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Article

Do Courts Create Moral Hazard?: When Judges Nullify Employer Liability in Arbitrations

Michael H. LeRoy[†]

Identify the moral dilemma in the following scenario: responding to rising litigation costs¹ and soaring liability from employment lawsuits,² a large company compels its employees

[†] Professor, School of Labor and Employment Relations, and College of Law, at the University of Illinois at Urbana-Champaign. Copyright © 2008 by Michael H. LeRoy.

1. See Gillian K. Hadfield, *The Price of Law: How the Market for Lawyers Distorts the Justice System*, 98 MICH. L. REV. 953, 957–61 (2000) (providing detailed empirical estimates of litigation costs). The minimum cost to litigate a business claim is estimated at \$100,000. *Id.* at 957. A typical bill to evaluate a case and file a complaint is \$6,000 if the stakes are under \$150,000 and \$12,000 if they are over \$2 million; the cost of an action for summary judgment is \$18,000 or more. *Id.* at 958–59.

2. See Kathy Bergen & Carol Kleiman, *Mitsubishi Will Pay \$34 Million*, CHI. TRIB., June 12, 1998, at 1 (reporting that the car maker agreed to pay \$34 million to settle a class action lawsuit claiming sexual harassment); Katherine Bishop, *California Women Receiving Millions To Settle Sex Bias Case*, N.Y. TIMES, Jan. 20, 1988, at A1 (reporting that State Farm Insurance Company agreed to pay female employees up to \$300 million to settle a sex-discrimination lawsuit); Caren Chesler, *Wall Street's Catch-22: Its Managers Keep Tripping over Their Own Feet in Female/Minority Hiring and Firing*, INVESTMENT DEALERS' DIG., Sept. 19, 2005, at 24, 27 (reporting that Morgan Stanley settled an EEOC sex-discrimination lawsuit for \$54 million in July 2004); Jim Fitzgerald, *Anti-Bias Efforts, Payments to Blacks OK'd*, CHI. SUN-TIMES, Nov. 16, 1996, at 1 (reporting that Texaco agreed to spend \$176.1 million to settle a race-discrimination suit); Mary B. Rogers & Kimberly A. O'Sullivan, *Image Discrimination: Is That Advertising Campaign Really Worth It?*, METROPOLITAN CORP. COUNS., Nov. 2006, at 23, available at <http://www.metrocorp.counsel.com/pdf/2006/November/23.pdf> (reporting that Abercrombie & Fitch paid \$50 million in 2005 to settle a race-discrimination lawsuit, which alleged that Hispanic, African American, and Asian employees were assigned backroom duties during regular sales hours because they did not physically match the company's advertising models); Henry Unger, *17 Coke Class-Action Parties Planning Individual Suits*, ATLANTA J.-CONST., July 7, 2001, at F3 (reporting that a judge approved Coca-Cola's \$192.5 million settlement of a class action employment-discrimination lawsuit).

to sign an agreement that waives their right to sue. The contract refers all disputes to binding arbitration, where both parties must pay equal forum fees.³ A clause in the agreement provides, however, for de novo court review of an arbitration award—a ruling by the arbitrator.⁴

Eventually, an employee sues the company over a workplace dispute. The court dismisses her lawsuit and orders arbitration of her legal claims.⁵ The judge cites the Supreme Court's strong precedents favoring enforcement of arbitration agreements.⁶ The arbitration agreement drafted by the employer names the provider of arbitration services and sets procedural rules for the private adjudication.⁷

After a hearing occurs, the arbitrator renders a ruling for the employee. The award rules that the employer breached a legal duty and orders large damages.⁸ Appealing the award to court, the employer invokes the expanded review clause in the arbitration agreement. The court vacates the award,⁹ leaving

3. *E.g.*, *Shankle v. B-G Maint. Mgmt. of Colo., Inc.*, 163 F.3d 1230, 1232 (10th Cir. 1999) (noting that a janitor reluctantly signed an arbitration agreement that made him pay half of the arbitrator's fees and that he later learned that to pursue his race and age discrimination claims, he had to make a deposit of \$6,000 to initiate the proceedings).

4. *See, e.g.*, *Hughes v. Cook*, 254 F.3d 588, 590 (5th Cir. 2001) (discussing an arbitration agreement, which effectively provided that “[e]ither party may bring an action in any court of competent jurisdiction . . . to vacate an arbitration award. However, in [these] actions . . . the standard of review to be applied to the arbitrator’s findings of fact and conclusions of law will be the same as that applied by an appellate court reviewing a decision of a trial court sitting without a jury.”).

5. *See, e.g.*, *Smith v. PSI Serv. II, Inc.*, No. Civ. A. 97-6749, 2001 WL 41122, at *1 (E.D. Pa. Jan. 12, 2001).

6. *See Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991); *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984) (stating that by enacting the FAA, “Congress declared a national policy favoring arbitration”).

7. *Cf. Hooters of Am., Inc. v. Phillips*, 173 F.3d 933, 935–36 (4th Cir. 1999) (finding that the arbitration agreement had been drafted by the employer and making reference to other rules also drafted by the employer).

8. *See, e.g.*, *Collins v. Blue Cross Blue Shield of Mich.*, 103 F.3d 35, 36 (6th Cir. 1996) (stating that an arbitrator found that an employer violated state and federal discrimination laws and awarded back pay, attorney fees, and reinstatement to a comparable position).

9. *See, e.g.*, *Prescott v. Northlake Christian Sch.*, 369 F.3d 491, 498 (5th Cir. 2004). A school principal who sued her employer, alleging sexual harassment under Title VII and whistleblower violations, was ordered by the court to arbitrate her claim. *Id.* at 493. After she prevailed at arbitration and was awarded \$157,856.52, the school district went to federal court to vacate the award. *Id.* at 494. The lower court denied the motion, but was reversed by the Fifth Circuit Court of Appeals. *Id.* at 494–98. Judge Edith Jones ruled that

the employee without access to a court and stuck with a useless award that cost her thousands of dollars.

What is the moral dilemma here? The following are potential answers to this quandary:

1. The employer compelled its employee to forego access to the courts, depriving her access to a jury trial.¹⁰

2. In substituting arbitration for a court, the employer took advantage of its economic superiority by shifting forum costs to the individual worker.¹¹

3. There is no moral dilemma. The parties had a contract. Although the employer drafted the agreement and took advantage of its superior bargaining power over the individual, this arrangement was not so unfair as to void the contract under the doctrine of adhesion.¹² The employee received her end of the bargain—and notably, she won.

4. The employer failed to take responsibility for the consequences of its own promise to substitute arbitration for a court. By inserting a clause for expanded judicial review of the arbi-

“the parties intended judicial review to be available beyond the normal narrow range of the FAA or MUAA.” *Id.* at 498. In vacating the district court’s order confirming the arbitration award, she wryly noted, “[s]o much for saving money and relationships through alternative dispute resolution. Perfect justice is not always found in this world.” *Id.* at 493.

10. See Jean R. Sternlight, *Panacea or Corporate Tool? Debunking the Supreme Court’s Preference for Binding Arbitration*, 74 WASH. U. L.Q. 637, 684 (1996) (“Large companies will also attempt to select a decision maker likely to decrease their likely payout. One of the company’s chief goals in selecting arbitration over litigation is generally to avoid a jury trial.”).

11. Reginald Alleyne, *Arbitrators’ Fees: The Dagger in the Heart of Mandatory Arbitration for Statutory Discrimination Claims*, 6 U. PA. J. LAB. & EMP. L. 1, 4–5 (2003) (“If the mandatory-arbitration agreement requires that the employee and employer share the arbitrator’s fee, the employee may be unable to afford it and other arbitration costs, as the Supreme Court has recently acknowledged.”); Stephan Landsman, *ADR and the Cost of Compulsion*, 57 STAN. L. REV. 1593, 1613 (2005) (“Others seem to have adopted a strategy to raise the cost of proceedings so high that few claimants will dare to go forward.”); Jennifer L. Peresie, *Reducing the Presumption of Arbitrability*, 22 YALE L. & POL’Y REV. 453, 460 (2004) (“[W]here they face likely high costs, plaintiffs, specifically those with limited means, are unlikely to gamble their food or housing money on the chance of a substantial arbitration award.”).

12. *But see* *Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669, 690 (Cal. 2000) (holding that a mandatory employment arbitration agreement was adhesive). “It was imposed on employees as a condition of employment and there was no opportunity to negotiate. . . . [T]he economic pressure exerted by employers . . . may be particularly acute, for the arbitration agreement stands between the employee and necessary employment, and few employees are in a position to refuse a job because of an arbitration requirement.” *Id.*

tration, the employer preserved “two bites at the apple” for itself when, ostensibly, the intent of the contract was to treat the arbitrator’s decision as final and binding. Meanwhile, the employee was deprived a trial and was stuck with a useless arbitration award.

No answer is wrong. Rather, the right answer depends on your perspective. If you chose the first answer, you would agree with many commentators who criticize mandatory employment arbitration.¹³ The second answer represents the consensus of many judges,¹⁴ while others disagree.¹⁵ The third viewpoint is widely approved by judges.¹⁶

13. See, e.g., Richard A. Bales, *Normative Considerations of Employment Arbitration at Gilmer’s Quinceañera*, 81 TUL. L. REV. 331, 393–94 (2006); Miriam A. Cherry, *Whistling in the Dark? Corporate Fraud, Whistleblowers, and the Implications of the Sarbanes-Oxley Act for Employment Law*, 79 WASH. L. REV. 1029, 1078–83 (2004); Judith Resnik, *Uncovering, Disclosing, and Discovering How the Public Dimensions of Court-Based Processes Are at Risk*, 81 CHI.-KENT L. REV. 521, 521 (2006); Maureen A. Weston, *Universes Colliding: The Constitutional Implications of Arbitral Class Actions*, 47 WM. & MARY L. REV. 1711, 1778–79 (2006). But see, e.g., Stephen J. Ware, *The Case for Enforcing Adhesive Arbitration Agreements—with Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM. ARB. 251, 252–53 (2006) (arguing that enforcement of adhesive arbitration agreements benefits society by reducing process costs, thereby benefitting consumers, employees, and other adhering parties). See generally Sarah Rudolph Cole, *Managerial Litigants? The Overlooked Problem of Party Autonomy in Dispute Resolution*, 51 HASTINGS L.J. 1199 (2000); Robert A. Gorman, *The Gilmer Decision and the Private Arbitration of Public-Law Disputes*, 1995 U. ILL. L. REV. 635; Joseph R. Grodin, *Arbitration of Employment Discrimination Claims: Doctrine and Policy in the Wake of Gilmer*, 14 HOFSTRA LAB. L.J. 1 (1996); Margaret M. Harding, *The Redefinition of Arbitration by Those with Superior Bargaining Power*, 1999 UTAH L. REV. 857; Martin H. Malin, *Arbitrating Statutory Employment Claims in the Aftermath of Gilmer*, 40 ST. LOUIS U. L.J. 77 (1996); Martin H. Malin, *Privatizing Justice—but by How Much? Questions Gilmer Did Not Answer*, 16 OHIO ST. J. ON DISP. RESOL. 589 (2001); Geraldine Szott Moohr, *Arbitration and the Goals of Employment Discrimination Law*, 56 WASH. & LEE L. REV. 395 (1999); George Nicolau, *Gilmer v. Interstate/Johnson Lane Corp.: Its Ramifications and Implications for Employees, Employers and Practitioners*, 1 U. PA. J. LAB. & EMP. L. 177 (1998); David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33; Sternlight, *supra* note 10, at 644–74; Katherine Van Wezel Stone, *Mandatory Arbitration of Individual Employment Rights: The Yellow Dog Contract of the 1990s*, 73 DENV. U. L. REV. 1017 (1996); Katherine Van Wezel Stone, *Rustic Justice: Community and Coercion under the Federal Arbitration Act*, 77 N.C. L. REV. 931 (1999); Julian J. Moore, Note, *Arbitral Review (Or Lack Thereof): Examining the Procedural Fairness of Arbitrating Statutory Claims*, 100 COLUM. L. REV. 1572 (2000).

14. See, e.g., *Perez v. Globe Airport Sec. Serv., Inc.*, 253 F.3d 1280, 1287 (11th Cir. 2001); *Shankle v. B-G Maint. Mgmt. of Colo., Inc.*, 163 F.3d 1230, 1232–35 (10th Cir. 1999); *Cole v. Burns Int’l Sec. Serv.*, 105 F.3d 1465, 1484 (D.C. Cir. 1997) (“There is no doubt that parties appearing in federal court

I have explored the perspectives underlying answers one,¹⁷ two,¹⁸ and three¹⁹ in my previous empirical studies of arbitration. In this Article, I launch a new approach—the moral hazard perspective in answer four—by using data on court review of employment arbitration awards.

may be required to assume the cost of filing fees and other administrative expenses, so any reasonable costs of this sort that accompany arbitration are not problematic. However, if an employee like Cole is required to pay arbitrators' fees ranging from \$500 to \$1,000 per day *or more* in addition to administrative and attorney's fees, is it likely that he will be able to pursue his statutory claims? We think not." (citation omitted). *But see, e.g.,* Green Tree Fin. Corp. v. Randolph, 531 U.S. 79, 91 (2000) (stating a presumptive rule to enforce cost-sharing obligations in arbitration agreements that involved poor individuals who are precluded from suing large corporations). The Court stated that "[t]o invalidate the agreement on that basis would undermine the 'liberal federal policy favoring arbitration agreements.' It would also conflict with our prior holdings that the party resisting arbitration bears the burden of proving that the claims at issue are unsuitable for arbitration." *Id.* (citation omitted) (quoting *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)).

15. *Id.* at 26; *see also* U.S. GEN. ACCOUNTING OFFICE, EMPLOYMENT DISCRIMINATION: MOST PRIVATE-SECTOR EMPLOYERS USE ALTERNATIVE DISPUTE RESOLUTION 5 (1995) ("[Employers'] concerns have recently increased as a result of (1) million dollar jury awards to employees and (2) the provision in the Civil Rights Act of 1991 that permits punitive damages in cases of intentional discrimination under Title VII of the Civil Rights Act of 1964 and the Americans With Disabilities Act.").

16. *See* *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 32–33 (1991) ("Mere inequality in bargaining power . . . is not a sufficient reason to hold that arbitration agreements are never enforceable in the employment context."). Many courts have echoed this view. *See* *Caley v. Gulfstream Aerospace Corp.*, 428 F.3d 1359, 1377 (11th Cir. 2005) ("Although there is some bargaining disparity here, as often in the employment context, the plaintiffs have failed to show that the DRP and its making is so one-sided as to be unconscionable."); *Faber v. Menard, Inc.*, 367 F.3d 1048, 1053 (8th Cir. 2004) ("There was unquestionably a disparity in bargaining power, as Menards is a large national company and Faber did not have the ability to negotiate and change particular terms in the form contract. Mere inequality in bargaining power does not make the contract automatically unconscionable."); *Cooper v. MRM Inv. Co.*, 367 F.3d 493, 505 (6th Cir. 2004) ("While the district court's compassion for job applicants is laudable, under its approach practically every condition of employment would be an adhesion contract which could not be enforced because it would have been presented to the employee by the employer in a situation of unequal bargaining power on a take it or leave it basis.").

17. Michael H. LeRoy, *Jury Revival or Jury Reviled? When Employees Are Compelled to Waive Jury Trials*, 7 U. PA. J. LAB. & EMP. L. 767, 767–72 (2004).

18. Michael H. LeRoy & Peter Feuille, *When Is Cost an Unlawful Barrier to Alternative Dispute Resolution? The Ever Green Tree of Employment Arbitration*, 50 UCLA L. REV. 143, 143–44. (2002).

19. Michael H. LeRoy, *Getting Nothing for Something: When Women Prevail in Employment Arbitration Awards*, 16 STAN. L. & POL'Y REV. 573, 573–81 (2005).

Part I of this Article connects the idea of moral hazard to employment arbitration, explaining that laws and social programs reduce personal incentives to avoid risks and arguing that judicial review can serve as government insurance by relieving employers of liability for socially undesirable conduct.

Part II describes how individual employment arbitration helps employers manage litigation costs, while simultaneously disadvantaging some individuals.

Part III describes the complex web of standards that courts use to review arbitration awards. I also demonstrate that common law standards for vacatur²⁰ increasingly interfere with arbitration.

Part IV pinpoints four scenarios that often occur in conjunction with reversal of arbitrator rulings: courts find that the arbitrator's remedy is unauthorized or excessive; when courts vacate awards, delay and litigation expenses grow large; vacatur is sometimes caused by arbitration agreements that embed broad, judicial review standards; and state arbitration laws tend to increase court interference with awards.

Part V is the heart of my study, consisting of research methods and statistical findings, that identifies a disturbing trend regarding court review of arbitration awards: state courts vacated many arbitration wins for employees, but not for employers.

Part VI states that courts create moral hazard by vacating a high percentage of employee wins at arbitration. I also propose two public policy changes to reduce moral hazard.

I. HOW DOES MORAL HAZARD APPLY TO EMPLOYMENT ARBITRATION?

A. WHAT IS MORAL HAZARD? THE INSURANCE ORIGIN OF MORAL HAZARD

Moral hazard is created by risk-sharing contracts or public policies that discourage individuals from avoiding costly behaviors.²¹ When the insured has an incentive to act inappropriately-

20. Vacatur means a rule or order by which a proceeding is set aside. BLACK'S LAW DICTIONARY 1584 (8th ed. 2004).

21. For lawyers, a useful orientation to the subject appears in Tom Baker's article, *On the Genealogy of Moral Hazard*, 75 TEX. L. REV. 237 (1996). For early studies that develop the moral-hazard idea, see Kenneth J. Arrow, *Uncertainty and the Welfare Economics of Medical Care*, 53 AM. ECON. REV. 941 (1963); Isaac Ehrlich & Gary S. Becker, *Market Insurance, Self-Insurance, and*

ly by exposing the insurer to the consequences of the insured's loss, moral hazard occurs.²²

Consider the experience of nineteenth-century insurers.²³ They recognized a potential hazard in allowing people to over-insure for a loss:²⁴ an insured might create a loss and use insurance to come out ahead. This result might influence people who "were unusually susceptible to the temptation that insurance can create."²⁵

Tom Baker's study of Aetna's Insurance Guide from the 1860s concluded that "the insured should never make money by a loss. The contract should never be so arranged, that under any circumstances it would be profitable to the insured to meet with disaster. Any other arrangement is offering a premium for carelessness and roguery."²⁶

Kenneth Arrow applied the concept of moral hazard to government-sponsored health insurance. Arrow concluded that the entitlement might cause individuals to take less responsibility for their own care.²⁷ Current studies explore the government's role in causing people to fail to reduce their risk for unhealthy behaviors. For instance, a tax code that allows individuals to deduct medical expenses encourages less purchasing of private health insurance policies. But private insurance reduces unhealthy behaviors because people pay more as their risks increase.²⁸ State laws that require health insurance to cover al-

Self-Protection, 80 J. POL. ECON. 623 (1972); John M. Marshall, *Moral Hazard*, 66 AM. ECON. REV. 880 (1976); Mark V. Pauly, *Overinsurance and Public Provision of Insurance: The Roles of Moral Hazard and Adverse Selection*, 88 Q.J. ECON. 44 (1974); Mark V. Pauly, *The Economics of Moral Hazard: Comment*, 58 AM. ECON. REV. 531 (1968); Richard Zeckhauser, *Medical Insurance: A Case Study of the Tradeoff Between Risk Spreading and Appropriate Incentives*, 2 J. ECON. THEORY 10 (1970).

