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Contracting for Judicial Review of Arbitration Awards: Can an “Errors of Law” Clause Provide Two Bites of the Apple?

*Gateway Technologies, Inc. v. MCI Telecommunications Corp.*¹

I. INTRODUCTION

Arbitration awards are generally binding, final, and subject to appeal only on the narrow grounds provided by the Federal Arbitration Act and a few judicially created exceptions.² Moreover, courts that do review arbitration awards are hesitant to set aside the decision of an arbitrator and will do so only in “very unusual circumstances.”³

Recently, provisions in some arbitration agreements have purported to provide judicial review for “errors of law”, but there has been a split of authority as to the validity of such clauses.⁴ These clauses present an interesting paradox: while arbitration is designed to avoid the costly and lengthy judicial review process, it also strives to recognize the parties’ rights to tailor their own binding, contractual agreements.⁵ In *Gateway Technologies, Inc. v. MCI Telecommunications Corp.*, the Fifth Circuit held that an arbitration agreement which included language purporting to allow a court to review an arbitration award for “errors of law” was valid.⁶

This Note will proceed in five sections. Section II will set forth the factual framework of the *Gateway* case and the holding of the Fifth Circuit. Section III will briefly examine the legal background behind the standard of review for arbitration awards. Section IV will explore the analysis and decision of the Fifth Circuit in *Gateway*. Finally, section V will comment on the *Gateway* court’s holding and discuss its policy implications. This Note will conclude that arbitration agreements which purport to provide judicial review for “errors of law” violate separation of powers and the public policy which underlies arbitration. Consequently, the “errors of law” clauses must be disallowed.

1. 64 F.3d 993 (5th Cir. 1995).

2. See *infra* notes 27-30.

3. See *infra* notes 31-44.

4. See *infra* notes 69-72, 99-106.

5. See *infra* notes 90-94.

6. See *infra* notes 66-67.

II. FACTS AND HOLDING

In 1990, MCI Telecommunications Corp. ("MCI") successfully bid with the Virginia Department of Corrections ("VADOC") to design and install a telephone system.⁷ MCI secured the local telephone lines over which the calls would be made and subcontracted with Gateway Technologies ("Gateway") to provide, connect, and maintain all of the equipment and technology necessary to provide automated collect calling.⁸ The contract between Gateway and MCI expressly stated that both parties were independent contractors and that neither party was the other's agent, joint venturer, or partner.⁹ The contract also required the parties to negotiate in good faith any disputes which arose from the contract.¹⁰ If the good faith negotiations proved unsuccessful, the contract provided for binding arbitration, "except that errors of law shall be subject to appeal."¹¹

After Gateway had installed the VADOC automated phone system, MCI made complaints that the system was not properly completing many of the calls.¹² MCI then integrated an automated system of its own to bypass Gateway's system and sent Gateway a notice of default.¹³ Gateway responded with a proposal to remedy the system's defects and update its software, but MCI did not sign the confidentiality agreement for updated software.¹⁴ MCI formally terminated the contract with Gateway in January of 1993.¹⁵

Arbitration ensued, and the arbitrator found that MCI's primary motivation for abandoning the Gateway system was the promise of a substantial increase in profit¹⁶ and that "MCI had breached its contractual duty to negotiate in good faith."¹⁷ As a result of these findings, the arbitrator awarded Gateway actual damages for their attorneys' fees and punitive damages in the amount of \$2,000,000.¹⁸ MCI moved to vacate the award in the United States District Court for the Northern District of Texas, and Gateway moved to confirm the award.¹⁹

7. *Gateway*, 64 F.3d at 995. VADOC desired a telephone system that would allow inmates to make collect calls to authorized persons without the assistance of an operator. *Id.* For example, the system would allow an inmate to "dial an authorized number and, when the recipient answered, a recorded message would announce the inmate's name and inform the recipient that he could accept charges for the call" by dialing or pressing a certain number. *Id.*

8. *Id.*

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.*

13. *Id.* at 995-96.

14. *Id.* at 996.

15. *Id.*

16. *Id.* at 995. This finding was supported by an internal MCI memoranda that was introduced during the arbitration. *Id.* The memoranda contained an estimate of nearly \$84,000 a month in savings if MCI integrated its own system and abandoned the Gateway system. *Id.*

17. *Id.* at 996.

18. *Id.* at 995.

