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**DO COURTS CREATE MORAL HAZARD?  
WHEN JUDGES NULLIFY EMPLOYER LIABILITY IN ARBITRATIONS:  
AN EMPIRICAL ANALYSIS**

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### *Summary*

State courts are creating conditions for moral hazard in the arbitration of employment disputes. The problem begins when employers compel individuals to arbitrate their legal claims, denying them access to juries and other benefits of a trial. This empirical study identifies a disturbing trend. State courts vacated many arbitration wins for employees, but not for employers. My database has 443 federal and state court rulings from 1975-2007. Remarkably, state appellate courts confirmed only 56.4% of employee wins in arbitration. But when the same courts ruled on employer victories, they confirmed 86.7% of awards. The difference in rates was statistically significant. Similarly, federal appeals courts upheld 85.7% of employer wins. Lower courts behaved like appellate courts. These state courts confirmed only 77.6% of employee wins, while federal district judges enforced 92.7% of these awards.

The lopsided results suggest a moral hazard. When courts vacate many awards that rule for employees, the individual must either return to a lengthy and costly “do over” arbitration— or worse, be stuck with a useless award, and no other recourse because *Gilmer v. Interstate/Johnson Lane Corp.* bars employees from suing.

Throughout this Article, the reader will sense snowballing futility for employees. The problem is that the number of award reviewing standards is growing, due to new state laws and creeping expansion of common law standards. This causes judges to deviate from the FAA’s extremely deferential principles. As a result, court review is becoming an insurance program that protects employers from costly awards. This poses a moral hazard, as judges reduce incentives for employers to be responsible for their actions. Because *Gilmer* permanently bars employees from suing, employers are double-insulated from being held to account for their unlawful conduct.

This trend undermines the purpose of the Federal Arbitration Act (FAA). The law meant to end court interference with awards. *Gilmer* reinforced this view by stating a theory of forum substitution— the idea that by “agreeing to arbitrate a statutory claim, a party . . . submits to their resolution in an arbitral, rather than a judicial, forum.” After *Gilmer*, employers adopted mandatory arbitration to control litigation costs and liability. But the data raise new doubts about forum substitution. Courts interfere with arbitration more than the FAA or *Gilmer* envisioned.

I propose two solutions. Judicial review of awards in all courts should be limited to the four explicit FAA standards. This would free arbitration from court interference, just as Congress intended. Indeed, the gist of my legislative proposal was supported in the current term of the Supreme Court, when *Preston v. Ferrar* said: “The Act (FAA), which rests on Congress’ 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.” Second, arbitration losers who incur liability should be required to post judgment bonds if they challenge an award. This idea borrows from civil procedure codes, and is therefore consistent with the goal of forum substitution. The current practice erodes award finality by allowing employers to make cost free appeals. Arbitration offers attractive benefits: reduced cost, simplicity, and easy accessibility to disputants. But these benefits will not be achieved until the growing vacatur problem— and its attendant quality of relieving employers of liability for unlawful behavior— is addressed.

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## I. INTRODUCTION

## A. Overview: Moral Hazard in Arbitration

Identify the moral dilemma in the following scenario. Responding to rising litigation costs,<sup>1</sup> and soaring liability from employment lawsuits,<sup>2</sup> a large company compels its employees 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.<sup>3</sup> A clause in the agreement provides, however, for *de novo* court review of an arbitration award—a ruling by the arbitrator.<sup>4</sup>

Eventually, an employee sues the company over a workplace dispute. The court

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<sup>1</sup> See Gillian K. Hatfield, *The Price of Law: How the Market for Lawyers Distorts the Justice System*, 98 MICH. L. REV. 953 (2000), providing detailed empirical estimates of litigation costs. The minimum cost to litigate a business claim is \$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; and the cost of action for summary judgment is \$18,000. *Id.* at 958.

<sup>2</sup> See Mary B. Rogers & Kimberly A. O'Sullivan, *Image Discrimination: Is that Advertising Campaign Really Worth It?*, METROPOLITAN CORP. COUNSEL NORTHEAST ED. (November 2006) (Abercrombie & Fitch paid \$50 million in 2005 to settle race discrimination lawsuit that 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); Caren Chesler, *Wall Street's Catch-22: Its Managers Keep Tripping over Their Own Feet in Female/Minority Hiring and Firing*, INVESTMENT DEALERS' DIGEST (Sept. 19, 2005) (Morgan Stanley settled sex discrimination lawsuit filed by the EEOC for \$54 million in July 2004); Kathy Bergen & Carol Kleiman, *Mitsubishi Will Pay \$34 Million*, CHI. TRIB., June 12, 1998, at 1 (reporting that car maker agreed to pay \$34 million to settle class action lawsuit claiming sexual harassment); Henry Unger, *17 Coke Class-Action Parties Planning Individual Suits*, ATLANTA J.-CONST., July 7, 2001, at 3F (reporting that a judge approved Coca-Cola's \$192.5 million settlement of a class action employment discrimination lawsuit), available at 2001 WL 3681156; 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); and *Record \$300M Agreement in State Farm Sex-Bias Suit*, NEWSDAY, Jan. 20, 1988, at 45 (reporting that the insurance company agreed to pay 1,100 female employees up to \$300 million to settle a sex discrimination lawsuit).

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

<sup>4</sup> *E.g.*, *Hughes v. Cook*, 254 F.3d 588 (5th Cir. 2001), in which a mandatory employment arbitration agreement modified the usual standard for reviewing an award, stating: "Either 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." *Id.* at 590.

dismisses her lawsuit, and orders arbitration of her legal claims.<sup>5</sup> The judge cites the Supreme Court's strong precedents favoring enforcement of arbitration agreements.<sup>6</sup> The arbitration agreement drafted by the employer names the provider of arbitration services, and sets procedural rules for the private adjudication.<sup>7</sup>

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.<sup>8</sup> Appealing the award to court, the employer invokes the expanded review clause in the arbitration agreement. The court vacates the award,<sup>9</sup> leaving 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?

1. The employer compelled its employee to forego access to the courts, depriving her access to a jury trial.<sup>10</sup>
2. In substituting arbitration for a court, the employer took advantage of its

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<sup>5</sup> A typical example is recounted in the factual background for *Smith v. PSI Services, Inc.*, 2001 WL 41122 (E.D. 2001).

<sup>6</sup> See *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984), stating that by enacting the Federal Arbitration Act, "Congress declared a national policy favoring arbitration." This idea was reaffirmed in the landmark ruling, *Gilmer v. Interstate/Johnson Lane Corp.*, *infra* note 82, at 26.

<sup>7</sup> E.g., *Hooters of America, Inc. v. Phillips*, 173 F.3d 933, 938 (4th Cir. 1999), finding that the only possible purpose of the employer's arbitration rules was "to undermine the neutrality of the proceeding."

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

<sup>9</sup> E.g., *Prescott v. Northlake Christian School*, 369 F.3d 491 (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, 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.* Judge Edith Jones ruled that "the parties intended judicial review to be available beyond the normal narrow range of the FAA or MUAA." *Id.* at 498. By vacating the district court's order confirming the arbitration award, she wryly noted: "So much for saving money and relationships through alternative dispute resolution. Perfect justice is not always found in this world." *Id.* at 493.

<sup>10</sup> 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."

economic superiority by shifting forum costs to the individual worker.<sup>11</sup>

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.<sup>12</sup> 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 arbitration, 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.

As you might expect, no answer is wrong. The right answer depends on your perspective. If you chose the first answer, you would agree with many commentators who

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<sup>11</sup> Stephan Landsman, *ADR and the Cost of Compulsion*, 57 STAN. L. REV. 1593, 1613 (2006) (“Others seem to have adopted a strategy to raise the cost of proceedings so high that few claimants will dare to go forward.”); 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.”); and 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.”).

<sup>12</sup> See *Armendariz v. Foundation Health Psychcare Services, Inc.*, 99 Cal.Rptr.2d 745, 768 (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.”).

criticize mandatory employment arbitration.<sup>13</sup> The cost shifting issue in the second answer has produced disagreement among judges.<sup>14</sup> The third viewpoint is widely

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<sup>13</sup> Current and representative examples include Richard A. Bales, *Normative Considerations of Employment Arbitration at Gilmer's Quinceañera*, 81 TUL. L. REV. 331 (2006); Maureen A. Weston, *Universes Colliding: The Constitutional Implications of Arbitral Class Actions*, 47 WM. & MARY L. REV. 1711 (2006); Judith Resnik, *Uncovering, Disclosing, and Discovering How The Public Dimensions of Court-Based Processes Are At Risk*, 81 CHI.-KENT L. REV. 521 (2006); and 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 (2004) (by enforcing mandatory arbitration agreements, courts avoid dealing with a considerable volume of employment litigation). For a favorable view of contemporary arbitration, see Stephen J. Ware, *The Case for Enforcing Adhesive Arbitration Agreements— With Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM. ARB. 251 (2006) (enforcement of adhesive arbitration agreements benefits society by reducing process costs, thereby benefiting consumers, employees and other adhering parties). More generally, see Martin H. Malin, *Privatizing Justice— But By How Much? Questions Gilmer Did Not Answer*, 16 OHIO ST. J. ON DISP. RESOL. 589 (2001); Sarah Rudolph Cole, *Managerial Litigants? The Overlooked Problem of Party Autonomy in Dispute Resolution*, 51 HASTINGS L.J. 1199 (2000); Julian J. Moore, Note, *Arbitral Review (Or Lack Thereof): Examining the Procedural Fairness of Arbitrating Statutory Claims*, 100 COLUM. L. REV. 1572 (2000); Margaret M. Harding, *The Redefinition of Arbitration by Those with Superior Bargaining Power*, 1999 UTAH L. REV. 857 (1999); Geraldine Szott Moohr, *Arbitration and the Goals of Employment Discrimination Law*, 56 WASH. & LEE L. REV. 395 (1999); Katherine Van Wezel Stone, *Rustic Justice: Community and Coercion under the Federal Arbitration Act*, 77 N.C. L. REV. 931 (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 (1997); Jean R. Sternlight, *supra* note 10; Joseph R. Grodin, *Arbitration of Employment Discrimination Claims: Doctrine and Policy in the Wake of Gilmer*, 14 HOFSTRA LAB. & EMP. L.J. 1 (1996); Martin H. Malin, *Arbitrating Statutory Employment Claims in the Aftermath of Gilmer*, 40 ST. LOUIS U. L.J. 77 (1996); Katherine Van Wezel Stone, *Mandatory Arbitration of Individual Employment Rights: The Yellow Dog Contract of the 1990s*, 73 DENVER U. L. REV. 1017 (1996); and Robert A. Gorman, *The Gilmer Decision and the Private Arbitration of Public-Law Disputes*, 1995 U. ILL. L. REV. 635 (1995).

<sup>14</sup> Some courts have expressed strong reservations about enforcing cost-shifting provisions in mandatory employment arbitration agreements because of the potential barrier that this condition creates for an employee. The D. C. Circuit Court of Appeals took this approach in *Cole v. Burns Int'l Securities Svcs.*, 105 F.3d 1465, 1484 (D.C. Cir. 1997), stating:

There is no doubt that parties appearing in federal court 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.

Other appellate courts who have voiced similar concerns, see *Shankle, supra* note 3, and *Perez v. Globe Airport Sec. Services, Inc.*, 253 F.3d 1280, 1287 (11<sup>th</sup> Cir. 2001).

But in *Green Tree Fin. Corp.-Ala. v. Randolph*, 521 U.S. 79, 90 (2000), the Supreme Court stated a presumptive rule to enforce cost sharing obligations in arbitration agreements that involved poor individuals who are precluded from suing large corporations: "To 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 (citations omitted)."



approved by judges.<sup>15</sup>

At various times, I have answered No. 1,<sup>16</sup> No. 2,<sup>17</sup> and No. 3<sup>18</sup> in my empirical studies of arbitration. In this Article, I launch a new approach. Using data on court review of employment arbitration awards, I link the concept of moral hazard to arbitration.

### *B. Organization of This Article*

Part II connects the idea of moral hazard to employment arbitration.<sup>19</sup> In Part II.A,<sup>20</sup> I explore the insurance origins of moral hazard. Insurers were concerned that a person could profit from claiming a loss, and consequently, fail to avoid risks.<sup>21</sup> The same section examines theoretical and empirical studies that show how laws and social programs reduce personal incentives to avoid risks.<sup>22</sup> Part II.B examines employment based insurance programs,<sup>23</sup> such as pension guarantees and workers compensation. I explain my theory of moral hazard for judicial review of employment arbitration awards

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<sup>15</sup> See Gilmer, *infra* note 82, at 32-33: “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, including *Caley v. Gulfstream Aerospace Corp.* 428 F.3d 1359, 1377 (11<sup>th</sup> 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 (8<sup>th</sup> 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 Investment Co.*, 367 F.3d 493, 505 (6<sup>th</sup> 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.”).

<sup>16</sup> \_\_\_\_\_, *Jury Revival or Jury Reviled? When Employees Are Compelled to Waive Jury Trials*, 7 U. PENN. J. OF LAB. & EMP. L. 767 (2005).

<sup>17</sup> \_\_\_\_\_ & Peter Feuille, *When Is Cost an Unlawful Barrier to Alternative Dispute Resolution? The Ever Green Tree of Employment Arbitration*, 50 UCLA L. REV. 143 (2002).

<sup>18</sup> \_\_\_\_\_, *Getting Nothing for Something: When Women Prevail in Employment Arbitration Awards*, 16 STAN. L. & POL’Y REV. 573 (2005).

<sup>19</sup> *Infra* notes 44 - 97.

<sup>20</sup> *Infra* notes 44 - 63.

<sup>21</sup> *Infra* notes 44 - 51.

<sup>22</sup> *Infra* notes 44 – 46, and 53 – 63.

<sup>23</sup> *Infra* notes 64 - 75.

in Part II.C.<sup>24</sup>

Part III describes how individual employment arbitration helps employers manage litigation costs.<sup>25</sup> Part III.A explores how employment arbitration creates process disadvantages for individuals.<sup>26</sup> But the same process is also beneficial to many employees, and these advantages are discussed in Part III.B.<sup>27</sup>

Part IV describes the complex web of standards that courts use to review arbitration awards.<sup>28</sup> Following an overview in Part IV.A,<sup>29</sup> Part IV.B describes how the Federal Arbitration Act (FAA), and equivalent state laws, provide standards for vacating awards.<sup>30</sup> I show how common law standards for vacatur increasingly interfere with arbitration in Part IV.C.<sup>31</sup>

Part V is the heart of my study, consisting of research methods and statistical findings.<sup>32</sup> Part V.A describes the method for creating the sample,<sup>33</sup> and Part V.B reviews similar empirical studies that measure how often appellate courts reverse lower court rulings.<sup>34</sup> I present my data and findings in Part V.C.<sup>35</sup>

Part VI looks beyond vacatur statistics,<sup>36</sup> and pinpoints four scenarios that often occur in conjunction with reversal of arbitrator rulings. Courts find that the arbitrator's

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24      *Infra* notes 76 – 97.  
 25      *Infra* notes 98 – 169.  
 26      *Infra* notes 101 – 147.  
 27      *Infra* notes 148 – 169.  
 28      *Infra* notes 170 – 231.  
 29      *Infra* notes 170 – 178.  
 30      *Infra* notes 179 – 200.  
 31      *Infra* notes 201 – 231.  
 32      *Infra* notes 232 – 247.  
 33      *Infra* notes 232 – 240.  
 34      *Infra* notes 241 – 246.  
 35      *Infra* note 247.  
 36      *Infra* notes 248 – 321.

remedy is unauthorized or excessive, as I discuss in Part VI.A.<sup>37</sup> When courts vacate awards, delay and litigation expenses grow large, as Part VI.B reports.<sup>38</sup> In Part VI.C,<sup>39</sup> I show that vacatur is sometimes caused by arbitration agreements that embed broad, judicial review standards. Part VI.D<sup>40</sup> explores how state arbitration laws tend to increase court interference with awards.