22. See Joseph E. Stiglitz, *Risk, Incentives and Insurance: The Pure Theory of Moral Hazard*, 8 GENEVA PAPERS ON RISK AND INS. 4, 6 (1983) ("[T]he more and better insurance that is provided against some contingency, the less incentive individuals have to avoid the insured event, because the less they bear the full consequences of their actions."); see also Amitai Aviram, *The Placebo Effect of Law: Law's Role in Manipulating Perceptions*, 75 GEO. WASH. L. REV. 54, 94 (2006).

23. Baker, *supra* note 21, at 251.

24. *Id.* at 250.

25. *Id.*

26. *Id.*

27. Arrow, *supra* note 21, at 961–63.

28. Louis Kaplow, *The Income Tax as Insurance: The Casualty Loss and Medical Expense Deductions and the Exclusion of Medical Insurance Premiums*, 79 CAL. L. REV. 1485, 1486–87 (1991).

cohol abuse have seen higher rates of consumption compared to states that do not insure for this risk.²⁹ Apart from insuring personal losses, government programs create moral hazard by making individuals pay less for their losses.³⁰

Other forms of publicly funded insurance create moral hazard. The federal flood insurance program pays property owners for failing to avoid known risks, such as building homes in the path of hurricanes.³¹ Storm insurance creates moral hazard when it fails to relocate vulnerable populations to safer areas after a devastating event.³² Federal bank deposit insurance has a similar effect. It reduces lending costs for banks, thereby making credit easier to obtain and enabling banks to make riskier loans.³³

B. MORAL HAZARD IN EMPLOYMENT-BASED INSURANCE

Widespread use of insurance in the employment relationship creates possibilities for moral hazards. Certain pensions, called defined benefit plans, promise employees an automatic stream of retirement income. To protect retirees from the loss of this benefit, Congress created a pension insurance corporation.³⁴ The Pension Benefit Guaranty Corp. (PBGC) insures against losses by taxing employers.³⁵ Moral hazard occurs when companies continue to make future pension obligations while they underfund current contributions.³⁶

29. Jonathan Klick & Thomas Stratmann, *Subsidizing Addiction: Do State Health Insurance Mandates Increase Alcohol Consumption?*, 35 J. LEGAL STUD. 175, 186–87 (2006).

30. See Eric D. Beal, *Posner and Moral Hazard*, 7 CONN. INS. L.J. 81, 85 (2001) (postulating that the moral hazard inherent in many forms of insurance is mitigated through devices like copayments, deductibles, limits, and insurance ratings, which pass a part of the cost back to the insured, providing a partial incentive to minimize risk).

31. Daniel A. Farber, *Basic Compensation for Victims of Climate Change*, 155 U. PA. L. REV. 1605, 1654 n.160 (2007).

32. *Id.* at 1654.

33. Rajeev Dehejia & Adriana Lleras-Muney, *Financial Development and Pathways of Growth: State Branching and Deposit Insurance Laws in the United States, 1900–1940*, 50 J.L. & ECON. 239, 243–44 (2007).

34. See 29 U.S.C. § 1302 (2000 & Supp. V 2005). The PBGC was modeled after the Federal Deposit Insurance Corporation. See 120 CONG. REC. 29,950 (1974) (statement of Sen. Bentsen).

35. See 29 U.S.C. § 1306(a)(1) (2000 & Supp. V 2005).

36. Daniel Keating, *Pension Insurance, Bankruptcy and Moral Hazard*, 1991 WIS. L. REV. 65, 107 (explaining that companies have an incentive to spend capital in ways other than funding pension plans).

Similarly, workers' compensation laws insure employees for lost income and medical expenses from on-the-job injuries.³⁷ These laws also create indirect insurance for employers by extinguishing tort liability for causing an injury.³⁸ Workers' compensation laws require employers to purchase insurance or self-insure to pay employee claims.³⁹ Like other insurance systems, workers' compensation may create incentives for individuals to avoid the financial consequences of a lost-time injury.⁴⁰ A worker might prolong her leave of absence beyond the endpoint of medical necessity because the insurance fund essentially pays her to remain idle.⁴¹

Employers also face moral hazard in that they may fail to reduce risky behaviors by relying on insurance to pay for avoidable accidents. In *Mandolidis v. Elkins Industries*,⁴² an employer ordered workers to speed production on power saws and removed safety guards.⁴³ Later, an employee sawed off two fingers.⁴⁴ When other workers were similarly hurt, the employer callously dismissed their concerns, stating that claimants were paid for their loss.⁴⁵

C. A THEORY OF MORAL HAZARD FOR JUDICIAL REVIEW OF EMPLOYMENT ARBITRATION AWARDS

The implications of moral hazard studies are significant for my empirical investigation of employment arbitration awards. I equate employment arbitration agreements to insurance contracts for employers. These contracts manage two general risks for employers: the high cost of trials and related litigation⁴⁶ and liability for wrongdoing.⁴⁷

37. MARK A. ROTHSTEIN & LANCE LIEBMAN, *EMPLOYMENT LAW: CASES AND MATERIALS* 908–09 (5th ed. 2003).

38. *Id.* at 958–59.

39. *Id.* at 909.

40. Martha T. McCluskey, *The Illusion of Efficiency in Workers' Compensation "Reform"*, 50 RUTGERS L. REV. 657, 684–90 (1998). Examples include injured workers who use compensation benefits to prolong their leave, and noninjured workers who file fraudulent lost-time claims. *Id.*

41. *Id.* at 817.

42. 246 S.E.2d 907 (W. Va. 1978).

43. *Id.* at 915.

44. *Id.* at 915–16.

45. *Id.*

46. See Hadfield, *supra* note 1, at 957–60.

47. See *Pollard v. E.I. du Pont de Nemours & Co.*, 532 U.S. 843 (2001).

My theory focuses on employer expenses for liability. In the 1991 Civil Rights Act, Congress authorized courts to order make-whole relief and punitive damages for victims of intentional employment discrimination.⁴⁸ By enacting Title VII, lawmakers also forced employers to self-insure for the societal harm that results from workplace discrimination.⁴⁹ The point is that employment discrimination laws can be compared to insurance. By making employers pay for their discrimination, Congress hoped to diminish the spillover costs to the nation's economy when minorities are excluded from the workforce.

Lawmakers could have appropriated funds to hire government lawyers to enforce Title VII. Instead, a provision in the law authorizes courts to order employers to pay a prevailing plaintiff's attorney's fees.⁵⁰ This law creates more incentive for employers to avoid liability because private attorney's fees can be high.⁵¹ As a result, more employers should want to reduce risks associated with Title VII liability.

Let us now consider government regulation of employment arbitration. When *Gilmer v. Interstate/Johnson Lane Corp.*⁵² broadly approved arbitration as a substitute for trials, the Supreme Court promised that by "agreeing to arbitrate a statutory claim, a party [would] not forgo the substantive rights afforded by the statute. . . ."⁵³ *Gilmer* states a theory of forum substitution. Arbitrators serve as substitute judges. The theory

48. When Congress increased employer penalties for employment discrimination, lawmakers reasoned: "Monetary damages are also necessary to make discrimination victims whole for the terrible injury to their careers, to their mental and emotional health, and to their self-respect and dignity." Civil Rights Act of 1991, Pub. L. No. 102-166, § 206(A), 105 Stat. 1071 (codified as amended in scattered sections of 2 U.S.C. & 42 U.S.C.).

49. 42 U.S.C. § 1981a(1) (2000) ("In an action brought by a complaining party under section 706 or 717 of the Civil Rights Act of 1964 against a respondent who engaged in unlawful intentional discrimination . . . the complaining party may recover compensatory and punitive damages." (internal citation omitted)).

50. 42 U.S.C. § 2000e-5(k) ("In any action or proceeding under this subchapter the court, in its discretion, may allow the prevailing party . . . a reasonable attorney's fee . . .").

51. *E.g.*, *DeGaetano v. Smith Barney, Inc.*, 983 F. Supp. 459 (S.D.N.Y. 1997).

52. 500 U.S. 20 (1991).

53. *Id.* at 26; *see also* U.S. GEN. ACCOUNTING OFFICE, *supra* note 15 ("[Employers'] concerns have recently increased as a result of (1) million dollar jury awards to employees and (2) the provision in the Civil Rights Act of 1991 that permits punitive damages in cases of intentional discrimination under Title VII of the Civil Rights Act of 1964 and the Americans With Disabilities Act.").

implies that when arbitrators determine that evidence supports a finding of employer liability, they should provide the relief that a judge would order.

Let us now assume that the arbitrator performs this role, but the employer refuses to accept the financial consequences of its wrongdoing. When a court vacates the arbitrator's ruling in favor of the employee, forum substitution is undermined.

Therefore, employers use vacatur courts to counteract the negative effects of risky behaviors just as home owners and beachfront developers use federal disaster insurance. These parties seek government intervention to bail them out of the consequences of risky behaviors that turn costly. The moral hazard model indicates that vacatur courts act as government insurers by relieving employers of liability for socially undesirable conduct.

I postulate that employers enter into employment arbitration agreements because they perceive arbitration as a better forum. Through arbitration, they can avoid the growing cost of court procedures and rulings.⁵⁴ Also, employers exploit their superior knowledge of information about these contracts.⁵⁵ A typical clause states that an arbitrator's award shall be final and binding. I hypothesize that an employee would be more likely than an employer to take this language at face value and be deterred from challenging an adverse ruling.⁵⁶ As a more informed party, however, an employer realizes that it has re-

54. See Hadfield, *supra* note 1, at 957–61 (noting the high recent estimates of litigation costs).

55. See Lisa B. Bingham, *On Repeat Players, Adhesive Contracts, and the Use of Statistics in Judicial Review of Employment Arbitration Awards*, 29 MCGEORGE L. REV. 223, 223–24 (1998) (citing Marc Galanter, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change*, 9 LAW & SOC'Y REV. 95, 97–110 (1974)) (noting the numerous advantages that repeat players have over one-shotters in litigation). My theory is based on the idea that "repeat players have strategic superiority in that they can structure a transaction to their advantage." *Id.* at 233.

56. See Alan M. White & Cathy Lesser Mansfield, *Literacy and Contract*, 13 STAN. L. & POL'Y REV. 233, 261–62 (2002) (analyzing research that shows a high percentage of literate adults who are unable to extract pertinent information from form contracts); *id.* at 266 ("[T]he legal system is engaging in the fiction of a free and informed market, while turning a blind eye to the realities of the marketplace and to the fact that consumers cannot understand and do not actually assent to the terms of the consumer contracts they sign."); see also Jean R. Sternlight, *Creeping Mandatory Arbitration: Is It Just?*, 57 STAN. L. REV. 1631, 1654–55 (2005) (showing that employees find it difficult and expensive to challenge an arbitration clause in court, and that the extra legal hurdle of mandatory arbitration makes it harder for employees to retain an attorney).

course to challenge an award in court. Furthermore, depending on language in the arbitration agreement, an employer can improve its odds of overcoming the presumption of award finality—and achieve an outcome that allows the employer to avoid liability for wrongdoing.⁵⁷

These liability avoidance tactics vary. Some contracts provide for de novo review of an arbitrator's award.⁵⁸ These agreements are contradictory. They preclude an employee's access to courts and treat arbitrator awards as final and binding. But they preserve access to courts for the purpose of appealing an award, and furthermore, they allow judges to conduct a de novo review of the arbitrator's ruling. The result: employers have *two* separate adjudications to avoid liability.

In another award-avoidance tactic, some employers draft a favorable choice-of-law provision.⁵⁹ Parties can review awards under the Federal Arbitration Act (FAA)⁶⁰ or state arbitration law equivalents.⁶¹ More states are expanding grounds for challenging an arbitrator's award.⁶² By choosing a state law that facilitates judicial nullification of awards, employers can improve their odds of avoiding liability.⁶³

57. See, e.g., *Harris v. Parker Coll. of Chiropractic*, 286 F.3d 790, 793 (5th Cir. 2002) (holding that parties may contractually modify the standard of review of an arbitration award); *Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287, 288 (3d Cir. 2001) (holding that contracting parties can opt out of the FAA's default vacatur standards); *Hughes Training Inc. v. Cook*, 254 F.3d 588, 592–93 (5th Cir. 2001) (finding that parties may structure the standard of review for arbitration awards as they see fit); *Syncor Int'l Corp. v. McLeland*, No. 96-2261, 1997 WL 452245, at *5 (4th Cir. Aug. 11, 1997) (noting that any doubt about the scope of an arbitration agreement should be resolved in favor of arbitration); *Collins v. Blue Cross Blue Shield of Mich.*, 103 F.3d 35, 36 (6th Cir. 1996) (noting that arbitration agreements may specify the jurisdiction for enforcement); *Bargenquast v. Nakano Foods, Inc.*, 243 F. Supp. 2d 772, 774–75 (N.D. Ill. 2002) (noting that there is a circuit split on whether parties can contractually expand the judicial standard of review of an arbitration award and concluding that they cannot).

58. E.g., *Harris*, 286 F.3d at 794 (concluding that in the Fifth Circuit, a de novo standard of review will be applied to questions of law decided by arbitrators).

59. E.g., *Roadway Package Sys., Inc.*, 257 F.3d at 294 (involving an arbitration agreement that was to be governed by New York state law).

60. Federal Arbitration Act, 9 U.S.C. § 10(a) (2006).

61. See UNIF. ARBITRATION ACT § 12 (amended 2000), 7 U.L.A. 497 (1956); see, e.g., MINN. STAT. § 572.19 (2006).

62. See UNIF. ARBITRATION ACT § 23, 7 U.L.A. 73–83 (2000); Am. Arbitration Ass'n, *RUAA and UMA Legislation from Coast to Coast*, DISP. RESOLUTION TIMES, Aug. 31, 2005, at 1.

63. E.g., *Prescott v. Northlake Christian Sch.*, 369 F.3d 491, 493–94 (5th Cir. 2004) (involving an employer's arbitration agreement that incorporated

I now connect this theoretical framework to my empirical investigation. If courts enforced a very high percentage of awards—let us suppose 100%—no moral hazard would be created. The employer would bear the consequences of its behavior by paying damages every time for its unlawful behavior. Suppose, however, that courts vacated most awards that order employers to pay for their liability. The employee would lose the benefit of the bargain for final and binding arbitration. Also, because *Gilmer* requires courts to enforce arbitration agreements, the employee would have no recourse in court. The employer would avoid liability that was determined by an arbitrator. The vacatur court would insure employers from paying for their liability.

How would this situation compare to other models of moral hazard? As in the general insurance model, a contract would tempt one party (an employer) to avoid the full consequences of its actions and to act inappropriately by exposing another party (an employee) to the injurious effects of its misconduct.⁶⁴

As a result, employers would be less deterred to engage in risky behaviors that create liability, compared to the case where the employer would be required to pay.⁶⁵ The arbitration agreement would, in effect, create a temptation that “[brings] out the bad in otherwise good people.”⁶⁶

I note an important caveat. Proof of moral hazard would require evidence that an employer’s avoidance of liability in arbitration actually caused this party to fail to take future precautions to avoid the same risk.⁶⁷ For example, an employer who vacated an award that remedied sexual harassment would fail to learn from the experience and continue to tolerate sexual harassment in its workplace. My empirical study does not measure employer responses to court rulings that vacate pro-worker awards.

the Montana Uniform Arbitration Act, even though parties were located in Louisiana).

64. See Stiglitz, *supra* note 22 (“[T]he more and better insurance that is provided against some contingency, the less incentive individuals have to avoid the insured event, because the less they bear the full consequences of their actions.”).

65. See Aviram, *supra* note 22 (“[T]hird-party actions that reduce a risk to an individual may create an incentive for the individual to take fewer precautions against the same risk . . .”).

66. Baker, *supra* note 21, at 251.

67. See Beal, *supra* note 30, at 85–86.

II. EMPLOYER MOTIVATION TO USE ARBITRATION: MANAGING THE RISK OF LIABILITY OR SEEKING A BETTER ADR PROCESS?

Consider, again, the Aetna insurance model.⁶⁸ Aetna assumed that allowing people to buy excess insurance would induce people who “were unusually susceptible to the temptation that insurance can create” to engage in fraudulent activities for profit.⁶⁹ The Aetna model assumed that some people would succumb to “carelessness and roguery.”⁷⁰ Thus, Aetna wrote insurance contracts to make it impossible for anybody to come out ahead by claiming a loss.

By analogy, I theorize that some employers take a rogue’s approach to the contractual promise to treat arbitration awards as final and binding. They use courts to insure against a loss. When courts are too permissive in relieving their fault, rogue employers are rewarded for failing to take responsibility for their own misconduct.

Another phenomenon that is important to consider in light of this moral hazard problem is the recent explosion of employment arbitration. I examine why employers prefer arbitration to courts since there has been no visible evidence of employee preference for arbitration over courts. There are two schools of thought on this subject.

The “dark side,” as examined in Part II.A, is that employers prefer arbitration because it manages their risk of liability for unlawful conduct. In particular, arbitration creates process disadvantages for employees. Therefore, the odds of employer liability are lower as compared to the civil court system. Even if arbitration produces a good outcome for the individual, judicial review of awards creates “two bites at the apple” for the employer.

The “bright side,” as examined in Part II.B, looks at how inaccessible courts are due to cost, delay, and over-emphasis on procedural manoeuvring. Arbitration holds real promise of an adjudicatory hearing for ordinary individuals because of its lower cost and simplicity. Moreover, studies show that arbitration is providing positive outcomes for many employees.

68. Baker, *supra* note 21, at 250; *see supra* Part I.A.

69. Baker, *supra* note 21, at 250.

70. *Id.* (citing AETNA GUIDE TO FIRE INSURANCE FOR THE REPRESENTATIVES OF THE AETNA INSURANCE CO. 157 (1867)).

A. THE DARK SIDE OF EMPLOYMENT ARBITRATION: MANAGING THE RISK OF LIABILITY BY CREATING PROCESS DISADVANTAGES FOR EMPLOYEES

For more than a century, the doctrine of employment-at-will defined American employment law, allowing either the employer or individual to terminate the work relationship at any time, for any reason.⁷¹ However, fundamental changes in government regulation of employment during the 1960s altered this arrangement. Congress passed sweeping employment discrimination laws.⁷² In the same period, state courts developed common law exceptions to employment at will.⁷³

As the field of employment law expanded, so did employer liability. A critical threshold was reached when courts applied tort theories and remedies to workplace disputes, including the public policy exception to employment-at-will⁷⁴ and related whistleblower protection,⁷⁵ emotional distress,⁷⁶ assault and

71. See H. G. WOOD, A TREATISE ON THE LAW OF MASTER AND SERVANT § 134 (1877) (“With us the rule is inflexible, that a general or indefinite hiring is *prima facie* a hiring at will, and if the servant seeks to make it out a yearly hiring, the burden is upon him to establish it by proof. . . . [I]t is an indefinite hiring and is determinable at the will of either party, and in this respect there is no distinction between domestic and other servants.”).