19. *Id.*

The district court's review of the award purported to apply the "errors of law" standard agreed upon in the arbitration clause; however, the court did not interpret this standard to require "a scrutiny as strict as would be applied by an appellate court reviewing the actions of a trial court."²⁰ Instead, the district court reviewed the award "under the harmless error standard, but with due regard for the federal policy favoring arbitration."²¹ The district court then confirmed the award.²²

On appeal, the Fifth Circuit vacated the award of punitive damages and affirmed the arbitration award in all other respects.²³ The Fifth Circuit held that the district court erred in refusing to apply a *de novo* standard of review to errors of law,²⁴ that MCI had waived any objections to the arbitrator's award of attorney's fees as actual damages,²⁵ and that there was no fiduciary relationship between Gateway and MCI to produce the independent tort required for an award of punitive damages under Virginia law.²⁶

III. LEGAL HISTORY

A. The Standard of Review for Arbitration Awards

An arbitration award is typically binding, final, and subject to appeal only on narrow grounds.²⁷ The Federal Arbitration Act (FAA) allows arbitration awards to be judicially confirmed;²⁸ however, having an award set aside is much more difficult because the standard of review for a district court is quite narrow.²⁹ Under this narrow standard, a district court reviewing the decision of an arbitrator may set the decision aside only in "very unusual circumstances."³⁰

20. *Id.* at 996.

21. *Id.*

22. *Id.*

23. *Id.* at 1001.

24. *Id.* at 997.

25. *Id.* at 998.

26. *Id.* at 1001.

27. DONOVAN LEISURE & NEWTON IRVINE, *ADR PRACTICE BOOK 54* (John H. Wilkinson, ed. 1990).

28. 9 U.S.C. § 9 (1994).

29. *Antwine v. Prudential Bache Securities, Inc.*, 899 F.2d 410, 413 (5th Cir. 1990) (noting that, typically, a district court's standard of review for an arbitration award is "extraordinarily narrow"); see also *Revere Copper & Brass, Inc. v. Overseas Private Inv. Corp.*, 628 F.2d 81, 83 (D.C. Cir. 1980) (emphasizing that judicial review of arbitration awards is "narrowly limited").

30. *First Options of Chicago, Inc. v. Kaplan*, 115 S.Ct 1920, 1923 (1995). In *First Options*, Justice Breyer reasons that, in effect, a party who agrees to arbitrate a dispute relinquishes the right to have a court decide the merits of such a dispute. *Id.* Accordingly, a court will set aside the award of an arbitrator "only in very unusual circumstances." *Id.*

Section 10(a) of the FAA³¹ statutorily defines the clearest set of "unusual circumstances" which a district court can use as grounds to set aside an arbitration award:

- (1) Where the award was procured by corruption, fraud, or undue means.
- (2) Where there was evident partiality or corruption in the arbitrators, or either of them.
- (3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.
- (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.³²

Under section 10, courts should give an arbitrator's decision "considerable leeway . . . setting aside his or her decision only in certain narrow circumstances."³³

Case law provides a second set of standards under which an arbitration award may be vacated by a federal court: essence of contract, illegality, manifest disregard of law, and public policy.³⁴ As with the statutory grounds for review, the nonstatutory grounds are also extremely narrow.³⁵ Courts that recognize the nonstatutory grounds for vacating arbitration awards are cautious in employing them, and the guiding principle used by these courts appears to be a reluctance to vacate.³⁶

For example, in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*,³⁷ the district court issued an order vacating an arbitration award on the ground that the arbitrators had ignored applicable law and, hence, acted in "manifest disregard of the law."³⁸

31. 9 U.S.C. § 10 (1994).

32. *Id.* Section 10(b) also allows a district court to vacate an award "upon the application of a person, other than the party to the arbitration, who is adversely affected or aggrieved by the award, if the use of arbitration or the award is clearly inconsistent with the factors set forth in section 572 of title 5." *Id.*

33. *First Options*, 115 S.Ct. at 1923.

34. See Bret F. Randall, *The History, Application, and Policy of the Judicially Created Standards of Review for Arbitration Awards*. 1992 B.Y.U. L. REV. 759. An extended discussion of these nonstatutory grounds for review would exceed the scope of this Note. See Randall for a further examination of this topic. Also see Stephen L. Hayford, *Law in Disarray: Judicial Standards for Vacatur of Commercial Arbitration Awards*. 30 GA. L. REV. 731 (1996).

