of review, which it termed the "completely irrational" standard.¹⁵⁸ Although the Third Circuit's articulation of the completely irrational standard has not been widely adopted,¹⁵⁹ other circuits have similarly relied on this same line of labor arbitration cases when dealing with disputes over interpretation of the contract. Cases which rely on the *Enterprise Wheel* standard are quite common in the commercial arbitration context.¹⁶⁰ The Eighth Circuit, for example, while rejecting the manifest disregard of the law standard,¹⁶¹ has noted its acceptance of this "draws its essence from the contract" standard as an independent basis of review.¹⁶² The Tenth Circuit also appears to accept this standard.¹⁶³

The *Enterprise Wheel* line of cases, however, differs from commercial arbitration cases. Labor cases are controlled not by the FAA, but by the Taft-Hartley Act¹⁶⁴ and, more broadly, by a national labor policy under which arbitration plays a very important role. These policies behind labor cases are quite different from commercial arbitration,¹⁶⁵ and therefore support different justifications for review.¹⁶⁶ Thus, reliance on labor cases in this context is not entirely adequate.

158. *Id.* at 1130-31 (citation omitted).

159. *Cf. French v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 784 F.2d 902, 906 (9th Cir. 1986) (accepting completely irrational standard as well as manifest disregard of the law standard).

160. *See, e.g., Osceola County Rural Water Sys.*, 914 F.2d at 1075 (accepting "draws its essence from the contract" standard); *Jenkins v. Prudential-Bache Sec., Inc.*, 847 F.2d 631, 634 (10th Cir. 1988) (stating the Tenth Circuit's acceptance for this standard).

161. *Marshall v. Green Giant Co.*, 942 F.2d 539, 550 (8th Cir. 1991) (en banc) ("This circuit has never adopted manifest disregard as a basis for vacating an arbitrator's award. . . .").

162. *Osceola County Rural Water Sys.*, 914 F.2d at 1075.

163. *See Jenkins*, 847 F.2d at 634 ("We have previously adopted the *Enterprise Wheel* analysis."); *see also Kelley v. Michaels*, 830 F. Supp. 577, 578-79 (N.D. Okla. 1993) (relying on "draws its essence from the contract" as the standard of review), *aff'd*, 59 F.3d 1050 (10th Cir. 1995); *infra* notes 167-72 and accompanying text (discussing Tenth Circuit's approach).

164. Labor Management Relations (Taft-Hartley) Act § 301, 29 U.S.C. § 185 (1988).

165. 4 Macneil, *supra* note 1, § 40.5.2.6 (noting the differences between FAA arbitration and labor arbitration); *see United Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 578 (1960) (explaining policy differences between commercial and labor arbitration); *see also American Postal Workers Union v. United States Postal Serv.*, 52 F.3d 359, 362 (D.C. Cir. 1995) (addressing the inapplicability of FAA to employment/labor cases under 9 U.S.C. § 1 and § 301 of Taft-Hartley Act).

166. In Macneil, the commentators question the use of labor cases as precedent in commercial arbitration due to the alleged inability of labor arbitrators to look beyond the particular collective bargaining agreement and consider the general tenets of labor law. Thus, "the principles against arbitrator application of law . . . are peculiar to collective bargaining arbitration and have no proper place in FAA arbitration." 4 Macneil, *supra* note 1, § 40.5.2.6, at 40:55; *see Douglas E. Ray, Court Review of Labor Arbitration Awards Under the Federal Arbitration Act*, 32 Vill. L. Rev. 57, 60-66 (1987) (discussing disagreement among federal courts over the propriety of applying labor case as precedent in commercial arbitration cases).

Moreover, while labor cases generally focus on the contract because the collective bargaining agreement is the heart of the dispute, the underlying contract itself is less likely to be the ultimate issue in most securities arbitration cases. This distinction is a meaningful one, because in any case in which the dispute centers on the contract, whether a labor case or otherwise, the ultimate issue for determination is the parties' agreement. When the dispute centers on the application of some public law framework, such as the federal securities statutes, the parties' agreement is irrelevant to whether the activity is a statutory violation. Thus, the *Enterprise Wheel* line of cases is irrelevant when the dispute is over a statute.

For example, in *Jenkins v. Prudential-Bache Securities, Inc.*,¹⁶⁷ the dispute centered on whether Jenkins' employment contract envisioned the closing of his particular branch office in Provo, Utah.¹⁶⁸ The issue thus became whether or not the parties intended the employment agreement to be limited to employment at the Provo office and no other. This is distinguishable from a question of statutory law, where the parties' agreement is not determinative. For example, whether a given action constitutes churning¹⁶⁹ under the Securities Exchange Act does not hinge on the parties' contract but applies uniformly to all brokers.¹⁷⁰ In the former situation, to ask if the award "draws its essence from the contract" may be appropriate, while in the latter, such a query makes little sense.

