RECENT DEVELOPMENTS IN ARBITRATION & MEDIATION LAW

A Review of Recent Cases, Statutes and Rules Affecting the Practice of Mediation, Arbitration and Settlement Negotiation for Attorneys Practicing in Southern California

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ARBITRATION PANEL

Peter Collisson, Attorney-Mediator-Arbitrator
Rex Heinke, Partner, Akin Gump Strauss Hauer & Feld LLP
Barbara A. Reeves Neal, Arbitrator-Mediator-Special Master, JAMS

MEDIATION PANEL

Christopher Blank, Attorney-Mediator
Lisa Jaye, Circuit Mediator, Ninth Circuit Court of Appeals
Gail Killefer, ADR Director, U.S. District Court, Central District of California
Lance La Belle, Partner, Berger Kahn

PROGRAM CHAIR & MODERATOR

Rebecca Callahan, Mediator-Arbitrator, ADR Services

SEMINAR LOCATION

Orange County Bar Association Building
4101 Westerly Place, Newport Beach, CA

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MESSAGE FROM THE PROGRAM CHAIR

Welcome to the third recent developments seminar program sponsored by the ADR Section of the Orange County Bar Association. Given all that is going on in the field of ADR generally, coupled with the increased utilization and acceptance of ADR over the years, the ADR Section decided in 2013 that an annual seminar was in order to give those interested in the study and advancement of alternative means for resolving disputes an opportunity to look back at the prior year's developments and trends.

Much of what is contained in the following materials are case digests. It is ironic that processes aimed at helping disputants avoid litigation in the courts have come to be defined by the courts. But these handout materials are testament to that being the case, whether talking about arbitration, mediation or settlement negotiation.

Arbitration has been an accepted alternative to litigation for almost 100 years. The process itself is defined by statute at both the state and federal levels and has found itself the subject of discussion and dissection in numerous reported cases. The same is not true for mediation. Mediation is relatively new as an alternative to civil litigation, and has only recently (the last 20 years or so) become the subject of statutory and reported case law.

Arbitration, mediation and settlement have been bundled together for a couple of reasons: 1. They share the fact that they are all alternatives to litigation in the courts. 2. While they are alternatives to each other, they are not mutually exclusive. It is not unusual to have some combination of ADR processes in play. Accordingly, it makes sense when sitting down to look at what's happened in one area of ADR to take a moment to look at the other areas as well.

We are fortunate to have on our panel some of the most accomplished practitioners in the fields of mediation and arbitration. We have enlisted their help to talk us through some of the more interesting cases or more difficult/noteworthy developments and to add their perspectives and experiences so as to enrich our understanding of the issues and where the case or statutory development fits in to the "big picture."2

If history is any indicator, our audience will be full of accomplished neutrals. While we have a lot of material to cover in a short amount of time, questions, comments and input from the audience is most certainly welcome.

This handout includes "background" sections for each major topic that are written from my perspective, after years of practice and study. There are many points of view in this rapidly changing/developing area, so I do not mean to suggest by any means that what is set forth in those sections is the final word on those subjects. In addition to the "background" sections, the materials contain case digests and short discussions about statutory developments and other trends. This is my "give back" to the legal community I serve in the hopes that, in some small way, this collection of digests will improve how we understand, access and utilize ADR. Special thanks and recognition are in order to Gail Killefer and Chris Blank who provided some of the case digest materials.

The analysis in these materials in quite detailed in the hope that you will use it as a reference tool and that it will save you research time and effort should that need arise. I hope you enjoy reading the following materials as much as I enjoyed writing them. I would love your feedback (pro and con). Please email me at Rebecca@callahanADR.com.

Thank you for attending our program!