72. See Civil Rights Act of 1964, Pub. L. No. 88-352, Title VII, § 703, 78 Stat. 214, 255–57 (codified as amended at 29 U.S.C. 206 & 50 U.S.C. 781 (2000)) (prohibiting discrimination in employment on the basis of “race, color, religion, sex, or national origin.”); S. REP. NO. 88-872, pt. 1, at 11 (1964), *as reprinted in* 1964 U.S.C.C.A.N. 2355, 2365 (“[A] total of 32 [states] now protect against discrimination and segregation in public accommodations and facilities.”); H.R. REP. NO. 88-914, pt. 1, at 18 (1963), *as reprinted in* 1964 U.S.C.C.A.N. 2391, 2393 (“Considerable progress has been made in eliminating discrimination in many areas because of local initiative . . .”).

73. See, e.g., *Monge v. Beebe Rubber Co.*, 316 A.2d 549, 551 (N.H. 1974) (finding covenant of good-faith-dealing exception to employment-at-will); *Petermann v. Int’l Bhd. of Teamsters Local 396*, 344 P.2d 25, 27 (Cal. Dist. Ct. App. 1959) (finding a public-policy exception to employment-at-will).

74. E.g., *Harless v. First Nat’l*, 246 S.E.2d 270, 275 (W.Va. 1978) (holding that the discharge of an employee who tried to convince his employer to comply with the consumer credit laws violated a clear public policy of protecting consumers); *O’Sullivan v. Mallon*, 390 A.2d 149, 150 (N.J. Super. Ct. Law Div. 1978) (holding that employer had no at-will right to discharge an x-ray technician who refused to perform catheterizations because it would have been illegal for this employee to perform the procedure).

75. E.g., *Green v. Ralee Engineering Co.*, 960 P.2d 1046, 1061 (Cal. 1998).

76. E.g., *Wilson v. Monarch Paper Co.*, 939 F.2d 1138, 1142 (5th Cir. 1991) (applying Texas law to an emotional-distress claim); *Bustamento v. Tucker*, 607 So. 2d 532, 538 (La. 1992) (noting that intentional infliction of emotional distress can occur in the workplace).

battery in severe cases of sexual harassment,⁷⁷ negligence,⁷⁸ and defamation.⁷⁹ State constitutions compounded this trend by creating privacy rights for workers.⁸⁰

In the early 1990s, two critical streams in employment law were joined. The 1991 Civil Rights Act⁸¹ and Americans with Disabilities Act in 1992⁸² posed a liability threat to employers. Employment discrimination lawsuits in federal courts doubled in five years, as filings soared from 8273 in 1990 to 19,059 in 1995.⁸³ To put this trend in perspective, consider that employment claims, including those under Title VII of the 1964 Civil Rights Act, comprised about fifty-two percent of all civil rights cases filed in federal courts in 1995.⁸⁴

The 1991 amendments expressly allowed discrimination victims to recover up to \$300,000 in punitive damages.⁸⁵ This supplemented the strong remedial provisions in Title VII.⁸⁶ Al-

77. *E.g.*, Maksimovic v. Tsogalis, 687 N.E.2d 21 (Ill. 1997).

78. *E.g.*, Malorney v. B & L Motor Freight, Inc., 496 N.E.2d 1086, 1089 (Ill. App. Ct. 1986).

79. *E.g.*, Lewis v. Equitable Life Assurance Soc'y, 389 N.W.2d 876, 892 (Minn. 1986).

80. *E.g.*, Soroka v. Dayton Hudson Corp., 1 Cal. Rptr. 2d 77, 89 (Cal. Ct. App. 1991) (concluding that the California constitution protects employees' right to privacy).

81. Civil Rights Act of 1991, Pub. L. No. 102-166, 105 Stat. 1071 (codified as amended in scattered sections of 2 U.S.C. & 42 U.S.C.).

82. Americans with Disabilities Act of 1990, Pub. L. No. 101-336, 104 Stat. 327 (codified as amended in scattered sections of 42 U.S.C.).

83. ADMIN. OFFICE OF THE U.S. COURTS, U.S. DIST. COURT CASES: JUDICIAL FACTS AND FIGURES, CIVIL CASES FILED BY NATURE OF SUIT 2 tbl.4.4 (2006), <http://www.uscourts.gov/judicialfactsfigures/2006/Table404.pdf>.

84. *Id.* (citing 36,600 "Civil Rights" cases in federal courts in 1995, of which 19,059 were "Employment" cases).

85. *See* 42 U.S.C. § 1981a(a)(1), (b)(3) (2000) (specifying the compensatory and punitive damages available under Title VII).

86. *See* Pollard v. E.I. du Pont de Nemours & Co, 532 U.S. 843, 852 (2001) (explaining the expansion of Title VII remedies). When Congress originally conceived section 706(g) of the 1964 Civil Rights Act, it authorized courts to enjoin intentional acts of discrimination and order make-whole-type remedies (e.g., back pay), similar to those under the National Labor Relations Act. *Id.* at 848–50. Congress broadened judicial power to remedy intentional acts of discrimination in 1972 because courts could not always provide effective relief. *Id.* at 849–50. But some acts of discrimination make reinstatement an unworkable remedy. Thus, front pay—ongoing financial relief until a plaintiff finds equivalent employment at another workplace—is also authorized in section 706(g). *Id.* at 850. When Congress revisited the remedy issue in 1991, it "determined that victims of employment discrimination were entitled to *additional remedies.*" *Id.* at 852. Thus, Congress authorized "the recovery of compensatory and punitive damages in addition to previously available remedies, such as front pay." *Id.* at 854. The result is that an employer who commits in-

so, the total cost of remedies in the 1991 law exceeds the facial limit of \$300,000 for compensatory damages. *Pollard v. E.I. du Pont de Nemours & Co.* demonstrates the point.⁸⁷ After finding that a female worker experienced flagrant discrimination, the district court awarded her \$107,364 in back pay and benefits, \$252,997 in attorney's fees, and \$300,000 in compensatory damages.⁸⁸

The trial court said that it wanted to award more in compensatory damages under the Civil Rights Act of 1991—based on the fact that Sharon Pollard could not return to her former job because of a severe and continuing hostile work environment—but declined to award future damages because the court believed that the law's cap on "future pecuniary loss" also applied to front pay.⁸⁹ The Supreme Court ruled, however, that front pay did not count against the \$300,000 limit.⁹⁰ On remand, the trial court awarded Pollard approximately \$2.2 million in compensatory damages (for back pay, front pay, and infliction of emotional distress) and \$2.5 million in punitive damages on the emotional distress claim.⁹¹ *Pollard* shows that Title VII is costly for employers.

A second stream in employment law emerged in 1991 with the Supreme Court's strong approval of mandatory arbitration for an age discrimination claim in *Gilmer v. Interstate/Johnson*

tentional acts of discrimination may be ordered to pay tort-like damages, and in addition, be subject to the equitable remedies of back pay and front pay.

87. 532 U.S. 843, 845 (2001).

88. *Id.* As the only female worker in her department, Pollard was shunned by male employees who believed that the Bible teaches that women must totally submit to men. In addition, she was constantly subjected to derogatory terms regarding women, including "bitches," "cunts," "heifers," and "split tails." *Pollard v. E.I. DuPont de Nemours Co.*, 213 F.3d 933, 938 (6th Cir. 2000), *rev'd*, 532 U.S. 843 (2001). The men also sabotaged Pollard's work. *Id.* Pollard felt threatened after her tires were slashed and male coworkers provoked confrontations with her. *Id.* at 939–40. Eventually, she went on a disability leave that DuPont's psychologist approved. *Id.* at 941. When DuPont's plant management could not guarantee that she would not be assigned to work with these men, she again refused to return, prompting DuPont to fire her. *Id.*

89. *Pollard v. E.I. DuPont de Nemours, Inc.*, 16 F. Supp. 2d 913, 924 n.19 (W.D. Tenn. 1998) (noting that 42 U.S.C. § 1981a(b)(3) (2000) limits compensatory and punitive damages under Title VII to \$300,000 and that the statute defines the former element as "future pecuniary losses, emotional pain, suffering, inconvenience, mental anguish, loss of enjoyment of life, and other non-pecuniary losses.").

90. *Pollard*, 532 U.S. at 853–54.

91. *Pollard v. E.I. DuPont de Nemours, Inc.*, 412 F.3d 657, 666 (6th Cir. 2005), *aff'g*, 338 F. Supp. 2d 865 (W.D. Tenn. 2003).

*Lane Corp.*⁹² *Gilmer* held that an employee who had been required by his employer to sign an arbitration agreement was precluded from suing in court.⁹³ The ruling gave employers hope for curtailing their expanding liability. More recently, the Court's ruling in *Circuit City Stores, Inc. v. Adams*⁹⁴ expanded *Gilmer*.

These oddly conjoined streams encouraged employers to use arbitration agreements to bypass courts in hopes of lowering the cost of employment disputes.⁹⁵ In a late-1990s national survey, most Fortune 1000 companies reported that they use employment arbitration.⁹⁶ Ninety percent said that they adopted an ADR method as a "critical cost technique."⁹⁷ Commentators concluded that adoption of arbitration enabled employers to limit litigation risks and costs.⁹⁸ The trend is reflected today in arbitration procedures that allow employers to

92. 500 U.S. 20, 26 (1991) (listing prior cases where the court has enforced arbitration agreements).

93. See *id.* at 26–27. This ruling is synonymous with the expression "mandatory arbitration." In mandatory arbitration, one party conditions a contractual benefit or entitlement—for example, employment or use of a credit card—on the other party's agreement to submit any dispute to arbitration instead of going to court. Because the arbitration clause is a nonnegotiable condition for the contractual relationship, it is called mandatory.

94. 532 U.S. 105, 119 (2001) (ruling that all employment arbitration agreements are enforceable under the FAA, with the exception of a small sliver of agreements that cover transportation workers).

95. See Ken May, *Arbitration: Attorney Urges Employers to Adopt Mandatory Programs as Risk Management*, DAILY LAB. REP. (WASH., D.C.), May 14, 2001, at A-5 ("The major advantages of mandatory arbitration, Copus observed, are to limit damages and eliminate class actions. The real risk of litigation, he said, is from tort claims in which a single plaintiff can get millions of dollars. Arbitration programs should cap damages, he said, adding that he suggests capping damages at the limit of a Title VII claim.").

96. See *Alternative Dispute Resolution: Most Large Employers Prefer ADR as Alternative to Litigation, Survey Says*, DAILY LAB. REP., May 14, 1997, at A-4 ("The survey found that over the last three years . . . 79 percent [of employers] have used arbitration.").

97. *Id.*

98. See David B. Lipsky & Ronald L. Seeber, *Patterns of ADR Use in Corporate Disputes*, 54 DISP. RESOL. J. 66, 71 (1999) ("All else being equal, ADR is widely considered cheaper and faster . . ."); Francis J. Mootz III, *Insurance Coverage of Employment Discrimination Claims*, 52 U. MIAMI L. REV. 1, 3 (1997) ("For many employers, managing this risk of liability is a vital part of their human resources mission and an important part of their general corporate cost-control program."); cf. Jack M. Sabatino, *ADR as "Litigation Lite": Procedural and Evidentiary Norms Embedded Within Alternative Dispute Resolution*, 47 EMORY L.J. 1289, 1301 (1998) ("[T]he business world has become enamored with ADR.").

manage risk by “eliminat[ing] the jury trial, class actions, and large attorney’s fees”⁹⁹

Specific cases lend support for the risk-management thesis. Arbitration agreements require workers to waive their right to sue¹⁰⁰ and to replace a court with arbitration.¹⁰¹ Often, workers cannot bargain over this forum.¹⁰² Companies create their own justice rules to shield themselves from stricter enforcement.¹⁰³ Prehearing risk-control tactics include limits on discovery,¹⁰⁴ shorter periods to file claims,¹⁰⁵ selection of arbitrators without employee input,¹⁰⁶ and inconvenient venues.¹⁰⁷ Some employers not only bar access to courts, but they also deter employee

99. Scott Baker, *A Risk-Based Approach to Mandatory Arbitration*, 83 OR. L. REV. 861, 862 (2004); see also David S. Schwartz, *Understanding Remedy-Stripping Arbitration Clauses: Validity, Arbitrability, and Preclusion Principles*, 38 U.S.F. L. REV. 49, 53 (2003) (contending that employers use arbitration as a risk-management device).

100. See, e.g., *Baldeo v. Darden Rests., Inc.*, No. 04-CV-2185(JG), 2005 WL 44703, at *2 (E.D.N.Y. Jan. 11, 2005).

101. See, e.g., *Gold v. Deutsche Aktiengesellschaft*, 365 F.3d 144, 146 (2d Cir. 2004).

102. See, e.g., *Brennan v. Bally Total Fitness*, 198 F. Supp. 2d 377, 380 (S.D.N.Y. 2002).

103. See DAVID B. LIPSKY ET AL., *EMERGING SYSTEMS FOR MANAGING WORKPLACE CONFLICT* 103 tbl.3.11 (2003) (reporting that 36.9% of employers identified “avoids legal precedents” and that 59.3% of employers identified “has limited discovery” as reasons for using arbitration).

104. See, e.g., *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 31 (1991) (“Although those procedures might not be as extensive as in the federal courts, by agreeing to arbitrate, a party ‘trades the procedures and opportunity of the courtroom for the simplicity, informality, and expedition of arbitration.’” (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985))).

105. See, e.g., *Marie v. Allied Home Mortgage Corp.*, 402 F.3d 1, 11 (1st Cir. 2005) (ruling that arbitrator had authority to rule on validity of sixty-day filing requirement); *Chappel v. Lab. Corp. of America*, 232 F.3d 719, 726–27 (9th Cir. 2000) (holding that because ERISA provides a four-year statute of limitations for an action to recover benefits under a written contract, the plan administrator breached its fiduciary duty by adopting a mandatory arbitration clause that set a sixty-day time limit in which to demand arbitration); *Louis v. Geneva Enter.*, 128 F. Supp. 2d 912, 917 n.2 (E.D. Va. 2000) (finding that a sixty-day filing limit in arbitration agreement drafted by the employer unlawfully conflicted with three-year statute of limitations for Fair Labor Standards Act claims).

106. See, e.g., *Hooters of Am. v. Phillips*, 173 F.3d 933, 938 (4th Cir. 1999) (“Given the unrestricted control that one party (Hooters) has over the panel, the selection of an impartial decision maker would be a surprising result.”).

107. See, e.g., *Poole v. L.S. Holding, Inc.*, No. 2001-57, 2001 WL 1223748, at *1 (D.V.I. 2001) (rejecting contention by Virgin Islands employee that Massachusetts is a prohibitively expensive venue to arbitrate claim).

access to arbitration by requiring employees to pay large forum costs associated with the hearing process.¹⁰⁸

Once the arbitrator has been appointed and the hearing commences, additional risk management controls may still be in place. Some arbitration agreements bar class actions.¹⁰⁹ They may include remedial limits on statutory claims¹¹⁰ and strictures against punitive damages in awards.¹¹¹

The arbitration agreement may also anticipate a finding adverse to the employer. As an additional risk control, the agreement may authorize the losing party to appeal the arbitrator ruling and seek expanded review of the award.¹¹² Such a provision is intended to circumvent highly deferential court re-

108. *See, e.g., Morrison v. Circuit City Stores, Inc.*, 317 F.3d 646, 669 (6th Cir. 2003) (“The default cost-splitting rule in the Circuit City arbitration agreement would deter a substantial percentage of potential litigants from bringing their claims in the arbitral forum.”).

109. *See, e.g., Adkins v. Labor Ready, Inc.*, 185 F. Supp. 2d 628, 646 (S.D.W. Va. 2001) (“[P]laintiff has entered into a valid contract to arbitrate any employment related issue thereby waiving his right to proceed as a part of a class action . . .”).

110. *See, e.g., Morrison v. Circuit City Stores, Inc.*, 70 F. Supp. 2d 815, 827 (S.D. Ohio 1999) (upholding \$162,000 limit imposed by arbitration agreement although Title VII permits up to \$300,000 in punitive damages).

111. *See, e.g., Great W. Mortgage Corp. v. Peacock*, 110 F.3d 222, 225 (3d Cir. 1997) (“[T]he Agreement provided that the arbitrator could not award punitive or exemplary damages.”).

112. *See, e.g., Harris v. Parker Coll. of Chiropractic*, 286 F.3d 790, 793 (5th Cir. 2002) (“[T]he Award of the Arbitrator shall be binding on the parties hereto, although each party shall retain his right to appeal any questions of law, and judgment may be entered thereon in any court having jurisdiction.”); *Hughes Training Inc. v. Cook*, 254 F.3d 588, 590 (5th Cir. 2001) (“Either party may bring an action in any court of competent jurisdiction . . . to vacate an arbitration award. . . . [T]he standard of review to be applied to the arbitrator’s findings of fact and conclusions of law will be the same as that applied by an appellate court reviewing a decision of a trial court sitting without a jury.”); *Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287, 288 (3d Cir. 2001) (“[The Agreement] contains a generic choice-of-law clause, stating that it ‘shall be governed by and construed in accordance with the laws of the Commonwealth of Pennsylvania.’”); *Syncor Int’l Corp. v. McLeland*, No. 96-2261, 1997 WL 452245, at *15 (4th Cir. Aug. 11, 1997) (“[A]rbitrator shall not have the power to commit errors of law or legal reasoning, and the award may be vacated or corrected by judicial review for any such error.”); *Collins v. Blue Cross Blue Shield of Mich.*, 103 F.3d 35, 36 (6th Cir. 1996) (stating that agreement provided for judicial review of the arbitration award “as established by law” and for the arbitrator’s “clear error of law”); *Bargenquast v. Nakano Foods, Inc.*, 243 F. Supp. 2d 772, 774 (N.D. Ill. 2002) (“The arbitrator . . . shall have no power, in rendering the award, to alter or depart from any express provision of this Agreement or to make a decision which is not supported by law and substantial evidence.”).

view of arbitration awards. In effect, these employers seek a “do over” of the arbitration.

B. THE BRIGHT SIDE OF EMPLOYMENT ARBITRATION: A BETTER DISPUTE RESOLUTION FORUM COMPARED TO COURTS

Arbitration has advantages in terms of cost, time, precedent, and privacy as compared to trials.¹¹³ Some employers use arbitration in a broader context. As corporations, they seek to limit liability in all transactions and disputes, including those that arise in the employment relationship.¹¹⁴

Employer preference for arbitration is better understood with historical context. For over three hundred years, businesses have found courts to be unwieldy and expensive forums in which to resolve disputes. In response to businesses that were dissatisfied with public tribunals, an English statute of 1697 authorized courts to enforce arbitration awards.¹¹⁵ Economists in the 1600s favored arbitration because courts wasted time and money.¹¹⁶ Under Lord Mansfield’s influence, English commercial law deferred to arbitration rulings.¹¹⁷

113. See ALAN SCOTT RAU ET AL., PROCESSES OF DISPUTE RESOLUTION 600–01 (3d ed. 2002) (concluding that arbitration allows parties to select their own decisionmaker, proceed to a hearing relatively quickly, dispense with tediously formal rules, and reduce the friction that accompanies trials); Frank E.A. Sander & Stephen B. Goldberg, *Fitting the Forum to the Fuss: A User-Friendly Guide to Selecting an ADR Procedure*, 10 NEGOTIATION J. 49, 55 tbl.1 (1994) (showing likelihood that ADR will overcome impediments to settlement).