In *Jenkins*, the court explained:

While the 'manifest disregard' analysis deals mainly with willful unattentiveness to the governing law, several other terms of art have been employed to ensure that the arbitrator's decision relies on his interpretation of the contract as contrasted with his own beliefs of fairness and justice. . . .

We have previously adopted the *Enterprise Wheel* analysis [where] . . . "the role of the courts in reviewing arbitral awards is limited to the determination of whether the arbitrator's award 'draws its essence from the contract of the parties.'" . . . "[This standard protects] not only asserted errors in determining the credibility of witnesses, the weight to be given their testimony, . . . and [the] application of the collective bargaining agreement." As the Supreme Court has stated, 'it is the arbitrator's construction which is bargained for, and so far as the arbitrator's decision concerns con-

167. 847 F.2d 631 (10th Cir. 1988).

168. *Id.* at 633.

169. Churning occurs when a broker, in an effort to increase commissions, initiates transactions on a customer's account which are excessive, given the character of the account and the customer's objectives. See *Kelley v. Michaels*, 830 F. Supp. 577, 578 n.1 (N.D. Okla. 1993) (citing *Black's Law Dictionary* 220 (5th ed. 1979)).

170. That is not to say that there are no factual distinctions to be made in each case, or even that the parties' understanding as to access to the account is irrelevant. Rather, the distinguishing idea is that churning is not defined by contract, but subjects all people to the same legal standard.

struction of the contract, the courts have no business overruling him because their interpretation of the contract is different from his.' ”¹⁷¹

The arbitrator’s construction of the law, on the other hand, is arguably open to less deference, because the parties have not agreed to be bound by the arbitrator’s interpretation of the securities laws. Rather, the parties as well as the rest of the industry are subject to the same law. The law, unlike a contract, is not subject to an interpretation of the subjective understanding of the parties. Thus, the “draws its essence from the contract” standard is inapplicable where the law, rather than the contract itself, is at issue.

In *Jenkins*, the Tenth Circuit blurred this distinction by generalizing a single legal standard of review, which it loosely termed “a sort of ‘abuse of discretion’ standard.”¹⁷² Unlike *Jenkins*, the First Circuit in *Advest, Inc. v. McCarthy*,¹⁷³ recognized this distinction and identified two separate categories of review:

[T]his array of alternatively worded formulations consists of two classes of cases where an arbitral award is subject to review. One category, usually involving labor arbitration, is where an award is contrary to the plain language of the collective bargaining agreement. The second category embraces instances where it is clear from the record that the arbitrator recognized the applicable law—and then ignored it.¹⁷⁴

Advest’s first category, dealing with the proper construction of a contract, is subject to this “contrary to the plain language of the contract” standard,¹⁷⁵ and is distinct from the standard of review of the applicable law. The First Circuit’s approach, distinguishing review in contract interpretation cases from review of the law, appropriately preserves the meaning of each standard.¹⁷⁶ Thus, the “draws its essence from the contract” standard is distinguishable from the manifest disregard of the law standard.

171. *Jenkins*, 847 F.2d at 634-35 (citations omitted).

172. *Id.* at 634.

173. 914 F.2d 6 (1st Cir. 1990).

174. *Id.* at 9 (citations omitted).

175. While the First Circuit fails to define this standard more fully, it appears to be based on the *Enterprise Wheel* standard. See *Strathmore Paper Co. v. United Paperworkers Int’l Union*, 900 F.2d 423, 427 (1st Cir. 1990) (basing analysis on *Enterprise Wheel* considerations); *Berklee College of Music v. Berklee Chapter of the Massachusetts Fed. of Teachers*, 858 F.2d 31, 32-33 (1st Cir. 1988) (basing analysis on *Enterprise Wheel*), *cert. denied*, 493 U.S. 810 (1989).

176. Other circuits also appear to recognize this distinction. See, e.g., *Kanuth v. Prescott, Ball & Turben, Inc.*, 949 F.2d 1175 (D.C. Cir. 1991). In *Kanuth*, the court analyzed separately a claim that arbitrators ignored the plain language of an employment contract, *id.* at 1179-82, from a claim that the arbitrators manifestly disregarded the law in calculating damages for breach of that contract. *Id.* at 1182.