I.
ARBITRATION – SIGNIFICANT CASES

A. ARBITRATOR DISQUALIFICATION – REQUIRED DISCLOSURES AND EVIDENT PARTIALITY

(1) Background Statement re Federal Disclosure Standard

The Federal Arbitration Act ("FAA") does not specifically address the matter of pre-appointment disclosure by arbitrators or arbitrator disqualification. Instead, at the back end of the process, the FAA provides generally that an award may be vacated when an arbitrator has failed to disclose an interest or relationship that amounts to "evident partiality," meaning that such circumstance might affect impartiality or create an appearance of partiality. 9 U.S.C. § 10(a)(2).The details of what constitutes a required disclosure is a matter of case law, and starts with the United States Supreme Court's 1968 decision in *Commonwealth Coatings Corp. v. Continental Casualty Co.,* 393 U.S. 145 (1968).

In *Commonwealth Coatings,* the arbitrator was a leading and respected consulting engineer who had performed services for most of the prime contractors in Puerto Rico, where the project and dispute were venued. The arbitrator was well known to the subcontractor's counsel and they were personal friends. Id. at 152-153. While the subcontractor's counsel knew the arbitrator and knew of his reputation and business ties in the community, he was not aware of the fact that the arbitrator had performed services for the prime contractor whose bond was in issue, and that fact was not made known to claimant by the arbitrator or anyone else until after the award had been made. It is not clear from the facts whether the personal ties between the arbitrator and the subcontractor's counsel were disclosed to the contractor or his counsel. However, when the award came out against the subcontractor and in favor of the contractor, the subcontractor complained that the arbitrator's undisclosed, past business relationship with the prime contractor created an impression of bias. The district court refused to set aside the award because there was no charge that the arbitrator was guilty of fraud or actual bias in deciding the case. The court of appeal affirmed.

On further review by the United States Supreme Court, the confirmation of the award was reversed and the award vacated. In *Commonwealth Coatings*, the Supreme Court held that a party seeking to vacate an arbitration award for evident partiality

need not show that the arbitrator "was actually guilty of fraud or bias in deciding th[e] case;" that "evident partiality" is distinct from actual bias. Id. at 147. The Court held that the arbitrator's failure to "disclose to the parties any dealings that might create an impression of possible bias" is sufficient to support vacatur. Id. at 149. The Court found this standard was satisfied where a neutral arbitrator in a dispute between a contractor and subcontractor failed to disclose that he had previously performed consulting work worth about $12,000 for the contractor. Although "there had been no dealings between them for about a year immediately preceding the arbitration," the arbitrator's past relationship with the contractor had included irregular contacts "over a period of four of five years" and had gone "so far as to include the rendering of services on the very projects involved in th[e] lawsuit." Id. at 146. While the Court recognized "that arbitrators cannot sever all their ties with the business world," it emphasized that because arbitrators "have completely free rein to decide the law as well as the facts and are not subject to appellate review," courts must "be even more scrupulous to safeguard the[ir] impartiality." Id. at 148-149.

What qualifies as a matter creating an impression of possible bias is a fact-driven inquiry. As a result the landscape is populated with cases where the courts have conducted their own case-by-case factual analysis to determine whether an undisclosed relationship rises to the level of a conflict sufficient to create an impression of possible bias and thus support vacatur. There is thus no "bright line" test. For example, in *Woods v. Saturn Distribution Corp.*, 78 F.3d 424 (9th Cir. 1996), cert dism., 518 U.S. 1051 (1996), the Ninth Circuit refused to vacate the award rendered by an arbitration panel consisting of Saturn employees and dealers notwithstanding a charge of "evident bias" because the parties' pre-dispute agreement provided for Saturn's dispute resolution process to be the one utilized by the parties. That process was expressly described as one in which both mediation and binding arbitration would be conducted by a panel of two Saturn dealers and two Saturn employees, randomly selected from a pool of volunteers consisting of ten Saturn dealers and ten Saturn employees.