114. See Sternlight, *supra* note 10, at 680 (“The profit maximizing company will attempt to draft a dispute resolution contract so as to maximize its profits and minimize its losses. The company will seek an agreement that will minimize the likelihood of having any claims made against it at all. In addition, where claims are to be brought, the company will attempt to minimize both its own transaction costs of engaging in dispute resolution and the cost of the actual payout upon loss of a claim to a consumer.”).

115. An Act for Determining Differences by Arbitration, 1697, 9 & 10 Will. 3, c. 15 (Eng.) (“Now for promoting trade, and rendering the awards of arbitrators the more effectual in all cases, for the final determination of controversies referred to them by merchants and traders, or others, concerning matters of account or trade, or other matters; be it enacted . . .”). John Locke’s role in formulating the statute is documented in Henry Horwitz & James Oldham, *John Locke, Lord Mansfield and Arbitration During the Eighteenth Century*, 36 THE HIST. J. 137, 138–39 (1993).

116. See, e.g., JOSIAH CHILD, A NEW DISCOURSE OF TRADE 141–44 (4th ed. 1745). Child’s chapter, “Concerning a Court Merchant,” said that “this Kingdom will at length be blessed with a happy method, for the speedy, easy, and cheap deciding of differences between Merchants, Masters of Ships, and seamen by some Court or Courts of Merchants . . .” *Id.* at 141. He complained that conventional litigation in courts of law entailed “tedious attendance and

This view was shared by nineteenth-century American courts that upheld arbitration agreements. A New York court ruled in 1832 that “[a]wards are much favored, and the court will intend everything in their favor.”¹¹⁸ In rejecting a challenge to an award, the court was troubled that a cost-saving process could be overturned by a subsequent and expensive trial.¹¹⁹

Early in the twentieth century, businesses complained that courts were costly and inefficient providers of commercial justice. Thus, in 1925 Congress enacted the United States Arbitration Act¹²⁰ (and renamed it the Federal Arbitration Act in 1947¹²¹) to help businesses reduce expense and delay in resolving their legal disputes.¹²² Congress learned from businesses that too many courts refused to enforce their private arbitration agreements.¹²³ Thus, a national arbitration law with federal jurisdiction was proposed.¹²⁴

vast expenses.” *Id.* at 142.

117. See C.H.S. FIFOOT, LORD MANSFIELD 104–05 (1936) (“The collaboration of judge and merchant, if it was to exercise its due influence upon the law, required adequate channels of communication. In the development of the special jury Lord Mansfield found the vital medium. . . . Lord Mansfield converted an occasional into a regular institution and trained a corps of jurors as a permanent liaison between law and commerce.”).

118. *Campbell v. Western*, 3 Paige 124, 128 n.1 (N.Y. Ch. 1832).

119. See *id.* at 138 (“If every party who arbitrates, in relation to a contested claim, to save trouble and expense, is to be subjected to a chancery suit, and to several hundred dollars cost, if the arbitrators happen to err upon a doubtful question as to the admissibility of a witness, the sooner these domestic tribunals of the parties’ own selection are abolished the better. Such a principle is wholly inconsistent with common sense, and cannot be the law of a court of equity.”).

120. United States Arbitration Act, ch. 213, 43 Stat. 883 (1925) (codified as amended at 9 U.S.C. §§ 1–16 (2006)).

121. See Act of July 30, 1947, ch. 392, 61 Stat. 669 (1947) (amending the United States Arbitration Act) (codified at 9 U.S.C. §§ 1–16 (2006)).

122. See S. REP. NO. 68-536, at 3 (1924) (stating that the FAA was proposed to help businesses “avoid the delay and expenses of litigation”); H.R. REP. NO. 68-96, at 2 (1924) (asserting that Congress believed that the simplicity of arbitration would “reduc[e] technicality, delay, and [keep] expense to a minimum and at the same time safeguard[] the rights of the parties”).

123. See *Arbitration of Interstate Commercial Disputes: Hearings on S. 1005 and H.R. 646 Before the Subcomm. of the Comm. on the Judiciary*, 68th Cong. 8 (1924) [hereinafter *Arbitration of Interstate Commercial Disputes: Hearings*] (statement of Charles L. Bernheimer, Chairman, Comm. on Arbitration, Chamber of Commerce of the State of New York).

124. H.R. REP. NO. 68-96, at 1 (“The purpose of this bill is to make valid and enforceable agreements for arbitration contained in contracts involving interstate commerce or within the jurisdiction of[] admiralty, or which may be the subject of litigation in the Federal courts.”).

Business leaders complained that lawsuits led to “ruinous litigation”¹²⁵ and hurt American consumers because firms had to pass along litigation costs in their prices.¹²⁶ Companies avoided these problems when they voluntarily submitted their disputes to arbitration.¹²⁷ Arbitration offered “the best means yet devised for an efficient, expeditious, and inexpensive adjustment of . . . disputes.”¹²⁸

Today, employers voice similar concerns about courts. When Congress studied arbitration in 1997, its survey found that nearly one in five employers used arbitration.¹²⁹ Companies said that arbitration reduced “employment-related litigation.”¹³⁰ Also, a case study of mandatory arbitration found that a large company and its employees mutually benefited from the method.¹³¹ Other studies show that arbitration reduced legal fees.¹³²

Besides promoting efficiency and cost savings, employer-generated arbitration systems produced surprisingly positive results for claimants. A comparison of trials in the federal court in New York City and nearby arbitrations held by NASD and NYSE found that discrimination complainants fared better in

125. *Arbitration of Interstate Commercial Disputes: Hearings*, *supra* note 123, at 6.

126. *See id.* (“The litigant’s expenses—that is, whatever is necessary to cover the annual outlay for litigation or the fear of litigation, consultations with lawyers, the possibility of cancellations, and so forth, eventually creeps into the selling price as well.”).

127. *See id.* at 31 (statement of Wilson J. Vance, Secretary, New Jersey State Chamber of Commerce) (“[T]here are very few cases that have [actually come] to trial in the arbitration tribunals, [because] business men have adopted the practice of getting together and settling their business differences.”).

128. *Id.* (statement of Thomas B. Paton, General Counsel, American Bankers Association).

129. GEN. ACCOUNTING OFFICE, GAO/GGD 97-157, ALTERNATIVE DISPUTE RESOLUTION 2 (1997), <http://www.gao.gov/archive/1997/gg97157.pdf>.

130. *Id.* at 18.

131. *See* RICHARD A. BALES, COMPULSORY ARBITRATION 169 (1997) (“Compulsory employment arbitration offers tremendous benefits to both employers and employees. It can reduce significantly the costs and time involved in resolving disputes. It also provides a forum for adjudicating grievances to employees currently shut out of the litigation system.”).

132. *See* Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 DISP. RESOL. J. 44, 51 (Nov. 2003–Jan. 2004) (finding faster case processing in arbitration); Lewis L. Maltby, *The Projected Economic Impact of the Model Employment Termination Act*, 536 ANNALS AM. ACAD. POL. & SOC. SCI. 103, 117 (1994) (finding that legal fees in employment arbitrations were low).

the arbitrations.¹³³ Other studies found similar win rates for individuals in arbitration.¹³⁴ In sum, these research findings provide supporters and critics of mandatory arbitration reason to question their original assumptions about this dispute resolution process.

The explosion of arbitration as a means for resolving employment disputes may stem from its popularity with employers seeking a favorable mechanism for conflict resolution or from its advantages as a cost-saving device.¹³⁵ Regardless of the rationale for the increase in employment arbitration, however, the fact that employment arbitration is so commonly used has implications for my theory of moral hazard.

III. JUDICIAL REVIEW OF ARBITRATION AWARDS

A. OVERVIEW

In this section, I first explain the research methodology for collecting data from court opinions that reviewed arbitration awards. Second, I support the moral hazard thesis by showing that courts that vacate many awards also function like a government insurance agency that relieves a private party of costly liability.

133. See Michael Delikat & Morris M. Kleiner, *An Empirical Study of Dispute Resolution Mechanisms: Where Do Plaintiffs Better Vindicate Their Rights?*, 58 DISP. RESOL. J. 56, 57–58 (Nov. 2003–Jan. 2004) (finding that employees prevail 33.6% of the time in court versus 46.2% of the time in arbitration; that median damages awarded are \$95,554 in court versus \$100,000 in arbitration; and that the average award of attorneys' fees is \$149,756 in court versus \$36,282 in arbitration).

134. See Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate over Predispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RESOL. 559, 564–65 (2001) (“[S]ome evidence suggests that claimants win more cases in arbitration than they do in court”); Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 OHIO ST. J. ON DISP. RESOL. 777, 808, 810 (2003) (arbitrations under AAA’s rules did not reveal bias against employees); William M. Howard, *Arbitrating Claims of Employment Discrimination*, 50 DISP. RESOL. J. 40, 42–43 (Oct.–Dec. 1995) (comparing win rates and award amounts for litigation and arbitration in the securities industry from 1992 to 1994, employees won 28% of nonjury trials, 38% of jury trials, and 48% of arbitrations); Lewis L. Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29, 46 (1998) (finding that employees win 63% of their claims in arbitration and only 14.9% of their claims in litigation).

135. *Arbitration of Interstate Commercial Disputes: Hearings*, *supra* note 123, at 6.

The FAA is supplemented by parallel legislation in nearly every state. These laws, which were based on the Uniform Arbitration Act of 1955 (UAA),¹³⁶ set forth their own reviewing standards for state courts.¹³⁷ State laws usually mirror FAA standards while adding one or more grounds for judicial review of an award.¹³⁸ The Revised Uniform Arbitration Act (RUAA), published in 2000 and later adopted by twelve states,¹³⁹ adds another layer of court review.¹⁴⁰

Federal courts provide additional reviewing standards when they use common law principles to rule on award challenges. Some principles—for example, that the award shall not be made in manifest disregard of the law—are unique common law adjuncts to FAA standards.¹⁴¹

Federal courts also apply an entirely different set of common law reviewing principles. These are standards that the Supreme Court promulgated specifically for voluntary labor arbitration awards. Such arbitrator rulings are unique insofar as they resolve union grievances that allege an employer violation of a labor agreement.

Because labor arbitration is often a quid pro quo for a union's waiver of a right to strike, Congress provided special treatment of these rulings.¹⁴² This was accomplished by enacting § 301 of the Labor Management Relations Act (LMRA), a law that provides federal jurisdiction to enforce collective bargaining agreements (CBAs) and their embedded arbitration clauses.¹⁴³ The privately adopted custom to arbitrate contract disputes, backed by the LMRA, allowed labor arbitration to be-

136. UNIF. ARBITRATION ACT (amended 2000), 7 U.L.A. 95 (1956).

137. See, e.g., MINN. STAT. § 572.19 (2006).

138. See *infra* note 167.

139. See *infra* note 169.

140. See UNIF. ARBITRATION ACT § 23, 7 U.L.A. 73–83 (2000).

141. See *infra* Part III.C.2.

142. See *Textile Workers Union of Am. v. Lincoln Mills of Ala.*, 353 U.S. 448, 455 (1957) (“Plainly the agreement to arbitrate grievance disputes is the quid pro quo for an agreement not to strike.”). Empirical evidence from the 1950s, when union organizing was at a high level, confirms this observation. See BUREAU OF LABOR STATISTICS, U.S. DEP’T OF LABOR, LABOR-MANAGEMENT CONTRACT PROVISIONS 10 (1953) (reporting that eighty-nine percent of 1442 firms covered by a labor agreement had an arbitration provision in their contract); see also ARCHIBALD COX ET AL., LABOR LAW: CASES AND MATERIALS 518 (9th ed. 1980) (estimating that arbitration provisions reflecting this bargained exchange appear in about ninety-six percent of all labor agreements).

143. See Labor Management Relations (Taft-Hartley) Act, ch. 120, § 301(a), 61 Stat. 156 (1947) (codified as amended at 29 U.S.C. § 185(a) (2000)).

come “the means of solving the unforeseeable by molding a system of private law for all the problems which may arise”¹⁴⁴

The point is that court review of these challenged awards occurs under § 301 of the LMRA, rather than the FAA. Section 301 does not specify court reviewing standards, but merely creates federal jurisdiction to enforce a collective bargaining agreement.¹⁴⁵ To address this vague jurisdiction, the Supreme Court articulated standards in the *Steelworkers Trilogy*, three companion decisions that specifically applied to dispute resolution in union-management relations.¹⁴⁶ Despite the unique character of *Steelworkers Trilogy* standards, there are numerous court decisions under the FAA in which these labor-management principles are applied side-by-side with FAA grounds.

While courts are sincere in proclaiming great deference to arbitration in hundreds of cases,¹⁴⁷ many fail to recognize that the FAA’s list of four narrow standards has quietly ballooned over the years. Judges are slow to acknowledge that common law doctrines further expand their powers. Most recently, they have overlooked a new trend in state arbitration law that continues to expand grounds for courts to review awards.

Thus, a snowball effect has been created, and the growing list of reviewing standards is transforming court review into an insurance program that protects arbitration losers—particularly employers—from costly awards.

This is ironic. When legislatures and courts apply non-FAA standards, they may intend to protect the weaker party in arbitration from procedural abuses that were created by the drafter

144. *United Steelworkers of Am. v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 581 (1960).

145. § 301(a), 61 Stat. at § 156.

146. *See Warrior & Gulf Navigation Co.*, 363 U.S. at 582–85; *United Steelworkers of Am. v. Am. Mfg. Co.*, 363 U.S. 564, 566–68 (1960); *United Steelworkers of Am. v. Enter. Wheel & Car Corp.*, 363 U.S. 593, 596–98 (1960).

147. *See, e.g., Durkin v. CIGNA Prop. & Cas. Corp.*, 986 F. Supp. 1356, 1358 (D. Kan. 1997) (noting that arbitrator’s decisions deserve a maximum level of deference). The court in *Durkin* stated that: the standard of review of arbitration awards “is among the narrowest known to law.” It went onto note that: INDFNOnce an arbitration award is entered, the finality that courts should afford the arbitration process weighs heavily in favor of the award, and courts must exercise great caution when asked to set aside an award. Because a primary purpose behind arbitration agreements is to avoid the expense and delay of court proceedings, it is well settled that judicial review of an arbitration award is very narrowly limited. *Id.* (quoting *ARW Exploration Corp. v. Aguirre*, 45 F.3d 1455, 1462–63 (10th Cir. 1995)).

of arbitration agreements.¹⁴⁸ How do employers take advantage of a system that is evolving to curb their unilateral control of arbitration? The moral hazard theory suggests that employers perceive many opportunities to overturn an unacceptable award.¹⁴⁹ This is because courts and legislatures are regulating every aspect of this private dispute resolution process. Thus, more courts are vacating awards. As this occurs, government plays the unwitting role of insurer against adverse awards.

“Government” in this context has a complex meaning. It is not a single government, but four separate and uncoordinated government bodies that regulate arbitration: the 1925 Congress who passed the FAA and its four standards, the federal courts that have developed their own common law for reviewing awards, state legislatures that passed the UAA and RUAA, and state courts that have added their own interpretive doctrines for various facets of award review. Furthermore, these regulatory bodies have never had clear and exclusive boundaries, nor has there been any effort to coordinate this layered approach. For employers, the disjointed patchwork of regulation presents a wide array of reviewing standards that represent a fertile field of possibilities to attack, and perhaps escape, an award.

B. STATUTORY REGULATION: FAA AND STATE LAWS PATTERNED ON THE UAA

The main concern of lawmakers who passed the FAA was to end judicial hostility to arbitration agreements.¹⁵⁰ Congress did not want courts to let parties out of an arbitration agreement and into a lawsuit. Thus, Congress was primarily concerned about court intervention in private disputes before or during the arbitration.

Lawmakers gave only passing thought to arbitration disputes that arise after the ADR process runs its full course and results in an award. The FAA’s brief legislative history said:

148. *See generally* UNIF. ARBITRATION ACT prefatory note, 7 U.L.A. 2–7 (2000) (noting that the drafters considered fundamental fairness and bargaining powers in deciding whether or not to allow waiving of sections of the UAA).

149. *See supra* note 21 (listing sources for an introduction to the moral hazard theory).

150. In the 1924 Senate debate about the FAA, Senator Thomas J. Walsh explained: “In short, the bill provides for the abolition of the rule that agreements for arbitration will not be specifically enforced.” 66 CONG. REC. 984 (1924) (statement of Sen. Walsh). The same point was raised during the House debate of the FAA. *See* 68 CONG. REC. 1931 (1924) (statement of Rep. Graham).

“The award may then 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.”¹⁵¹ In 1924, the Senate created a more complete report, reasoning that an award could be set aside if it was secured by corruption, fraud, or undue means; if there was partiality or corruption on the part of the arbitrators; in a situation where an arbitrator is guilty of misconduct or refused to hear evidence; because of prejudicial misbehavior by the parties; or because the arbitrator exceeded his or her powers.¹⁵² A lawyer’s brief on common law vacatur provided the main outline for judicial reviewing standards in the FAA¹⁵³ and now appears in § 10 of the act.¹⁵⁴

Contemporary courts believe that these grounds are strikingly narrow.¹⁵⁵ The first subsection requires proof of arbitrator fraud or corruption.¹⁵⁶ The second is similarly narrow when it requires proof of evident partiality by the arbitrator.¹⁵⁷ The third basis refers to unlikely events during the arbitration proceedings.¹⁵⁸ A hearing must be scheduled, and a party must request a postponement of the hearing.¹⁵⁹ In addition, the arbi-

151. H.R. REP. NO. 68-96, at 2 (1924).

152. S. REP. NO. 68-536, at 4 (1924).

153. At the joint hearing, Julius Henry Cohen, American Bar Association member of the commerce, trade, and commercial law committee and general counsel for the New York State Chamber of Commerce, provided a brief that was accepted into the record and which stated:

The courts are bound to accept and enforce the award of the arbitrators unless there is in it a defect so inherently vicious that, as a matter of common morality, it ought not to be enforced. This exists only when corruption, partiality, fraud or misconduct are present or when the arbitrators exceeded or imperfectly executed their powers or were influenced by other undue means—cases in which enforcement would obviously be unjust. There is no authority and no opportunity for the court, in connection with the award, to inject its own ideas of what the award should have been.

Arbitration of Interstate Commercial Disputes: Hearings, supra note 123, at 33–36 (statement and brief of J.H. Cohen, General Counsel, New York State Chamber of Commerce). The legislative reports and debates said nothing as to whether postaward and state court litigation rules should be preempted by the new federal law.