C. *Review of the Law Based on § 10(a)(4): Arbitrators Exceeding Their Powers*

The last group of circuits justify the manifest disregard of the law standard and related standards as interpretations of § 10(a)(4), which provides for review where arbitrators "exceeded their powers." The Tenth Circuit, for example, holds "a broad interpretation of subsection [10(a)(4)]"¹⁷⁷ as one premise for substantive judicial review.¹⁷⁸

In *Kelley v. Michaels*,¹⁷⁹ the district court explained that it had power under FAA § 10(a)(4) to review arbitration awards "'[w]here the arbitrators exceeded their powers.'"¹⁸⁰ The court went on to explain that the Tenth Circuit interpreted the scope of such review to be limited to a determination of whether the award "'draws its essence from the contract.'"¹⁸¹ As stated above, such a scheme adopts the arbitrators' view of the facts and of the contract unless that view is so contrary to the clear meaning of the contract that no reasonable minds could differ.¹⁸² In such a case, the award may be reviewed for abuse of discretion.¹⁸³

The Third Circuit recognizes a similar link between its completely irrational standard and § 10(a)(4) of the FAA.¹⁸⁴ In reviewing an arbitration award, the Third Circuit determines whether the award is consistent with § 10(a)(4) by applying the completely irrational test.¹⁸⁵ Using a two-part test, the court scrutinizes whether both the form of the award and its terms are rationally inferable.¹⁸⁶ First, the court must determine if the form of the award is rationally based on the submission.¹⁸⁷ Second, the court must determine if the actual result is

177. *Jenkins*, 847 F.2d at 633.

178. *See, e.g., Kelley v. Michaels*, 830 F. Supp. 577, 578-79 (N.D. Okla. 1993) (relying on § 10(a)(4)), *aff'd*, 59 F.3d 1050 (10th Cir. 1995).

179. *Id.*

180. *Id.* at 578 (quoting 9 U.S.C. § 10 (1988)).

181. *Id.* (citing *Jenkins*, 847 F.2d at 635); *see supra* part II.B.2 (discussing the "draws its essence from the contract" standard).

182. *Kelley*, 830 F. Supp. at 578-79.

183. *Id.* at 579.

184. *See Mutual Fire, Marine & Inland Ins. v. Norad Reinsurance*, 868 F.2d 52, 56 (3d Cir. 1989) (relying on § 10 to determine the extent of the court's discretion in vacating an arbitrators' judgment); *Swift Indus. v. Botany Indus.*, 466 F.2d 1125, 1130 n.11 (3d Cir. 1972) ("These principles [of reviewing arbitral awards] are consistent with the provisions of the Federal Arbitration Act, 9 U.S.C. s 10[(a)(4)]. . . .").

185. *Mutual Fire*, 868 F.2d at 56 (determining "whether appellants were entitled to vacate the arbitration award pursuant to 9 U.S.C. § 10[(a)(4)]" (citations omitted)).

186. *Id.* ("In conducting our review we must examine both the form of the relief awarded . . . as well as the terms of that relief."); *see also Northeast Fin. Corp. v. Insurance Co. of N. Am.*, 757 F. Supp. 381, 385 (D. Del. 1991) (adopting a "two-part inquiry").

187. *See, e.g., Mutual Fire*, 868 F.2d at 56 (finding that the arbitration panel's determination of coverage was not completely irrational); *Northeast Financial*, 757 F. Supp. at 386 (finding that the arbitration panel's consideration of insurance provisions was rational).

completely irrational.¹⁸⁸ While this approach differs in form from the manifest disregard of the law standard,¹⁸⁹ it nonetheless attempts to define the scope of review set forth in § 10(a)(4).¹⁹⁰

Unlike some circuits that blatantly create a new standard, these circuits attempt to link the expanded review to the statute.¹⁹¹ The link, however, is tenuous at best. Section 10(a)(4) allows review “[w]here 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.”¹⁹² Read as a whole, the statute appears to create both an outer boundary for arbitrators’ authority, as well as a minimal standard for arbitrators’ awards. The outer limits of the arbitrators’ power suggests that the award may not go beyond what the parties submitted, nor what the courts will enforce.¹⁹³ The minimum standard of mutuality, finality, and definiteness suggests that the arbitrators must address all of the issues submitted to them, and give a complete award. This limitation focuses “upon the subject matter submitted,”¹⁹⁴ not upon the law applied.