Part VII presents my conclusions.<sup>41</sup> Part VII.A explains that state courts create moral hazard by vacating a high percentage of employee wins at arbitration.<sup>42</sup> I conclude in Part VII.B by proposing two public policy changes to reduce to moral hazard.<sup>43</sup>

## II. 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.<sup>44</sup> When the insured has an incentive to act inappropriately by exposing the insurer to the consequences of the insured's loss, moral hazard occurs.<sup>45</sup> An insurance company or government agency contributes to moral

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<sup>37</sup> *Infra* notes 249 – 258.

<sup>38</sup> *Infra* notes 259 – 291.

<sup>39</sup> *Infra* notes 292 – 311.

<sup>40</sup> *Infra* notes 312 – 321.

<sup>41</sup> *Infra* notes 322 – 357.

<sup>42</sup> *Infra* notes 322 – 342.

<sup>43</sup> *Infra* note 343 – 357.

<sup>44</sup> For lawyers, a useful orientation to the subject appears in Tom Baker, *On the Genealogy of Moral Hazard*, 75 TEX. L. REV. 237. 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); 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); Isaac Ehrlich & Gary S. Becker, *Market Insurance, Self-Insurance, and Self-Protection*, 80 J. POL. ECON. 623 (1972); Mark V. Pauly, *Overinsurance and Public Provision of Insurance: The Roles of Moral Hazard and Adverse Selection*, 88 Q.J. ECON. 44 (1974), and John M. Marshall, *Moral Hazard*, 66 AM. ECON. REV. 880 (1976).

<sup>45</sup> Joseph E. Stiglitz, *Risk, Incentives and Insurance: The Pure Theory of Moral Hazard*, 8 GENEVA PAPERS ON RISK AND INS. 4, 6 (1983) (“The 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

hazard when it creates an “incentive for the individual to take fewer precautions against the same risk.”<sup>46</sup>

Consider the experience of nineteenth century insurers.<sup>47</sup> They recognized a potential hazard in allowing people to over-insure for a loss.<sup>48</sup> This situation could influence people who “were unusually susceptible to the temptation that insurance can create.”<sup>49</sup> An insured might create a loss and use insurance to come out ahead.

Tom Baker’s study of Aetna’s Insurance Guide from the 1860s found 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.”<sup>50</sup> This example shows how insurance creates incentives that bring “out the bad in otherwise good people.”<sup>51</sup>

Kenneth Arrow pioneered this concept when he studied government sponsored health insurance. The entitlement might cause individuals to take less responsibility for their own care.<sup>52</sup> Current studies explore the government’s role in causing people to fail to reduce their risk for unhealthy behaviors. 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

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the full consequences of their actions.”).

<sup>46</sup> Amitai Aviram, *The Placebo Effect of the Law: Law’s Role in Manipulating Perceptions*, 75 GEO. WASH. L. REV. 54, 94 (2006).

<sup>47</sup> Baker, *supra* note 44, at 251.

<sup>48</sup> *Id.* at 250.

<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

<sup>51</sup> *Id.* at 251.

<sup>52</sup> Arrow, *supra* note 44.

increase.<sup>53</sup> State laws that require health insurance to cover alcohol abuse have more consumption compared to states that do not insure for this risk.<sup>54</sup> Apart from insuring personal losses, government programs create moral hazard by making individuals pay less for their losses.<sup>55</sup>

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.<sup>56</sup> Storm insurance creates moral hazard when it fails to relocate vulnerable populations to safer areas after a devastating event.<sup>57</sup> Federal bank deposit insurance has a similar effect. It reduces lending costs for banks, thereby making credit easier to obtain; and this enables banks to make riskier loans.<sup>58</sup>

Recently, lenders sold home mortgages to investors in securities that known as collateralized debt obligations. CDOs create moral hazard by allowing sub-prime lenders to escape usual “market discipline.”<sup>59</sup> When loan purchasers underwrite risky debt without requiring borrowers to invest their own equity, another moral hazard is created.<sup>60</sup> Investor capital is at risk for default when borrowers have little or no equity to lose.

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<sup>53</sup> 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 (1991).

<sup>54</sup> Jonathan Klick & Thomas Stratman, *Subsidizing Addiction: Do State Health Insurance Mandates Increase Alcohol Consumption?*, 35 J. LEGAL STUDIES 175 (2006).

<sup>55</sup> 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 co-payments, deductibles, limits, and insurance ratings. These devices pass a part of the cost back to the insured, providing a partial incentive to minimize risk.”

<sup>56</sup> Daniel A. Farber, *Basic Compensation for Victims of Climate Change*, 155 U. PA. L. REV. 1605, 1654, n.160 (2007).

<sup>57</sup> *Id.* at 1654.

<sup>58</sup> 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 (2007).

<sup>59</sup> Kathleen C. Engel & Patricia A. McCoy, *Turning A Blind Eye: Wall Street Finance Of Predatory Lending*, 75 FORDHAM L. REV. 2039, 2067-68 (2007) (noting that one CDO manager observed that CDOs “create ‘an awful lot of moral hazard in the [subprime RMBS] sector.’” *Id.* at 2068.

<sup>60</sup> *Id.*

Bankruptcy laws create a similar situation when debtor protections reduce a borrower's incentive "to restrain consumption in advance of financial misfortune."<sup>61</sup> Lenient laws that create broad relief for debtors create moral hazard.<sup>62</sup> This happens when companies "engage in high risk behavior [with] the knowledge that they can protect themselves from its consequences by taking the corporation into chapter 11."<sup>63</sup>

### *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.<sup>64</sup> The Pension Benefit Guaranty Corp. insures against losses by taxing employers.<sup>65</sup> Moral hazard occurs when companies continue to make future pension obligations while they underfund current contributions.<sup>66</sup>

Workers compensation laws insure employees for lost income and medical expenses from on-the-job injuries.<sup>67</sup> These laws also create indirect insurance for employers by extinguishing tort liability for causing an injury.<sup>68</sup> Worker compensation laws require employers to purchase insurance or self-insure to pay employee claims.<sup>69</sup>

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<sup>61</sup> Adam Feibelman, *Defining the Social Insurance Function of Consumer Bankruptcy*, 13 AM. BANKR. INST. L. REV. 129, 143 (2005).

<sup>62</sup> See Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425 (1993).

<sup>63</sup> Judith R. Starr, *Bankruptcy Court Jurisdiction to Release Insiders from Creditor Claims in Corporate Reorganizations*, 9 BANKR. DEV. J. 485, 499 (1993).

<sup>64</sup> See 29 U.S.C.A. § 1302 (2007). The PBGC was modeled after the Federal Deposit Insurance Corporation. See 120 Cong.Rec. 29950 (1974) (statement of Sen. Bentsen).

<sup>65</sup> See 29 U.S.C.A. § 1306(a)(1).

<sup>66</sup> Daniel Keating, *Pension Insurance, Bankruptcy, and Moral Hazard*, 1991 WIS. L. REV. 65, 107 (1991) (companies have "an incentive to spend capital in ways other than funding pension plans.").

<sup>67</sup> MARK A. ROTHSTEIN & LANCE LIEBMAN, *EMPLOYMENT LAW: CASES AND MATERIALS* 908-09 (5<sup>th</sup> ed. 2003).

<sup>68</sup> *Id.* at 958-59.

<sup>69</sup> *Id.* at 909.

Like other insurance systems, workers compensation may create incentives for individuals to avoid the financial consequences of a lost-time injury.<sup>70</sup> A worker might prolong her leave of absence beyond the endpoint of medical necessity because the insurance fund pays her too long to remain idle.<sup>71</sup>

Employers also face moral hazard. In *Mandolidis v. Elkins Industries*,<sup>72</sup> an employer ordered workers to speed production on power saws by removing safety guards.<sup>73</sup> Later, an employee sawed off two fingers.<sup>74</sup> When other workers were similarly hurt, the employer callously dismissed their concerns, stating that claimants were paid for their loss.<sup>75</sup> *Mandolidis* shows how an employer fails to reduce risky behaviors by relying on insurance to pay for avoidable accidents.

### *C. A Theory of Moral Hazard for Judicial Review of Employment Arbitration Awards*

At this juncture, I build a theoretical bridge from moral hazard studies to my empirical investigation of employment arbitration awards. For now, I paint with broad brush strokes; but in Part III, I show in detail how a theory of moral hazard applies to court review of employment arbitration awards.

To begin, 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 litigation,<sup>76</sup> and liability for wrongdoing.<sup>77</sup>

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<sup>70</sup> Martha T. McCluskey, *The Illusion of Efficiency in Workers' Compensation "Reform,"* 50 RUTGERS L. REV. 657 (1998). Examples include injured workers who use compensation benefits to prolong their leave, and non-injured workers who file fraudulent lost-time claims.

<sup>71</sup> *Id.* at 817.

<sup>72</sup> 161 W.Va. 695 (W.Va. 1975).

<sup>73</sup> *Id.* at 707-08.

<sup>74</sup> *Id.* at 707.

<sup>75</sup> *Id.* at 710.

<sup>76</sup> See Hatfield, *supra* note 1.

<sup>77</sup> See Pollard, *infra* note 117.

My theory focuses on employer expenses for liability. By way of background, Congress authorized courts in the 1991 Civil Rights Act to order make-whole relief, and punitive damages, for victims of intentional employment discrimination.<sup>78</sup> Congress believed that discrimination is costly to the nation's economy.<sup>79</sup>

The point is that employment discrimination laws can be compared to insurance. By enacting Title VII, lawmakers forced employers to self-insure for societal harm that results from workplace discrimination. 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.<sup>80</sup> This law creates more incentive for employers to avoid liability, because private attorney's fees can be high.<sup>81</sup> 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.*<sup>82</sup> broadly approved arbitration as a substitute for trials, the Supreme Court promised that by "agreeing to arbitrate a statutory claim, a party

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<sup>78</sup> 42 U.S.C.A. § 1981a (2007), stating: "In an action brought by a complaining party under section 706 or 717 of the Civil Rights Act of 1964 . . . (citation omitted) against a respondent who engaged in unlawful intentional discrimination . . . the complaining party may recover compensatory and punitive damages. . . ."

<sup>79</sup> When Congress increased employer penalties for employment discrimination, lawmakers Congress 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." P.L. 102-166, Civil Rights Act of 1991, H. Rep. 102-40(I), April 24, 1991, at \*64 - \*65.

<sup>80</sup> 42 U.S.C. § 2000e-5(k) provides: "In any action or proceeding under this subchapter the court, in its discretion, may allow the prevailing party . . . reasonable attorney's fees . . . ."

<sup>81</sup> *E.g.*, DeGaetano, *infra* note 223.

<sup>82</sup> 500 U.S. 20 (1991).



[would] not forgo the substantive rights afforded by the statute. . . .”<sup>83</sup> This policy helps to explain the moral hazard model. *Gilmer* states a theory of forum substitution.

Arbitrators serve as substitute judges. When they determine that evidence supports a finding of employer liability, this theory implies that arbitrators 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 for its wrongdoing. When a court vacates the arbitrator’s ruling in favor of the employee, forum substitution is undermined.

My adaptation of the moral hazard model adds an element: Vacatur courts act as government insurers by relieving employers of liability for socially undesirable conduct. In concept, employers use vacatur courts in a way that is similar to home owners and beachfront developers who use federal disaster insurance. These parties seek government intervention to bail them out of the consequences of risky behaviors that turn costly.

I postulate that employers enter into employment arbitration agreements because they perceive arbitration as a better forum to avoid the growing cost of court procedures and rulings.<sup>84</sup> Also, employers exploit their superior knowledge of information about these contracts.<sup>85</sup> 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

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<sup>83</sup> *Id.* at 26. Alternative Dispute Resolution, GAO/HEHS 95-150 (July 5, 1995) GAO/HEHS 95-150, 1995 WL 488006 (F.D.C.H.), reporting that employers prefer alternative dispute resolution forums to court because of growing concerns about “(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.”

<sup>84</sup> See Hatfield, *supra* note 1, for recent estimates litigation costs.

<sup>85</sup> 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), relying on Marc Galanter, *Why the “Haves” Come Out Ahead: Speculations on the Limits of Legal Change*, 9 LAW & SOC’Y REV. 95 (1974). 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.

this language at face value and be deterred from challenging an adverse ruling.<sup>86</sup> As a more informed party, however, an employer realizes that it has recourse 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.<sup>87</sup>

These liability avoidance tactics vary. Some contracts provide for *de novo* review of an arbitrator's award.<sup>88</sup> In concept, 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, 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.<sup>89</sup> Parties can review awards under the Federal Arbitration Act,<sup>90</sup> or state arbitration law equivalents.<sup>91</sup> Among the latter, more states are expanding grounds for

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<sup>86</sup> I extrapolate this idea from Alan M. White & Cathy Lesser Mansfield, *Literacy and Contract*, 13 STAN. L. REV. & POL'Y REV. 233 (2002). The authors, after analyzing research that shows a high percentage of literate adults who are unable to extract pertinent information from form contracts, concluded that “the 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.” *Id.* at 266. My idea also derives support from Jean Sternlicht, *Creeping Mandatory Arbitration*, 57 STAN. L. REV. 1631, 1654 (2005), who shows that employees find it difficult and expensive to challenge an arbitration clause in court, and the extra legal hurdle makes it harder for employees to retain an attorney.

<sup>87</sup> Syncor Int'l Corp., *infra* note 142; Collins, *infra* note 143; Harris, *infra* note 144; Hughes Training Inc., *infra* note 145; Bargaquast, *infra* note 146; and Roadway Package System, Inc., *infra* note 147.

<sup>88</sup> *E.g.*, Harris, *infra* note 144, at 794 (Fifth Circuit concluded that a *de novo* standard of review is to be applied concerning questions of law that are decided by arbitrators).

<sup>89</sup> *E.g.*, Roadway Package System, Inc., *infra* note 147, at 294.

<sup>90</sup> United States Arbitration Act, Section 10, *infra* note 156.

<sup>91</sup> Uniform Arbitration Act, and accompanying state vacatur standards, *infra* note 187.

challenging an arbitrator's award.<sup>92</sup> By choosing a state law that facilitates judicial nullification of awards, employers can improve their odds of avoiding liability. The strategic opportunities in choice-of-law tactics is illustrated by the case of a Louisiana employer who selected Montana arbitration law to govern its agreement.<sup>93</sup>

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.<sup>94</sup>

A government body— here, courts— would create an “incentive for the individual to take fewer precautions against the same risk.”<sup>95</sup> As a result, employers

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<sup>92</sup> See *RUA and UMA Legislation from Coast to Coast*, *infra* note 188; and the Revised Uniform Arbitration Act, *infra* note 186.

<sup>93</sup> *E.g.*, Prescott, *supra* note 9 (employer's arbitration agreement incorporated Montana Uniform Arbitration Act, even though parties were located in Louisiana).

<sup>94</sup> Stiglitz, *supra* note 4, at 6 (“The 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.”).

<sup>95</sup> Aviram, *supra* note 46, at 94.

would be less deterred to engage in risky behaviors that create liability, compared to the case where the employer would be required to pay. The arbitration agreement would, in effect, create a temptation that brings “out the bad in otherwise good people.”<sup>96</sup>

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.<sup>97</sup> 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.

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

Consider, again, the Aetna insurance model.<sup>98</sup> It did not assume that everybody is motivated to cheat on their insurance contracts. Instead, Aetna assumed that allowing people to buy excess insurance would induce people who “were unusually susceptible to the temptation that insurance can create”<sup>99</sup> to engage in fraudulent activities that profited them. The Aetna model assumed that some people would succumb to “carelessness and roguery.”<sup>100</sup> 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

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<sup>96</sup> Baker, *supra* note 44, at 251.

<sup>97</sup> Beal, *supra* note 45, at 85.

<sup>98</sup> Baker, *supra* notes 47 – 51.

<sup>99</sup> Baker, *supra* note 44, at 250.

<sup>100</sup> *Id.*

employers are rewarded for failing to take responsibility for their misconduct.