154. See Federal Arbitration Act, 9 U.S.C. § 10(a) (2006).

155. *E.g.*, *Baravati v. Josephthal, Lyon & Ross, Inc.*, 28 F.3d 704, 706 (7th Cir. 1997) (“Judicial review of arbitration awards is tightly limited; perhaps it ought not to be called ‘review’ at all.”).

156. 9 U.S.C. § 10(a)(1).

157. *Id.* § 10(a)(2).

158. *Id.* § 10(a)(3).

159. *Id.*

trator must refuse to grant the request for postponement.¹⁶⁰ Assuming that these conditions occur, the party moving to vacate an award must prove that the arbitrator was “guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown.”¹⁶¹ Similar to the first two FAA provisions, vacatur depends on arbitrator misconduct.¹⁶² The other basis in the third vacatur element requires proof that the arbitrator refused to hear evidence pertinent and material to the controversy, or that the arbitrator was guilty of other misbehavior that prejudiced the rights of a party.¹⁶³ The fourth and final ground appears to be the broadest since it refers to arbitrator judgment and discretion.¹⁶⁴ A court may vacate an award where arbitrators exceeded their powers.¹⁶⁵ Alternatively, an award may be vacated for being so indefinite that it is imperfectly executed.¹⁶⁶

In addition, thirty-five states have adopted the UAA, proposed in 1955 to repeal state laws that obstructed arbitration agreements, while fourteen other states have enacted similar legislation.¹⁶⁷ Many state laws contain the four statutory standards in § 10 of the FAA and add a fifth basis to vacate an award.¹⁶⁸

160. *Id.*

161. *See id.* § 10(a)(3).

162. *See id.*

163. *Id.*

164. *Id.* § 10(a)(4).

165. *Id.*

166. *Id.*

167. UNIF. ARBITRATION ACT prefatory note, 7 U.L.A. 2–7 (2000).

168. The Uniform Arbitration Act (UAA) also adds a fifth basis for vacating an award, which the states inherently adopt when codifying the UAA. Section 12, “Vacating an Award,” states that “[u]pon application of a party, the court shall vacate an award where” the award was a result of corruption, arbitrator partiality, where an arbitrator exceeded his or her powers, or where an arbitrator should have postponed a hearing. UNIF. ARBITRATION ACT § 12 (amended 2000), 7 U.L.A. 497 (1956). The UAA vacatur standards have been adopted by many states. *See, e.g.*, ALASKA STAT. § 09.43.120 (2006) (Vacating an Award); ARIZ. REV. STAT. ANN. § 12-1512 (2003) (Opposition to an Award); ARK. CODE ANN. § 16-108-212 (2006) (Vacating an Award); IDAHO CODE ANN. § 7-912 (2004) (Vacating an Award); 710 ILL. COMP. STAT. 5/12 (2007) (Vacating an Award); IND. CODE § 34-57-1-17, 2-13 (2008) (Causes which may be Shown, Vacating an Award); KAN. STAT. ANN. § 5-412 (2001) (Vacating an Award); KY. REV. STAT. ANN. § 417.160 (West 2005) (Vacating an Award); ME. REV. STAT. ANN. tit. 14, § 5938 (2003) (Vacating an Award); MINN. STAT. § 572-19 (2006) (Vacating an Award); MO. REV. STAT. § 435.405 (2000) (Vacating an Award); MONT. CODE ANN. § 27-5-312 (2007) (Vacating an Award); NEB. REV. STAT. § 25-2613 (1995) (Vacating an Award); S.C. CODE ANN. § 15-48-130 (1977) (Vacating an Award); S.D. CODIFIED LAWS § 21-25A-24 (2004)

This fairly uniform approach began to fragment after 2000, when a national panel of experts approved the RUAA. In a 2005 survey of all state laws, the American Arbitration Association reported that twelve states adopted the RUAA.¹⁶⁹ The revised vacatur standards appear in Section 23.¹⁷⁰

The RUAA drafters identified fourteen issues that required updating in contemporary arbitration.¹⁷¹ By regulating arbitrations in more detail, these provisions supply award losers with more grounds to challenge any alteration in procedure. Thus, these new rules function like an insurance policy for award challengers.

The RUAA and UAA drafters said that courts should ensure fairness in arbitration. Thus, the RUAA treats arbitration as a consensual process.¹⁷² The model law also broke new ground by regulating arbitrator neutrality.¹⁷³ It expanded arbitrator powers to order discovery, rule on summary judgment motions, conduct prehearing conferences, and manage arbitration processes.¹⁷⁴ A new rule empowered courts to enforce a preaward ruling.¹⁷⁵

The RUAA drafters also regulated the remedial boundary that overlaps arbitration and courts.¹⁷⁶ A new section prescribed arbitrator powers to order attorney's fees, punitive damages, and other exemplary relief.¹⁷⁷ The RUAA also al-

(Grounds for Vacation of Award); TENN. CODE ANN. § 29-5-213 (2000) (Vacation of Award); VA. CODE ANN. § 8.01-581.010 (2007) (Vacating an Award). Alaska retains the UAA structure, but it also adopted the Revised Uniform Arbitration Act (RUAA). *See* Revised Uniform Arbitration Act, ALASKA STAT. § 09.43.300-.595 (2006).

169. *See* Am. Arbitration Ass'n, *supra* note 62. The states that adopted the RUAA are Alaska, Colorado, Hawaii, Nevada, New Jersey, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Utah, and Washington. *Id.*

170. UNIF. ARBITRATION ACT § 23, 7 U.L.A. 73-83 (2000). The revised vacatur standards, appearing in RUAA section 23, added a sixth element and made other changes in its incorporation of the four FAA standards and the fifth standard in the UAA. *Id.*

171. *Id.* prefatory note, at 1.

172. *Id.* prefatory note, at 1-2 (“[A]rbitration is a consensual process in which autonomy of the parties who enter into arbitration agreements should be given primary consideration, so long as their agreements conform to notions of fundamental fairness.”).

173. *Id.* § 12 (Disclosure by Arbitrator).

174. *Id.* §§ 15, 17 (Arbitration Process, Witnesses; Subpoenas; Depositions; Discovery).

175. *Id.* § 18 (Judicial Enforcement of Preaward Ruling by Arbitrator).

176. *Id.* § 21 (Remedies; Fees and Expenses of Arbitration Proceeding).

177. *Id.* § 21(a)-(b).

lowed courts to award attorney's fees and costs to a prevailing party.¹⁷⁸

In addition, the revised act reaffirmed the need for arbitral finality.¹⁷⁹ Its regulations were meant to facilitate "the relative speed, lower cost, and greater efficiency of the [arbitration] process."¹⁸⁰ In particular, RUAA drafters believed that "in most cases parties intend the decisions of arbitrators to be final with minimal court involvement unless there is clear unfairness or a denial of justice."¹⁸¹

The moral hazard thesis raises a question with respect to the RUAA: did its drafters appreciate the tendency by sore losers in arbitration to challenge the results of their private adjudication? The FAA deters challenges by providing very limited judicial review standards. But the RUAA expanded procedural regulation of arbitration and also broadened the reviewing role of courts. The RUAA, therefore, acts as an implicit insurance program for arbitration losers.

C. COMMON LAW STANDARDS FOR REVIEWING ARBITRATION AWARDS

1. The *Steelworkers Trilogy*

The FAA was enacted in 1925 to enable businesses to settle their disputes in arbitration rather than in court.¹⁸² In 1947, Congress enacted another federal law for arbitration clauses in collective bargaining agreements, though the statute did not provide standards for reviewing arbitration awards.¹⁸³ The Labor Management Relations Act (LMRA) was intended to reduce strikes and friction between unions and employers by creating federal jurisdiction to enforce collective bargaining agreements.¹⁸⁴ Notably, the purposes of the FAA and LMRA are so

178. *Id.* § 25 (Judgment on Award; Attorney's Fees and Litigation Expenses).

179. *Id.* § 25 cmt. n.3 ("Section 25(c) promotes the statutory policy of finality of arbitration awards by adding a provision for recovery of reasonable attorney's fees and reasonable expenses of litigation to prevailing parties in contested judicial actions to confirm, vacate, modify or correct an award.").

180. *Id.* prefatory note, at 1.

181. *Id.*

182. *See* *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24–26 (1991) (explaining the congressional intent in passing the FAA).

183. Labor Management Relations (Taft-Hartley) Act, ch. 120, 61 Stat. 156 (1947) (codified as amended at 29 U.S.C. § 185(a) (2000)).

184. *Textile Workers Union of Am. v. Lincoln Mills of Ala.*, 353 U.S. 448, 455 (1957).

distinct that earlier courts questioned whether labor arbitration awards were reviewable under an arbitration law that was intended for business disputes.¹⁸⁵ The Supreme Court ended this debate by fashioning federal common law principles to review labor arbitration awards.¹⁸⁶ In the *Steelworkers Trilogy*,¹⁸⁷ the Court outlined award reviewing standards.

In terms more vague than the § 10 standards in the FAA, the Court said that “an arbitrator is confined to interpretation and application of the collective bargaining agreement; he does not sit to dispense his own brand of industrial justice.”¹⁸⁸ An arbitrator “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.”¹⁸⁹ By using expressions such as “essence from the collective bargaining agreement”¹⁹⁰ and “own brand of industrial justice,”¹⁹¹ *Enterprise Wheel* left some room for courts to review the merits of an award.

Enterprise Wheel underscored its main theme of deference to the arbitrator when it said that mere ambiguity in the arbitrator’s opinion accompanying an award is not grounds for refusing to enforce that award.¹⁹² Furthermore, an award should not be disturbed unless the arbitrator “has abused the trust the parties confided in him and has not stayed within the areas marked out for his consideration.”¹⁹³ A court should not vacate an award merely because it disagrees with the arbitrator’s construction of the agreement.¹⁹⁴

185. See Donald H. Wollett & Harry H. Wellington, *Federalism and Breach of the Labor Agreement*, 7 STAN. L. REV. 445, 458 (1955) (“[The] applicability of the [FAA] to collective agreements turns upon the construction of the phrase ‘contracts of employment.’ There is disagreement as to whether a collective agreement is a contract of employment. But the weight of authority holds that it is, and therefore that the [FAA] is inapplicable to collective bargaining agreements.”).

186. See *United Steelworkers of Am. v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582–85 (1960); *United Steelworkers of Am. v. Am. Mfg. Co.*, 363 U.S. 564, 566–68 (1960); *United Steelworkers of Am. v. Enter. Wheel & Car Corp.*, 363 U.S. 593, 596–98 (1960).

187. See *Warrior & Gulf Navigation*, 363 U.S. at 582–85; *Am. Mfg. Co.*, 363 U.S. at 566–68; *Enter. Wheel*, 363 U.S. at 596–98.

188. *Enter. Wheel*, 363 U.S. at 597.

189. *Id.*

190. *Id.*

191. *Id.*

192. *Id.* at 598.

193. *Id.*

194. *Id.* at 599 (“[T]he question of interpretation of the collective bargain-

Other *Steelworkers Trilogy* decisions emphasized the unique institutional features of labor arbitration.¹⁹⁵ These points are important insofar as they suggest that FAA and RUA courts should not use *Steelworkers Trilogy* standards to review individual employment awards. *American Manufacturing* noted that the “function of the court is very limited when the parties have agreed to submit all questions of contract interpretation to the arbitrator” because it is “the arbitrator’s judgment . . . that was bargained for.”¹⁹⁶ This suggests that the *Steelworkers Trilogy* Court was referring to voluntary arbitration, where a union and employer agreed to substitute arbitration in place of strikes, lockouts, and other forms of self-help. At the time of the *Steelworkers Trilogy*, these reviewing principles were not intended to apply to mandatory arbitration or in any other nonlabor context.¹⁹⁷

The *Steelworkers Trilogy* has been updated in one essential area when an award appears to contradict a public policy.¹⁹⁸ Intending to limit review of these awards, *United Paperworkers International Union v. Misco* held that awards may be set aside only if they “would violate some explicit public policy that is well defined and dominant, and is to be ascertained by reference to the laws and legal precedents and not from general considerations of supposed public interests.”¹⁹⁹

ing agreement is a question for the arbitrator. It is the arbitrator’s construction which was bargained for; and so far as the arbitrator’s decision concerns construction of the contract, the courts have no business overruling him because their interpretation of the contract is different from his.”)

195. See, e.g., *Steelworkers of Am. v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 581–85 (1960).

196. *United Steelworkers of Am. v. Am. Mfg. Co.*, 363 U.S. 564, 567–68 (1960) (emphasis added).

197. See *Warrior & Gulf Navigation*, 363 U.S. at 581 (“[The arbitrator] is not a public tribunal imposed upon the parties by superior authority which the parties are obliged to accept. . . . He is rather part of a system of self-government created by and confined to the parties.” (quoting Harry Shulman, *Reason, Contract, and Law in Labor Relations*, 68 HARV. L. REV. 999, 1016 (1955))). The Court added that “the labor arbitrator is usually chosen because of the parties’ confidence in his knowledge of the common law of the shop and their trust in his personal judgment to bring to bear considerations which are not expressed in the contract as criteria for judgment.” *Warrior & Gulf Navigation*, 363 U.S. at 582.

198. See *United Paperworkers Int’l Union v. Misco, Inc.*, 484 U.S. 29, 43–45 (1987).

199. *Id.* at 43 (citations omitted). More recently, the Court reaffirmed the principle that judges must demonstrate restraint in reviewing awards. See *E. Associated Coal Corp. v. United Mine Workers of Am.*, 531 U.S. 57, 61–62 (2000) (reminding federal judges that “both employer and union have granted

As discussed below, surprisingly, FAA and RUAA courts use award-review principles from the *Steelworkers Trilogy*. Regardless of whether such borrowing is legally appropriate, I note for purposes of my moral hazard analysis: (1) the *Steelworkers Trilogy* award-review standards—while narrow—are broader than the extremely specific vacatur provisions in the FAA's § 10; and (2) when courts add *Steelworkers Trilogy* grounds in their review of an arbitrator's ruling, award losers gain an extra layer of insurance on top of § 10.

2. Manifest Disregard of the Law

Although *United Paperworks International Union v. Misco*²⁰⁰ was anchored in a labor arbitration context, some courts apply its test when they review individual employment arbitration awards.²⁰¹ In addition, some award-reviewing courts apply a similar though more narrow concept: manifest disregard of the law.²⁰² This common law standard can lead to vacatur.²⁰³

Federal circuit courts are divided in their use of manifest disregard.²⁰⁴ Adopting the standard, the Second Circuit ex-

to the arbitrator the authority to interpret the meaning of their contract's language, including such words as 'just cause' and that the parties 'have bargained for' the 'arbitrator's construction' of their agreement" and therefore "courts will set aside the arbitrator's interpretation of what their agreement means only in rare instances" (internal citations omitted); *see also* Major League Baseball Players Ass'n v. Garvey, 532 U.S. 504, 511 (2001) ("[E]stablished law ordinarily precludes a court from resolving the merits of the parties' dispute on the basis of its own factual determinations, no matter how erroneous the arbitrator's decision."). In *Garvey*, the Supreme Court, frustrated by the Ninth Circuit's meddling, called the court's behavior "nothing short of baffling" and admonished the federal judiciary not to overturn "the arbitrator's decision because it disagree[s] with the arbitrator's factual findings, particularly those with respect to credibility." *Id.* at 510.

200. *Misco, Inc.*, 484 U.S. 29.

201. *E.g.*, *DiRussa v. Dean Witter Reynolds, Inc.*, 121 F.3d 818, 824–25 (2d Cir. 1997).

202. *E.g.*, *LaPrade v. Kidder, Peabody & Co.*, 246 F.3d 702, 706 (D.C. Cir. 2001); *Kanuth v. Prescott, Ball & Turben, Inc.*, 949 F.2d 1175, 1178 (D.C. Cir. 1991).

203. *E.g.*, *DeGaetano v. Smith Barney, Inc.*, 983 F. Supp. 459, 464 (S.D.N.Y. 1997). The court vacated the panel's denial of attorney's fees because the arbitrators "appreciate[d] the existence of a clearly governing legal principle but decide[d] to ignore or pay no attention to it." *Id.* at 464 (quoting *DiRussa*, 121 F.3d at 821).

204. The standard has been adopted by various circuit courts. *See Patten v. Signator Ins. Agency, Inc.*, 441 F.3d 230, 234 (4th Cir. 2006); *Prestige Ford v. Ford Dealer Computer Servs., Inc.*, 324 F.3d 391, 395 (5th Cir. 2003); *Buchignani v. Vining-Sparks IBG*, No. 98-6692, 2000 WL 263344, at *1 (6th Cir. Mar. 2, 2000); *Ainsworth v. Skurnick*, 960 F.2d 939, 940–41 (11th Cir. 1992) (per

plained in *Halligan v. Piper Jaffray, Inc.* that arbitrators cannot “ignore[] the law or the evidence or both.”²⁰⁵ However, the standard does not presume that arbitrators know specific laws.²⁰⁶ Taking a different view, the Seventh Circuit cast doubt on this standard in Judge Posner’s scholarly opinion.²⁰⁷

Many state courts also apply the manifest disregard standard. *Madden v. Kidder Peabody & Co.* explained: “[i]n certain circumstances, the 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.”²⁰⁸

In sum, judicial review of an employment award under the FAA is not limited to federal courts. State courts play a nearly co-equal role. Reading only the FAA, one might believe that courts review employment arbitration awards under the four standards that Congress enumerated in § 10. To the contrary, arbitration losers may present up to thirteen separate arguments for vacating awards.²⁰⁹ Common law standards play a

curiam); *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056, 1060 (9th Cir. 1991); *Drayer v. Krasner*, 572 F.2d 348, 352 (2d Cir. 1978). A Tenth Circuit district court used the standard in *Durkin v. CIGNA Property & Casualty Corporation*, 986 F. Supp. 1356, 1358 (D. Kan. 1997).

205. *Halligan v. Piper Jaffray, Inc.*, 148 F.3d 197, 204 (2d Cir. 1998).

206. In *DiRussa*, an age-discrimination complainant was awarded \$220,000, but his request for attorney’s fees—totaling \$249,050.10—was denied. *DiRussa*, 121 F.3d at 820. In his motion to vacate that part of the award, DiRussa argued that the arbitrators manifestly disregarded the ADEA’s policy for granting attorney’s fees to prevailing plaintiffs. *Id.* at 822. The Second Circuit disagreed, stating that “the remedy for that does not lie with us.” *Id.* at 823. The court further noted that “‘knowing’ all of the provisions of a particular statutory scheme without assistance from the parties is a daunting task, even for a skilled lawyer or judge.” *Id.*

207. See *Baravati v. Josephthal, Lyon & Ross, Inc.*, 28 F.3d 704, 706 (7th Cir. 1994). Judge Posner expressed strong doubts about the manifest-disregard standard by noting that “[w]e can understand neither the need for the formula nor the role that it plays in judicial review of arbitration (we suspect none—that it is just words). If it is meant to smuggle review for clear error in by the back door, it is inconsistent with the entire modern law of arbitration.” *Id.*

208. *Madden v. Kidder Peabody & Co.*, 883 S.W.2d 79, 83 (Mo. Ct. App. 1994) (citing *Advest, Inc. v. McCarthy*, 914 F.2d 6, 10 (1st Cir. 1990)).