35. AAA GENERAL COUNSEL'S ANN. REP. (1987-1988).

36. MACNEIL ET. AL., IV FEDERAL ARBITRATION LAW § 40.5.2.1 (1994); see also *Advest, Inc. v. McCarthy*, 914 F.2d 6, 8 (1st Cir. 1990) (Although courts "retain a very limited power to review arbitration awards outside of Section 10 . . . non-reviewability remains the general rule -- and exceptions are few and far between.").

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

38. *Id.* at 931.

After noting that the manifest disregard doctrine is to be seriously limited, the Second Circuit found that the arbitrators had carefully and conscientiously considered applicable laws.³⁹ The Second Circuit then held that the arbitrators had not acted in manifest disregard of the law and reversed the district court's order.⁴⁰ In reasoning towards this decision, the Second Circuit emphasized that district courts are "not at liberty to set aside an arbitration panel's award because of an arguable difference regarding the meaning or applicability of laws urged upon it."⁴¹

The policy rationale behind the narrow standard of review for arbitration awards is in keeping with the general policy rationales of alternative dispute resolution: narrow construction reflects the strong federal policy which favors voluntary arbitration of commercial disputes.⁴² In recognition of this policy, courts refuse to second-guess "an arbitrator's resolution of a contract dispute."⁴³ Thus, narrow construction is applied to deter parties from resorting to the lengthy judicial process of review that, by its nature, arbitration seeks to avoid.⁴⁴

B. Arbitration Policy: Enforce Private Agreements Between Parties

Although the policy of the FAA promotes arbitration, the FAA recognizes the freedom of parties to structure arbitration agreements to suit their own needs.⁴⁵ In *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*,⁴⁶ Stanford contracted with Volt to install an electrical conduit system.⁴⁷ The contract included an agreement to arbitrate any disputes that arose out of the contract or breach of the contract.⁴⁸ Additionally, the contract contained a choice-of-law clause which provided that the contract would be "governed by the law of the place where the Project is located."⁴⁹ Following a dispute regarding payment for extra work, Volt formally demanded arbitration.⁵⁰ In turn, Stanford filed a suit in California Superior Court against Volt, alleging breach of contract and fraud.⁵¹ Subsequently, Volt moved to compel arbitration, and Stanford moved to stay

39. *Id.* at 936.

40. *Id.*

41. *Id.* at 934.

42. Richard J. Medalie, *Commercial Arbitration for the 1990's*, 1991 A.B.A. SEC. LITIGATION 95.

43. *Id.* (quoting *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 808 F.2d 930, 930-37 (2nd Cir. 1986)).

44. *Federal Commerce and Navigation Co. v. Kanematsu-Gosho, Ltd.*, 457 F.2d 387 (2nd Cir. 1972).

45. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S.Ct. 1212 (1995).

46. 489 U.S. 468 (1989).

47. *Id.* at 470.

48. *Id.*

49. *Id.*

50. *Id.* at 471.

51. *Id.*

arbitration.⁵² The Superior Court granted Stanford's motion to stay the arbitration and denied Volt's motion to compel.⁵³ This decision was affirmed by the California Court of Appeals and eventually arrived at the United States Supreme Court.⁵⁴

In affirming, Chief Justice Rehnquist first stated that the FAA did not supplant California's existing arbitration law; rather, it allows state courts to stay arbitration proceedings pending the resolution of other related litigation.⁵⁵ Chief Justice Rehnquist then explained:

[I]t does not follow that the FAA prevents the enforcement of agreements to arbitrate under different rules than those set forth in the Act itself. Indeed such a result would be quite inimical to the FAA's purpose of ensuring that private agreements to arbitrate are enforced according to their terms. Arbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit. Just as they may limit by contract the issues they will arbitrate, so too may they specify by contract the rules under which that arbitration will be conducted.⁵⁶

Thus, the nature of arbitration and the public policy behind the FAA allow parties to tailor their own agreements to suit their needs.⁵⁷ But does this power to "specify by contract the rules under which [the] arbitration will be conducted" include contractually providing for judicial review? If so, should it?