In Part III, I examine evidence that explains the recent explosion of employment arbitration. No one disputes that this is an employer driven phenomenon. There has been no visible evidence of employee preference for arbitration over courts. Thus, it is important to understand why employers prefer arbitration to courts. There are two schools of thought on this subject.

The “dark side” 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” looks at how inaccessible courts are due to cost, delay, and over-emphasis on procedural maneuvering. 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.

*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.<sup>101</sup> However, fundamental changes in government

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<sup>101</sup> The doctrine was first recognized in HORACE G. WOOD, A TREATISE ON THE LAW OF MASTER AND SERVANT (1877). Comparing American and English law, Wood wrote that: 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. . . . It 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.

*Id.*, § 134 at 272. English law presumed that master and servant were bound to each other for one year,

regulation of employment during the 1960s altered this arrangement. Congress passed sweeping employment discrimination laws.<sup>102</sup> In the same period, state courts developed common law exceptions to employment-at-will.<sup>103</sup>

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— for example, the public policy exception to employment-at-will<sup>104</sup> and related whistleblower protection,<sup>105</sup> emotional distress,<sup>106</sup> assault and battery in severe cases of sexual harassment,<sup>107</sup> negligence,<sup>108</sup> and defamation.<sup>109</sup> State constitutions compounded this trend by creating privacy rights for workers.<sup>110</sup>

In the early 1990s, two critical streams in employment law were joined. The 1991 Civil Rights Act,<sup>111</sup> and Americans with Disabilities Act in 1992,<sup>112</sup> posed a liability threat to employers. Employment discrimination lawsuits in federal courts doubled in five

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unless varied by contract.

<sup>102</sup> See S.Rep. No. 872, 88<sup>th</sup> Cong., 2d Sess., pt. 1, at 11, 24 (1964); H.R.Rep. No. 914, 88<sup>th</sup> Cong., 1st Sess., pt. 1, at 18 (1963); H.R.Rep. No. 914, 88<sup>th</sup> Cong., 1st Sess., pt. 2, at 1-2 (1963). Title VII of the Civil Rights Act of 1964 prohibits discrimination in employment on the basis of “race, color, religion, sex, and national origin.”

<sup>103</sup> Early cases include *Petermann v. Teamsters Local 396*, 344 P.2d 25 (Cal.App.1959) (finding a public policy exception to employment-at-will); and *Monge v. Beebe Rubber Co.*, 316 A.2d 549 (1974) (finding covenant of good faith dealing exception to employment-at-will).

<sup>104</sup> *E.g.*, *Harless v. First Nat’l Bank in Fairmount*, 246 S.E.2d 270 (W.Va. 1978) (finding 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); and *O’Sullivan v. Mallon*, 390 A.2d 149 (Law Div. 1978) (finding 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).

<sup>105</sup> *E.g.*, *Green v. Ralee Engineering Co.*, 78 Cal.Rptr.2d 16 (Cal. 1998).

<sup>106</sup> *E.g.*, *Wilson v. Monarch Paper Co.*, 939 F.2d 1138 (5<sup>th</sup> Cir. 1991) (federal court applied Texas law to emotional distress claim), and *Bustamento v. Tucker*, 607 So.2d 532 (La. 1992).

<sup>107</sup> *Maksimovic v. Tsogalis*, 177 Ill.2d 511 (1997).

<sup>108</sup> *Malorney v. B & L Motor Freight, Inc.*, 496 N.E.2d 1086 (Ill.App. 1986).

<sup>109</sup> *Lewis v. Equitable Life Assurance Society*, 389 N.W.2d 876 (Minn. 1986).

<sup>110</sup> *Soroka v. Dayton Hudson Corp.*, 1 Cal.Rptr.2d 77 (Cal.App. 1991).

<sup>111</sup> Civil Rights Act of 1991, Pub. L. No. 102-166, 105 Stat. 1071 (1991).

<sup>112</sup> American with Disabilities Act of 1990, Pub. L. No. 101-336, 104 Stat. 328 (1990).

years, as filings soared from 8,273 in 1990 to 19,059 in 1995.<sup>113</sup>

To put this trend in perspective, consider that employment claims, including those under Title VII of the 1964 Civil Rights Act, comprised about 52% of all civil rights cases filed in federal courts in 1995.<sup>114</sup> The 1991 amendments expressly allowed discrimination victims to recover up to \$300,000 in punitive damages.<sup>115</sup> This supplemented the strong remedial provisions in Title VII.<sup>116</sup>

Also, 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.*<sup>117</sup> demonstrates the point. After finding that a female worker experienced flagrant discrimination, the district court awarded her \$107,364 in backpay and benefits, \$252,997 in attorney's fees, and \$300,000 in compensatory damages.<sup>118</sup>

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<sup>113</sup> Administrative Office of the U.S. Courts (2006), *U.S. District Court Cases, Judicial Facts and Figures, Civil Cases Filed By Nature of Suit*, tbl. 4.4, at 2 (see Employment, under the heading Civil Rights, at Line 3), available at <http://www.uscourts.gov/judicialfactsfigures/2006/Table404.pdf>.

<sup>114</sup> *Id.* There were 36,600 "Civil Rights" cases in federal courts in 1995. This figure included 19,059 "Employment" cases.

<sup>115</sup> See 42 U.S.C. § 1981(a)(1), (b)(3) (specifying the compensatory and punitive damages available under Title VII).

<sup>116</sup> The Supreme Court explained the expansion of Title VII remedies in *Pollard v. E.I. du Pont de Nemours & Co.*, *infra* note 117. 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 848-49. Congress broadened judicial power to remedy intentional acts of discrimination in 1972 because courts could not always provide effective relief. 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 (emphasis in original)." *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 intentional 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.

<sup>117</sup> 532 U.S. 843 (2001).

<sup>118</sup> *Id.* at 846. 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; and in addition, was constantly subjected to language calling women "bitches," "cunts," "heifers," and "split tails." *Pollard v. E.I. duPont de Nemours & Co.*, 213 F.3d 933, 938 (6<sup>th</sup> Cir. 2000). The men also sabotaged Pollard's work. *Id.* Pollard felt threatened after her tires were slashed and male co-workers provoked confrontations with her. *Id.* at 939-940. Eventually, she went on a disability leave that DuPont's psychologist approved.

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.<sup>119</sup> The Supreme Court ruled, however, that front pay did not count against the \$300,000 limit.<sup>120</sup> 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.<sup>121</sup> *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 Lane Corp.*<sup>122</sup> *Gilmer* held that an employee who had been required by his employer to sign an arbitration agreement was precluded from suing in court.<sup>123</sup> The ruling gave employers hope for curtailing their expanding liability. More recently, the Court’s ruling in *Circuit City Stores, Inc. v. Adams*<sup>124</sup> expanded *Gilmer*.

These oddly conjoined streams encouraged employers to use arbitration

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*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.*

<sup>119</sup> *Id.* noting that the 1991 Civil Rights Act, Section 1981a(b)(3), limits compensatory and punitive damages under Title VII to \$300,000 and defines the former element as “future pecuniary losses, emotional pain, suffering, inconvenience, mental anguish, loss of enjoyment of life, and other non-pecuniary losses.” *Id.*

<sup>120</sup> *Id.* at 853.

<sup>121</sup> *Pollard v. E.I. DuPont De Nemours, Inc.*, 412 F.3d 657 (6<sup>th</sup> Cir. 2005).

<sup>122</sup> *Supra* note 82.

<sup>123</sup> 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 credit card— on the other party’s agreement to submit any dispute to arbitration, instead of a court. Because the arbitration clause is a non-negotiable condition for the contractual relationship, it is called mandatory.

<sup>124</sup> 121 S.Ct. 1302 (2001), ruling that all employment arbitration agreements are enforceable under the FAA, except a small sliver of agreements that cover transportation workers.



agreements to bypass courts with the hope of lowering the cost of employment disputes.<sup>125</sup> In a late-1990s national survey, most Fortune 1000 companies reported that they use employment arbitration.<sup>126</sup> Ninety percent said that they adopted an ADR method as a “critical cost technique.”<sup>127</sup> Commentators concluded that adoption of arbitration enabled employers to limit litigation risks and costs.<sup>128</sup> The trend is reflected today in arbitration procedures that allow “employers to manage risk by eliminating jury trials, class actions, and large attorney’s fees.”<sup>129</sup>

Specific cases lend support for the risk-management thesis. Arbitration agreements require workers to waive their right to sue,<sup>130</sup> and replace a court with arbitration.<sup>131</sup> Often, workers cannot bargain over this forum.<sup>132</sup> Companies create their own justice rules to shield themselves from stricter enforcement.<sup>133</sup> Pre-hearing risk-

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<sup>125</sup> See *Arbitration: Attorney Urges Employers to Adopt Mandatory Programs as Risk-Management*, DAILY LAB. REPT, (No. 93) May 14, 2001, reporting an employment lawyer’s view that mandatory arbitration helps employers limit damages and eliminate class action lawsuits. David Copus also notes that the biggest financial risk for employers in termination lawsuits— tort claims in which a single plaintiff can be awarded millions of dollars— is controlled by arbitration agreements that cap damages.

<sup>126</sup> See Bureau of National Affairs, *Alternative Dispute Resolution: Most Large Employers Prefer ADR as Alternative to Litigation, Survey Says*, DAILY LABOR REPORT (May 14, 1997), at A-4 (79% of the 530 responding firms said that they use employment arbitration).

<sup>127</sup> *Id.*

<sup>128</sup> Jack M. Sabatino, *ADR as “Litigation Lite”: Procedural and Evidentiary Norms Embedded Within Alternative Dispute Resolution*, 47 EMORY L.J. 1289, 1301 (1998); David B. Lipsky & Ronald L. Seeber, *Patterns of ADR Use in Corporate Disputes*, 54 DISP. RESOL. J. 66, 66-71 (1999); also Francis J. Mootz III, *Insurance Coverage of Employment Discrimination Claims*, 52 U. MIAMI L. REV. 1, 2 (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.”).

<sup>129</sup> Scott Baker, *A Risk-Based Approach To Mandatory Arbitration*, 83 OR. L. REV. 861, 862 (2005). Also see David S. Schwartz, *Understanding Remedy-Stripping Arbitration Clauses: Validity, Arbitrability, and Preclusion Principles*, 38 U.S.F. L. REV. 49 (2003), contending that employers use arbitration as a risk-management device.

<sup>130</sup> *Baldeo v. Darden Rest., Inc.*, 2005 WL 44703 (E.D.N.Y. 2005), at \* 2.

<sup>131</sup> *Gold v. Deutsche Aktiengesellschaft*, 365 F.3d 144, 146 (2d Cir. 2004).

<sup>132</sup> *E.g.*, *Brennan v. Bally Total Fitness*, 198 F.Supp.2d 377, 381 (S.D.N.Y. 2002).

<sup>133</sup> See DAVID B. LIPSKY ET AL., *EMERGING SYSTEMS FOR MANAGING WORKPLACE CONFLICT* (2003).

control tactics include limits on discovery,<sup>134</sup> shorter periods to file claims,<sup>135</sup> selection of arbitrators without employee input,<sup>136</sup> and inconvenient venues.<sup>137</sup> One method not only bars access to courts, but deters employee access to arbitration by requiring employees to pay large forum costs associated with the hearing process.<sup>138</sup>

Once the arbitrator has been appointed and the hearing commences, additional risk management controls may be in place. Some arbitration agreements bar class actions.<sup>139</sup> They may include remedial limits on statutory claims,<sup>140</sup> and strictures against punitive damages in awards.<sup>141</sup>

The arbitration agreement may also anticipate an adverse award for 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. Such a provision is intended to circumvent highly deferential court review of arbitration awards. In effect, these employers seek a “do over” of the arbitration. Examples appear in *Syncor Int’l Corp. v.*

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<sup>134</sup> See *Cole v. Burns Int’l Sec. Servs.*, 105 F.3d 1465, 1478 (D.C. Cir. 1997).

<sup>135</sup> E.g., *Marie v. Allied Home Mortgage Corp.*, 402 F.3d 1 (1<sup>st</sup> Cir. 2005) (ruling that arbitrator had authority to rule on validity of sixty-day filing requirement); *Louis v. Geneva Enterprise, Inc.*, 128 F.Supp.2d 912 (E.D. Va. 2001) (the 60-day filing limit in arbitration agreement drafted by the employer unlawfully conflicts with three year statute of limitations for FLSA claims); and *Chappel v. Laboratory Corp. of America*, 232 F.3d 719 (9<sup>th</sup> Cir. 2000) (because ERISA provides a four-year statute of limitations for an action to recover benefits under a written contract, plan administrator breached its fiduciary duty by adopting a mandatory arbitration clause that set a 60-day time limit in which to demand arbitration).

<sup>136</sup> See *Hooters of America v. Phillips*, 173 F.3d 933, 938 (4<sup>th</sup> Cir. 1999), finding that the only possible purpose of the employer’s arbitration rules was “to undermine the neutrality of the proceeding.”

<sup>137</sup> E.g., *Poole v. L.S. Holding, Inc.*, 2001 WL 1223748 (D.V.I. 2001) (court rejects contention by Virgin Islands employee that Massachusetts is a prohibitively expensive venue to arbitrate claim).

<sup>138</sup> See *Morrison v. Circuit City Stores, Inc.*, 317 F.3d 646, 669 (6<sup>th</sup> Cir. 2003), where the Sixth Circuit concluded that “the potential costs of arbitrating the dispute easily reach thousands, if not tens of thousands, of dollars, far exceeding the costs that a plaintiff would incur in court.”

<sup>139</sup> E.g., *Adkins v. Labor Ready, Inc.*, 185 F.Supp. 2d 628 (S.D. W.Va. 2001).

<sup>140</sup> E.g., *Johnson v. Circuit City Stores, Inc.*, 148 F.3d 373 (4<sup>th</sup> Cir. 2000); and *Morrison v. Circuit City Stores, Inc.*, 70 F.Supp.2d 815 (S.D. Ohio 1999) (although Title VII permits up to \$300,000 in punitive damages, court upheld \$162,000 limit imposed by arbitration agreement).

<sup>141</sup> E.g., *Great W. Mortgage Corp. v. Peacock*, 110 F.3d 222, 225 (3d Cir. 1997).

*McLeland*,<sup>142</sup> *Collins v. Blue Cross Blue Shield of Michigan*,<sup>143</sup> *Harris v. Parker College of Chiropractic*,<sup>144</sup> *Hughes Training Inc. v. Cook*,<sup>145</sup> *Bargenquast v. Nakano Food, Inc.*,<sup>146</sup> and *Roadway Package System, Inc. v. Kayser*.<sup>147</sup>

*B. The Bright Side of Employment Arbitration:  
A Better Dispute Resolution Forum Compared to Courts*

Arbitration has advantages compared to trials.<sup>148</sup> Disputants consider factors such as cost, time, precedent, and privacy when they choose this process.<sup>149</sup> 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.<sup>150</sup>

Employer preference for arbitration is better understood with a longer horizon. For over 300 years, businesses have found courts to be unwieldy and expensive forums to

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<sup>142</sup> No. 96-2261, 1997 U.S. App. LEXIS 21248, \*15 (4th Cir. Aug. 11, 1997) (“arbitrator 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.”).

<sup>143</sup> 103 F.3d 35, 36 (6th Cir. 1996) (agreement provided for judicial review of the arbitration award “as established by law” and for the arbitrator’s “clear error of law.”).

<sup>144</sup> 286 F.3d 790, 793 (5th Cir. 2002) (agreement said that “the 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.”).

<sup>145</sup> 254 F.3d 588, 590 (5th Cir. 2001) (contract said that “[e]ither 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.”).

<sup>146</sup> 243 F. Supp. 2d 772, 774 (N.D. IL. 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.”).

<sup>147</sup> 257 F.3d 287, 288 (3d Cir. 2001) (agreement “shall be governed by and construed in accordance with the laws of the Commonwealth of Pennsylvania”).