209. Such arguments include: (1) manifest disregard of the law (non-*Steelworkers Trilogy* common law standard); (2) exceed powers or imperfectly execute award (9 U.S.C. § 10(a)(4) (2006) or state UAA equivalent); (3) partiality (9 U.S.C. § 10(a)(2) or state UAA equivalent); (4) award violated a public policy (*Steelworkers Trilogy* common law); (5) misconduct (9 U.S.C. § 10(a)(3) or state UAA equivalent); (6) lacks jurisdiction due to timeliness requirements (9 U.S.C. § 12 or state equivalent); (7) arbitrator committed a fact-finding er-

major role in this process. Some are from the *Steelworkers Trilogy*; others, such as manifest disregard for the law, are unique to FAA review. But this odd balkanization is hard to defend. Neither Congress nor the Supreme Court intended federal and state courts to vary so much in the standards that they apply to contested awards.

IV. CASE ANALYSIS AND QUALITATIVE ASSESSMENTS: EXPLAINING THE CONTEXT OF THE STATISTICAL FINDINGS

Part IV features an examination of cases in which courts defied the norm of confirming awards. When combined with the data in Part V, my discussion of the qualitative problems in confirming awards informs the analysis of moral hazard in arbitration.

A. COURTS ALTER THE ARBITRATOR'S REMEDY

In *DaimlerChrysler Corp. v. Carson*, the Michigan Court of Appeals vacated an arbitrator's award of \$915,214 in front pay to an employee who was discharged after a supplier brought a charge against him.²¹⁰ The arbitrator found that DaimlerChrysler breached its express agreement to "conduct a 'fair and thorough investigation' of a supplier's allegations" against the employee before discharging him.²¹¹ The arbitrator ordered the company to reinstate Mr. Carson pending a thorough and fair investigation and to give him back pay from the time of discharge until reinstatement.²¹²

However, after the company failed to reinstate Mr. Carson or to conduct another investigation, the arbitrator awarded the employee \$450,000 in back pay and \$915,214 in front pay, less \$144,000 in mitigation earnings.²¹³ The award was based on

ror (*Steelworkers Trilogy* common law); (8) arbitrary and capricious, irrational, or gross error (non-*Steelworkers Trilogy* common law standard); (9) arbitrator exceeded authority (*Steelworkers Trilogy* common law); (10) award procured by corruption, fraud, or undue means (9 U.S.C. § 10(a)(1) or state UAA equivalent); (11) award did not draw its essence from the agreement (*Steelworkers Trilogy* common law); (12) remedy was punitive, excessive, or unauthorized (non-*Steelworkers Trilogy* common law standard); and (13) unconstitutional or due process challenge (non-*Steelworkers Trilogy* common law standard).

210. See *DaimlerChrysler Corp. v. Carson*, No. 237315, 2003 WL 888043, at *1-2 (Mich. Ct. App. Mar. 6, 2003).

211. See *Id.* at *1.

212. *Id.* at *4.

213. *Id.*

evidence that Mr. Carson sent out nearly five hundred resumes, attended four job fairs, and had eighty-one interviews without finding another permanent job.²¹⁴ The arbitrator determined that the employee's work-life expectancy was age sixty-seven and set this as the endpoint for front pay.²¹⁵

This case is highlighted because the state court appeared to usurp the arbitrator's adjudicatory function. Specifically, the court reviewed DaimlerChrysler's argument that Carson was not entitled to relief beyond nominal damages because he was an at-will employee.²¹⁶ The court ruled that Carson's employment contract fell "between the extremes of at-will and just-cause."²¹⁷ This was a legal ruling on the merits of the parties' contentions at arbitration, as though the judges were the appointed arbitrators.

The court also relitigated another part of the employment dispute when the judges modified the remedy. In vacating the front-pay award, the court reasoned that the arbitrator had no authority to order "damages in lieu of reinstatement."²¹⁸ The court ignored the fact that the company never complied with the original award that ordered reinstatement and a fair investigation. In sum, *Carson* shows how a court intervenes piecemeal to usurp an arbitrator's authority.²¹⁹

B. EXCESSIVE DELAY AND LITIGATION EXPENSE CAUSED BY LOWER COURT VACATUR OF AN AWARD

While vacatur of awards may be justified on rare occasion, it can leave the disputants without a ruling. As discussed below, *Sawtelle v. Waddell & Reed, Inc* highlights a trend in which vacatur prolongs a process that is usually fast and low-cost.²²⁰ In *Sawtelle*, a fired securities broker alleged that his employer maliciously tried to sever his relationship with clients by defaming him.²²¹ The arbitration was lengthy and expen-

214. *Id.*

215. *See id.*

216. *Id.* at *4.

217. *See id.* at *1.

218. *Id.* at *5.

219. The *Carson* opinion conflicts with the idea that a "court cannot interfere with an arbitration proceeding—without abusing its discretion—if a valid arbitration agreement exists and the specific dispute falls within the substance and scope of that agreement." *Smith, Barney, Harris Upham & Co. v. Robinson*, 12 F.3d 515, 520 (5th Cir. 1994).

220. 754 N.Y.S.2d 264 (N.Y. App. Div. 2003).

221. *Id.* at 267–68.

sive.²²² Arbitrators awarded Mr. Sawtelle nearly \$1.83 million in actual damages and \$25 million in punitive damages.²²³

The first state court to rule on Sawtelle's employer's challenge largely confirmed the award.²²⁴ But the New York Court of Appeals vacated the punitive award and remanded the case to the same arbitrators.²²⁵ The judges reasoned that "in awarding \$25 million in punitive damages, the [arbitration] panel completely ignored applicable law, an error that provides a separate basis for vacating the award."²²⁶ They also believed that Sawtelle's award for punitive damages could not be justified under the guideposts of *BMW of North America v. Gore*.²²⁷ Thus, the award manifestly disregarded the law.²²⁸

On remand, the arbitrators "accepted voluminous written submissions, held a one-day hearing, and issued a second award."²²⁹ Their new award contained only one cosmetic change²³⁰ and the same punitive damages.²³¹ When the lower court reviewed the matter again, it vacated the punitive part a second time because of its disproportionate ratio to actual damages.²³²

Concerned that another remand to the same panel would not change anything, the lower court ordered a third arbitration before a new panel.²³³ This prompted Sawtelle to ask the court to order remittitur for the excessive portion of the punitive award and spare him the additional time and expense in re-arbitrating his case.²³⁴ The court conceded that Mr. Saw-

222. *Id.* at 268.

223. *Id.*

224. *Id.* at 269 (noting that the New York State Supreme Court reduced compensatory damages to \$1.08 million but left punitive damages untouched).

225. *Id.* at 276.

226. *Id.* at 273.

227. *Id.* at 270–72 (citing *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559 (1996)).

228. *Id.* at 274.

229. *Sawtelle v. Waddell & Reed, Inc.*, 789 N.Y.S.2d 857, 858 (N.Y. App. Div. 2004).

230. *Id.* (noting that the only change that the panel made was to modify its finding that the employer "orchestrated a campaign of deception" to the phrase that the company "orchestrated and conducted a horrible campaign of deception, defamation and persecution of Claimant").

231. *Id.*

232. *Id.* at 859.

233. *Id.*

234. *Id.*

telle's "suggestion seems to make sense,"²³⁵ and that the "history of this arbitration undermines the very purpose of arbitration . . . to provide a manner of dispute resolution more swift and economical than litigation in court."²³⁶ Still, the lower court denied the motion because no statute authorized a conditional reduction in an award. The court affirmed its earlier order for a third round of arbitration before new arbitrators.²³⁷ Another arbitration odyssey appears in *Selby General Hospital v. Kindig*,²³⁸ a case that began with a contract dispute in February, 1998 and ended in a July, 2006 decision by an Ohio Court of Appeals.²³⁹

C. EXPANDED REVIEW OF AN AWARD

Expanded review clauses may also lead to award nullification. For instance, in *Hughes Training, Inc. v. Cook*, an African-American woman quit her job after her supervisor required her to repeat a performance test and threatened to fire her.²⁴⁰ During a stressful disciplinary meeting, Gracie Cook cried, stuttered, and rubbed her arm.²⁴¹ Her doctor believed that she suffered stress-induced mini-strokes.²⁴² After she sued her employer, Raytheon, in state court on claims that included emotional distress and discrimination, the dispute was submitted to an arbitrator.²⁴³

The arbitrator ruled for the Cooks, granting the former employee \$200,000 in damages for intentional infliction of emotional distress and her husband \$25,000 in damages for loss of consortium.²⁴⁴ Raytheon sued to vacate the award on the

235. *Id.*

236. *Id.*

237. *Id.* at 860.

238. No. 04CA53, 2006 WL 2457436 (Ohio Ct. App. July 17, 2006).

239. *Id.* at *1.

240. 254 F.3d 588, 591–92 (5th Cir. 2001).

241. *Id.* at 591.

242. *Id.*

243. *Hughes Training, Inc. v. Cook*, 148 F. Supp. 2d 737, 741 (N.D. Tex. 2000), *aff'd*, 254 F.3d 588 (5th Cir. 2001). Cook originally filed a complaint in Texas state court alleging intentional infliction of emotional distress in connection with the end of her employment. *Id.* Later, her complaint was amended to include a Title VII discrimination claim and a tort claim on behalf of her husband for loss of consortium. *Id.* After the company moved to compel arbitration of the claims, the parties submitted their dispute to an arbitrator. *Id.*

244. *Id.* The arbitrator determined that the company knew that Cook had previously suffered a stroke when it assigned her back to her former job duties

grounds that the parties bargained for expanded review and the evidence did not support the arbitrator's tort finding. Ms. Cook disagreed, contending that the expanded review clause was "inconsistent with the agreement itself and unconscionable in light of the parties' respective bargaining positions."²⁴⁵

The district court vacated the award, and the Fifth Circuit affirmed the vacatur ruling.²⁴⁶ The district court appeared to re-arbitrate the dispute when it reasoned that Raytheon's treatment of Ms. Cook was not extreme and outrageous conduct.²⁴⁷ Ignoring the finality of the award, the court said that "it was not unfair for the arbitration agreement to include a standard of review that allowed the district court to assess the arbitrator's legal and factual conclusions."²⁴⁸ The Fifth Circuit continued by evaluating the merits of the arbitration case when it reviewed the conduct of Raytheon's supervisor, finding that it was not extreme and outrageous.²⁴⁹

Another arbitration award was nullified as a result of an expanded review clause. A principal of a Christian school sued her administrator and school board for Title VII sexual harassment and whistleblower violations in *Prescott v. Northlake Christian School*.²⁵⁰ A court ordered arbitration after the school presented an employment contract that reflected the parties' agreement to use dispute resolution principles and procedures from the Institute of Christian Conciliation.²⁵¹ The contract incorporated the Montana Uniform Arbitration Act (MUAA)²⁵² and contained the parties' handwritten amendment providing that "[n]o party waives appeal rights, if any, by signing this agreement."²⁵³

upon her return. *Id.* Thus, the arbitrator concluded that the company's treatment of Cook caused her stress, and that placing her in that situation was "extreme and outrageous." *Id.* at 745.

245. *Hughes Training, Inc.*, 254 F.3d at 592.

246. *Id.* at 595.

247. *Id.* at 592 (reporting that the district court "determined that Raytheon's decision to immediately continue Cook's time-sensitive evaluation was not extreme and outrageous conduct").

248. *Id.* at 594.

249. *Id.* at 595 ("Employers cannot be expected to cater to the peculiar sensitivities of an employee who cannot physically work in a stressful environment.").

250. 369 F.3d 491 (5th Cir. 2004).

251. *Id.* at 493.

252. *Id.* The Institute of Christian Conciliation rules and procedures "included conducting the arbitration pursuant to" the MUAA. *Id.*

253. *Id.* at 494.

After Ms. Prescott won her arbitration and was awarded \$157,856.52, the school district returned to federal court to vacate the award.²⁵⁴ The district court denied the motion, interpreting the handwritten amendment to mean that the parties could only appeal under the narrow limits of the Montana arbitration law.²⁵⁵ The Fifth Circuit Court of Appeals disagreed and construed a disputed contract term as ambiguous.²⁵⁶

Ignoring the principle of deferring to awards,²⁵⁷ Judge Edith Jones reasoned that the “FAA . . . does not bar parties from structuring an arbitration by means of their contractual agreements, nor does it preempt all state laws regarding arbitration.”²⁵⁸ Writing that “a contractual modification is acceptable,”²⁵⁹ Judge Jones concluded that the “parties intended judicial review to be available beyond the normal narrow range of the FAA or MUAA.”²⁶⁰

A recent Supreme Court decision on expanded review of an arbitrator’s award would likely have affected the outcome of these cases. In *Hall Street Associates v. Mattel, Inc.*,²⁶¹ a commercial landlord required a manufacturer who leased the property to indemnify the landowner for any environmental liabilities.²⁶² The parties became embroiled in a dispute over liability for pollutants in the well water.²⁶³ After litigating the lease’s termination clause in federal district court, the parties agreed, under the court’s supervision, to arbitrate the indemnification clause.²⁶⁴ Notably, the arbitration agreement contained a provision for expanded judicial review of the award.²⁶⁵

The Supreme Court recognized that arbitration is meant to be flexible—so flexible that parties may “tailor some, even many features of arbitration by contract, including the way arbitrators are chosen, what their qualifications should be, which

254. *Id.*

255. *Id.*

256. *Id.* at 497–98.

257. *Id.* at 494–95.

258. *Id.* at 496.

259. *Id.* (quoting *Gateway Techs., Inc. v. MCI Telecomms. Corp.*, 64 F.3d 993, 996 (5th Cir. 1995), *abrogated by* *Hall St. Assocs. v. Mattel, Inc.*, 128 S. Ct. 1396 (2008)).

260. *Id.* at 498.

261. 128 S. Ct. 1396 (2008).

262. *Id.* at 1400.

263. *Id.* at 1400–01.

264. *Id.* at 1401.

265. *Id.*

issues are arbitrable, along with procedure and choice of substantive law.”²⁶⁶ But the Court ruled that parties cannot agree to expand judicial review of awards beyond the statutory standards in the FAA.²⁶⁷

This ruling likely means that the employment arbitration cases featured in Part V.C and decided in favor of employers who drafted expanded review provisions would be treated differently today. Courts would not enforce these expanded review provisions,²⁶⁸ and consequently, a source for the moral hazard problem would be eliminated. However, because less than two percent of the arbitration contracts in this study’s database had expanded review clauses, much of the moral hazard dilemma is unaffected by *Hall Street*. The larger problem is that courts have added common law standards,²⁶⁹ and some states have expanded review by adopting the RUAAs.²⁷⁰

D. STATE REGULATION OF ARBITRATION PROCEDURES

The FAA does not regulate arbitrator disclosure of conflicts of interest,²⁷¹ but some states do.²⁷² *Ovitz v. Schulman*,²⁷³ an important decision by a California appeals court, shows how a disclosure law leads to vacatur.²⁷⁴ Ms. Schulman never proved

266. *Id.* at 1400–01.

267. *Id.* at 1404 (noting that the text of the FAA “compels a reading of the §§ 10 and 11 categories as exclusive”). Explaining its ruling, the Court observed that reviewing standards in Section 10 of the FAA deal with extreme arbitration misconduct. Thus, the opinion concluded, “‘Fraud’ and a mistake of law are not cut from the same cloth.” *Id.* at 1405.

268. *Id.*

269. *See supra* notes 182–209 and accompanying text.

270. *See supra* notes 169–81 and accompanying text.

271. David Allen Larson, *Conflicts of Interests and Disclosures: Are We Making a Mountain out of a Molehill?*, 49 S. TEX. L. REV. 879, 883 (2008).

272. *See* Ruth V. Glick, *California Arbitration Reform: The Aftermath*, 38 U.S.F. L. REV. 119, 133–36 (2003) (noting that in addition to California, “[a]t least two other states, New York and Texas, have begun to draft legislation regulating arbitrator disclosure”).

273. 35 Cal. Rptr. 3d 117 (Cal. Ct. App. 2005).

274. *Id.* at 118 (citing CAL. CIV. PROC. CODE § 1286.2, subd. (a)(6)(A)) (noting that the vacatur dispute involved the California Ethics Standards for Neutral Arbitrators in Contractual Arbitrations, created in response to a legislative mandate). The arbitration involved a wrongful termination claim by Cathy Schulman, former president of a major film company. *Id.* at 119. During the proceedings, the arbitrator accepted another appointment in a separate arbitration involving the same movie company. *Id.* at 120–21. After the arbitrator denied Schulman’s claims and awarded her former employer approximately \$1.5 million in damages and \$1.9 million in attorney fees and costs, Schulman invoked the disclosure law as grounds for vacating the award. *Id.* at

or tried to show arbitrator bias or evident partiality,²⁷⁵ as the FAA would require.²⁷⁶ She simply made her vacatur case on the arbitrator's unwitting noncompliance with the state's disclosure statute, an easier proof.²⁷⁷ *Ovitz* shows how a court vacates an award for a technicality that is unrelated to proof of actual injury.²⁷⁸

Some state laws also regulate the awarding of attorney's fees in arbitration.²⁷⁹ This is relevant because private arbitration services have rules that authorize this remedy.²⁸⁰ The FAA does not preclude this relief.²⁸¹ Thus, federal courts acting under the FAA confirm awards that order attorney's fees.²⁸² But, Section 21(b) of the RUAA regulates this remedy. It opens the door to award challenges, stating that "arbitrator[s] may award reasonable attorney's fees and other reasonable expenses of arbitration *if such an award is authorized by law in a civil action involving the same claim or by the agreement of the parties to the arbitration proceeding.*"²⁸³ Some state courts vacate awards

121–22. The appellate court found merit in her argument and affirmed the trial court's denial to reconsider its vacatur. *Id.* at 129–30.

275. *Id.* at 135.

276. *Id.* at 131.

277. *Id.* at 122. By contrast, the FAA is silent on the subject of arbitrator disclosures. Larson, *supra* note 271. If Schulman had sued under this law, her prospects of vacating the award would have been highly doubtful. She would have been required to prove that the inadvertent nondisclosure amounted to bias or partiality. *Ovitz*, 35 Cal. Rptr. 3d at 118 (citing Federal Arbitration Act, 9 U.S.C. § 10(a)(2) (2006)).

278. 35 Cal. Rptr. 3d at 128.

279. Michael H. LeRoy & Peter Feuille, *Happily Never After: When Final and Binding Arbitration Has No Fairy Tale Ending*, 13 HARV. NEGOT. L. REV. 167, 192 (2008).

280. See JAMS, JAMS POLICY ON EMPLOYMENT ARBITRATION: MINIMUM STANDARDS OF PROCEDURAL FAIRNESS 2 (2005), http://www.jamsadr.com/images/PDF/Employment_Arbitration_Min_Std.PDF ("All remedies that would be available under the applicable law in a court proceeding, including attorneys fees and exemplary damages, must remain available in the arbitration. Post-arbitration remedies, if any, must remain available to an employee.").

281. Michael H. LeRoy, *Misguided Fairness? Regulating Arbitration by Statute: Empirical Evidence of Declining Award Finality*, 83 NOTRE DAME L. REV. 551, 592–93 (2008).