The first limit on the arbitrators’ power was addressed by the D.C. Circuit Court of Appeals in *Kanuth v. Prescott, Ball & Turben, Inc.*¹⁹⁵ There, the court pointed to the limits of the parties’ submission, stating: “[T]he arbitrators did not have the authority *under the contract itself* to construct the kind of remedy that they have proposed.”¹⁹⁶

The second limit on the arbitrators’ power under § 10(a)(4) is the limit of what the courts will enforce. One possible example of such a limitation might have been raised had the Supreme Court denied arbitrators the power to award punitive damages.¹⁹⁷ In that case, if the arbitrators’ award included punitive damages, that portion of the

188. *Mutual Fire*, 868 F.2d at 56; *Northeast Financial*, 757 F. Supp. at 385.

189. The Third Circuit, in labor cases, refers to a “manifest disregard of the agreement” standard as equivalent to the “draws its essence from the contract” standard. See *News Am. Publications v. Newark Typographical Union, Local 103*, 918 F.2d 21, 24 (3d Cir. 1990) (emphasis added). This standard has not been applied to the manifest disregard of applicable law.

190. See *Swift Indus. v. Botany Indus.*, 466 F.2d 1125, 1130 n.11 (3d Cir. 1972) (finding review consistent with § 10).

191. The D.C. Circuit, for example, links its expanded review to § 10(a)(4). See *Kanuth v. Prescott, Ball & Turben, Inc.*, 949 F.2d 1175, 1180-81 (D.C. Cir. 1991). The D.C. Circuit, however, posits no equivalent link to its manifest disregard of the law standard. See *id.* at 1182.

192. 9 U.S.C. § 10(a)(4) (1994).

193. See 4 Macneil, *supra* note 1, §§ 40.5.2.1-40.5.2.2 (finding that whether arbitrators have exceeded their powers depends on the parties’ consent to the arbitrators’ decision and the courts’ willingness to enforce it).

194. 9 U.S.C. § 10(a)(4).

195. 949 F.2d 1175 (D.C. Cir. 1991).

196. *Id.* at 1180 (emphasis added); see also *Michigan Mut. Ins. v. Unigard Sec. Ins.*, 44 F.3d 826, 830 (9th Cir. 1995) (holding that under § 10(a)(4) arbitrators exceed their power when they rule on matters not submitted or matters outside the agreement).

197. See *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212 (1995). This recent case purports to settle the long-standing dispute over the ability of arbitra-

award might have been vacated under § 10(a)(4), because the arbitrators exceeded the limits of the courts' willingness to enforce the award.¹⁹⁸ Thus, review under § 10(a)(4) is best viewed as focusing on the limits of the arbitrators' authority, rather than on the substance of the award.

The Fourth Circuit, in *Miller v. Prudential Bache Securities, Inc.*,¹⁹⁹ rejected the argument that § 10(a)(4) provides a basis for substantive review. In *Miller*, a customer alleged that the arbitration panel had incorrectly used a New York statute of limitations to bar her claim. The court refused to consider this as a basis for review since "federal courts have consistently held that they will not 'set aside an arbitrator's award for mere errors of law.'"²⁰⁰ Thus, according to *Miller*, § 10(a)(4) does not allow substantive review.²⁰¹ Therefore, despite some courts' attempts to anchor substantive review of the law in the plain language of § 10(a)(4), the statute does not support such review.²⁰² In fact, that section is limited to the form of the award, rather than its substance.

This overview of the approaches taken by the federal courts of appeals reveals the ineffectiveness of attempts to establish substantive legal review of arbitration awards. The confusion of these high courts evidences an ineffectiveness and lack of consensus. Moreover, an examination of the FAA confirms the lack of support for such review.²⁰³ Although various approaches are taken, each fails to create an adequate basis for substantive legal review of arbitration awards.

III. ARBITRATION MODELS

The courts' attempts to articulate a workable standard of judicial review for legal error in arbitration reflect the fundamental conflict between the speed, informality, and economic efficiency of arbitration and the exhaustive legal precision of the litigation process. The courts' inability to balance successfully these competing interests in the manifest disregard of the law standard suggests the need to re-examine the arbitration process.

tors to issue punitive damages, concluding that they are allowable. *But see* Katsoris, *supra* note 2, at 144 (arguing that *Mastrobuono's* effects are open to question).

198. *See* *NCR Corp. v. Sac-Co.*, 43 F.3d 1076, 1080 (6th Cir.) (finding award of punitive damages to nonparty "exceeded [the arbitrators'] powers"), *cert. denied*, 116 S. Ct. 272 (1995).

199. 884 F.2d 128 (4th Cir. 1989), *cert. denied*, 497 U.S. 1004 (1990).

200. *Id.* at 130 (quoting *Textile Workers Union v. American Thread Co.*, 291 F.2d 894, 896 (4th Cir. 1961)).