<sup>148</sup> ALAN SCOTT RAU, ET. AL, PROCESSES OF DISPUTE RESOLUTION 599-600 (4<sup>th</sup> ed. 2006) (arbitration allows parties to select their own judge, proceed to a hearing relatively quickly, dispense with tediously formal rules, and reduce friction that accompanies trials).

<sup>149</sup> See Frank E. A. Sander & Stephen B. Goldberg, *Fitting the Forum to the Fuss: A User-Friendly Guide to Selecting an ADR Procedure*, 10 NEG. J. 49, 55 (tbl. 1) (1994).

<sup>150</sup> 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.

resolve disputes. In response to businesses who were dissatisfied with public tribunals, an English statute of 1697 authorized courts to enforce arbitration awards.<sup>151</sup> Economists in the 1600s favored arbitration because courts wasted time and money.<sup>152</sup> Under Lord Mansfield's influence, English commercial law deferred to arbitration rulings.<sup>153</sup>

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.”<sup>154</sup> 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.<sup>155</sup>

Early in the twentieth century, businesses complained that courts were costly and inefficient providers of commercial justice. Thus, in 1925 Congress enacted the United

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<sup>151</sup> 9 & 10 William III c. 15 (1697). The preamble of the law stated: “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. . . .” 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 HISTORICAL J. 137, 138-139 (1993).

<sup>152</sup> E.g., SIR JOSIAH CHILD, A NEW DISCOURSE OF TRADE 141-144 (4<sup>th</sup> ed., 1745). His chapter, “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 Merchant. . . .” *Id.* at 141. He complained that conventional litigation in courts of law entailed “tedious attendance and vast expenses.” *Id.* at 412.

<sup>153</sup> 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.

<sup>154</sup> *Campbell v. Western*, 3 Paige Ch. 124, 128, n.1 (N.Y. 1832).

<sup>155</sup> *Id.* at 138 (N.Y. 1832), noting:

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.

States Arbitration Act,<sup>156</sup> and renamed it the Federal Arbitration Act (FAA) in 1947,<sup>157</sup> to help businesses reduce expense and delay in resolving their legal disputes.<sup>158</sup> Congress learned from businesses that too many courts refused to enforce their private arbitration agreements. Thus, a national arbitration law with federal jurisdiction was proposed.<sup>159</sup>

Business leaders complained that lawsuits led to “ruinous litigation,”<sup>160</sup> and hurt American consumers because firms had to pass along litigation costs in their prices.<sup>161</sup> Companies avoided these problems when they voluntarily submitted their disputes to arbitration.<sup>162</sup> Arbitration offered “the best means yet devised for an efficient, expeditious, and inexpensive adjustment of . . . disputes.”<sup>163</sup>

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<sup>156</sup> United States Arbitration Act, ch. 213, 43 Stat. 883 (1925), renamed the Federal Arbitration Act in 1947, codified as amended at 9 U.S.C. §§ 1-16 (2000). *See* Act of Feb. 12, 1925, ch. 213, § 1, 43 Stat. 883, amended by Act of July 30, 1947, ch. 392, 61 Stat. 669.

<sup>157</sup> *See* Act of July 30, 1947, ch. 392, 61 Stat. 669.

<sup>158</sup> S. REP. NO. 68-536 (1924), at 2 (stating that the FAA was proposed to help businesses avoid “the delay and expenses of litigation”); and H.R. REP. NO. 68-96 (1924), at 2 (showing that Congress believed the simplicity of arbitration would “reduce[e] technicality, delay, and [keep] expense to a minimum and at the same time safeguard the rights of the parties”).

<sup>159</sup> *Hearings on the Subject of Interstate Commercial Disputes Before the Subcommittees on the Judiciary*, 68<sup>th</sup> Cong., 1<sup>st</sup> Sess., at 6 (Statement of Charles L. Bernheimer, January 9, 1924). The House Report stated: “The purpose of this bill is to make valid and enforceable agreements for arbitration contained in contracts involving interstate commerce or within the jurisdiction o[f] admiralty, or which may be the subject of litigation in the Federal courts.” H.R. REP. NO. 68-96, *id.*, at 3.

<sup>160</sup> *Joint Hearings before the Subcommittees of the Committees on the Judiciary*, 68<sup>th</sup> Cong., 1<sup>st</sup> Sess., on S. 1005 and H.R. 646, at 6 (1924) (Statement of Charles L. Bernheimer, Chairman of Committee on Arbitration):

I have made a study of the question of arbitration ever since the panic of 1907. The difficulties merchants then met with, that of having repudiations and other business troubles, resulting in much loss and expense outside of the costly and ruinous litigation, caused me to start on a study of the subject of arbitration, and the deeper I got into it the more I was convinced we should have legislation in State and Nation that would make arbitration a reality, that would cause an agreement or contract in writing providing for arbitration to be binding upon the parties and an irrevocable proposition.

<sup>161</sup> *Id.* observing that “[t]he 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.”

<sup>162</sup> *Id.* at 31 (Statement of Wilson J. Vance, Secretary of New Jersey State Chamber of Commerce): “there 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.”

<sup>163</sup> *Id.* (Statement of Thomas B. Paton, American Bankers Association).

Today, employers voice similar concerns about courts. When Congress studied arbitration in 1997, its survey found that nearly one in five employers used arbitration.<sup>164</sup> Companies said that arbitration reduced employment related litigation.<sup>165</sup> Also, a case study of mandatory arbitration found that a large company and its employees mutually benefited from the method.<sup>166</sup> Other studies show that arbitration reduced legal fees.<sup>167</sup>

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 the arbitrations.<sup>168</sup> Other studies found similar win rates for individuals in arbitration.<sup>169</sup>

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<sup>164</sup> GENERAL ACCOUNTING OFFICE, ALTERNATIVE DISPUTE RESOLUTION – EMPLOYERS’ EXPERIENCES WITH ADR IN THE WORKPLACE (Aug. 12, 1997), GAO/GGD 97-157, at 2 (available at <http://www.gao.gov/archive/1997/gg97157.pdf>).

<sup>165</sup> *Id.* For example, at Brown & Root, the arbitration program was credited with facilitating settlements. The GAO reported that 43 of 74 arbitration requests between June 1993 and December 1996 were either settled or dropped without an arbitration decision. *Id.* at 18.

<sup>166</sup> RICHARD A. BALES, LABOR AND EMPLOYMENT LAW COMPULSORY ARBITRATION: THE GRAND EXPERIMENT IN EMPLOYMENT 169 (1997). This intensive study of mandatory employment arbitration concluded that a company’s ADR methods produce net gains to the employer and also its workers: “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.” *Id.*

<sup>167</sup> See Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 DISP. RESOL. J. 44 (2003-2004) (finding faster case processing in arbitration); and 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).

<sup>168</sup> Michael Delikat & Morris M. Kleiner, *An Empirical Study of Dispute Resolution Mechanisms: Where Do Plaintiffs Better Vindicate Their Rights?*, 58 DISP. RESOL. J. 56 (Nov. 2003— Jan. 2004), at 56-57. Employees prevailed 33.6% of the time in court versus 46% of the time in arbitration. The median damages award was \$95,554 in court versus \$100,000 in arbitration. The median award of attorneys’ fees was \$69,338 in court versus \$76,684 in arbitration.

<sup>169</sup> Samuel Estreicher, *Saturns for Rickshaws: The Stakes in the Debate Over Pre-Dispute Employment Arbitration Agreements*, 16 OHIO ST. J. ON DISP. RESOL. 559, 563-65 (2001) (claimants win more cases in arbitration than they do in litigation); 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); and Lewis L. Maltby, *Private Justice: Employment Arbitration and Civil Rights*, 30 COLUM. HUM. RTS. L. REV. 29, 46-49 (1998) (finding that employees win 63% of their claims in arbitration and only 15% of their claims in litigation); William Howard, *Arbitrating Claims of Employment*

## IV. JUDICIAL REVIEW OF ARBITRATION AWARDS

## A. Overview

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

I began this research with a data form that had a brief menu of the four FAA grounds for vacating an award. As the database grew, I revised the form several times to include additional vacatur grounds.

The FAA is supplemented by parallel legislation in nearly every state. These laws, which were based on the Uniform Arbitration Act of 1955,<sup>170</sup> set forth their own reviewing standards for state courts.<sup>171</sup> State laws usually mirror FAA standards while adding one or more grounds for judicial review of an award.<sup>172</sup>

To account for these different laws, I modified the data form. Over time, I found more grounds for judicial review. The Revised Uniform Arbitration Act (RUAA) was published in 2000, and later adopted by 12 states. This model act and its current state-law embodiments were added to the list of grounds for court review.

The lengthy checklist continued to grow as I discovered that federal courts also use common law principles to review disputed awards. Some principles— for example,

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*Discrimination*, 50 DISP. RESOL. J. (Oct.-Dec., 1995), 42-43 (comparing win rates and award amounts for litigation and arbitration in the securities industry from 1992-94, employees won 28% of non-jury trials, 38% of jury trials, and 48% of arbitrations); and \_\_\_\_\_ & Peter Feuille, *Judicial Enforcement of Predispute Arbitration Agreements: Back to the Future*, 18 OHIO ST. J. DISP. RESOL. 249 (2003) (study of 152 employment arbitration rulings between 1977 and 2003 found that employers won in 50.7%, while employees partially prevailed in 19.7% of the awards and entirely won in 29.6% of the awards).

<sup>170</sup> *Infra* note 187.

<sup>171</sup> *Infra* note 187.

<sup>172</sup> *Id.* (see citations to specific state arbitration laws).

the award shall not be made in manifest disregard of the law— are unique, common law adjuncts to FAA standards.

To my surprise, an entirely different set of common law reviewing principles also appeared in cases. These are standards that the Supreme Court promulgated specifically for voluntary labor arbitration awards. These 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.<sup>173</sup> This was accomplished by enacting Section 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.<sup>174</sup> The privately adopted custom to arbitrate contract disputes, backed by the LMRA, allowed labor arbitration to become “the means of solving the unforeseeable by molding a system of private law for all the problems which may arise.”<sup>175</sup>

The point is that court review of these challenged awards occurs under Section 301 the LMRA, rather than the FAA. Section 301 does not specify court reviewing

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<sup>173</sup> See Justice Douglas's observation in *Textile Workers Union of Am. v. Lincoln Mills of Alabama*, 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). Also see ARCHIBALD COX ET AL., LABOR LAW: CASES AND MATERIALS 717 (13<sup>th</sup> ed. 2001) (reporting that arbitration provisions reflecting this bargained exchange appear in about ninety-six percent of all labor agreements).

<sup>174</sup> Labor Management Relations (Taft-Hartley) Act, c. 120, Title III, § 301, 61 Stat. 156 (June 23, 1947), §301(a), codified at 29 U.S.C. §185(a)(2005), stating:

Suits for violation of contracts between an employer and a labor organization representing employees in an industry affecting commerce as defined in this [Act] . . . may be brought in any district court of the United States having jurisdiction of the parties, without respect to the amount in controversy or without regard to the citizenship of the parties.

<sup>175</sup> See *United Steelworkers of Am. v. Warrior & Gulf Nav. Co.*, *infra* note 205, at 581.



standards, but merely creates federal jurisdiction to enforce a collective bargaining agreement. To address this vague jurisdiction, the Supreme Court articulated standards in the *Steelworkers Trilogy*,<sup>176</sup> three companion decisions that specifically applied to dispute resolution in union-management relations.

Given the unique character of *Trilogy* standards, I was surprised to encounter numerous court decisions under the FAA in which these labor-management principles were applied side-by-side with FAA grounds. And so, the checklist grew again.

There is more to tell here besides explaining how my checklist grew. As I read hundreds of cases, courts repeatedly cautioned that they use highly deferential standards to review awards. The following was typical: “[M]aximum deference is owed to the arbitrator’s decision and the standard of review of arbitration awards is among the narrowest known to law. Once 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.”<sup>177</sup>

While courts are sincere in proclaiming great deference to arbitration, 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.

As the following discussion unfolds, the reader will sense this snowball effect.

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<sup>176</sup> *Infra* note 205.

<sup>177</sup> *Durkin v. CIGNA Property & Cas. Corp.*, 986 F.Supp. 1356, 1358 (D. Kan. 1997), quoting *ARW Exploration Corp. v. Aguirre*, 45 F.3d 1455, 1462-63 (10<sup>th</sup> Cir. 1995). The *Durkin* court added: “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.*

For now, I highlight this Article's thesis: 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 usually intend to protect the weaker party in arbitration from procedural abuses that were created by the drafter of arbitration agreements.<sup>178</sup> 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. 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.

As I learned from collecting data, “government” 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 who have developed their own common law for reviewing awards, state legislatures who passed the UAA and RUAA, and state courts who have added their own interpretive doctrines for various facets of award review. Furthermore, these public policies were never created with clear and exclusive boundaries, nor has there been any effort to coordinate this layered approach.

The disjointed patchwork of regulation presents an insurance opportunity to employers. They see what I observed in my ever-growing checklist: a wide array of reviewing standards that represents a fertile field of possibilities to attack, and perhaps escape, an award. I now explain my theory in detail.

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<sup>178</sup> See RUAA Prefatory Note, *infra* note 186.

*B. Statutory Regulation: FAA and State Laws Patterned on the UAA*

The main concern of lawmakers who passed the Federal Arbitration Act was to end judicial hostility to arbitration agreements.<sup>179</sup> 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: "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."<sup>180</sup> The 1924 Senate report was more complete, stating that the award could be set aside if it was secured by corruption, fraud, or undue means; or if there was partiality or corruption on the part of the arbitrators; or in a situation where an arbitrator is guilty of misconduct or refuses to hear evidence or because of prejudicial misbehavior by the parties; or the arbitrator exceeds his or her powers.<sup>181</sup> A lawyer's brief on common law vacatur provided the main outline for judicial reviewing standards in the FAA,<sup>182</sup> and

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<sup>179</sup> During Senate debate on 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." Remarks of Senator Walsh, 68 Cong. Rec. 984 (1924). The same point was raised during House debate. See Remarks of Congressman Graham, 68 Cong. Rec. 1931 (1924).

<sup>180</sup> H.R. REP. NO. 68-96, *supra* note 158, at 2.

<sup>181</sup> S. REP. NO. 68-536, *supra* note 158, at 4, stating:

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.

<sup>182</sup> See *Joint Hearings before the Subcommittees of the Committees on the Judiciary*, 68<sup>th</sup> Cong. 1<sup>st</sup> Sess, on S. 1005 and H.R. 646, at 36 (1924) (Statement of W.W. Nichols, January 9, 1924). The legislative reports and debates said nothing as to whether post-award and state court litigation rules should be preempted by the new federal law.

now appears in Section 10.<sup>183</sup>

Contemporary courts believe that these grounds are strikingly narrow.<sup>184</sup> The first sub-section requires proof of arbitrator fraud or corruption. The second is similarly narrow when it requires proof of evident partiality by the arbitrator. The third basis refers to unlikely events during the arbitration proceedings. A hearing must be scheduled, and a party must request a postponement of the hearing. In addition, the arbitrator must refuse to grant the request for postponement. 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.”<sup>185</sup> Similar to the first two FAA provisions, vacatur depends on arbitrator misconduct. 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. The fourth and final ground appears to be the broadest, since it refers to arbitrator judgment and discretion. A court may vacate an award where arbitrators exceeded their powers. Alternatively, an award may be vacated for being so indefinite that it is imperfectly executed.

In addition, thirty-five states have adopted the Uniform Arbitration Act (UAA),

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<sup>183</sup> See United States Arbitration Act, ch. 213, 43 Stat. 883 (1925), codified as amended at 9 U.S.C. § 10 (2000), authorizing courts to vacate an award where

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

<sup>184</sup> *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.”).