C. Arbitration Policy: Avoid Costly and Lengthy Litigation

Arbitration is generally more efficient than litigation in terms of both money and time.⁵⁸ The high costs of litigation and the increasing congestion in the courts are major factors in many decisions to use arbitration agreements. Review that exceeds the FAA's statutory grounds undermines these decisions:

Where parties have selected arbitration as a means of dispute resolution, they presumably have done so in recognition of the speed and inexpensiveness of the arbitral process; federal courts ill serve these aims and that of the facilitation of commercial intercourse by engaging in any

52. *Id.* Stanford's motion was pursuant to the California Code "which permits a court to stay arbitration pending resolution of related litigation between a party to the arbitration agreement and third parties not bound by it, where 'there is a possibility of conflicting rulings on a common issue of law or fact.'" *Id.* (citing CAL. CIV. PROC. CODE § 1281.2(c)(West 1982)).

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.* at 479.

57. *Id.*; see also LYNCH ET. AL., NEGOTIATION AND SETTLEMENT § 7:30, at 208-09 (1992).

58. See LEISURE, *supra* note 27, at 34; see also GOLDBERG ET. AL., DISPUTE RESOLUTION: NEGOTIATION, MEDIATION, AND OTHER PROCESSES 200 (1992).

more rigorous review than is necessary to ensure compliance with [the FAA's] statutory standards.⁵⁹

Accordingly, parties who agree to arbitrate recognize that in favor of economical and prompt resolution of disputes, they sacrifice, to some degree, the procedures that add to the cost and length of litigation. Addressing this issue, Judge Learned Hand stated:

Arbitration may or may not be a desirable substitute for trials in courts; as to that the parties must decide in each instance. But when they have adopted it, they must be content with its informalities; they may not hedge it about with those procedural limitations which it is precisely its purpose to avoid. They must content themselves with looser approximations to the enforcement of their rights than those that the law accords them, when they resort to its machinery.⁶⁰

Thus, economic and prompt dispute resolution depends to some extent upon a "looser approximation" of the parties' procedural rights.⁶¹ But do the "procedural limitations" mentioned by Judge Hand include contractual provisions for judicial review? If so, should they?

IV. THE INSTANT DECISION

In *Gateway Technologies, Inc. v. MCI Telecommunications Corp.*,⁶² the Fifth Circuit stated that an appellate court will review de novo a district court's confirmation of an arbitration award.⁶³ The court began its analysis by stating the general rule that a district court must review arbitration awards very narrowly, vacating the award only: (1) if it was procured through corruption, fraud, or any other undue means; (2) if evidence exists of corruption or partiality on the part of the arbitrator; (3) if misconduct by the arbitrator prejudiced a party's rights; or (4) if the arbitrator exceeded her powers.⁶⁴ The *Gateway* court then observed that the parties in this case had contractually provided for expanded review of an arbitration award by the federal courts with an "errors of law" clause.⁶⁵

The court initially noted that the pro-arbitration policy of the FAA does not ignore the wishes of the parties; rather, the FAA's policy ensures that a private

59. *Davis v. Chevy Chase Financial Ltd.*, 667 F.2d 160, 164-65 (D.C. Cir. 1981).

60. *American Almond Products Co. v. Consolidated Pecan Sales*, 144 F.2d 448, 451 (2d Cir. 1944).

61. *Id.*

62. 64 F.3d 993 (5th Cir. 1995).

63. *Id.* at 996.

64. *Id.*; see also 9 U.S.C. § 10(a)(1)-(4)(Supp. 1995).

65. *Gateway*, 64 F.3d at 996.

arbitration agreement is enforced according to its terms.⁶⁶ The court then found that the contractual agreement of the parties to expand judicial review supplemented the standard of review under the FAA and common law and allowed for a de novo review of issues of law within the arbitration award.⁶⁷ Finally, the Fifth Circuit stated that the district court had erred by refusing to review errors of law de novo; therefore, the Fifth Circuit would review both the actual and punitive damages de novo for errors of law.⁶⁸

The Fifth Circuit first reviewed the arbitrator's award of attorney's fees to Gateway as actual damages, noting that the arbitrator's premise for the award was that Gateway's litigation expenses were reasonably foreseeable when MCI breached its duty to negotiate in good faith.⁶⁹ MCI argued that the American Rule on attorney's fees prohibits litigants from collecting litigation expenses from a losing party unless such an award is provided for in a contract or statute or unless a losing party is found to have willfully violated a court order or initiated litigation in bad faith.⁷⁰ Noting that MCI had failed to object to the award of attorney's fees at any time during the arbitration, the Fifth Circuit found that MCI had waived any objections to the imposition of attorney's fees.⁷¹ Accordingly, the court confirmed the arbitrator's award of attorney's fees.⁷²