201. *See id.*; *accord* *Kanuth v. Prescott, Ball & Turben, Inc.*, 949 F.2d 1175, 1180 (D.C. Cir. 1991) (limiting review to the "kind" of the award).

202. *See supra* notes 125-31 and accompanying text (discussing the congressional reports).

203. *See supra* notes 120-31 and accompanying text (discussing FAA text and reports).

In order to develop a uniform model of arbitration in which these goals are balanced, analogies can be drawn from other accepted mechanisms for settling disputes. One such mechanism is the consent decree, whereby the parties' privately reached settlement is given binding effect when entered by the court as a judgment. This approach leaves little room for judicial review. An alternative mechanism is the litigation process, whereby the trial court's judgment is subjected to the review of the appellate process. Both alternatives suggest not only a standard for judicial review, but also an extensive revision of the arbitral scheme.

A. *The Consent Decree Model*

The first alternative is based on the consent decree model of arbitration. Under this approach, the parties' predispute arbitration agreement is presumed to be an election to settle disputes fully and finally through private means. This is consistent with the Supreme Court's *Burchell v. Marsh*²⁰⁴ conception of arbitration as the selection of a forum where "[a]rbitrators are judges chosen by the parties to decide the matters submitted to them, finally and without appeal."²⁰⁵ In essence, the parties agree to bring their disagreements to the private arbitrators, who, in a procedurally fair forum, reach a decision for the parties. By selecting arbitration, the parties adopt the arbitrators' decision, so long as it is fairly reached.²⁰⁶

The only judicial role required under this scheme is that role played by courts entering a consent decree, where the private settlement is not scrutinized in the same way as a judgement on the merits.²⁰⁷ Rather, the court must accept the settlement unless there is evidence of procedural unfairness, unreasonableness, or inadequacy.²⁰⁸ The only grounds on which to vacate a consent decree are fraud, lack of consent, or lack of jurisdiction.²⁰⁹ Thus, as with a consent decree, courts will not scrutinize the merits of the private arbitral settlement.

204. 58 U.S. (17 How.) 344 (1854).

205. *Id.* at 349.

206. This, of course, presumes that arbitration is a voluntary, consensual process, selected by the parties. *Cf. supra* note 2 (discussing contracts of adhesion).

207. *United States v. Metropolitan St. Louis Sewer Dist.*, 952 F.2d 1040, 1044 (8th Cir. 1992).

208. *Id.*; *Sierra Club v. Electronic Controls Design, Inc.*, 909 F.2d 1350, 1355 (9th Cir. 1990).

209. *Swift & Co. v. United States*, 276 U.S. 311, 324 (1928). In that case, the Supreme Court explained:

Decrees entered by consent have been reviewed upon appeal or bill of review where there was a claim of lack of actual consent to the decree as entered; or of fraud in its procurement; or that there was lack of federal jurisdiction because of the citizenship of the parties. But "a decree, which appears by the record to have been rendered by consent, is always affirmed, without considering the merits of the cause."

Id. (citations omitted) (quoting *Nashville, Chattanooga & St. Louis Ry. v. United States*, 113 U.S. 261, 266 (1885)); *see also* Owen M. Fiss, *Justice Chicago Style*, 1987 U.

Lack of judicial review does not exempt the arbitrators from applying the law. Rather, they will be called upon to apply the law presented by the parties.²¹⁰ The courts, however, may not review the law applied, but rather entrust that to the safeguards of the adversarial forum.²¹¹ In this way, the arbitrators' determination is final.

Such a model is consistent with the current federal scheme,²¹² as well as parties' expectations of arbitration. As under the current process, this approach would require no formal opinion, only an award.²¹³ Thus, both time and money are preserved, since the arbitrators need only present the result without explaining their reasoning or findings. This allows arbitrators to handle more cases, while limiting the expense of an arbitrator's time spent on each case.

Similarly, this approach is consistent with the informal arbitration atmosphere in which the formal rules of evidence and discovery are not strictly enforceable.²¹⁴ Rather, the arbitrator is left to decide what is relevant in each case.²¹⁵ This is also consistent with arbitration's

Chi. Legal F. 1, 12-16 (explaining the limitations of a judge's ability to review a consent decree).

Obviously, distinctions exist between the consent decree and an agreement to arbitrate. Most obvious, perhaps, is the reality that in a consent decree the consent follows the settlement agreement. This does not always result from the ideal of consent, however, because consent decrees are often reached in order to avoid less pleasant consequences. Moreover, with an election to arbitrate, the consent is an election of the mechanism rather than the result. In this way, many of the consent decree's procedural safeguards are provided by the arbitration mechanism.