<sup>185</sup> See *supra* note 156, at 9 U.S.C. § 10(3).

proposed in 1955 to repeal state laws that obstructed arbitration agreements, while fourteen other states have enacted similar legislation.<sup>186</sup> Many state laws contain the four statutory standards in Section 10 of the FAA, and add a fifth basis to vacate an award.<sup>187</sup>

This fairly uniform approach began to fragment after 2000, when a national panel of experts approved the Revised Uniform Arbitration Act (hereafter, RUAA). In a recent survey of all state laws, the American Arbitration Association reported that 12 states adopted the RUAA.<sup>188</sup> The revised vacatur standards appear in Section 23.<sup>189</sup>

<sup>186</sup> The Revised Uniform Arbitration Act (Prefatory Note),

<http://www.law.upenn.edu/bll/ulc/uarba/arbitrat1213.htm>.

<sup>187</sup>

The Uniform Arbitration Act is reproduced by the American Arbitration Association at <http://www.adr.org/sp.asp?id=29567>. Section 12, “Vacating an Award,” states:

(a) Upon application of a party, the court shall vacate an award where: (1) The award was procured by corruption, fraud or other undue means; (2) There was evident partiality by an arbitrator appointed as a neutral or corruption in any of the arbitrators or misconduct prejudicing the rights of any party; (3) The arbitrators exceeded their powers; (4) The arbitrators refused to postpone the hearing upon sufficient cause being shown therefor or refused to hear evidence material to the controversy or otherwise so conducted the hearing, contrary to the provisions of Section 5, as to prejudice substantially the rights of a party; or (5) There was no arbitration agreement and the issue was not adversely determined in proceedings under Section 2 and the party did not participate in the arbitration hearing without raising the objection; but the fact that the relief was such that it could not or would not be granted by a court of law or equity is not ground for vacating or refusing to confirm the award.

UAA vacatur standards appear in Alaska (Ak. St. § 09.43.120, Vacating an Award); Arizona (A.R.S. 12-1512, Opposition to an Award); Arkansas (A.C.A. § 16-108-212, Vacating an Award); Idaho (I.C. § 7-912, Vacating an Award); Illinois (710 ILCS 5/12, Vacating an Award); Indiana (I.C. § 34-57-2-13, Vacation of an Award); Kansas (Ks. St. § 5-412, Vacating an Award); Kentucky (K.R.S. § 417.160, Vacating an Award); Maine (14 M.R.S.A. § 5938, Vacating Award); Massachusetts (M.G.L.A. 150C §12, Vacation of an Award); Minnesota (M.S.A. § 572-19, Vacating an Award); Missouri (V.A.M.S. 435.405, Vacating an Award); Montana (Mt. St. 27-5-312, Vacating an Award); Nebraska (Neb. Rev. St. § 25-2613, Vacating an Award); South Carolina (Code 1976, § 15-48-130); South Dakota (S.D.C.L. § 21-25A-24, Grounds for Vacation of an Award); Indiana (I.C. § 34-57-1-17, Grounds Against Rendition of Award on Judgment); Tennessee (T.C.A. § 29-5-213); Virginia (Va. Code Ann. § 8.01-581-010). Alaska and Colorado retain the UAA structure but also adopted the Revised Uniform Arbitration Act. *See id.*, Revised Uniform Arbitration Act (Prefatory Note).

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*See RUAA and UMA Legislation from Coast to Coast*, DISPUTE RESOLUTION TIMES, in <http://www.adr.org/sp.asp?id=26600>. The states are Alaska, Colorado, Hawaii, Nevada, New Jersey, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Utah, and Washington.

<sup>189</sup>

The Revised Uniform Arbitration Act, *supra* note 186. 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. In reproducing the vacatur provision, I italicize all additions to Section 10 of the FAA; and italicize and underline additions to Section 12 of the UAA:

SECTION 23. VACATING AWARD.

The RUAA drafters identified fourteen issues that required updating in contemporary arbitration.<sup>190</sup> 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.

Drafters said that courts should ensure fairness in arbitration. Thus, the RUAA treats arbitration as a consensual process.<sup>191</sup> The model law also broke new ground by regulating arbitrator neutrality.<sup>192</sup> It expanded arbitrator powers to order discovery, rule on summary judgment motions, conduct pre-hearing conferences, and manage arbitration

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(a) Upon [motion] to the court by a party to an arbitration proceeding, the court shall vacate an award made in the arbitration proceeding if: (1) the award was procured by corruption, fraud, or other undue means; (2) there was: (A) evident partiality by an arbitrator appointed as a neutral arbitrator; (B) corruption by an arbitrator; or (C) misconduct by an arbitrator prejudicing the rights of a party to the arbitration proceeding; (3) an arbitrator refused to postpone the hearing upon showing of sufficient cause for postponement, refused to consider evidence material to the controversy, or otherwise conducted the hearing contrary to Section 15, so as to prejudice substantially the rights of a party to the arbitration proceeding; (4) an arbitrator exceeded the arbitrator's powers; (5) there was no agreement to arbitrate, unless the person participated in the arbitration proceeding without raising the objection under Section 15(c) not later than the beginning of the arbitration hearing; or (6) the arbitration was conducted without proper notice of the initiation of an arbitration as required in Section 9 so as to prejudice substantially the rights of a party to the arbitration proceeding.

<sup>190</sup> *Id.* The RUAA list includes: (1) who decides the arbitrability of a dispute and by what criteria; (2) whether a court or arbitrators may issue provisional remedies; (3) how a party can initiate an arbitration proceeding; (4) whether arbitration proceedings may be consolidated; (5) whether arbitrators are required to disclose facts reasonably likely to affect impartiality; (6) what extent arbitrators or an arbitration organization are immune from civil actions; (7) whether arbitrators or representatives of arbitration organizations may be required to testify in another proceeding; (8) whether arbitrators have the discretion to order discovery, issue protective orders, decide motions for summary dispositions, hold pre-hearing conferences and otherwise manage the arbitration process; (9) when a court may enforce a pre-award ruling by an arbitrator; (10) what remedies an arbitrator may award, especially in regard to attorney's fees, punitive damages or other exemplary relief; (11) when a court can award attorney's fees and costs to arbitrators and arbitration organizations; (12) when a court can award attorney's fees and costs to a prevailing party in an appeal of an arbitrator's award; and (13) which sections of the UAA would not be waivable; particularly when one party has significantly less bargaining power than another; and (14) the use of electronic information in the arbitration process.

<sup>191</sup> *Id.* Prefatory Note ("arbitration 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").

<sup>192</sup> *Id.* Section 12, Disclosure by Arbitrator.

processes.<sup>193</sup> A new rule empowered courts to enforce a pre-award ruling.<sup>194</sup>

Drafters also regulated the remedial boundary that overlaps arbitration and courts.<sup>195</sup> A new section prescribed arbitrator powers to order attorney's fees, punitive damages, and other exemplary relief.<sup>196</sup> The RUAA also allowed courts to award attorney's fees and costs to a prevailing party.<sup>197</sup>

In addition, the revised act reaffirmed the need for arbitral finality.<sup>198</sup> Its regulations were meant to facilitate "the relative speed, lower cost, and greater efficiency of the [arbitration] process."<sup>199</sup> 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."<sup>200</sup>

The moral hazard thesis raises a question: Did the RUAA 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

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<sup>193</sup> *Id.* Section 17, Witnesses, Subpoenas, Depositions, Discovery.

<sup>194</sup> *Id.* Section 18, Judicial Enforcement of Preaward Ruling.

<sup>195</sup> *Id.* Section 21, Remedies; Fees and Expenses of Arbitration Proceeding.

<sup>196</sup> *Id.* Section 21(a)-(b).

<sup>197</sup> *Id.* Section 25, Judgment on the Award; Attorney's Fees and Litigation Expenses.

<sup>198</sup> *Id.* Section 25, Comment ("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.").

<sup>199</sup> *Id.* Prefatory Note.

<sup>200</sup> *Id.*

I pause to refocus this complex discussion. The FAA was enacted in 1925 to enable businesses to settle their disputes in arbitration rather than court.<sup>201</sup> In 1947, Congress enacted a separate federal law for arbitration clauses in collective bargaining agreements,<sup>202</sup> though the statute did not provide standards for reviewing arbitration awards. The Labor-Management Relations Act (LMRA) was intended to reduce strikes and frictions between unions and employers by creating federal jurisdiction to enforce these contracts.<sup>203</sup> Important to note here, the purposes of the FAA and LMRA are so distinct that earlier courts questioned whether labor arbitration awards were reviewable under an arbitration law that was intended for business disputes.<sup>204</sup> The Supreme Court ended this debate by fashioning federal common law principles to review labor arbitration awards. In the *Steelworkers Trilogy*,<sup>205</sup> the Court analyzed how unions and employers mutually select arbitrators, and voluntarily submit issues for resolution.

Many years later, the surprise is that FAA and RUA courts use award review principles from the *Trilogy*. I am not judging whether such borrowing is legally appropriate. Instead, my moral hazard analysis notes that: (1) the *Trilogy* award review standards— while narrow— are broader than the extremely specific vacatur provisions in the FAA’s Section 10, and (2) when courts add *Trilogy* grounds in their review of an arbitrator’s ruling, award losers gain an extra layer of insurance on top of Section 10.

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<sup>201</sup> See Gilmer, *infra* note 326, explaining congressional intent in passing the FAA.

<sup>202</sup> *Supra* note 174.

<sup>203</sup> See Lincoln Mills, *supra* note 173.

<sup>204</sup> This conclusion is extensively supported in Donald H. Wollett & Harry H. Wellington, *Federalism and Breach of the Labor Agreement*, 7 STAN. L. REV. 445 (1955). The authors noted that “applicability of the [Federal] Arbitration Act to collective agreements turns upon the construction of the phrase ‘contracts of employment.’” *Id.* at 458. Their analysis continued: “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 (citations omitted).” *Id.*

<sup>205</sup> See *United Steelworkers of Am. v. Warrior & Gulf Nav. Co.*, 363 U.S. 574 (1960); *United Steelworkers of Am. v. Am. Mfg. Co.*, 363 U.S. 564 (1960); and *United Steelworkers of Am. v. Enter. Wheel & Car Corp.*, 363 U.S. 593 (1960).



What are the award reviewing standards under the *Steelworkers Trilogy*? In more vague terms, as compared to Section 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.”<sup>206</sup> 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.”<sup>207</sup> By using expressions such as “essence from the collective bargaining agreement” and “own brand of industrial justice,” *Enterprise Wheel* left some room for courts to review the merits of an award.

*Enterprise Wheel* returned to its main theme of deference to the arbitrator when it said that a “mere ambiguity in the opinion accompanying an award, which permits the inference that the arbitrator may have exceeded his authority, is not a reason for refusing to enforce the award. Arbitrators have no obligation to the court to give their reasons for an award.”<sup>208</sup> 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.”<sup>209</sup> A court should not vacate an award merely because it disagrees with the arbitrator’s construction of the agreement.<sup>210</sup>

Other *Trilogy* decisions emphasized the unique institutional features of labor arbitration. These points are important insofar as they suggest that FAA and RUAA

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<sup>206</sup> *Id.* (Enterprise Wheel, at 597).

<sup>207</sup> *Id.*

<sup>208</sup> *Id.* at 598.

<sup>209</sup> *Id.*

<sup>210</sup> *Id.* at 598, stating that “the question of interpretation of the collective bargaining 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.”

courts should not use *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.*”<sup>211</sup> The emphasis means that the *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. There was no thought at the time of the *Trilogy* that these reviewing principles would apply to mandatory arbitration or any other non-labor context.

Another *Trilogy* decision, *Warrior & Gulf*, made this point clearly, noting that 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.”<sup>212</sup>

The *Trilogy* has been updated in one essential area, when an award appears to contradict a public policy. Intending to limit review of these awards, *United Paperworkers Int’l Union v. Misco*<sup>213</sup> 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 laws and legal precedents and not from general considerations of supposed public interests.”<sup>214</sup> *Misco* refined *Trilogy* principles by admonishing lower courts not to interfere with “improvident, even silly factfinding.”<sup>215</sup> The Court reminded

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<sup>211</sup> American Mfg., *supra* note 205, at 568.

<sup>212</sup> *Warrior & Gulf*, *supra* note 205, at 581. 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.” *Id.* at 582.

<sup>213</sup> 484 U.S. 29 (1987).

<sup>214</sup> *Id.* at 43.

<sup>215</sup> *Id.* at 39.

judges: “This is hardly a sufficient basis for disregarding what the agent appointed by the parties determined to be the historical facts.”<sup>216</sup>

More recently, the Court reaffirmed these principles. *Eastern Associated Coal Corp. v. United Mine Workers District 17*<sup>217</sup> rebuked judges who fail to review awards with great deference.<sup>218</sup> *Major League Baseball Players Ass’n v. Garvey*<sup>219</sup> used another example of court interference in arbitration to emphasize that judges must use restraint.<sup>220</sup>

## 2. Manifest Disregard of the Law

Although *Misco* was anchored in a labor arbitration context, some courts apply its test when they review individual employment arbitration awards.<sup>221</sup> In addition, some award-reviewing courts apply a similar though more narrow concept—manifest disregard of the law.<sup>222</sup> This common law standard can lead to vacatur.<sup>223</sup>

Federal circuit courts are divided in their use of manifest disregard.<sup>224</sup> Adopting

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<sup>216</sup> *Id.*

<sup>217</sup> 531 U.S. 57 (2000).

<sup>218</sup> The Court reminded federal judges that “both employer and union have granted to the arbitrator the authority to interpret the meaning of their contract’s language, including such words as just cause.” *Id.* at 61. Additionally, *Eastern* said: “They have bargained for the arbitrator’s construction of their agreement. And courts will set aside the arbitrator’s interpretation of what their agreement means only in rare instances (emphasis added).” *Id.* at 62.

<sup>219</sup> 532 U.S. 504 (2001).

<sup>220</sup> The Supreme Court, frustrated by the Ninth Circuit’s meddling, called the court’s behavior “nothing short of baffling.” *Id.* at 510. *Garvey* emphasized that “established 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.” *Id.* at 511. *Garvey* 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.

<sup>221</sup> *E.g.*, *DiRussa v. Dean Witter Reynolds Inc.*, 121 F.3d 818, 825 (2d Cir. 1997).

<sup>222</sup> *E.g.*, *LaPrade v. Kidder, Peabody & Co., Inc.*, 246 F.3d 702, 706 (D.C. Cir. 2001); and *Kanuth v. Prescott, Ball & Turben, Inc.*, 949 F.2d 1175 (D.C. Cir. 1991).

<sup>223</sup> *E.g.*, *DeGaetano v. Smith Barney, Inc.*, 983 F.Supp. 459 (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.

<sup>224</sup> The standard has been adopted by the Second Circuit (*Drayer v. Krasner*, 572 F.2d 348, 352 (2d Cir. 1978)), Fourth Circuit (*Patten v. Signator Ins. Agency, Inc.*, 441 F.3d 230 (4<sup>th</sup> Cir. 2006)), Fifth Circuit (*Prestige Ford v. Ford Dealer Computer Svcs., Inc.*, 324 F.3d 391, 395 (5<sup>th</sup> Cir. 2003)), Sixth Circuit (*Buchignani v. Vining Sparks IBG, Inc.*, 208 F.3d 212 (6<sup>th</sup> Cir. 2000)); Ninth Circuit (*Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056, 1060 (9<sup>th</sup> Cir. 1991)), and Eleventh Circuit

the standard, the Second Circuit explained in *Halligan v. Piper Jaffray, Inc.*, that arbitrators cannot “ignore[] the law or the evidence or both.”<sup>225</sup> However, the standard does not presume that arbitrators know specific laws.<sup>226</sup> Taking a different view, the Seventh Circuit cast doubt on this standard in Judge Posner’s scholarly opinion.<sup>227</sup>

Many state courts also apply the manifest disregard standard. *Madden v. Kidder Peabody & Co.*,<sup>228</sup> explained: “In 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.”<sup>229</sup> *Madden* demonstrated the narrow scope of the standard when it concluded that the “case at bar, however, is not cut to so rare a pattern: appellant has utterly failed to show that the arbitrators inevitably must have recognized [the controlling rule of law].”<sup>230</sup>

In sum, judicial review of an employment award under the Federal Arbitration Act 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 Section 10. To the contrary, arbitration losers

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(*Ainsworth v. Skurnick*, 960 F.2d 939, 940-41 (11<sup>th</sup> Cir. 1992) (per curiam)). A Tenth Circuit district court used the standard in *Durkin v. CIGNA Property & Cas. Corp.*, 986 F.Supp. 1356 (D. Kan. 1997).