In contrast, in *Schmitz v. Zilveti*, 20 F.3d 1043 (9th Cir. 1994), the Ninth Circuit vacated an award for evident partiality where the arbitrator's law firm had represented the parent company of a party "in at least nineteen cases during a period of 35 years" with the most recent representation ending less than two years before the arbitration was submitted. Id. at 1044. The Ninth Circuit disagreed with the district court's conclusion that evident partiality could not be shown because the arbitrator did not have actual knowledge of his law firm's conflict during the arbitration. Id. Based on *Commonwealth Coatings*, the court concluded that the standard for evident partiality is whether there are "facts showing a 'reasonable impression of partiality.'" Id. at 1048. The court explained that this standard can be satisfied even where an arbitrator is

unaware of the facts showing a reasonable impression of partiality because the arbitrator "may have a duty to investigate independent of [his] . . . duty to disclose."Id.

In further contrast, in the Ninth Circuit's decision in *Lagstein v. Certain Underwriters at Lloyds, London*, 607 F.3d 634 (9th Cir. 2010), cert. den., __ U.S. __, 131 S.Ct. 832 (2010), the court seems to have limited required arbitrator disclosures to relationships and dealings with the current arbitration participants. In *Lagstein*, a three-arbitrator panel concluded that Lloyds had breached an insurance contract and acted unreasonably with regard to the handling of the insured's claims, but the panel split on the amount of damages to be awarded. The majority concluded that Lagstein (the insured) should be awarded the full value of his policy ($900,000), plus $1.5 Million for emotional distress. The dissenting arbitrator would have awarded Lagstein only $11,000 and would not have awarded emotional distress damages. Subsequent to the initial award, proceedings were held on request for punitive damages. Again, the majority awarded Lagstein punitive damages in the amount of $4 Million, whereas the dissenting arbitrator argued that the panel lacked jurisdiction and, even if it had jurisdiction, the award should be limited to $50,000. Following the panel's awards, Lloyds investigated the backgrounds of the arbitrators and discovered that the arbitrators forming the majority had been involved in an ethics controversy over a decade earlier. Lloyds then filed a motion to vacate the arbitration award on several grounds, including the arbitrators' failure to disclose their involvement in the prior ethics controversy. The district court granted vacatur, but not on the ground of "evident partiality" resulting from the majority arbitrators' failure to disclose the ethics controversy. On appeal, the district court's vacatur was reversed and remanded with instructions. However, with regard to the "evident partiality" challenge, the Ninth Circuit agreed with the district court that Lloyds did not establish the existence of "an inappropriate relationship or contact" between the two arbitrators or a failure to disclose "information that would warrant vacating the award." Id. at 645. To show "evident partiality" in an arbitrator, the court held that the moving party "must establish specific facts indicating actual bias toward or against a party or show that [the arbitrator] failed to disclose to the parties information that creates '[a] reasonable impression of bias.'" Id. at 645-646, citing *Woods v. Saturn Distribution Corp.*, supra, 78 F.3d at 427. Vacatur of an arbitration award is not required under Section 10(a)(2) of the FAA simply because an arbitrator fails to disclose a matter that might be of some interest to a party. Instead, an arbitrator is required to disclose "only facts indicating that he 'might reasonably be thought biased against one litigant and favorable to another.'" Id. at 646, citing *Commonwealth Coatings*, supra, 393 U.S. at 150. Here, the Ninth Circuit found that Lloyds failed to show any connection between the parties to the present arbitration and any of the majority arbitrator's past difficulties that would give rise to a reasonable impression of partiality toward Lagstein. Indeed, the court

found that the majority arbitrator's alleged misconduct occurred more than a decade before the subject arbitration and concerned neither of the parties to the current case. Id., citing *Paine-Webber Group, Inc. v. Zinsmeyer Trusts P'ship*, 187 F.3d 988, 995 (9th Cir. 1999) (characterizing a claim of evident partiality as "border[ing] on frivolous" where there was no alleged relationship between the parties and the arbitrators, and "there [was] no evidence the arbitrators had any financial or personal interest in the outcome of the arbitration"). [Note: After remand, there was a further appeal and reported decision concerning the ability of the court to award interest where the arbitration award was silent.]