The Fifth Circuit then examined Gateway's award of \$2 million for punitive damages.⁷³ First, the court noted that the arbitrator's rationale for awarding punitive damages was mentioned solely in one "opaque statement" concerning a dispute before neither the arbitrator nor the district court.⁷⁴ Next, the court observed that any award of punitive damages must conform to the provisions of substantive state law which govern such arbitration.⁷⁵ Thus, the court noted that "if Virginia law allowed the arbitrator to impose punitive damages and if the arbitration contract did not expressly prevent the arbitrator from doing so, then such an award would have fallen under the arbitrator's broad discretion to decide damages and fashion remedial relief."⁷⁶

66. *Id.*

67. *Id.* at 997.

68. *Id.*

69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.*

73. *Id.* at 998.

74. *Id.* The arbitrator's finding that the punitive damages were justified was contained in the following passage, which was described as "extremely confusing" by the Fifth Circuit: "[I]n part for an additional reason perhaps not assigned by Claimant, but found by the Arbitrator: that Respondent's attempt to terminate Claimant for default was part of a deceptive scheme in wanton disregard of Respondent's obligations to Claimant." *Id.*

75. *Id.* In *Gateway*, the arbitrator heard the dispute in Richmond, Virginia and stated that he would apply Virginia's substantive law. Under the substantive law of either Texas or Virginia, however, punitive damages are unavailable for a mere breach of contract. *Id.* at 999.

76. *Id.*

In the instant case, the court found that the arbitrator did wield the power to assess punitive damages; however, the court also found that the applicable Virginia law allows the imposition of punitive damages only if predicated upon tort liability.⁷⁷ The parties vigorously contested whether a tort claim had, in fact, been properly pleaded and preserved by Gateway.⁷⁸ The Fifth Circuit found some merit in MCI's argument that Gateway had clearly disclaimed any tort claim against MCI; nonetheless, the court was unwilling to hold that Gateway had completely waived its tort claims against MCI.⁷⁹

The Fifth Circuit then considered whether a tort claim of breach of fiduciary duty could be sustained under these circumstances.⁸⁰ First, the court noted that the contract made clear that the parties were neither agents, partners, nor joint venturers.⁸¹ Then, the court rejected Gateway's argument that an informal fiduciary relationship existed between the two parties, relying on Gateway's admission that it was a nominal subcontractor in the VADOC contract and that the two parties were competitors before the contract was signed.⁸² The court also noted that neither MCI's vastly superior financial position nor Gateway's complete dependence on MCI could transform their contractual relationship into a fiduciary one.⁸³

Because the court found no support for a finding that the parties were fiduciaries under Virginia law, there could be no independent tort to support an award of punitive damages.⁸⁴ Accordingly, the Fifth Circuit held that the district court erred in refusing to apply a *de novo* standard of review to errors of law,⁸⁵ that MCI had waived any objections to the arbitrator's award of attorney's fees as actual damages,⁸⁶ and that there was no fiduciary relationship between Gateway and MCI to produce the independent tort required for an award of punitive damages under Virginia law.⁸⁷

77. *Id.*

78. *Id.* MCI contended that Gateway failed to make a timely allegation of tortious conduct or a timely request for punitive damages during arbitration. In fact, the record shows that the arbitrator did allow Gateway to submit an untimely claim. MCI also contended that Gateway had subsequently and repeatedly disclaimed its tort theories against MCI, "choosing to rely exclusively on contractual bases for recovery." *Id.*

79. *Id.* at 1000. Since Gateway did not expressly waive its claims for breach of fiduciary duty that were made in the brief that the arbitrator accepted, the court was "unwilling to hold that these claims were waived by Gateway's more general denials of fraud and conspiracy." *Id.*

80. *Id.*

81. *Id.*

82. *Id.* at 1000-01.

83. *Id.* at 1001.

84. *Id.*

85. *Id.* at 997.

86. *Id.* at 998.

87. *Id.* at 1001.