<sup>225</sup> *Halligan v. Piper Jaffray, Inc.*, 148 F.3d 197, 204 (2d Cir. 1998).

<sup>226</sup> In *DiRussa v. Dean Witter Reynolds, Inc.*, *supra* note 221, an age discrimination complainant was awarded \$220,000, but his request for attorney’s fees— totaling \$249,050— was denied. 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. The Second Circuit disagreed, stating: “the remedy for that does not lie with us.” *Id.* at 823. The court continued 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.*

<sup>227</sup> See *Baravati v. Josephthal*, 28 F.3d 704, 706 (7th Cir. 1997). Judge Posner expressed strong doubts about the manifest disregard standard, noting: “We 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.”

<sup>228</sup> 883 S.W.2d 79 (Mo. App. 1994).

<sup>229</sup> *Id.* at 83.

<sup>230</sup> *Id.*

present up to thirteen separate arguments for vacating awards.<sup>231</sup> Common law standards play a major role in this process. Some are from the *Trilogy*— for example, the arbitrator exceeds his or her authority, and the award fails to draw its essence from the agreement. 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.

## V. EMPIRICAL RESEARCH METHODS AND STATISTICAL RESULTS

### A. Method for Creating the Sample

I used research methods from my earlier empirical studies.<sup>232</sup> The sample was derived from Westlaw’s internet service. Federal and state databases were searched for cases because employers and individuals are allowed a choice of forum to contest awards. Keywords were derived from terms in the FAA, RUAA and state arbitration laws.<sup>233</sup>

Cases were limited to arbitrations involving an individual and employer. Each case involved a post-award dispute in which an arbitrator’s ruling was challenged by

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<sup>231</sup> In rank order of their frequency, the issues were: (1) Manifest Disregard of the Law (Non-Trilogy Common Law Standard), (2) Exceed Powers or Imperfectly Execute Award (9 U.S.C. § 10(4) or State UAA Equivalent), (3) Partiality (9 U.S.C. § 10(2) or State UAA Equivalent), (4) Award Violated a Public Policy (Trilogy Common Law), (5) Misconduct (9 U.S.C. § 10(3) or State UAA Equivalent), (6) Lacks Jurisdiction Due to Timeliness Requirements (9 U.S.C. § 12/State Equivalent), (7) Arbitrator Committed A Fact-Finding Error (Trilogy Common Law), (8) Arbitrary & Capricious, Irrational, or Gross Error (Non-Trilogy Common Law Standard); (9) Arbitrator Exceeded Authority (Trilogy Common Law), (10) Award Procured by Corruption, Fraud, or Undue Means (9 U.S.C. § 10(1) or State UAA Equivalent), (11) Award Did Not Draw Its Essence from the Agreement (Trilogy Common Law); (12) Remedy Was Punitive, Excessive, or Unauthorized (Non-Trilogy Common Law Standard), and (13) Unconstitutional or Due Process (Non-Trilogy Common Law Standard).

<sup>232</sup> E.g., \_\_\_\_\_ & 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). Also see \_\_\_\_\_ & Peter Feuille, *Reinventing the Enterprise Wheel: Court Review of Punitive Awards in Labor and Employment Arbitrations*, 10 HARV. NEGOT. L. REV. 199, 230-34 (2006); and \_\_\_\_\_ & Peter Feuille, *Private Justice in the Shadow of Public Courts: The Autonomy of Workplace Arbitration Systems*, 17 OHIO ST. J. ON DISP. RES. 19, 45-48 (2001).

<sup>233</sup> E.g., “PROCURED BY CORRUPTION,” or “EVIDENT PARTIALITY,” or “REFUSING TO POSTPONE THE HEARING,” or “ARBITRATORS EXCEEDED THEIR POWERS,” or “IMPERFECTLY EXECUTED.”

either an employee or employer. Arbitration cases involving unions and employers were excluded because they involve unique characteristics of labor-management relations.<sup>234</sup>

The sample began with a 1975 decision,<sup>235</sup> and ended with cases from September 2007. After a potential case was identified, I read it to see if it met the inclusion criteria. For example, pre-arbitration disputes over enforcement of an arbitration clause were excluded. Cases were included, on the other hand, where employees resisted arbitration, were compelled to arbitrate their claims, and were later involved in a post-award lawsuit.<sup>236</sup> Some cases involved employees who preferred court to arbitration but prevailed in the private forum, leading the employer to seek vacatur.<sup>237</sup>

Once a case met the criteria, it was checked against a roster of previously coded cases to avoid duplication.<sup>238</sup> Next, relevant data were taken 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 (3) appellate ruling, where appropriate. Other data were analyzed for companion studies.<sup>239</sup>

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<sup>234</sup> See *Warrior & Gulf*, *supra* note 205 (reference to industrial self-government).

<sup>235</sup> *McClure v. Montgomery County Community Action Agency*, 1975 WL 181652 (Ohio App. 2 Dist. 1975).

<sup>236</sup> *Gold v. Deutsche Aktiengesellschaft*, 365 F.3d 144 (2d Cir. 2004).

<sup>237</sup> In *Madden*, *supra* note 228, an employee sued but was ordered by the court to arbitrate his claim. After he prevailed and was awarded \$250,000, the employer sued to vacate the award, but the court denied the motion.

<sup>238</sup> The roster appears in Appendix I. In rare cases, an award was challenged once and remanded to arbitration; and after arbitrators ruled again, the award was challenged a second time. I treated these award challenges as separate cases, even though the parties and dispute remained the same, because the awards differed. See *Sawtelle*, *infra* note 259.

<sup>239</sup> \_\_\_\_\_ & Peter Feuille, *Happily Never After: When Arbitration Has No Fairy Tale Ending*, \_\_ HARV. NEGOT. L. REV. \_\_ (forthcoming, 2008) reporting on a recent spurt of award-review cases, exemplified by the finding that 64.9% of federal district award-review courts decisions occurred since 2000. Another companion study is \_\_\_\_\_, *Misguided Fairness? Regulating Arbitration by Statute: Empirical Evidence of Declining Award Finality*, 82 NOTRE DAME L. REV. \_\_ (2008). Using an earlier database, this study concluded that states are expanding arbitration reviewing standards. This development is undermining the national policy that favors arbitration.

The present study adds two innovations. Here, the study analyzes awards by the winning party. Vacatur rates are computed for awards that were won by employees, and awards that ruled for employers.

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 for RUAA, five *Trilogy* standards, and five separate federal common law standards.<sup>240</sup> 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? These rates are hard to interpret unless they are obviously low or high. A benchmark was needed to scale whatever vacatur rate is measured. Therefore, as the database grew, research began on similar studies— those 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 following hierarchy of court deference was created: **(A)**

**Extreme Deference**<sup>241</sup> (affirmance rate of 92.0% or more, or reversal rate of 8.0% or

This empirical question is then related to a new theoretical question: whether judicial review of employment arbitration creates moral hazard.

<sup>240</sup> Earlier, I explained that parties have 13 arguments to challenge employment awards. *See supra* note 231. But here I enumerate more grounds. The difference is that some arguments are redundant, for example, the arbitrator exceeded his authority. This is an FAA and *Trilogy* standard. Thus, it is coded in two separate places on the form.

<sup>241</sup> Kevin M. Clermont & Theodore Eisenberg, *Plaintiphobia in the Appellate Courts: Civil Rights Really Do Differ from Negotiable Instruments*, 2002 U. ILL. L. REV. 947 (2002). This study examined 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 956. 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 Catherson, *Changes in Appellate Caseload and Its Processing*, 48 ARIZ. L. REV. 287 (2006). This study showed that as the circuit's caseload has mushroomed from 1945 to 2005, appellate courts have reversed far fewer rulings. *Id.* at 291 (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%. *Id.* at 287.

less); or **(B) Great Deference**<sup>242</sup> (affirmance rate of 84.0% to 91.9%, or reversal rate of 8.1% to 16.0%), or **(c) High Deference**<sup>243</sup> (affirmance rate of 76.0% to 83.9%, or reversal rate of 16.1% to 24.0%), or **(d) Moderate Deference**<sup>244</sup> (affirmance rate of 68.0% to 75.9%, or reversal rate of 24.1% to 32.0%), or **(e) Slight Deference**<sup>245</sup> (affirmance rate of 60.0% to 67.9%, or reversal rate of 32.1% to 40.0%), or **(f) No Deference**<sup>246</sup> (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.

Before proceeding to Table 1 (*infra*), I report on the frequency of employer and

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<sup>242</sup> E.g., James J. Brudney, *A Famous Victory: Collective Bargaining Protections and the Statutory Aging Process*, 74 N.C.L. REV. 939 (1996). Brudney analyzed 1,224 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. These rulings were reversed in only 14.7% of cases. *Id.* at 950.

<sup>243</sup> 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 for judge and jury verdicts in patent disputes at the same rate, 78%. *Id.* at 379.

<sup>244</sup> \_\_\_\_\_ & Peter Feuille, *The Steelworkers Trilogy and Grievance Arbitration Appeals: How the Federal Courts Respond*, 13 INDUS. REL. L.J. 78, 98 (1992). This research analyzed 1,148 federal district court decisions and 480 federal circuit court decisions that resulted in a court order which compelled or denied arbitration or which enforced or vacated an arbitrator's award in whole or in part. These decisions were published after June 23, 1960 and before July 1, 1991. A follow-up study, \_\_\_\_\_ & Peter Feuille, *Private Justice in the Shadow of Public Courts: The Autonomy of Workplace Arbitration Systems*, 17 OHIO ST. J. DISP. RESOL. 19, 50 tbl.1 (2001), reported data for court review of awards from 1991-2001. In the first study, award confirmation rates by district and appellate courts from 1960-1991 were, respectively, 71.8% and 70.5%. See \_\_\_\_\_ & Feuille, *The Steelworkers Trilogy and Grievance Arbitration Appeals*, at 102. In a more recent study that examined court rulings from 1991-2001, \_\_\_\_\_ and Feuille observed very similar confirmation rates. District courts enforced 70.3% of all challenged awards, and appellate courts confirmed 70.5% of awards. \_\_\_\_\_ & Feuille, *Private Justice in the Shadow of Public Courts*, at 49.

<sup>245</sup> \_\_\_\_\_ and Feuille's 2001 study showed an example of slight judicial deference. Federal appeals courts confirmed 66.4% of labor awards. *Id.* \_\_\_\_\_ & Feuille, *Private Justice in the Shadow of Public Courts*, at 49. Federal appeals courts confirmed 66.4% of labor awards. *Id.*

<sup>246</sup> 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 (2002), a study of Nebraska death penalty reversals that showed no appellate deference to lower court rulings. On appeal, courts vacated 19 of 29 death penalty sentences, or 66%. *Id.* at 503.



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, 160 district and 83 appeals courts ruled on an award [Table 1]. In district court, employers won 90 awards (56.3%). Individuals won 55 awards (34.4%), and split awards in the remaining 15 cases (9.3%). In federal appellate decisions [Table 3], employers won 56 awards (67.5%). Employees won 20 awards (24.1 %), and split awards in 7 cases (8.4%).

At the state level, the sample had rulings from 107 first-level courts [Table 2],<sup>247</sup> and 93 appellate courts [Table 4]. Employers won 47 of the awards at the first level, or 43.9% of the challenged awards in this category. Individuals won 49 awards (45.8%), and split awards in the remaining 11 cases (10.3%). In state appellate decisions, employers won 45 awards (48.4%). Employees won 39 awards (41.9%), and had split awards in 9 cases (9.7%).

**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%). 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%).

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<sup>247</sup> States use different names for courts that conduct first review of awards (e.g., circuit court, or superior court). These tribunals are generically called first-level courts.

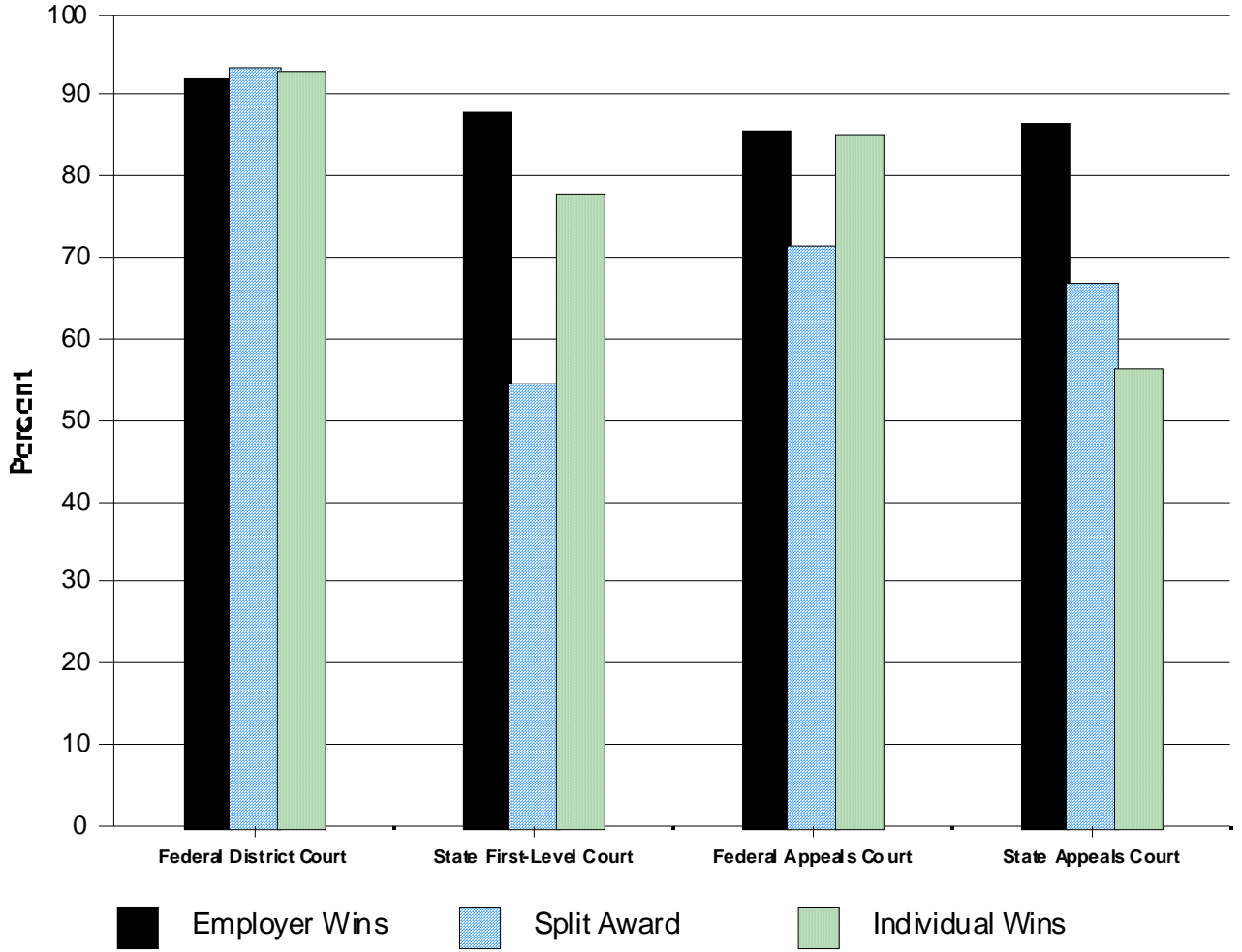
<b>Table 1</b> <b>Federal District Court Review of Arbitration Awards:</b> <b>Vacatur of Employee and Employer Wins</b>				
	Confirm Award	Partly Confirm Award	Vacate Award	Total
Employer Wins Award	83 92.2%	1 1.1%	6 6.7%	90
Split Award	14 93.3%	0 0%	1 6.7%	15
Employee Wins Award	51 92.7%	2 3.6%	2 3.6%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

<b>Table 2</b> <b>State First-Level Court Review of Arbitration Awards:</b> <b>Vacatur of Employee and Employer Wins</b>				
	Confirm Award	Partly Confirm Award	Vacate Award	Total
Employer Wins Award	41 87.2%	0 0%	6 12.8%	47
Split Award	6 54.5%	2 18.2%	3 27.3%	11
Employee Wins Award	38 77.6%	1 2.0%	10 20.4%	49
Total $\chi^2$ 13.351, df = 4, .010	85 79.4%	3 2.8%	19 17.8%	107

<b>Table 3</b> <b>Federal Appellate Court Review of Arbitration Awards:</b> <b>Vacatur of Employee and Employer Wins</b>				
	Confirm Award	Partly Confirm Award	Vacate Award	Total
Employer Wins Award	48 85.7%	0 0%	8 14.3%	56
Split Award	5 71.4%	0 0%	2 28.6%	7
Employee Wins Award	17 85.0%	3 15.0%	0 0%	20
Total $\chi^2$ 13.831, df = 4, .008	70 84.3%	3 3.6%	10 12.0%	83

<b>Table 4</b> <b>State Appellate Court Review of Arbitration Awards:</b> <b>Vacatur of Employee and Employer Wins</b>				
	Confirm Award	Partly Confirm Award	Vacate Award	Total
Employer Wins Award	39 86.7%	1 2.2%	5 11.1%	45
Split Award	6 66.7%	1 11.1%	2 22.2%	9
Employee Wins Award	22 56.4%	7 17.9%	10 25.6%	39
Total $\chi^2$ 10.553, df = 4, .032	67 72.0%	9 9.7%	17 18.3%	93

**Chart 1**  
**Court Confirmation of Award by Winning Party**



**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. Judges confirmed 92.7% [Table 1] of wins for employees and 92.2% of wins for employers [Table 1]. Federal appeals courts confirmed 85.7% [Table 3] of employer wins. This matched the percentage of pro-employee awards (85.0%) [Table 3].