An example of what qualifies as a "nontrivial conflict of interest" justifying vacatur for "evident partiality" can be found in the Ninth Circuit's decision in *New Regency Productions, Inc. v. Nippon Herald Films, Inc.*, 501 F.3d 1101 (9th Cir. 2007). In this case, a film distribution company and film production company agreed to arbitrate a dispute concerning their respective rights and obligations under a film distribution agreement. After conducting six days of hearing, the arbitrator decided that Nippon was entitled to return of the $440,000 fee it had paid New Regency for an undelivered film and New Regency was entitled to$2,341,257 from Nippon as its interest in the proceeds of a recoupment pool. When New Regency moved to confirm the award, Nippon objected and sought vacatur on several grounds, including the arbitrator's failure to disclose the fact that between the time of the last evidentiary hearing date and the issuance of his award, the arbitrator took a new job as a high-level executive with a film group that was in negotiations with one of the parties (New Regency) to finance and co-produce a major motion picture. The district court granted vacatur and the Ninth Circuit affirmed that decision. With regard to the challenge made under Section 10(a)(2) of the FAA, the Ninth Circuit concluded that the arbitrator had a duty to investigate potential conflicts when he accepted the high-level executive position while the arbitration was ongoing; that the parties could reasonably have expected the arbitrator to investigate potential conflict when, during the pendency of the arbitration, he took a job in which his duties included overseeing the legal department of another film company. In this regard, the court stated that it believe that the arbitrator's decision to accept a new, high-level executive job at a company in the same industry as the parties was precisely the type of situation where an arbitrator should have reason to believe that a nontrivial conflict of interest might exist and should investigate to determine the existence of potential conflicts. As it turned out, the conflict alleged by Nippon was quite real because the connection between the arbitrator's new employer and New Regency was not attenuated, and because of the high-profile nature of the film project in question, the court could not conclude that the negotiation between the two companies was unimportant to the arbitrator's new employer. Moreover, the

negotiation between New Regency and the arbitrator's new employer was not distant in time, but rather ongoing during the arbitration. Id. at 1110-1111.

The federal cases discussed in Section 4, below, are some recent examples of the fact situations the federal courts have been presented with for purposes of defining (a) under what circumstances an arbitrator has an affirmative duty to undertake an investigation for possible conflicts, and (b) what types of relationships and/or interests must be disclosed on penalty of vacatur for "evident partiality" if the arbitrator fails to do so. What is clear in the Ninth Circuit, however, is that to establish "evident partiality," bald allegations of partiality are not enough; the moving party must present evidence to support this claim. See, *Ventress v. Japan Airlines*, 603 F.3d 676, 679-680 (9th Cir. 2010).

(2) Background Statement re California Disclosure Standard

In 1961, California adopted the Uniform Arbitration Act. As originally enacted, there were no specific disclosure requirements imposed upon neutral arbitrators. In 1994, California enacted Code of Civil Procedure section 1281.9 to require specific arbitrator disclosures. As originally enacted, the disclosure requirements were relatively narrow, requiring only disclosure of information concerning prior arbitrations in which the arbitrator had served as a neutral or party arbitrator involving the parties or lawyers to the current arbitration. In 1997, Section 1281.9 was amended to expand those disclosure requirements to include any current or historical attorney-client relationship between the arbitrator and any party or lawyer to the current arbitration and any current or historical professional or significant personal relationships between the arbitrator, his or her spouse, or minor child living in the household, on the one hand, and any party or lawyer to the current arbitration. In September 2001, Section 1281.9 was amended again and Sections 1281.85 and 1281.91 were added.

Under new Code of Civil Procedure section 1281.85, the Legislature delegated to the California Judicial Council authority and responsibility for adopting mandatory ethical standards for all individuals serving as neutral arbitrators in contractual arbitrations held in California. Pursuant to this mandate, the Judicial Council adopted the "Ethics Standards for Neutral Arbitrators in Contractual Arbitration" originally codified in Division VI of the Appendix to the California Rules of Court and now found in the end of the California Rules of Court following Title 10 (Judicial Administration Rules) and the Standards for Judicial Administration. The statutory disclosure requirements set forth in Section 1281.9 incorporate the Ethics Standards as being among a private arbitrator's mandatory disclosure obligations.