V. COMMENT

Arbitration clauses generally give arbitrators broad powers without explicitly specifying any limitations. They are usually construed as implying the parties' consent to the arbitrator's decision, subject only to very limited judicial review.⁸⁸ In *Gateway*, however, the arbitration agreement specifically provided for judicial review with a clause that allowed for a court to examine the arbitrator's decision for "errors of law."⁸⁹ This "errors of law" clause highlights an internal conflict between two of arbitration's most compelling characteristics.

On the one hand, arbitration focuses on the parties' power to create a contractual dispute resolution agreement. As the Supreme Court recognized in *First Options of Chicago, Inc. v. Kaplan*, "the basic objective in this area is not to resolve disputes in the quickest manner possible, no matter what the parties' wishes, but to ensure that commercial arbitration agreements, like other contracts, are enforced according to their terms."⁹⁰ Therefore, parties should be able to create their own arbitration agreements which depart from traditional arrangements.⁹¹

On the other hand, the judiciary is reluctant to interfere with arbitration awards because the very goal of binding arbitration is to avoid lengthy litigation. The Supreme Court has declined to accept the view that arbitration should be absolutely final.⁹² However, the Court has also stated that "as long as the arbitrator is even arguably construing or applying the contract and acting within the scope of authority, that a court is convinced he committed serious error does not suffice to overturn his decision."⁹³ Thus, judicial review of arbitration awards is typically limited to an examination of the statutory grounds for review in § 10(a) of the FAA and, in rare exceptions, the nonstatutory standards of review.⁹⁴

In *Gateway*, the Fifth Circuit found the contractual provision for judicial review of the award to be acceptable.⁹⁵ Though the court relied on Supreme Court precedent to support this finding,⁹⁶ the decisions cited in *Gateway* concentrate only on the

88. See MACNEIL, *supra* note 36, at § 40.5.2.4.

89. *Gateway*, 64 F.3d at 995.

90. 115 S.Ct. at 1925.

91. MACNEIL, *supra* note 36, at § 40.5.2.2. Macneil describes consent of the parties as the touchstone of an arbitration agreement: "[t]he very nature of consensual arbitration requires that the scope of the adjudicative authority . . . be defined by the consent of the parties."); *but see* Forsythe Int'l, S.A. v. Gibbs Oil Co. of Texas, 915 F.2d 1017, 1022 (5th Cir. 1990) (parties who agree to arbitration "may not superimpose rigorous procedural limitations on the very process designed to avoid such limitations.").

92. See *United Paperworkers Int'l Union v. Misco*, 484 U.S. 29 (1987).

93. *Id.* at 30.

94. See *supra* notes 31-44.

95. See *supra* notes 65-68.

96. *Id.*; see *Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer*, 115 S.Ct. 2322 (1995) ("enforcing a contractual provision mandating arbitration in Tokyo, Japan"); *First Options*, 115 S.Ct. at 1925 ("the basic objective in this area is not to resolve disputes in the quickest manner possible, no matter what the parties' wishes, but to ensure that commercial arbitration agreements, like other contracts are enforced according to their terms."); *Allied-Bruce Terminix Companies v. Dobson*, 115 S.Ct. 834

importance of the parties' contractual rights and do not address arbitration's other underlying policy - avoiding the expensive and lengthy process of litigation.

This underlying policy was recognized in *Lapine Tech. Corp. v. Kyocera Corp.*,⁹⁷ which examined a similar contractual agreement allowing judicial review of an arbitration award for errors of law.⁹⁸ The *Lapine* court acknowledged the factual similarities with *Gateway* but reached an opposite result.⁹⁹ In doing so, *Lapine* followed the Seventh Circuit and relied on the reasoning of Judge Posner, who stated:

Federal courts do not review the soundness of arbitration awards. An agreement to submit a dispute over the interpretation of a labor or other contract to arbitration is a contractual commitment to abide by the arbitrator's interpretation. If the parties want, they can contract for an appellate arbitration panel to review the arbitrator's award. But they cannot contract for judicial review of that award; federal jurisdiction cannot be created by contract.¹⁰⁰

This jurisdictional barrier is the first hurdle that arbitration agreements which include judicial review must face. In *Lapine*, the court was critical of what it characterized as an effort to assume the "prerogative of Congress" and of the presumptive direction of a federal court as to the "substance and parameter of its exercise of judicial power."¹⁰¹ Indeed, an attempt to create jurisdiction through contract appears to directly conflict with Congressional intent because "[t]he sum and substance of the legitimate law of vacatur in commercial arbitration is articulated

(1995) (the FAA "intended courts to enforce arbitration agreements into which parties had entered and to place such agreements upon the same footing as other contracts."); *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 226 (1987) (courts should "rigorously enforce agreements to arbitrate.").