210. The election to arbitrate must be the equivalent of consent to have legal disputes decided by the arbitrators, rather than the courts. Still, this may not be appropriate in all cases. See *infra* notes 217-20 and accompanying text.

211. In an adversarial forum, the parties' opposition counterbalance each other and best equip the arbitrator with the information needed to reach the proper result. See Stephan Landsman, *The Adversary System: A Description and Defense* 2 (1984) (defining the adversarial system). According to Landsman, the elements of the adversarial system are: (1) a neutral and passive decision maker; (2) party presentation of evidence and argument in a competitive format; and (3) structured procedures. *Id.* at 2-6. Thus, these elements are largely present in the consent model.

212. See *Revere Copper & Brass Inc. v. Overseas Private Inv. Corp.*, 628 F.2d 81, 84 (D.C. Cir.) (finding that "[t]he strong federal policy in favor of voluntary commercial arbitration would be undermined if the courts had the final say on the merits of the award"), cert. denied, 446 U.S. 983 (1980).

213. See *supra* notes 84-86 and accompanying text.

214. Currently formal rules of evidence do not apply and discretion is left to the arbitrators. N.Y.S.E. Guide, *supra* note 2, ¶ 2620, Rule 620; N.A.S.D. Manual, *supra* note 2, ¶ 3734, § 34; see also Gregg A. Paradise, *Arbitration of Patent Infringement Disputes: Encouraging The Use of Arbitration Through Evidence Rules Reform*, 64 *Fordham L. Rev.* 247, 269-70 (1995) (addressing lack of formal rules of evidence in patent arbitration).

Also, the rules create a general outline of discovery and call for members to "cooperate fully." N.Y.S.E. Manual, *supra* note 2, ¶ 2619, Rule 619; N.A.S.D. Manual, *supra* note 2, ¶ 3732, § 32; see also *N.Y.S.E. Symposium, supra* note 2, at 1551-69 (discussing issues of discovery).

215. Securities Industry Conference on Arbitration, *The Arbitrator's Manual* 23-24 (1992) (explaining arbitrators' job is to decide evidentiary issues based on fairness to the parties); *id.* at 9-14 (suggesting discovery guidelines for arbitrators).

lack of case law development, since the only concern is with the current parties' case.

Most importantly, the consent decree model eliminates the necessity of substantive appeals. Rather, the parties have to show concrete procedural unfairness to proceed with an appeal or argue against entering the award.²¹⁶ Such a concrete standard is easily applied and leads to finality. Moreover, it enhances the speed, informality, and limited expense of arbitration for the parties and also serves to reduce the case loads of courts.

The consent decree model clearly distinguishes arbitration from litigation. Moreover, it highlights the distinctions the parties must consider prior to a dispute.²¹⁷ Because such a system favors efficiency over precision in complex legal matters, it may be unsuitable for certain complex cases or incompatible with certain federal statutory schemes.²¹⁸ Just as current rules contain exceptions for class actions,²¹⁹ this approach might allow an exemption or opt-out for complex legal issues, high dollar cases, or noncontractual disputes.²²⁰

On the other hand, it would provide a suitable and efficient forum for more routine customer complaints. As such, the model would require Congress, rather than the self-regulatory organizations, to take the lead in shaping arbitration, and especially in regulating the predispute arbitration agreement. Because this model represents a clearly distinct alternative to litigation, the distinctions must be clear to the parties at the time they enter the agreement.²²¹ Such a distinction certainly adds to uniformity and predictability.

B. *The Litigation Model*

The alternative model would make the federal arbitration scheme something more akin to a private courtroom. As with the consent

216. See *supra* notes 205-11 and accompanying text.

217. This model adds clarity to the choice of arbitration, helping to reduce the contract of adhesion dilemma. See *supra* note 2 (discussing contract of adhesion issue). Still, the model works best in a truly voluntary system.

218. For example, in employment discrimination cases or complex securities issues the consent decree model may not be proper. See C. Evan Stewart, *Securities Arbitration Appeal: An Oxymoron No Longer?*, 79 Ky. L.J. 347, 356-60 (1990-91) (discussing the need for greater judicial review in complex legal issues being arbitrated).

219. N.Y.S.E. Guide, *supra* note 2, ¶ 2600, Rule 600(d); N.A.S.D. Manual, *supra* note 2, ¶ 3712, § 12(d).

220. See *Revere Copper & Brass Inc. v. Overseas Private Inv. Corp.*, 628 F.2d 81, 84 (D.C. Cir.), cert. denied, 446 U.S. 983 (1980). In that case, the court discussed the potential power of Congress to exempt certain kinds of contracts from application of the FAA, even despite the parties' previous agreement to arbitrate. *Id.* In *Revere*, the subject was insurance contracts, and the court declined to exempt such contracts from the FAA. *Id.* In another context, it might be appropriate for Congress to recognize such an exemption for complex or noncontractual types of disputes.