A proposed neutral must timely disclose to the parties "all matters that could cause a person aware of the facts to reasonably entertain a doubt that the proposed neutral arbitrator would be able to be impartial," including a long list of specific information set forth in Standard 7(d) of the Ethics Rules. Code. Civ. Proc. § 1281.9(a). The disclosures must be made in writing within 10 calendar days of the proposed nomination or appointment. Code. Civ. Proc. § 1281.9(b). Under the Ethics Rules, arbitrators have a continuing duty to inform themselves about matters that need to be disclosed and to make all required disclosures from the time of appointment through the close of the arbitration. If something arises in the course of an arbitration that triggers a supplemental disclosure obligation, the arbitrator must make the required disclosures within 10 calendar days, and that disclosure will renew the parties' disqualification rights discussed below.

Because private arbitration is a matter of agreement between the parties to the dispute, an arbitrator must withdraw if all parties request the arbitrator to do so. If only one party objects to the arbitrator in an administered arbitration, the general practice was to leave the determination of challenges to an arbitrator's appointment to the provider institution (*e.g.*, AAA, JAMS, CPR) in accordance with their rules. In a non-administered (ad hoc) arbitration in which no specific institutional rules apply, the general practice recommended by the AAA / ABA Code was for the arbitrator to determine whether the reason for the challenge is "substantial" and, if so, to then determine whether he or she "can nevertheless act and decide the case impartially and fairly." Under California law, disqualification based upon an arbitrator's disclosures is an absolute right of the parties; it is not subject to review or determination by the provider institution or other higher outside authority.[1] See, *Azteca Construction, Inc. v. ADR Consulting, Inc.*, 121 Cal. App. 4th 1156, 1163 (2004); *Ovitz v. Schulman*, 133 Cal. App. 4th 830, 840 (2005). Under Code of Civil Procedure section 1281.91(b), disqualification is mandatory; operates as a peremptory challenge; and takes effect when a party timely serves a notice of disqualification.

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[1] The Court of Appeal in *Azteca* found that the provisions of the California Arbitration Act relating to arbitrator disqualification could not be waived because they were "enacted primarily for a public purpose." In this regard, the Court of Appeal found that the procedural rules of the provider institution (AAA) "must yield to the disqualification scheme set forth in sections 1281.9 and 1281.91, for a number of reasons." Among those reasons were the findings that (a) the neutrality of the arbitrator is of crucial importance to the private arbitration process and (b) the California Supreme Court's recognition that arbitrator neutrality is "essential to ensuring the integrity of the arbitration process." 121 Cal. App. 4th at 1168, citing *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal. 4th 83, 103 (2000).

Under Section 1281.91(b), there is no limit on the number of times a party may challenge a proposed arbitrator. For the recalcitrant party trying to avoid binding arbitration, an obvious tactic would be to serve a notice of disqualification within 15 days of each proposed arbitrator's disclosures. The only way to limit the number of peremptory challenges a party may assert is by seeking court intervention via a motion that asks the court to appoint the arbitrator as provided by Code of Civil Procedure section 1281.91. Section 1281.91(a)(2) then provides that a party shall have the right to disqualify one court-appointed arbitrator without cause in any single arbitration and, beyond that, may petition the court to disqualify a subsequent appointee "only upon a showing of cause."

Code of Civil Procedure section 1286.2 provides the "strong-arm" mechanism for enforcing arbitrator disclosures – namely, vacatur. As amended, Section 1286.2 mandates that a court "shall" vacate an arbitration award if the arbitrator making the award (a) failed to disclose a ground for disqualification of which the arbitrator was aware, or (b) was subject to disqualification upon grounds specified in Section 1281.9 but failed to disqualify himself or herself after receipt of a timely notice of disqualification. At least one court has commented that, on its face, "the statute leaves no room for discretion. If a statutory ground vacating an award exists, the trial court must vacate the award." See, *Ovitz v. Schulman*, supra, 133 Cal. App. 4th at 845; accord, *International Alliance of Theatrical Stage Employees, etc. v. Laughon*, 118 Cal. App. 4th 1380, 1386 (2004).