97. 909 F.Supp. 697 (N.D.Cal. 1995).

98. *Id.* at 702. Section 8.10 of the parties' arbitration agreement provided in part:

The arbitrators shall issue a written award which shall state the bases of the award and include detailed findings of fact and conclusions of law. The United States District Court for the Northern District of California may enter judgment upon any award, either by confirming the award or by vacating, modifying, or correcting the award. The Court shall vacate, modify or correct any award: (i) based upon any of the grounds referred to in the Federal Arbitration Act, (ii) where the arbitrators' findings of fact are not supported by substantial evidence, or (iii) where the arbitrators' conclusions of law are erroneous.

Id.

99. *Id.* at 705. *Lapine* held that "parties may not by agreement alter by expansion the provisions for judicial review contained in the Federal Arbitration Act." *Id.*

100. *Chicago Typographical Union No. 16 v. Chicago Sun-Times*, 935 F.2d 1501, 1505 (7th Cir. 1991); see also MACNEIL, *supra* note 36, at § 40.5.2.4:

The court leaves a very large loophole, however. Since an award can, according to the court, be set aside for a "violation of the agreement to arbitrate," it appears that parties can in effect contract for judicial review of procedures simply by making sufficiently explicit in the agreement the duties of the arbitrators to abide by specified procedures.

Id.

101. *Lapine*, 909 F. Supp. at 705.

in the clear and unambiguous language of section 10(a) of the FAA.¹⁰² This highlights perhaps the most critical problem with an "errors of law" clause. Clearly, Congress has expressed its intent to limit judicial review of arbitration awards by enacting section 10(a)'s rigorous standards of review. Based on this clear congressional intent, federal courts ignore Congress' will and violate the separation of powers when they allow parties to contractually provide for broader judicial review.

Another obstacle to "errors of law" clauses is grounded in public policy. Expanded judicial review "simply does not comply with the benefits usually contemplated by those who favor arbitration as an effective form of alternative dispute resolution."¹⁰³ Rather, contractual provisions in arbitration agreements that purport to select and to specify the scope of judicial review offend public policy by undermining two of arbitration's beneficial aspects.¹⁰⁴ First, "errors of law" clauses allow a party dissatisfied with the results of arbitration to assert an "error of law" and move the dispute into the judicial arena.¹⁰⁵ As a result, parties to such agreements may actually spend longer amounts of time resolving a dispute than they would have if there had been no arbitration agreement at all. Second, the "errors of law" clauses offend the judicial system by adding to, rather than easing, the courts' heavy responsibilities.¹⁰⁶ These two policy concerns, coupled with the separation of powers questions, expose disadvantages with "errors of law" clauses that the *Gateway* court did not address.

102. HAYFORD, *supra* note 34, at 841.

103. *Lapine*, 909 F. Supp. at 705. Public policy favors arbitration as an expedient and informal mode of alternative dispute resolution. *Id.*

104. *Id.*

105. *Cf.* HAYFORD, *supra* note 34, at 841 ("There is no compelling public policy reason to give the parties to a knowing, voluntary agreement to arbitrate a commercial dispute a 'second bite of the apple' when they believe themselves to have been wronged as a result of an erroneous decision by the arbitrator.").

106. *Lapine*, 909 F. Supp. at 706.

VI. CONCLUSION

Arbitration agreements which attempt to contractually select and specify the scope of judicial review present a paradox: arbitration is designed to avoid the costly and lengthy judicial review process, yet at the same time arbitration strives to recognize the parties' rights to tailor their own contractual agreements. The conflict between jurisdictions over the validity of "errors of law" clauses creates uncertainty, which in turn creates problems for contracting parties and the judiciary. Therefore, the question of whether parties can contractually select and specify the scope of judicial review in an arbitration agreement deserves further examination, consideration, and clarification. Courts examining the clauses should recognize that contracting for judicial review of an arbitration award presents serious jurisdictional and public policy problems. Consequently, courts should reject these "errors of law" clauses.

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