**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 [*compare* Table 1, Cell for Employer Wins (92.2%), and Table 3, Cell for Employer Wins (85.7%)]. In the same comparison for awards that favored employees, the difference between district and appellate court confirmation rates was 7.7 percentage points [*compare* Table 1, Cell for Employee Wins (92.7%), and Table 3, Cell for Employee Wins (85.0%)].

**Finding No. 4: State courts overturned more awards than federal courts.** In state courts where awards were first challenged, judges enforced only 77.6% [Table 2] of employee wins. 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 [*see* Table 2, chi-squared = 13.351 with 4 degrees of freedom, implying that the difference in rates would not likely occur by chance].

**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 and appellate cases [respectively, Table 2 (87.2%), and Table 4 (86.7%)]. In the same

comparison for awards that favored employees, the state confirmation rate fell 21.2 percentage points— from 77.6% [Table 2, Cell for Employee Wins] at first-level courts to 56.4% [Table 4, Cell for Employee Wins] for appellate courts.

**Finding No. 6: State appellate courts vacated many more wins for employees than for employers.** Comparing award enforcement at the appellate level, courts confirmed 86.7% of pro-employer awards (Table 4) but only 56.4% of employee wins at arbitration (Table 4). This difference was statistically significant [*see* Table 4, chi-squared = 10.553 with 4 degrees of freedom, implying that the difference in rates would not likely occur by chance].

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

Statistics tell an important story about judicial review of arbitration awards. These empirical portraits add new insights to the current research literature, which is dominated by qualitative case studies.<sup>248</sup> Part VI features courts that defied the norm of confirming awards. When combined with the data, my discussion of 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 court vacated the arbitrator's award of \$915,214 to an employee who was discharged for allegedly violating the company's ethical code after a supplier brought a charge against him.<sup>249</sup> The arbitrator found that DaimlerChrysler breached its express agreement to investigate ethical violations.<sup>250</sup> The arbitrator ordered the company to reinstate Mr. Carson pending a thorough and fair

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<sup>248</sup> A recent example of an insightful qualitative study is William B. Gould IV, *Kissing Cousins?: The Federal Arbitration Act And Modern Labor Arbitration*, 55 EMORY L.J. 609 (2006).

<sup>249</sup> 2003 WL 888043 (Mich. App. 2003), at \*1 - \*2.

<sup>250</sup> *Id.* at \*1.

investigation, and to give him back pay from the time of discharge until reinstatement.<sup>251</sup>

However, after the company failed to reinstate Mr. Carson or conduct another investigation, the arbitrator awarded the employee \$450,000 in backpay and \$915,214 in front pay, less \$144,000 in mitigation earnings.<sup>252</sup> The award was based on evidence that Mr. Carson sent out nearly 500 resumes, attended four job fairs, and had 81 interviews without finding another permanent job.<sup>253</sup> The arbitrator determined the employee's work-life expectancy was age sixty-seven, and set this as the endpoint for front-pay.<sup>254</sup>

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.<sup>255</sup> The court ruled that "Carson's employment contract fell between the extremes of at-will and just cause."<sup>256</sup> 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 re-litigated 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.<sup>257</sup> 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.<sup>258</sup>

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*Id.*

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*Id.*

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*Id.*

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*Id.*

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*Id.* at \*2.

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*Id.*

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*Id.*

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The DaimlerChrysler opinion conflicts with the idea that a "court cannot interfere with an

*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. *Sawtelle v. Waddell & Reed, Inc.*<sup>259</sup> highlights a trend in which vacatur prolongs a process that is usually fast and low-cost. Repeating arbitrations seem to be more common. Courts create the problem by finding fault with awards.

Consider the arbitration saga in *Sawtelle*. A fired securities broker alleged that his employer maliciously tried to sever his relationship with clients by defaming him.<sup>260</sup> The arbitration was lengthy and expensive.<sup>261</sup> Arbitrators awarded Mr. Sawtelle \$1.87 million in actual damages, and \$25 million in punitive damages.<sup>262</sup>

The first state court to rule on the employer's challenge confirmed the award.<sup>263</sup> But the appeals court vacated the punitive award and remanded to the same arbitrators.<sup>264</sup> 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."<sup>265</sup> They also believed that Sawtelle's award for punitive damages violated *BMW of N.A. v. Gore*.<sup>266</sup> Thus, the award manifestly disregarded the law.<sup>267</sup>

On remand, the arbitrators accepted voluminous written submissions, held another

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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., Inc. v. Robinson, 12 F.3d 515, 520-21 (5<sup>th</sup> Cir. 1994).

<sup>259</sup> 754 N.Y.S.2d 264 (2003).

<sup>260</sup> *Id.* at 267-68.

<sup>261</sup> *Id.* at 268.

<sup>262</sup> *Id.* at 269.

<sup>263</sup> *Id.* at 273.

<sup>264</sup> *Id.* at 276.

<sup>265</sup> *Id.* at 273.

<sup>266</sup> *Id.* at 270-71, citing 517 U.S. 559 (1996).

<sup>267</sup> *Id.* at 274.



hearing, and issued a second award.<sup>268</sup> Their new award contained only one cosmetic change,<sup>269</sup> and the same punitive damages.<sup>270</sup> When the lower court reviewed the matter again, it vacated the punitive part a second time because of its ratio to actual damages.<sup>271</sup>

Concerned that another remand to the same panel would not change anything, the lower court ordered a third arbitration before a new panel.<sup>272</sup> 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.<sup>273</sup> The court conceded that Mr. Sawtelle's "suggestion seems to make sense,"<sup>274</sup> 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."<sup>275</sup> 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.<sup>276</sup>

Another arbitration odyssey appears in *Selby General Hospital v. Kindig*.<sup>277</sup> The case began with a contract dispute in February 1998 and ended in a July 2006 decision by an Ohio court of appeals.<sup>278</sup> Dr. Kindig was completing an internship when she signed an employment agreement to practice with Selby General Hospital.<sup>279</sup> The dispute arose

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<sup>268</sup> Sawtelle v. Waddell & Reed, Inc., 789 N.Y.S.2d 857, 858 (2004).

<sup>269</sup> *Id.* 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."

<sup>270</sup> *Id.*

<sup>271</sup> *Id.*

<sup>272</sup> *Id.*

<sup>273</sup> *Id.* at 859.

<sup>274</sup> *Id.*

<sup>275</sup> *Id.*

<sup>276</sup> *Id.* at 860.

<sup>277</sup> 2006 WL 2457436 (Ohio App. 4 Dist. 2006).

<sup>278</sup> *Id.* at \*1.

<sup>279</sup> *Id.*

when the hospital informed the doctor that it would not be able to keep its promise to build an office for her because of financial problems.<sup>280</sup> By this time, Dr. Kindig received a \$25,000 signing bonus.<sup>281</sup> Nonetheless, she believed that Selby General breached the contract, and therefore she secured employment elsewhere in Ohio.<sup>282</sup> The hospital sought recovery of the \$25,000, and she counterclaimed for breach of contract.<sup>283</sup>

The first arbitration was marred by procedural controversies over Dr. Kindig's hiring of an expert witness. After the parties wrangled for several months, the arbitrators rendered an award for Dr. Kindig and ordered \$313,329 in relief.<sup>284</sup> A trial court vacated this award in July 2002, and remanded for a new hearing.<sup>285</sup> The judge believed that the arbitrators' failure to enforce deadlines in the agreement was unfair to the hospital.<sup>286</sup>

A second arbitration hearing took place in January 2004 before a new panel,<sup>287</sup> and resulted in another award for Dr. Kindig— this time, for \$267,329.<sup>288</sup> After the hospital challenged the second ruling, the trial court enforced the award; and the hospital appealed again.<sup>289</sup> The state court of appeals confirmed the first award, which granted Dr. Kindig more relief.<sup>290</sup> The appellate court wryly noted that “[a]rbitration is designed to provide an efficient, expedited, and economical remedy to resolve disputes.”<sup>291</sup>

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*Id.*

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*Id.*

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*Id.*

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*Id.* at \*2.

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*Id.*

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*Id.* at \*3.

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*Id.* The judge found that Dr. Kindig's designation of an expert witness was “extremely untimely,” and amounted to “arbitration by ambush.” *Id.*

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*Id.*

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*Id.*

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*Id.*

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*Id.*

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The hospital also contended that the award was procured by undue means because of the “particularly egregious procedural irregularities” that surrounded the hearing. *Id.* at \*6. However, the

*C. Expanded Review of an Award*

An African-American woman in *Hughes Training Inc. v. Cook* quit her job after her supervisor required her to repeat a performance test and threatened to fire her.<sup>292</sup> During a stressful disciplinary meeting, Gracie Cook cried, stuttered, and rubbed her arm.<sup>293</sup> Her doctor believed that she suffered stress induced mini-strokes.<sup>294</sup> After she sued her employer in state court on claims that included emotional distress and discrimination, the dispute was submitted to an arbitrator.<sup>295</sup>

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.<sup>296</sup> Raytheon sued to vacate the award on grounds 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."<sup>297</sup>

The district court vacated the award, and the Fifth Circuit affirmed the vacatur

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appeals court was not persuaded. Applying a deferential standard, the court reasoned that "[a]lthough Kindig's untimely disclosure of her expert was improper, it was not illegal or immoral. . . . Nor was her conduct equivalent in gravity to corruption or fraud." *Id.* at \*7.

<sup>292</sup> 254 F.3d 588, 591 (5<sup>th</sup> Cir. 2001).

<sup>293</sup> *Id.* at 591.

<sup>294</sup> *Id.*

<sup>295</sup> *Hughes Training, Inc. v. Cook*, 148 F.Supp.2d 737 (N.D. Tex. 2000). Cook originally filed a complaint in Texas state court alleging intentional infliction of emotional distress in connection with the end of her employment. *Id.* at 741. Later, her complaint was amended to include a Title VII discrimination claim and a tort claim in 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.*

<sup>296</sup> *Id.* The arbitrator determined that the company knew that Cook had previously suffered a stroke, and was exhibiting stroke-like symptoms at the disciplinary meeting. *Id.* Thus, the arbitrator concluded that the company's treatment of Cook caused her stress, and the stress was "extreme and outrageous." *Id.* at 745.

<sup>297</sup> Harris, *supra* note 292, at 592.

ruling.<sup>298</sup> 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.<sup>299</sup> 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.”<sup>300</sup> The appeals court continued by evaluating the merits of the arbitration case when it reviewed the conduct of Raytheon’s supervisor: “Although his conduct was insensitive to Cook’s peculiar physical susceptibility to stress, we agree with the district court that it was not extreme and outrageous.”<sup>301</sup>

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*.<sup>302</sup> 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.<sup>303</sup> The contract incorporated the Montana Uniform Arbitration Act (MUAA),<sup>304</sup> and contained the parties’ handwritten amendment providing that “[n]o party waives appeal rights, if any, by signing this agreement.”<sup>305</sup>

After Ms. Prescott won her arbitration, and was awarded \$157,856, the school

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<sup>298</sup> *Id.* at 595.

<sup>299</sup> *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.”

<sup>300</sup> *Id.* at 594.

<sup>301</sup> *Id.* at 595. The appeals court gratuitously remarked that “[e]mployers cannot be expected to cater to the peculiar sensitivities of an employee who cannot physically work in a stressful environment.” *Id.*

<sup>302</sup> 369 F.3d 491 (5th Cir. 2004).

<sup>303</sup> *Id.* at 493.

<sup>304</sup> *Id.*

<sup>305</sup> *Id.* at 494.

district returned to federal court to vacate the award.<sup>306</sup> 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.<sup>307</sup> The Fifth Circuit Court of Appeals disagreed, and construed a disputed contract term as ambiguous.<sup>308</sup>

Ignoring the principle of deferring to awards, 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.”<sup>309</sup> She believed that “a contractual modification is acceptable because, as the Supreme Court has emphasized, arbitration is a creature of contract and the FAA’s pro-arbitration policy does not operate without regard to the wishes of the contracting parties.”<sup>310</sup> Her ruling concluded that “contractual tidbits strongly suggest that the parties intended judicial review to be available beyond the normal narrow range of the FAA or MUAA.”<sup>311</sup>

#### *D. State Regulation of Arbitration Procedures*

The FAA does not regulate arbitrator disclosure of conflicts of interest, but some states do. *Ovitz v. Schulman*,<sup>312</sup> an important decision by a California appeals court, shows how a disclosure law leads to vacatur.<sup>313</sup> Ms. Schulman never proved or tried to

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*Id.*

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*Id.*

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*Id.* at 497 - 498.

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*Id.* at 496.

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*Id.*

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*Id.*

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133 Cal.App. 4<sup>th</sup> 830 (Cal. App. 2 Dist. 2005).

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The vacatur dispute involved the California Ethics Standards for Neutral Arbitrators in Contractual Arbitrations, created in response to a legislative mandate. *Id.* at 833, citing Code Civ. Proc., §1286.2, subd. (a)(6)(A). The arbitration involved a wrongful termination claim by Cathy Schulman, former president of a major film company. *Id.* at 834. During the proceedings, the arbitrator accepted another appointment in a separate arbitration involving the same movie company. *Id.* at 836. After the arbitrator denied Schulman’s claims and awarded her former employer approximately \$1.5 million in damages and \$1.8 million in attorney fees and costs, Schulman invoked the disclosure law as grounds for vacating the award. *Id.* at 837. The appellate court found merit in her argument and vacated the award. *Id.*

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

Some state laws also regulate the awarding of attorney's fees in arbitration. This is relevant because private arbitration services have rules that authorize this remedy.<sup>314</sup> The FAA does not preclude this relief. Thus, federal courts acting under the FAA confirm awards that order attorney's fees.<sup>315</sup> But, Section 21(b) of the RUAA regulates this remedy. It opens the door to award challenges, stating that "arbitrator 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* (emphasis added)."<sup>316</sup> Some state courts vacate awards that order employers to pay the attorney's fees of the prevailing employee.<sup>317</sup>

In addition, states regulate arbitrator awards of punitive damages. Unlike the

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Notably Schulman did not prove or attempt to show bias or evident partiality. She simply made her case for vacatur on the arbitrator's unwitting non-compliance with the disclosure law. By contrast, the FAA is silent on the subject of arbitrator disclosures. 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 non-disclosure amounted to bias or partiality.