Despite the breadth and detail of the Ethics Rules, the California Supreme Court has previously made clear that the disclosure requirements are intended to ensure the impartiality of the arbitrator, not mandate disclosure of "all matters that a party might wish to consider in deciding whether to oppose or accept the selection of an arbitrator." *Haworth v. Superior Court* (2010) 50 Cal. 4th 372. In this regard, the Supreme Court cautioned against construing the governing standard too broadly. "A impression of possible bias in the arbitration context means that one could reasonably form a belief that an arbitrator was biased *for or against a party for a particular reason.*" Id. at 389 (italics in original). One Court of Appeal (Fourth District) has construed the Ethics Rules such that "'ordinary and insubstantial business' arising from participation in the business or legal community do not necessarily require disclosure." *Luce, Forward, Hamilton & Scripps, LLP v. Koch* (2008) 162 Cal. App. 4th 720, 723, quoting *Guseinov v. Burns* (2006) 145 Cal. App. 4th 944, 959.

As evidenced by the recent decision of the Second District in *Mt. Holyoke Homes, L.P. v. Jeffer Mangels Butler & Mitchell*, 219 Cal. App. 4th 1299 (2013), coupled with the 2014 amendments to the disclosure requirements under the Ethics Rules (discussed in Section _____), the issue of what type of relationships require disclosure on penalty of vacatur just got a little bit broader.

(3) Conclusion

Whether operating under Federal or California state law, it is a universal principle of arbitrator ethics that arbitrators have a duty to disclose meaningful relationships with the parties, counsel and/or subject matter of the cases to which they are assigned. There is considerable gray area and no clear definition of what is "ordinary and insubstantial" and what is a meaningful business or personal relationship or life experience that should be disclosed. Unfortunately, the consequence of an arbitrator's failure to make a required disclosure is vacatur, which undermines the efficiency, economy and finality promised by arbitration. The state court cases discussed in Section 5, below, are recent decisions that continue the discussion/dissection of what is a required disclosure and what circumstances give rise to arbitrator disqualification because they could cause a person aware of the facts to reasonably entertain a doubt that the proposed neutral arbitrator would be able to be impartial.

(4) Cases - Federal

(a) District Court Reversed for Stepping in Midstream and Removing Arbitrator Before Entry of an Award – *In re Sussex*, 778 F.3d 1092 (9th Cir., Jan. 27, 2015)

We looked at this case last year as representing a noteworthy development because the district court stepped in and removed an arbitrator midstream due to what it perceived to be extreme circumstances warranting such action – namely, the arbitrator's evident partiality. See *Sussex v. Turnberry/MGM Grand Towers, LLC* 2013 WL 6895845 (Slip Opinion).

In the litigation giving rise to this case, plaintiffs were purchasers of condominium units in a luxury condominium project seeking rescission of their purchase agreements or money damages arising from a wide range of fraud and other claims. Pursuant to the arbitration clause contained in the purchase and sale agreement, the dispute was submitted to arbitration in 2011. At about the same time as his appointment, the arbitrator founded a company that "invests in high-value, high-probability legal claims and litigations." In connection with that business venture, the arbitrator participated as a panelist in a couple of litigation finance and investment seminars and created a website to attract investors to his new firm. The arbitrator did not disclose his litigation finance business venture, but at some point in time the defendants learned of it and asked the AAA to disqualify the arbitrator from further service in the matter, which request was denied. Defendants then petitioned the district

court, and that request was granted even though no arbitration award had yet been issued. The district court found that the arbitrator's founding of a company that intends to profit from funding large, potentially profitable litigations of the kind that he was overseeing was likely to give rise to justifiable doubt regarding his impartiality, particularly since he failed to disclose his new pursuit. In this regard, the Court noted that the arbitrator stood to profit from a business that funds plaintiffs in high-value cases such as the one before him; that the business pursuit he failed to disclose was substantial and his failure to disclose it created a reasonable impression of partiality that would likely lead to vacatur of any award he might eventually make. *5.

