"Be Careful What You Wish For — Or You May End Up In Arbitration Hell"

By Joseph W. Anthony

In what can only be described as "Arbitration Hell," a recent Minnesota Court of Appeals decision dramatically illustrates the serious risks that businesses face when they turn their disputes over to an arbitrator whose authority to make rulings and impose sanctions is virtually unlimited.

It is important to note that the recent Minnesota Court of Appeals decision in *Seagate Technology v. Western Digital* is not a departure from existing law. The Appellate Court's decision is consistent with and supported by existing law. What makes reading the *Seagate* decision so frightening is the realization that there is effectively no limit on an arbitrator's power under the most commonly used arbitration clauses.

In *Seagate*, the arbitrator awarded over $625 million in damages. In doing so, the arbitrator concluded that a Western Digital employee had fabricated evidence consisting of two slides in a presentation in an effort to make it appear that certain information had been previously disclosed and was, therefore, not a trade secret. As a sanction for "fabricating" evidence, the arbitrator refused to permit Western Digital to introduce evidence to dispute the validity of certain Seagate trade secret claims. Since Western Digital was precluded by the arbitrator's ruling from offering a defense on the trade secret claims, the arbitrator concluded that Seagate should prevail on those claims. The arbitrator then issued an award of $625 million on claims which the arbitrator concluded could not be disputed by Western Digital because it was precluded by his sanctions ruling from doing so.

The Hennepin County District Court vacated the arbitration award on the grounds that the arbitrator did not have the authority to impose sanctions for the fabrication of evidence and that, even if the arbitrator had such authority, he misapplied sanctions law by failing to consider a lesser sanction. The District Court also found that public policy supported vacatur.

The Court of Appeals reversed the District Court and in doing so made clear that if parties contract to have their disputes resolved in arbitration, they are stuck with the arbitrator's decision unless it can be proved that the arbitrator was guilty of fraud, bias or corruption. The Appellate Court explained: "…. the scope of arbitrators' power is controlled by the language of the submission and that when the arbitrators are not restricted by the submission to decide according to principles of law, **they may make an award according to their own notion of justice without regard to the law.**" (emphasis added by this author)

The signal to the business community is loud and clear. Be careful what you wish for … and be careful about the arbitration language that you include in your agreements. The arbitration language in the *Seagate* case was in an employment agreement between Seagate and one of its employees. When that employee left to join Western Digital, Seagate brought suit. The language of the arbitration clause is plain.

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It provided as follows:

Arbitration: Except as stated below, I agree that any dispute or controversy arising out of or relating to any interpretation, construction, performance or breach of this Agreement, shall be settled by arbitration to be held in Hennepin County, Minnesota, in accordance with the rules then in effect of the American Arbitration Association. The arbitrator may grant injunctions or other relief in such dispute or controversy. The decision of the arbitrator shall be final, conclusive and binding on the parties to the arbitration. Judgment may be entered on the arbitrator's decision in any court having jurisdiction. The Company and I shall each pay one-half of the costs and expenses of such arbitration, and each of us shall separately pay our counsel fees and expenses.

The arbitration clause in *Seagate* is a standard, plain vanilla arbitration clause. As interpreted by state and federal courts, however, it has now become the legal equivalent of an improvised explosive device. The plain vanilla language disguises rules that give the arbitrator the unfettered discretion to do whatever he likes. I would venture a guess that 99 percent of all business lawyers who include arbitration clauses in commercial and employment agreements have never read the AAA rules for commercial litigation.

Those rules provide that arbitrators have the power to determine the existence or validity of a contract and, in the exercise of their discretion to expedite proceedings, can direct the order of proof, bifurcate issues, and direct the parties to focus their presentations on issues the decision of which could dispose of all or part of the case. Conformity to the rules of evidence is not required and the arbitrators may receive affidavits in lieu of live testimony. Ever try to cross-examine an affidavit? The notion that an arbitrator has the power to eliminate the right of cross-examination is a staggering thought in the American system of justice.

The AAA rules also do not prohibit or limit the arbitrator's authority to grant injunctive relief, impose sanctions or award punitive damages. The Appellate Court in *Seagate* found that the lack of any prohibition to award sanctions combined with the broad language of the arbitration clause was sufficient to grant the arbitrator the authority to impose any sanction the arbitrator deemed appropriate. In this case, the sanction was that Western Digital could not offer evidence in opposition to Seagate's claims. Since the *Seagate* Appellate Court noted that an arbitrator is not required to follow the law, the conclusion one draws is that the arbitrator has "carte blanche" to do whatever he wants absent fraud, bias or corruption.

Under the Appellate Court's view, arbitrators are only limited by the language of the arbitration clause and arbitrators have broad powers to fashion any remedy they so choose. Unless there is limiting language in the arbitration agreement, arbitrators' powers are virtually unlimited. In *Seagate*, the Appellate Court held that the arbitrator's inherent authority to impose whatever sanctions the arbitrator chooses appears to be consistent with Minnesota case law. My speculation is that most transactional lawyers do not intend to turn over important or complex matters to be resolved by persons who have unlimited authority and discretion to do whatever they want. Nevertheless that is exactly what is done when a standard arbitration clause is employed.

So to the business practitioner who continues to operate under the misapprehension that arbitration is an efficient and inexpensive method to resolve disputes, keep this in mind. The best one can hope for in arbitration is "rough justice" with no resort to judicial review. If your view is that the arbitrator's "own notion of justice" without regard to the law is in your client's best interest, then a broad based arbitration clause is the way to go. On the other hand, if you think your client might be better served by having some nexus between the law and the matter in dispute then include language in the arbitration clause a provision that sets the standard of review that the arbitrator must follow. If you want to deprive the arbitrator of the right to impose sanctions or punitive damages, that limitation needs to be specified in the arbitration clause. Absent limiting language, a broad arbitration clause provides unlimited discretion to the arbitrator and your client will have to live with the consequences.

So, in the category of "being careful of what you wish for," it was Western Digital that successfully moved to compel arbitration, and Western Digital got its wish…but it came with a $625 million price tag.