221. This model will operate best in a system which preserves its voluntariness. At the very least, the distinctions should be clearly outlined in the predispute arbitration agreement.

decree model, Congress should take the lead in defining a uniform arbitration process. Under this approach, however, the model would define a clear judicial standard of review for legal errors in arbitration awards that is more analogous to ordinary litigation. Before addressing the scope of such review, several other procedural changes would be required to make this arbitral model complete.

First, the litigation model should mandate written findings of fact as well as legal conclusions for each award.²²² This would increase legal precision, make judicial review realistic, and eliminate arbitrators' ability to disregard the law. Moreover, these written findings would assist the development of case law. Such written findings might be waived in simple or low dollar amount cases.

Second, procedural rules should be designated to create greater uniformity. Such rules could be simple and straightforward, but also deal consistently with issues such as evidence²²³ and discovery.²²⁴ For example, such rules could create a uniform standard for document production,²²⁵ or supply guidelines for reliable evidence.²²⁶ Most important, such rules would be articulated at the federal level, creating a single approach to the arbitral forum.

Third, in order to facilitate the implementation of these changes, arbitrators should either be attorneys or, at the least, possess a minimum federally-mandated degree of training in the law relating to the type of cases handled by the arbitrator.²²⁷ This would reduce the incidence of legal error. Moreover, specialization in a given area of arbitration claims would allow the development of expertise, leading to accuracy, efficiency, and greater predictability.

Finally, a standard of substantive review must be articulated in § 10 to facilitate a uniform federal approach to judicial review. The standard must provide for meaningful review of legal error, more akin to appellate review of litigation, rather than the arbitrary approaches currently taken by the various circuits. It must provide for review of all reversible legal error, whether deliberate or otherwise. Findings of fact and interpretations of the contract, however, should be left to the arbitrator without judicial intervention.

222. Hochman, *supra* note 40, at 269-74 (calling for written explanation of awards); see Stewart, *supra* note 218, at 359-60 (calling for written opinions in complex cases); cf. *supra* note 85 (explaining that no written explanation is required). Speed could be facilitated by the development of an award form allowing simplified presentation in simple cases.

223. See *supra* note 214.

224. See *supra* note 214.

225. See *N.Y.S.E. Symposium*, *supra* note 2, at 1553-56 (proposing changes in discovery rules).

226. See Paradise, *supra* note 214, at 271-73 (discussing the problem of lack of evidence standards in patent arbitration).

227. See *supra* note 40.

Unlike the manifest disregard of the law standard, the uniform standard should apply to all serious errors of the law resulting in an erroneous award. Thus, the error need not be obvious or capable of readily being perceived by the average arbitrator.²²⁸ The mere fact that the arbitrators reached the wrong legal result is enough to trigger judicial examination. After all, even if an error is not deliberate, its effect is the same.²²⁹

Lastly, the fact that the arbitrator must articulate the legal reasoning as well as make factual findings, allows for a finding of error on the record. Under this scheme, if the arbitrators' application of the critical law is incorrect, the award should be vacated just as in a trial court.

At the same time, other aspects of the arbitrator's award should be entitled to a greater degree of deference. Such deference is implicit in the FAA and widely recognized by the courts. Such deference must continue with regard to the arbitrators' factual findings and interpretations of the contract.²³⁰ Thus, the same great deference is due to the arbitrators' factual findings and interpretations of the contract, while the applicable law is subject to virtually the same judicial scrutiny as ordinary litigation.

This model considerably increases legal precision and encourages uniformity and public confidence in arbitration. By creating meaningful substantive review, both by requiring a legal justification and by articulating a workable standard of review, the litigation model assures parties a more precise legal outcome. This approach also creates a valuable means for the development of case law in the areas which may be stagnant under the existing system. Moreover, by minimizing the difference between arbitration and litigation, much of the current confusion about judicial review of arbitration awards is also minimized.²³¹

Of course, these changes will sacrifice time, expense, and user-friendliness. More highly trained arbitrators will, no doubt, demand higher fees. In addition, the added findings requirement will also increase the expenditure of time and money for each case.²³² Moreover, technical procedural rules add to the complexity of the proceedings

228. See *supra* part I.A (discussing the view that error must be obvious and capable of being recognized by an average qualified arbitrator).

229. See *supra* part I.B (explaining circuit courts' rulings that innocent errors cannot be vacated by the reviewing court unless intentional).