On the issue of stepping in pre-award, the district court noted that while Section 10(a)(2) of the FAA does not expressly address a district court's ability to remove an arbitrator for evident partiality prior to the entry of a final award, it felt that the Ninth Circuit in *Aerojet-General Corp. v. American Arbitration Ass'n*, 478 F.2d 248 (9th Cir. 1973) had left open the possibility that a district court could consider such pre-award challenges in "extreme cases." 478 F.2d at 251. The court also noted that other federal courts had found that a district court may intervene in an ongoing arbitration proceeding under its power of equity. "[I]t simply does not follow that the policy objective of an expeditious and just arbitration with minimal judicial interference is furthered by categorically prohibiting a court from disqualifying an arbitrator prior to arbitration." *2, citing *Metropolitan Property and Cas. Ins. Co. v. J.C. Penney Cas. Ins. Co.*, 780 F.Supp. 885 (D.Conn. 1991). The district court concluded that it made no sense to require the parties to proceed through the arbitration to final award, only to have to go through the whole process again if the arbitrator was then disqualified; that that course would only promote delay and waste in time and resources. *3.

The plaintiff purchasers petitioned the Ninth Circuit for writ of mandate, which was granted. The Ninth Circuit disagreed with the district court that midstream intervention in the arbitration was warranted. "We conclude that the district court's ruling was clearly erroneous as to the legal standard for 'evident partiality' and the nature of the equitable concerns sufficient to justify a mid-arbitration intervention." On the first point, the court noted that while the Supreme Court had recognized a "reasonable impression of partiality" standard for vacatur in *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145, 146-149 (1968), it had clarified that this standard differed from the strict standards applicable to judges because "'arbitrators will nearly always, of necessity, have numerous contacts within their field of expertise …. [and]have many more potential conflicts of interest than judges.'" 776 F.3d at 1100, citing *Schmitz v. Zilveti*, 20 F.3d 1043, 1046 (9th Cir. 1994). The court went on to note that in *Lagstein v. Certain Underwriters at Lloyd's, London*, 607 F.3d 634, 639 (9th Cir. 2010), it held that an arbitrator's failure to disclose that he had been involved in an ethics

controversy that had led to his appearing before one of his co-arbitrators (then a judge) who had made rulings in his favor was insufficient for vacatur because there was no connection between the parties to the arbitration and the arbitrator's long-past ethical difficulties "that would give rise to a reasonable impression of partiality" towards one of the litigants." Id. Under these precedents, the Ninth Circuit held that the undisclosed facts concerning the arbitrator's "modest efforts to start a company to attract investors for litigation financing" did not give rise to a reasonable impression that he would be partial toward either party…. Viewed in light of our case law, the financial relationship in this case is contingent, attenuated, and merely potential (citations) and would not give a court grounds to vacate an award for evident partiality." 776 F.3d at 1101.

On the second point concerning the district court's perceived equitable power to justify its mid-arbitration intervention, that Ninth Circuit held that even if the arbitrator's undisclosed activities created a reasonable impression of partiality, the district court's equitable concern that delays and expenses would result if an arbitration award were vacated was "manifestly inadequate to justify a mid-arbitration intervention, regardless of the size and early stage of the arbitration." 776 F.3d at 1101. In this regard, the court noted that it had previously held that financial harm is insufficient to justify collateral review because mere cost and delay "is no different from the injury a party wrongfully denied summary judgment experiences when forced to go to trial. Id., citing *In re Cement Antitrust Litigation*, 688 F.2d 1297, 1303 (9th Cir. 1982). The court reasoned that the same rule applies in the arbitration context because cost and delay "do not constitute the sort of 'severe irreparable injury' or 'manifest injustice' that could justify such a step." Id.