<sup>314</sup> See JAMS Employment Arbitration Minimum Standards of Procedural Fairness (Apr. 2003), [http://www.jamsadr.com/rules/employment\\_arbitration\\_min\\_stds-2003.asp](http://www.jamsadr.com/rules/employment_arbitration_min_stds-2003.asp), Standard No. 1: "All remedies that would be available under the applicable law in a court proceeding, including attorney's fees and exemplary damages, must remain available in the arbitration. Post-arbitration remedies, if any, must remain available to an employee."

<sup>315</sup> *E.g.*, *Pirooz v. MEMC Electronic Materials, Inc.*, 2006 WL 568571 (E.D.Mo. 2006) (federal court ordered 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 \$113,482.19).

<sup>316</sup> The Revised Uniform Arbitration Act, *supra* note 186.

<sup>317</sup> For cases involving the RUAA statutes that were used to vacate awards of attorney's fees, see *Carson v. PaineWebber, Inc.*, 62 P.3d 996 (Colo. App. 2002), and *Moore v. Omnicare, Inc.*, 141 Idaho 809 (2005). In *Cassedy v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 751 So.2d 143 (Fla. Dist. Ct. App. 2000), the arbitrator ordered the employer to pay fired employee \$300,000 in compensatory damages and also \$160,000 in lawyer fees. The first court to hear the employer's appeal vacated the award. *Id.* at 144-45.

FAA, the RUAAs' Section 21 allows this challenge, if the arbitrator's remedy would not be justified in a civil action involving the same claim.<sup>318</sup> New York courts used this reasoning to vacate the punitive award in *Sawtelle*.<sup>319</sup> In contrast, in an FAA decision that left a punitive award undisturbed,<sup>320</sup> 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."<sup>321</sup>

## VII. CONCLUSIONS

### *A. State Courts Create Moral Hazard by Vacating a High Percentage of Employee Wins at Arbitration*

I posed a problem at the beginning of this Article. Recall that an employer compelled an individual to forgo court and arbitrate her legal claim. Their agreement said that the award would be final and binding. The arbitrator ruled for the employee. This led the employer to challenge the award in court. The court vacated the award, leaving the employee without access to a court—and seemingly stuck with a useless award.

Figure 1 (*infra*) conceptualizes this form of moral hazard. The FAA envisioned that courts would rarely vacate awards. My empirical research suggests, however, 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. Courts create conditions for employers to misuse arbitration. The possibility now exists for employers to take fewer

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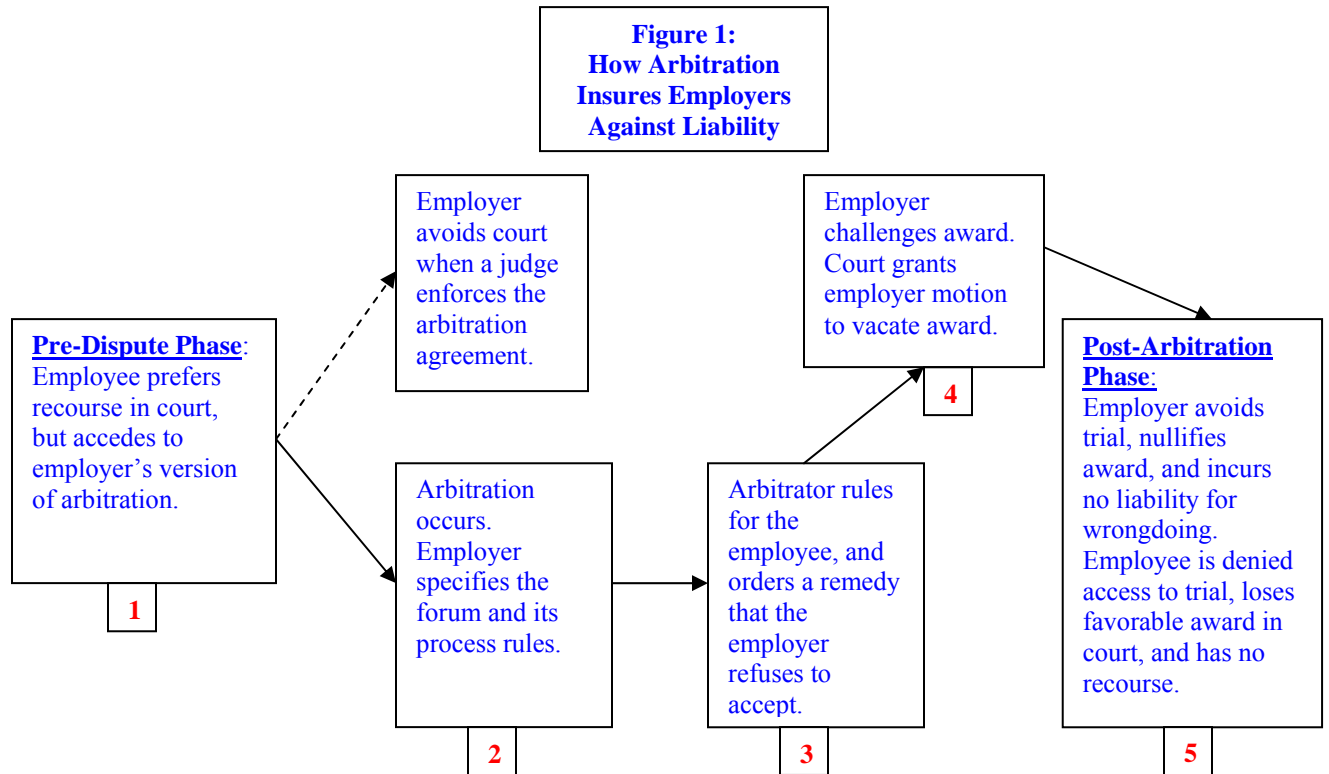
<sup>318</sup> See Revised Uniform Arbitration Act, *supra* note 186. The model law says that an "arbitrator may award punitive damages or other exemplary relief if such an award is authorized by law in a civil action involving the same claim and the evidence produced at the hearing justifies the award *under the legal standards otherwise applicable to the claim*." Emphasis is added because the law places a condition on this arbitrator power, thus limiting arbitrator discretion and creating a new ground for review.

<sup>319</sup> *Sawtelle*, *supra* note 268, at 858.

<sup>320</sup> *Acciardo v. Millennium Securities Corp.*, 83 F.Supp.2d 413 (S.D.N.Y. 2000).

<sup>321</sup> *Id.* at 423.

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.



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. Still, this result raises potential for moral hazard because employers tend to be “repeat players”<sup>322</sup> in arbitration. In contrast, individuals are one-shot players who have no strategic incentive to learn from this experience.<sup>323</sup> I theorize, as a corollary to my

<sup>322</sup> See Bingham, *supra* note 85.

<sup>323</sup> I extrapolate this conclusion from Kenneth G. Dau-Schmidt & Timothy A. Haley, *Governance of the Workplace: The Contemporary Regime of Individual Contract*, 28 COMP. LAB. L. &



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.*<sup>324</sup> 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 CBA. This phenomenon is labeled as “two bites at the apples” because a claimant is allowed to bring a similar claim on the same facts in two separate forums. “Two bites at the apple” is criticized because it “places those employers utilizing arbitration agreements at a serious disadvantage. Their employees will . . . be able to benefit from the more favorable of the two rulings. This result, however, discourages the use of arbitration agreements and is thus completely inconsistent with the policies underlying the FAA.”<sup>325</sup>

The moral hazard in 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 pro-employee awards? Is this not evidence of “judicial

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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.”

<sup>324</sup> 415 U.S. 36 (1974).

<sup>325</sup> E.E.O.C. v. Waffle House, Inc., 534 U.S. 279, 310 (2002) (J. Thomas, dissent).

hostility”<sup>326</sup> of arbitration—the very antithesis of congressional intent when the FAA was enacted? 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. Consistent with Box 1, the company set up an “EDRP”— Employee Dispute Resolution Program.<sup>327</sup> As shown in Box 2, the employee submitted the dispute to the company’s arbitration forum.<sup>328</sup> The arbitrator ruled for the employee (Box 3).<sup>329</sup> The award in *DaimlerChrysler Corp. v. Carson* ordered \$450,000 in back pay and \$915,214 in front pay.<sup>330</sup> As Box 4 illustrates, the Michigan court of appeals vacated the front-pay award.<sup>331</sup>

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*,<sup>332</sup> a recent Michigan appellate

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<sup>326</sup> See *supra* note 179. Also see *Gilmer*, *supra* note 82, at 24, observing that the purpose of the FAA 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.”

<sup>327</sup> *DaimlerChrysler Corp. v. Porter*, 2006 WL 3019682 (Mich. App. 2006), at \*1.

<sup>328</sup> *Id.*

<sup>329</sup> *Id.*

<sup>330</sup> 2003 WL 888043 (Mich. App. 2003), at \*1.

<sup>331</sup> *Id.* at \*5.

<sup>332</sup> *Id.*

decision that vacated another arbitrator's award in favor of an employee. Ernest Porter was terminated for falsifying his time records.<sup>333</sup> Mr. Porter was subject to DaimlerChrysler's EDRP (Box 1).<sup>334</sup> Thus, his claim went to arbitration instead of court (Box 2).<sup>335</sup> The arbitrator found that the company treated Mr. Porter differently from co-workers, and had no cause to fire him (Box 3).<sup>336</sup> But the lower court vacated the award, reasoning that that the arbitrator exceeded his authority by ignoring relevant law (Box 4).<sup>337</sup> The appeals court mostly agreed, and vacated \$915,214 in front-pay (Box 4).<sup>338</sup>

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. The two cases show that forum substitution is another name for a forum shell game.

Federal courts are not part of the problem. District and appellate courts behaved the same. Respectively, they confirmed 92% and 85% of challenged awards, whether individuals or employers prevailed in the arbitration. Compared to other appellate benchmarks, federal district courts used "extreme deference,"<sup>339</sup> and federal appeals courts exercised "great deference."<sup>340</sup>

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333 *Id.* at \*1.

334 *Id.*

335 *Id.*

336 *Id.*

337 *Id.* at \*2.

338 *Id.* at \*2 - \*3.

339 *See* Clermont & Eisenberg, *supra* note 241, and Catherson, *supra* note 241.

340 *See* Brudney, *supra* note 242.

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. Compared to benchmarks of other courts who exercised first-level review of adjudicatory rulings, these judges barely fell into the intermediate category of “high deference.”<sup>341</sup> Far worse, state appellate judges were indifferent to the norm of award finality, vacating about half of the awards that ruled in favor of employees. Comparative research puts this level in the “no deference”<sup>342</sup> category.

*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. This creates potential for moral hazard.

The current award review regime does not serve its intended purposes. My Article concludes with two policy proposals to address this situation. While these approaches differ from each other, they attempt to reduce moral hazard by creating stronger barriers to vacating awards.

- *Return to the simplicity of the FAA’s extremely narrow standards for vacating awards.* My empirical analysis shows that courts apply a hodgepodge of standards to review awards— including judicial tests from the FAA, UAA, RUAA, *Steelworkers’ Trilogy*, and common law. One possibility is re-enact the FAA with its original Section

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<sup>341</sup> See Moore, *supra* note 243.

<sup>342</sup> See Baldus, et al., *supra* note 246.

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. . . .”<sup>343</sup> Underscoring the FAA’s convoluted structure, the Court added: “Nevertheless, although enforcement of the Act is left in large part to the state courts, it nevertheless represents federal policy to be vindicated by the federal courts where otherwise appropriate.”<sup>344</sup>

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 Section 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.<sup>345</sup>

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 10%, with little difference in outcomes for pro-employee or pro-employer awards. Moreover, current pronouncements by the Supreme Court— including

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<sup>343</sup> Moses H. Cone Memorial Hosp. v. Mercury Const. Corp., 460 U.S. 1, 26, n.32 (1983).

<sup>344</sup> *Id.*

<sup>345</sup> Section 514(a) of ERISA provides that the statute shall “supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan.” 29 U.S.C. §1144(a) (2000).

decisions in the 2008 term— show a marked trend toward eclipsing a patchwork of state regulations in fields where federal laws have been enacted.<sup>346</sup> Indeed, the gist of my legislative proposal was supported in the current term, when the Court spoke in *Preston v. Ferrar*: “The Act (FAA), which rests on Congress’ 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.”<sup>347</sup>

- *Compel Employers to Pay Upfront 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 v. Texaco*.<sup>348</sup> After Pennzoil reached an agreement to purchase Getty Oil Co., Texaco upset the deal by topping Pennzoil’s purchase price.<sup>349</sup> Pennzoil sued in state court, claiming tortious breach of contract. A jury ruled for Pennzoil, finding actual damages of \$7.53 billion and punitive damages of \$3 billion.<sup>350</sup> Under Rule

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<sup>346</sup> See *Rowe v. New Hampshire Motor Transport Ass’n*, \_\_\_ S.Ct. \_\_\_ (2008), 2008 WL 440686 (U.S.), stating: “to interpret the federal law to permit these, and similar, state requirements could easily lead to a patchwork of state service-determining laws, rules, and regulations. . . .” *Id.* at \* 6. Also see *Riegel v. Medtronic, Inc.*, \_\_\_ S.Ct. \_\_\_ (2008), 2008 WL 440744 (U.S.), remarking: “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.” *Id.* at \* 6.

<sup>347</sup> \_\_\_ S.Ct. \_\_\_ (2008), 2008 WL 440670, at \* 3.

<sup>348</sup> 481 U.S. 1 (1987).

<sup>349</sup> *Id.* at 4.

<sup>350</sup> *Id.*

346(b) in Texas civil procedure, Texaco was required post a \$13 billion judgment bond as a condition for appealing the ruling.<sup>351</sup> 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.<sup>352</sup> These post-judgment laws immediately cost Texaco. Quickly, its stock fell, and the firm had credit and bond-rating problems.<sup>353</sup>

Compare *Pennzoil* to *Castleman v. AFC Enterprises, Inc.*, another Texas case.<sup>354</sup> A KFC franchisee required its employees to arbitrate all employment claims, including worker's compensation.<sup>355</sup> Denied access to the state's adjudicatory process, the fast-food worker submitted to arbitration and was awarded \$1,678,622 in damages.<sup>356</sup> The employer appealed, and lost its motion to vacate the award.<sup>357</sup>

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 loser 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 346(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 upfront costs for making a challenge would strengthen award finality. This would address the "no bites at the apple" phenomenon. It

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*Id.* at 5.

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*Id.* at 4 - 5.

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*Id.* at 5.

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

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*Id.* at 651.

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*Id.*

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*Id.* at 654.

would also strengthen forum substitution by treating a loser's challenge to an arbitrator's award the same as a loser's appeal of a court judgment. The current practice, in contrast, allows employers to make a cost free appeal. This buys time, and either postpones or reverses judgment. As a result, award finality erodes.

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 50% of arbitrations. But the benefits of employment arbitration will not be achieved, however, until the growing vacatur problem— and its attendant quality of “re-arbitrating” disputes that were meant for final and binding resolution— is addressed.

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 remodeled again with the RUAA in 2000. On a smaller scale, courts have built upon the modest shelter that Congress created for arbitration awards in 1925. The point is that this simple home is now creaking under the weight of baroque room additions that hang over the first floor of the FAA. Sadly, no architect was engaged at any point to oversee these reconstruction projects. 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 Section 10 will begin to topple on itself. Meanwhile, courts are creating moral hazard by tempting employers to avoid the consequences of their unlawful actions and renege on their contractual promise to resolve disputes in final and binding arbitration.



*Law review editors have discretion to publish the roster of cases. The rationale for publishing the full list is to enable readers to verify the empirical findings, and to share a valuable resource for policy-makers, judges, scholars, practitioners, and students. The author understands, however, that space and cost constraints might preclude publication of this roster.*

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