282. *E.g.*, *Pirooz v. MEMC Elec. Materials, Inc.*, No. 4:05MC521CDP, 2006 WL 568571, at *2, *8 (E.D. Mo. Mar. 7, 2006), *aff'd*, 237 Fed. App'x 125 (8th Cir. 2007) (ordering employer to comply with arbitrator's award granting payment of \$106,832.69 in attorney's fees to the prevailing employee, and increasing the amount due to \$120,253.35 to reflect arbitration costs and pre-judgment interest).

283. UNIF. ARBITRATION ACT § 20, 7 U.L.A. 69 (2000) (emphasis added).

that order employers to pay the attorney's fees of the prevailing employee.²⁸⁴

In addition, states regulate arbitrator awards of punitive damages. Unlike the FAA, the RUAA's Section 21 allows this challenge if the arbitrator's remedy would not be justified in a civil action involving the same claim.²⁸⁵ New York courts used this reasoning to vacate the punitive award in *Sawtelle*.²⁸⁶ In contrast, in an FAA decision that left a punitive award undisturbed,²⁸⁷ a federal judge reasoned that even if arbitrators ignored some evidence, their error was "not so obvious or egregious as to require overturning the award."²⁸⁸

V. EMPIRICAL RESEARCH METHODS AND STATISTICAL RESULTS

A. METHOD FOR CREATING THE SAMPLE

Drawing from methods derived in my earlier empirical studies,²⁸⁹ I used a sample based on Westlaw's Internet service.²⁹⁰ I searched federal and state databases for cases because

284. *Carson v. PaineWebber, Inc.*, 62 P.3d 996 (Colo. Ct. App. 2002) and *Moore v. Omnicare, Inc.*, 118 P.3d 141 (Idaho 2005), are two cases that involve the RUAA statutes that were used to vacate awards of attorney's fees. In *Casedy v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 751 So. 2d 143, 145 (Fla. Dist. Ct. App. 2000), the appellate court reversed the circuit court's vacatur of the arbitrator's order that the employer pay a fired employee \$300,000 in compensatory damages and also \$160,000 in lawyer fees.

285. See UNIF. ARBITRATION ACT § 20, 7 U.L.A. 69 (2000) ("An arbitrator may award punitive damages or other exemplary relief if such an award is authorized by law in a civil action involving the same claim and the evidence produced at the hearing justifies the award *under the legal standards otherwise applicable to the claim.*" (emphasis added)). Emphasis is added because the law places a condition on this arbitrator power, thus limiting arbitrator discretion and creating a new ground for review.

286. *Sawtelle v. Waddell & Reed, Inc.*, 789 N.Y.S.2d 857, 858–60 (N.Y. App. Div. 2004).

287. *Acciaro v. Millennium Secs. Corp.*, 83 F. Supp. 2d 413, 422–23 (S.D.N.Y. 2000).

288. *Id.* at 423.

289. *E.g.*, Michael H. LeRoy & Peter Feuille, *As the Enterprise Wheel Turns: New Evidence on the Finality of Labor Arbitration Awards*, 18 STAN. L. & POL'Y REV. 191, 202–03 (2007); see also Michael H. LeRoy & Peter Feuille, *Private Justice in the Shadow of Public Courts: The Autonomy of Workplace Arbitration Systems*, 17 OHIO ST. J. ON DISP. RESOL. 19, 45–48 (2001) [hereinafter LeRoy & Feuille, *Private Justice*]; Michael H. LeRoy & Peter Feuille, *Reinventing the Enterprise Wheel: Court Review of Punitive Awards in Labor and Employment Arbitrations*, 11 HARV. NEGOT. L. REV. 199, 230–34 (2006).

290. Datasets, programs, and survey commentary are the results of a survey independently completed by the author and not by the *Minnesota Law Re-*

employers and individuals are allowed a choice of forum to contest awards. I also used keywords derived from terms in the FAA, RUAA, and state arbitration laws.²⁹¹

I limited cases to arbitrations involving an individual and employer. Each case involved a post-award dispute in which an arbitrator's ruling was challenged by either an employee or employer. I excluded arbitration cases involving unions and employers because they involve unique characteristics of labor-management relations.²⁹²

The sample began with a 1975 decision²⁹³ and ended with cases from September, 2007. After I identified a potential case, I read it to see if it met the inclusion criteria. For example, I excluded pre-arbitration disputes over enforcement of an arbitration clause. On the other hand, I included cases where employees resisted arbitration, were compelled to arbitrate their claims, and were later involved in a postaward lawsuit.²⁹⁴ Some cases involved employees who preferred court to arbitration but prevailed in the private forum, leading the employer to seek vacatur.²⁹⁵

Once a case met the criteria, I checked it against a roster of previously coded cases to avoid duplication.²⁹⁶ Next, I took relevant data from each case. Variables included: (1) party who won the award; (2) state or federal court; (3) first court ruling on motion to confirm or vacate an award; and (4) appellate rul-

view. Survey results are on file with the author.

291. *E.g.*, "PROCURED BY CORRUPTION," or "EVIDENT PARTIALITY," or "REFUSING TO POSTPONE THE HEARING," or "ARBITRATORS EXCEEDED THEIR POWERS," or "IMPERFECTLY EXECUTED."

292. *See* United Steelworkers of Am. v. Warrior & Gulf Navigation Co., 363 U.S. 574, 581 (1960) ("[T]he grievance machinery under a collective bargaining agreement is at the very heart of the system of industrial self-government.").

293. McClure v. Montgomery County Cmty. Action Agency, No. 4798, 1975 WL 181652 (Ohio Ct. App. Nov. 7, 1975).

294. *E.g.*, Gold v. Deutsche Aktiengesellschaft, 365 F.3d 144, 145 (2d Cir. 2004).

295. For example, in *Madden v. Kidder Peabody & Co.*, 883 S.W.2d 79, 80–81 (Mo. Ct. App. 1994), an employee sued his employer but was ordered by the court to arbitrate his claim. After he prevailed in arbitration and was awarded \$250,000, the employer sued to vacate the award, but the court denied the motion. *Id.*

296. In rare cases, an award was challenged once and remanded to arbitration; after arbitrators ruled again, the award was challenged a second time. *See, e.g.*, Sawtelle v. Waddell & Reed, Inc., 789 N.Y.S.2d 857, 858 (N.Y. App. Div. 2004). Because the awards differed, I treated these award challenges as separate cases, even though the parties and dispute remained the same.

ing, where appropriate. Companion studies²⁹⁷ analyzed other data.

The data form contained a menu of grounds for a party to challenge an award. There were four FAA options, five UAA options (and a sixth possibility contained in the RUAA), five *Steelworkers Trilogy* standards, and five separate federal common law standards.²⁹⁸ The list also included a miscellaneous category for punitive awards, awards with excessive remedies, and awards that violated the Constitution.

B. METHOD FOR COMPARING REVERSAL RATES BY COURTS

As this research progressed, a question emerged: what should be an inappropriate rate for vacating awards? A benchmark was needed to scale whatever vacatur rate is measured. Therefore, as the database grew, research began on similar studies that provide statistical measures of appellate court affirmance or reversal of a lower court or agency ruling.

Comparative data provide a better assessment of whether judicial deference to awards is insufficient, moderate, or excessive. Based on this body of research depicting appellate reversal rates, the study created the following hierarchy of court deference: (A) Extreme Deference²⁹⁹ (affirmance rate of 92.0% or

297. LeRoy & Feuille, *supra* note 279, at 186 tbl.1 (finding a spurt of cases in the federal district courts since 2000 that review employment arbitration awards); LeRoy, *supra* note 281, at 600 (using an earlier database to conclude that states are expanding arbitration reviewing standards, a development that is undermining the national policy favoring arbitration). The present study adds two innovations. Here, the study analyzes awards by the winning party. It computes vacatur rates for awards that were won by employees, and awards won by employers. This empirical question is then related to a new theoretical question: whether judicial review of employment arbitration creates moral hazard.

298. Earlier, I explained the arguments that parties have to challenge employment awards. *See supra* Part IV. But here I enumerate more grounds. The difference is that some arguments are redundant. For example, “the arbitrator exceeded his authority” is an FAA and a *Steelworkers Trilogy* standard. Thus, it is coded in two separate places on the form.

299. *See, e.g.*, Kevin M. Clermont & Theodore Eisenberg, *Plaintiphobia in the Appellate Courts: Civil Rights Really Do Differ from Negotiable Instruments*, 2002 U. ILL. L. REV. 947, 947 (examining appellate court reversal of lower courts in the federal system). In employment discrimination cases, appellate courts reversed less than 6% of wins by employers at trial. *Id.* at 957. This is an extreme example of appellate court deference. A recent study of the Ninth Circuit Court of Appeals provides a second example of extreme judicial deference. *See* Cathy Catterson, *Changes in Appellate Caseload and Its Processing*, 48 ARIZ. L. REV. 287 (2006). This study showed that as the circuit’s caseload mushroomed from 1945 to 2005, appellate courts reversed rulings at

more, or reversal rate of 8.0% or less); (B) Great Deference³⁰⁰ (affirmance rate of 84.0% to 91.9%, or reversal rate of 8.1% to 16.0%); (C) High Deference³⁰¹ (affirmance rate of 76.0% to 83.9%, or reversal rate of 16.1% to 24.0%); (D) Moderate Deference³⁰² (affirmance rate of 68.0% to 75.9%, or reversal rate of 24.1% to 32.0%); (E) Slight Deference³⁰³ (affirmance rate of 60.0% to 67.9%, or reversal rate of 32.1% to 40.0%); or (F) No Deference³⁰⁴ (reversal rate 40.1% or more).

C. STATISTICAL FINDINGS AND QUANTITATIVE ASSESSMENT

The sample had 267 employment arbitration awards that were challenged in federal or state courts. Following a court's ruling, 176 cases were appealed. Overall, 443 court decisions confirmed or vacated awards, or rendered a split ruling.

a far lower rate. *Id.* at 289 tbl.1 (finding that the reversal rate was 32.1% in 1945, 22.5% in 1955, 23.6% in 1965, 21.4% in 1975, 18.2% in 1985, and 9.3% in 1995; the reversal rate in 2005 dropped to 7.4%).

300. See, e.g., James J. Brudney, *A Famous Victory: Collective Bargaining Protections and the Statutory Aging Process*, 74 N.C. L. REV. 939, 965–66 (1996) (analyzing 1224 National Labor Relations Board decisions that were appealed to federal courts). Courts reviewed NLRB decisions with great deference in cases where a union violated the National Labor Relations Act, reversing in only 14.7% of cases. *Id.* at 976 tbl.3.

301. See, e.g., Kimberly A. Moore, *Judges, Juries, and Patent Cases—An Empirical Peek Inside the Black Box*, 99 MICH. L. REV. 365 (2000). Moore found that appeals courts affirmed judge and jury factfinding in patent disputes at the same rate: 78%. *Id.* at 397 tbl.6.

302. See, e.g., Michael H. LeRoy & Peter Feuille, *The Steelworkers Trilogy and Grievance Arbitration Appeals: How the Federal Courts Respond*, 13 INDUS. REL. L.J. 78 (1991). This research analyzed 1148 federal district court decisions and 480 federal circuit court decisions that resulted in a court order that compelled or denied arbitration or that enforced or vacated an arbitrator's award in whole or in part. *Id.* at 98. These decisions were published after June 23, 1960 and before July 24, 1990. *Id.* at 98 n.105. A follow-up study compared this research with reported data for court review of awards from 1991–2001. LeRoy & Feuille, *Private Justice*, *supra* note 289, at 50 tbl.1. In the first study, award confirmation rates by district and appellate courts from 1960–1991 were, respectively, 71.8% and 70.5%. *Id.* The more recent study observed very similar confirmation rates, with district courts enforcing 70.3% of all challenged awards, and appellate courts confirming 66.4% of awards. *Id.*

303. For example, LeRoy & Feuille, *Private Justice*, *supra* note 289, demonstrated slight judicial deference. Federal appeals courts confirmed 66.4% of labor awards. *Id.* at 49.

304. See, e.g., David C. Baldus et al., *Arbitrariness and Discrimination in the Administration of the Death Penalty: A Legal and Empirical Analysis of the Nebraska Experience (1973–1999)*, 81 NEB. L. REV. 486, 506 (2002) (finding that the Nebraska Supreme Court vacated twelve of twenty-nine death penalty sentences for a reversal rate of 41.4%).

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Before proceeding to Table 1, *infra*, I report on the frequency of employer and employee wins at arbitration. The following percentages are not vacatur or confirmation rates. Rather, they show how often employees or employers won at arbitration.

At the federal level, district courts ruled on 160 awards and appeals courts ruled on eighty-three awards. In the district court cases (Table 1), employers had won ninety awards at arbitration (56.3%). Individuals had won fifty-five awards (34.4%) and split awards in the remaining fifteen cases (9.3%). In federal appellate decisions (Table 3), employers had won fifty-six awards at arbitration (67.5%). Employees had won twenty awards (24.1%) and split awards in seven cases (8.4%).

At the state level, the sample had 107 rulings from first-level courts (Table 2)³⁰⁵ and ninety-three rulings from appellate courts (Table 4). Employers had won arbitration awards in forty-seven of the cases at the first level, or 43.9% of the challenged awards in this category. Individuals had won forty-nine awards (45.8%) and split awards in the remaining eleven cases (10.3%). In state appellate decisions, employers had won forty-five awards at arbitration (48.4%). Employees had won thirty-nine awards (41.9%) and had split awards in nine cases (9.7%).

Table 1				
Federal District Court Review of Arbitration Awards:				
Vacatur of Employee and Employer Wins				
	Confirm Award	Partly Confirm Award	Vacate Award	Total
<i>Employer Wins Award</i>	83 92.2%	1 1.1%	6 6.7%	90
<i>Split Award</i>	14 93.3%	0 0%	1 6.7%	15
<i>Employee Wins Award</i>	51 92.7%	2 3.6%	2 3.6%	55
<i>Total</i> $\chi^2 2.063$, $df = .724$	148 92.5%	3 1.9%	9 5.6%	160

305. States use different names for courts that conduct first review of awards (e.g., circuit court, superior court). Here, these tribunals are generically called "first-level courts".

Table 2
State First-Level Court Review of Arbitration Awards:
Vacatur of Employee and Employer Wins

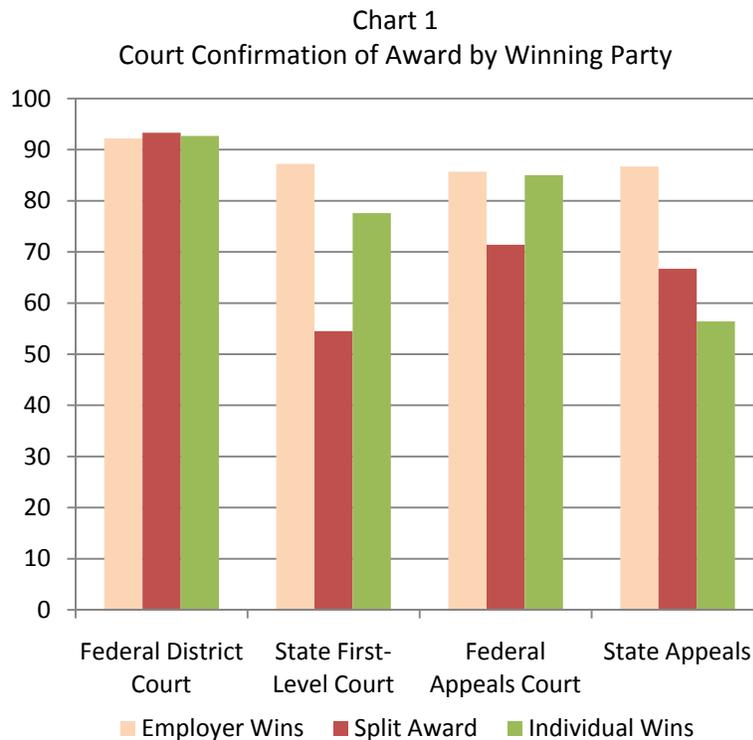
	Confirm Award	Partly Confirm Award	Vacate Award	Total
<i>Employer Wins Award</i>	41 87.2%	0 0%	6 12.8%	47
<i>Split Award</i>	6 54.5%	2 18.2%	3 27.3%	11
<i>Employee Wins Award</i>	38 77.6%	1 2.0%	10 20.4%	49
<i>Total</i> $\chi^2 13.351$, $df = 4, .010$	85 79.4%	3 2.8%	19 17.8%	107

Table 3
Federal Appellate Court Review of Arbitration Awards:
Vacatur of Employee and Employer Wins

	Confirm Award	Partly Confirm Award	Vacate Award	Total
<i>Employer Wins Award</i>	48 85.7%	0 0%	8 14.3%	56
<i>Split Award</i>	5 71.4%	0 0%	2 28.6%	7
<i>Employee Wins Award</i>	17 85.0%	3 15.0%	0 0%	20
<i>Total</i> $\chi^2 13.831$, $df = 4, .008$	70 84.3%	3 3.6%	10 12.0%	83

Table 4
State Appellate Court Review of Arbitration Awards:
Vacatur of Employee and Employer Wins

	Confirm Award	Partly Confirm Award	Vacate Award	Total
<i>Employer Wins Award</i>	39 86.7%	1 2.2%	5 11.1%	45
<i>Split Award</i>	6 66.7%	1 11.1%	2 22.2%	9
<i>Employee Wins Award</i>	22 56.4%	7 17.9%	10 25.6%	39
<i>Total</i> $\chi^2 10.553$, $df = 4, .032$	67 72.0%	9 9.7%	17 18.3%	93



Finding No. 1: All courts consistently confirmed awards at extremely high levels when employers won the arbitration. Federal district and appellate courts confirmed, respectively, employer-winning awards in 92.2% (Table 1) and 85.7% (Table 3) of the cases. The difference in these confirmation rates was small (6.5 percentage points). State courts behaved similarly, confirming employer wins in 87.2% (Table 2) and 86.7% (Table 4) of first-level and appellate rulings. Comparing state confirmation rates, there was virtually no difference between first-level and appeals courts (0.5 percentage points).

Finding No. 2: Federal courts ruled similarly on employee and employer wins at arbitration. Federal district courts treated employee wins at arbitration the same as employer victories. As shown in Table 1, judges confirmed 92.7% of wins for employees and 92.2% of wins for employers. Table 3 illustrates that federal appeals courts confirmed 85.7% of employer wins, which matched the percentage of pro-employee awards (85.0%).

Finding No. 3: Federal courts were consistent in their extremely high deference to awards, confirming only slightly more awards at the district level. Comparing awards that favored employers, the overall difference between district and appellate court confirmation rates was 6.5 percentage points.³⁰⁶ In the same comparison for awards that favored employees, the difference between district and appellate court confirmation rates was 7.7 percentage points.³⁰⁷

Finding No. 4: State courts overturned more awards than federal courts. As shown in Table 2, judges enforced only 77.6% of employee wins in state courts where awards were first challenged. This moderately high confirmation rate was 14.6% less than federal district courts (Compare Table 1, Cell for Employer Wins, 92.2%). This difference was statistically significant.³⁰⁸

Finding No. 5: State courts were inconsistent in reviewing awards, as their appellate courts confirmed fewer arbitrator rulings than their first-level courts. Comparing awards that ruled for employers, state courts ruled the same in first-level (87.2%) and appellate cases (86.7%).³⁰⁹ In the same comparison for awards that favored employees, the state confirmation rate fell 21.2 percentage points—from 77.6% at first-level courts in Table 2 to 56.4% for appellate courts in Table 4.