230. See *supra* text accompanying notes 167-76 (illustrating that the interpretation of the contract is distinct from application of the law).

231. Minimizing the differences makes the waiver of judicial litigation less significant. Moreover, this approach should comfort those who advocate that arbitration should offer identical procedural safeguards as litigation. See *supra* note 2.

232. See *Sargent v. Paine Webber Jackson & Curtis, Inc.*, 882 F.2d 529, 532 (D.C. Cir. 1989) ("[A]bsence of a duty to explain is presumably one of the reasons why arbitration should be faster and cheaper than an ordinary law suit."), *cert. denied*, 494 U.S. 1028 (1990).

and open the door for greater procedural error. These elements of the litigation model sacrifice many of arbitration's greatest attributes.

Most significantly, the added degree of judicial review, while fostering greater legal precision, risks making arbitration an additional step in the exhaustive litigation process. Rather than an opportunity to settle disputes quickly and efficiently, arbitration will become an alternative fact-finding body with an additional level of appeal for questions of law. Such a model seems very different from the system envisioned by the FAA.

IV. THE ADVANTAGES OF THE CONSENT DECREE MODEL

The consent decree model outlines an arbitration process where the goals of speed, informality, and economic efficiency are not needlessly sacrificed in the pursuit of exhaustive legal precision. While the current system aspires to these goals,²³³ the consent decree model realizes them. This distinction is magnified when the consent decree model is compared to the litigation model and its pursuit of legal precision. Therefore, the consent decree model offers the best solution to the problem of judicial review of arbitration for legal error.

The balance reached by the consent decree model is the most consistent with the FAA. This is clear from the language of the statute, which, when devising the limits of oversight by the courts, made no mention of review for legal error.²³⁴ The D.C. Circuit Court of Appeals, echoing the FAA mandate of a narrow judicial role, explained that in the "balance between the interest in rooting out possible error and the interest in assuring that judgment be swift and economical. . . . the latter must generally prevail."²³⁵ Thus, the preference for speed and efficiency is well founded.

The congressional reports confirm Congress' confidence in arbitrators' ability to provide legal precision,²³⁶ while depicting arbitration as an "arrangement[] for avoiding the delay and expense of litigation."²³⁷ Moreover, that arbitration was intended to favor informality and efficiency over legal precision is implicit in the Senate report's references to arbitration's "practical justice" and "common sense" rulings, rooted in the natural practice of referring disputes to friends or neutral third parties, as an alternative to the courts.²³⁸ These attitudes are consistent with the balance reached by the consent decree model.

233. See *supra* note 6 and accompanying text.

234. See *supra* notes 120-23 and accompanying text (analyzing the plain language of the FAA regarding substantive review of arbitration awards).

235. *Sargent*, 882 F.2d at 533.

236. See *supra* note 129 and accompanying text.

237. S. Rep. No. 569, *supra* note 127, at 3.

238. *Id.*

One final fact that is evident from the FAA is that arbitration is intended to offer an alternative to the crowded court system.²³⁹ If arbitration is to supply that alternative, it should remain distinct from litigation. The consent decree model best preserves that distinction by providing an approach to legal disputes that is faster, less formal, and more economically efficient than the litigation model.

CONCLUSION

Securities arbitration balances the competing interests of speed, informality, and economic efficiency against legal precision. This balancing is demonstrated in the area of judicial review of arbitral awards for legal error. Judicial review creates a fundamental conflict between the parties' election of a nonjudicial settlement through arbitration and traditional reliance on the courts to root out possible errors of law.

The current solution, advocated by many courts, is the manifest disregard of the law standard. According to this narrow standard, judicial review for legal error is limited to the deliberate disregard of clearly applicable law. The federal courts' widespread disagreement and difficulty defining the applicability of such standards renders the manifest disregard of the law standard inconsistent with the goals of arbitration and ineffective at providing meaningful review. Therefore, the manifest disregard standard should be rejected and the area of judicial review reconsidered.

This Note has proposed two models for reconsidering the competing interests of judicial review in arbitration. The consent decree model, drawing from analogy to the consent decree, aims to simplify arbitration and entrust legal issues to the arbitrators chosen by the parties. The litigation model, based on ordinary litigation, provides meaningful appeals of legal issues to the courts, along with its accompanying delay and expense. This Note argues that the speed, informality, and economic efficiency afforded by the consent decree model is most consistent with the FAA and congressional intent for arbitration. Moreover, because it provides a clear alternative to the slow and costly court system, it offers the best solution to the conflict over judicial review of arbitral awards.

239. *See id.*