Finding No. 6: State appellate courts vacated many more wins for employees than for employers. Comparing award enforcement at the appellate level, Table 4 illustrates that state courts confirmed 86.7% of proemployer awards but only 56.4% of employee wins at arbitration. This difference was statistically significant.³¹⁰

306. Compare *supra* tbl.1 (showing that federal district courts confirmed 92.2% of employer wins), with *supra* tbl.3 (demonstrating that federal appellate courts confirmed 85.7% of employer wins).

307. Compare *supra* tbl.1 (illustrating that federal district courts confirmed 92.7% of employee wins), with *supra* tbl.3 (showing that federal appellate courts confirmed 85.0% of employee wins).

308. See *supra* tbl.2 (chi-squared = 13.351 with 4 degrees of freedom, implying that the difference in rates would not likely occur by chance).

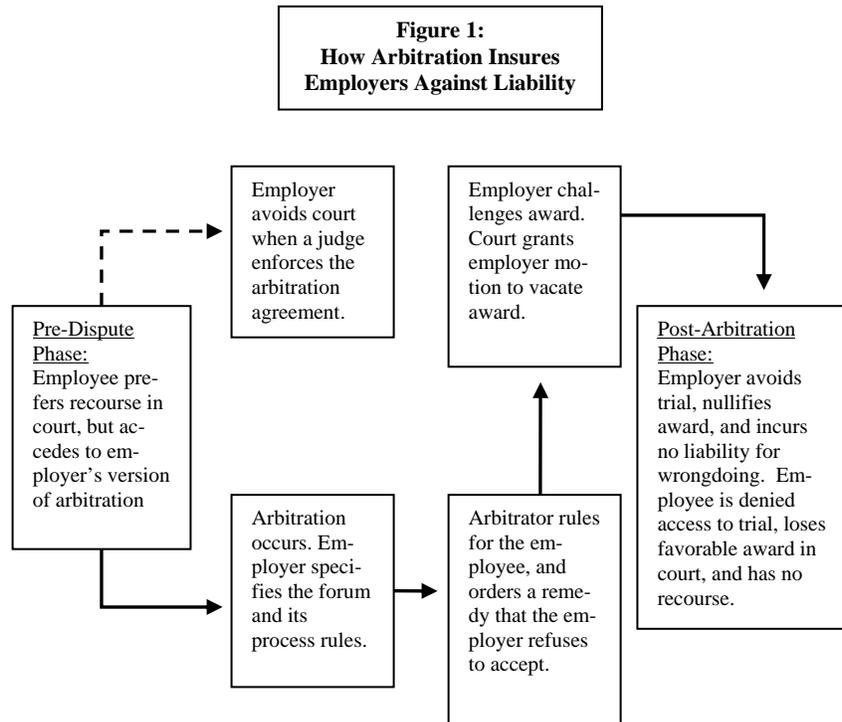
309. Compare *supra* tbl.2, with *supra* tbl.4 (showing that state courts rule the same in first-level and appellate cases).

310. See *supra* tbl.4 (implying that the difference in rates would not likely occur by chance with a calculated chi-squared value of 10.553 with 4 degrees of freedom).

VI. TWO SOLUTIONS

A. STATE COURTS CREATE MORAL HAZARD BY VACATING A HIGH PERCENTAGE OF EMPLOYEE WINS AT ARBITRATION

Although the FAA envisioned that courts would rarely vacate awards, this Article suggests that state courts interfere with arbitration outcomes more often than Congress envisioned. I postulate that these intrusions encourage employers to focus on defecting from the promise of offering arbitration as a forum substitute. The possibility now exists for employers to take fewer precautions against unlawful conduct that risks liability. My thesis is that vacatur courts function like an insurance agency by relieving at-fault employers of liability. Figure 1 conceptualizes this form of moral hazard.



Courts in this study also vacated some awards in favor of *employers*, though this very small percentage seems to be in

line with congressional intent that judges defer to arbitrators.³¹¹ Still, this result raises the potential for moral hazard because employers tend to be “repeat players” in arbitration.³¹² In contrast, individuals are one-shot players who have no strategic incentive to learn from this experience.³¹³ I theorize, as a corollary to my main thesis, that even when employers lose an award due to vacatur, the experience may teach them how to vacate employee wins in the future. Whether employers insert a clause for expanded court review of the arbitration, or are simply aware of the many grounds to challenge an adverse award, they understand arbitration better than employees.

This reality contrasts with a trend that began to favor employees in the 1970s. Consider workers who challenge an employer action—for example, termination—by arbitrating a contract grievance *and* suing separately under a discrimination statute. In *Alexander v. Gardner-Denver Co.*, the Supreme Court concluded that an employee’s statutory right to a trial under Title VII is not foreclosed by the prior submission of his discrimination claim to final and binding arbitration under a collective-bargaining agreement.³¹⁴ This phenomenon is described as “two bites at the apple” because a claimant is allowed to bring a similar claim on the same facts in two separate forums.³¹⁵

The moral hazard depicted in Figure 1 creates the opposite dilemma: “no bites at the apple” for some claimants. This outcome plainly violates *Gilmer’s* assumption of forum substitution. How else can one interpret the results for state appellate courts, which confirmed only 56.4% of proemployee awards?³¹⁶ Is this not evidence of “judicial hostility” to arbitration—the very antithesis of congressional intent when the FAA was

311. See *supra* tbls.1, 2, 3 & 4 (illustrating that, when an employer won in arbitration, federal district courts vacated only 6.7% of the awards, state district courts vacated 12.8%, federal appellate courts vacated 14.3%, and state appellate courts vacated 11.1%).

312. See Bingham, *supra* note 55.

313. See, e.g., Kenneth G. Dau-Schmidt & Timothy A. Haley, *Governance of the Workplace: The Contemporary Regime of Individual Contract*, 28 COMP. LAB. L. & POL’Y J. 313, 330 (2007) (“It has long been known in the legal literature that, when one side to a controversy is a repeat player and the other side is a ‘one-shot player,’ the law evolves to inefficient rules that favor the repeat player.”).

314. 415 U.S. 36, 49 (1974).

315. See *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 310 (2002) (Thomas, J., dissenting).

316. See *supra* tbl.4.

enacted?³¹⁷ When courts vacate awards so often as to invite challenges, the promise of final and binding arbitration erodes.

Figure 1 conceptualizes this moral hazard problem. Box 1 diagrams the diversion of the litigation stream following *Gilmer*'s broad approval of mandatory arbitration. But *Gilmer* failed to anticipate so much sore losing by employers, who are shown in this study to profit by contesting "final and binding" awards.

Consider the recent experience of DaimlerChrysler employees in Michigan.³¹⁸ Consistent with Box 1 of Figure 1, the company set up an employee dispute resolution program (EDRP).³¹⁹ As shown in Box 2, the employee submitted the dispute to the company's arbitration forum.³²⁰ The arbitrator ruled for the employee as demonstrated by Box 3.³²¹ The award in one of the DaimlerChrysler employee cases, *DaimlerChrysler Corp. v. Carson*, ordered \$450,000 in back pay and \$915,214 in front pay,³²² but as Box 4 illustrates, the Michigan Court of Appeals vacated the front-pay award.³²³

I suggest that DaimlerChrysler learned how to use Michigan's courts to circumvent adverse employment awards—an ironic result because the courts rewarded DaimlerChrysler for defecting from the arbitration system that the company intended as a binding alternative to a trial.

Now consider *DaimlerChrysler Corp. v. Porter*, a recent Michigan appellate decision that affirmed the trial court's vacation of another arbitrator's award in favor of an employee.³²⁴ Ernest Porter was terminated for falsifying his time records.³²⁵ Mr. Porter was subject to DaimlerChrysler's EDRP (Box 1).³²⁶ Thus, his claim went to arbitration instead of to court (Box

317. See *supra* note 155 and accompanying text; see also *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991) ("[The FAA's] purpose was to reverse the longstanding judicial hostility to arbitration agreements that had existed at English common law and had been adopted by American courts, and to place arbitration agreements upon the same footing as other contracts.").

318. See, e.g., *DaimlerChrysler Corp. v. Porter*, No. 270112, 2006 WL 3019682 (Mich. Ct. App. Oct. 24, 2006); *DaimlerChrysler Corp. v. Carson*, No. 237315, 2003 WL 888043 (Mich. Ct. App. Mar. 6, 2003).

319. *Porter*, 2006 WL 3019682, at *1.

320. *Id.*

321. *Id.*

322. 2003 WL 888043, at *1.

323. *Id.* at *5.

324. *Porter*, 2006 WL 3019682, at *2–3.

325. *Id.* at *1.

326. *Id.*

2).³²⁷ The arbitrator found that the company treated Mr. Porter differently from co-workers and had no cause to fire him (Box 3).³²⁸ But the lower court vacated the award, reasoning that the arbitrator exceeded his authority by ignoring relevant law, and its decision was affirmed on appeal (Box 4).³²⁹

This brief discussion shows that DaimlerChrysler avoided two trials, nullified all or most of two adverse awards, and incurred very limited liability for its wrongdoing as found in two *Gilmer* forum substitutes (Box 5). These courts nullified the judgments of arbitrators who, as surrogate judges, ordered damages for employees. The workers continued to be denied access to trials. They were left with no meaningful recourse after this lengthy process. Their *Gilmer* forum substitute was an empty promise.

Federal courts are not part of the problem. District and appellate courts behaved the same. Respectively, they confirmed 92.5%³³⁰ and 84.3%³³¹ of challenged awards, whether individuals or employers prevailed in the arbitration. Compared to other appellate benchmarks that I describe in Part VI.B, federal district courts used “extreme deference,”³³² and federal appeals courts exercised “great deference.”³³³

But state courts violated the FAA’s policy of ensuring finality of awards. In first-round challenges, state judges enforced only 77.6% of employee-favorable awards.³³⁴ Compared to benchmarks of other courts that exercised first-level review of adjudicatory rulings, state judges barely fell into the intermediate category of “high deference.”³³⁵ Far worse, state appellate judges were indifferent to the norm of award finality, vacating about half (56.4%) of the awards that ruled in favor of employees.³³⁶ Comparative research puts this level in the “no deference” category.³³⁷

327. *Id.*

328. *Id.*

329. *Id.* at *2–3.

330. *See supra* tbl.1.

331. *See supra* tbl.3.

332. *See supra* note 299 and accompanying text.

333. *See supra* note 300 and accompanying text.

334. *See supra* tbl.2.

335. *See supra* note 301 and accompanying text.

336. *See supra* tbl.4.

337. *See supra* note 304 and accompanying text.

B. TOWARD A SOLUTION: POLICIES TO REDUCE MORAL HAZARD

A solution is needed for the growing “moral hazard” problem of employer avoidance of public *and* private forums that would otherwise hold them liable for wrongful conduct. This study shows that arbitration is saddled with ever-expanding grounds to overturn an award. Ostensibly, each new ground intends to improve arbitration. But with each safeguard, courts weaken the legal backing for promises to arbitrate a dispute.

The current award-review regime does not serve its intended purposes. My Article concludes with two policy proposals that attempt to reduce moral hazard by creating stronger barriers to vacating awards.

1. Return to the Simplicity of the FAA’s Extremely Narrow Standards for Vacating Awards.

My empirical analysis shows that courts apply a hodge-podge of standards to review awards—including judicial tests from the FAA, UAA, RUAA, *Steelworkers Trilogy*, and common law. One possibility is to reenact the FAA with its original § 10 award review standards—with the new wrinkle of a broad and explicit preemption clause that displaces all state arbitration reviewing standards.

The FAA was enacted with no preemption clause. Indeed, the Supreme Court has remarked that “The Arbitration Act is something of an anomaly in the field of federal-court jurisdiction. It creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate, yet it does not create any independent federal-question jurisdiction”³³⁸

The findings in this Article cast a troubling light on the mysterious relationship between state and federal courts as they co-administer the FAA. Congress should adopt a preemption clause for the FAA’s § 10 reviewing standards and create exclusive jurisdiction in federal courts for award appeals. Preemption language from the Employee Retirement and Security Act (ERISA) would provide an appropriate model to ensure the supremacy of federal vacatur standards.³³⁹

338. *Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 25 n.32 (1983).

339. See 29 U.S.C. § 1144(a) (2000) (providing that the statute shall “supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan”).

The data suggest that this approach would reduce the moral hazard problem by eliminating the growing underbrush of state regulation of arbitration. The findings in this study show that when federal courts review awards, vacatur rates in district and appellate courts average about ten percent, with little difference in outcomes for pro-employee or pro-employer awards. Moreover, current pronouncements by the Supreme Court—including decisions in the 2008 term—show a marked trend toward eclipsing a patchwork of state regulations in fields where federal laws have been enacted.³⁴⁰ Indeed, the gist of my legislative proposal was supported in the current term, when the Court stated in *Preston v. Ferrer* that “The [FAA], which rests on Congress’s authority under the Commerce Clause, supplies not simply a procedural framework applicable in federal courts; it also calls for the application, in state as well as federal courts, of federal substantive law regarding arbitration.”³⁴¹

2. Compel Employers to Pay Up Front When They Seek to Vacate Awards.

While arbitration is a substitute for courts, private and public tribunals have different powers to execute their judgments. Awards depend on voluntary compliance for their execution. Otherwise, a winning party must sue on the award to secure a compulsory order. In contrast, a party who prevails in a state civil trial may be able to secure immediate relief—prior to any appeal taken by the loser—to secure compliance with the judgment. In other words, a party who loses at trial may be required to pay immediately.

Consider *Pennzoil Co. v. Texaco, Inc.*³⁴² After Pennzoil reached an agreement to purchase Getty Oil Co., Texaco upset the deal by topping Pennzoil’s purchase price.³⁴³ Pennzoil sued

340. See *Rowe v. N.H. Motor Transp. Ass’n*, 128 S. Ct. 989, 996 (2008) (“And to interpret the federal law to permit [a special checking system for carriers], and similar, state requirements could easily lead to a patchwork of state service-determining laws, rules, and regulations.”); see also *Riegel v. Medtronic, Inc.*, 128 S. Ct. 999, 1008 (2008) (“State tort law that requires a manufacturer’s catheters to be safer, but hence less effective, than the model the FDA has approved disrupts the federal scheme no less than state regulatory law to the same effect.”).

341. 128 S. Ct. 978, 981 (2008).

342. 481 U.S. 1 (1987).

343. *Id.* at 4.

in state court, claiming tortious breach of contract.³⁴⁴ A jury ruled for Pennzoil, finding actual damages of \$7.53 billion and punitive damages of \$3 billion.³⁴⁵ Under Texas Rule of Civil Procedure 346(b), Texaco was required to post a \$13 billion judgment bond as a condition for appealing the ruling.³⁴⁶ Moreover, under the lien and bond provisions of Texas law, Pennzoil had a right to commence enforcement of its judgment on the verdict before Texaco resolved its appeals.³⁴⁷ These post-judgment laws immediately cost Texaco; quickly, its stock fell, and the firm had credit and bond-rating problems.³⁴⁸

Compare *Pennzoil* to *Castleman v. AFC Enterprises, Inc.*, another Texas case.³⁴⁹ After removal to federal court, Castleman and the AFC franchisee agreed to submit the fast-food worker's claims to arbitration, and she was awarded \$1,678,622.40 in damages.³⁵⁰ The employer appealed and lost its motion to vacate the award.³⁵¹

Nonetheless, the case shows how the vacatur process can contribute to moral hazard. AFC Enterprises had a cost-free appeal, while Texaco encountered immediate problems due to an adverse court judgment. If, as a matter of law, winners and losers in arbitration were treated like judgment creditors and debtors, arbitration losers would feel an immediate consequence for conduct that created liability. An arbitration-review law patterned on Texas' Rule of Civil Procedure 364(b) would immediately cost an award loser for appealing the private order. Vacatur would become a costly bet by the award loser. In the *AFC Enterprises* example, the employer would recoup its bond only if its appeal had merit.

The point is that an award with up-front costs for making a challenge would strengthen award finality. This would address the "no bites at the apple" phenomenon. It would also strengthen forum substitution by treating a loser's challenge to an arbitrator's award and a loser's appeal of a court judgment identically. The current practice, in contrast, allows employers

344. *Id.*

345. *Id.*

346. *Id.* at 5; see also TEX. R. CIV. P. 364(b) (repealed 1986) (current version at TEX. R. APP. P. 24).

347. *Pennzoil Co.*, 481 U.S. at 4-5.

348. *Id.* at 5.

349. 995 F. Supp. 649 (N.D. Tex. 1997).

350. *Id.* at 651.

351. *Id.* at 651, 654.

to make a cost-free appeal. This buys time and either postpones or reverses judgment. As a result, award finality erodes.

CONCLUSION

Earlier, I posed a quandary surrounding an employer's successful challenge to an award that was ostensibly meant to be final and binding. Because the employer had also inserted a clause for expanded review of the award, the employer took a second bite at the apple—and eventually prevailed. The employee was denied a trial, as well as her victory at an arbitration that she initially resisted. I suggested that this protracted process created moral hazard because the employer used court review of an award to avoid the consequences of violating the rights of its employee.

Consider, now, the bigger picture that frames my moral hazard thesis. Arbitration offers reduced cost, simplicity, and easy accessibility to disputants. But after *Gilmer*, the process was derided because of concerns that employees would not be treated fairly. Statistical evidence in this study shows, however, that employees win all or part of their claims in nearly fifty percent of arbitrations. But the benefits of employment arbitration will not be achieved until the growing vacatur problem—and its attendant quality of “re-arbitrating” disputes that were meant for final and binding resolution—is addressed. As courts increasingly vacate awards in employees' favor, the individual must either engage in costly “do over” arbitration or be stuck with a useless award because *Gilmer* bars employees from suing.

This type of court interference is contrary to the intent of the FAA. When Congress enacted the FAA, it built a simple structure to house arbitration and insulate awards from the harsh winds of judicial interference. The “house” was renovated in 1955, with adoption of the UAA, and it was remodeled again with the RUAA in 2000. On a smaller scale, courts have also built upon the modest shelter that Congress created for arbitration awards in 1925. I argue that this simple home is now creaking under weighty additions that overburden the core FAA structure. Until Congress undertakes a systematic effort to fix this leaning structure, by coordinating and simplifying award review, the FAA's “home” for arbitration awards in § 10 will begin to topple on itself. Meanwhile, courts are creating moral hazard by tempting employers to avoid the consequences

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of their unlawful actions and renege on their contractual promise to resolve disputes in final and binding arbitration.

In this Article's exploration of answer four to the quandary I posed in the Introduction, I examined the implications of this finding of moral hazard, concluding that the current award structure does not serve its goals and that two public policy solutions offer the best chance of remedying a failing arbitral regime.