(b) Court Upbraids a Former Appellate Justice for Rendering an Arbitration Award "in Retaliation" and Vacates the Award Due to Evident Partiality in the Way he Decided and Handled the Disqualification Challenge – *Ruhe v. Masimo Corp.*, 14 F.Supp. 3d 1342 (C.D.Cal., Apr. 3, 2014) (Appeal taken to the Ninth Circuit)

This is an employment case in which the plaintiffs complained of wrongful termination from defendant Masimo. In September 2011, the Court ordered the parties to arbitration. That matter proceeded to arbitration and to evidentiary hearing before a JAMS arbitrator, Richard C. Neal (a former Court of Appeal Justice). Thirty-six hours before the final hearing, Masimo makes a for-cause challenge to the continued service of the arbitrator. The challenge was based upon Masimo's recent discovery that the Arbitrator's brother (Stephen C. Neal) had represented its chief competitor in two

highly contentious litigation losses to Masimo with liability verdicts totaling over half a billion dollars. One of the verdicts obtained against the Arbitrator's brother was reported as one of the largest jury verdicts handed down in 2005.

Instead of having the challenge heard by JAMS, as required by JAMS's rules, the Arbitrator himself determined that he was not subject to disqualification. The Arbitrator stated that he was not previously aware of his brother's representation of Masimo's rival or the defeats his brother had suffered, that he violated no disclosure obligations, and that even if he had known of the information concerning his brother's previous representation and losses, it was not "sufficient to cause a person to reasonably doubt [his] ability to be impartial in this case" because "[n]o advantage could flow to [him] from disfavoring a company simply because [his] brother was [a] lawyer for a Masimo opponent." The final hearing was the punitive damages hearing and it proceeded as scheduled on January 10, 2014.

Five days after the hearing, the Arbitrator issued the final award and found in favor of plaintiffs on their wrongful termination claim, awarding the full amount of compensatory damages they had requested – approximately $310,000. The Arbitrator then assessed Masimo with $5 million in punitive damages. The Arbitrator acknowledged that this award was more than 16 times the total compensatory damages awarded, but reasoned that it was "in no sense disproportionate [because] it is only a fraction of [Masimo's] annual net income."

Masimo then petitioned the district court to vacate the award under Section 10(a)(2) of the Federal Arbitration Act ("evident partiality or corruption in the arbitrator"). The district court granted the motion, finding that the Arbitrator had demonstrated evident partiality by deciding the disqualification challenge himself and then imposed punitive damages on Masimo for making the challenge and for other reasonable acts of advocacy by its attorneys. The court also took issue with the Arbitrator's "dismissive" statement that there was no conflict because his brother had simply "represented companies adverse to Masimo in litigation." The court found that "[t]he circumstances in reality were much more serious," and that the Arbitrator's decision to decide the disqualification challenge himself, without make additional disclosures or providing facts on the record to refute the alleged conflict, "undermined the fairness of the proceeding and demonstrated his partiality."

(c) An Arbitrator's Failure to Disclose a Lucrative Source of Repeat Business from One of the Parties to an Arbitration is the Type of Circumstance that Forms the Prima Facie Basis for Vacatur Due to a Reasonable Impression of Bias and Warrants Both Discovery and an Evidentiary Hearing – *Rosenhaus v. Jackson*, U.S. District Court, Central District of California, Case No. 2:14-cv-03154-MWF (JCGx)

This case has been in the news on several occasions, but has not yet been the subject of any reported decisions. It squarely involves the issue of lucrative repeat business and what obligations an arbitrator might have to make disclosures about those relationships under the FAA. It is thus worth keeping an eye on as it proceeds through the federal court system in the Central District of California. The background facts of the case and its current status are as follows.

Professional football player DeSean Jackson hired sports agent Drew Rosenhaus to work as his agent in 2009. During the course of that relationship, Rosenhaus made a loan to Jackson of over $375,000. The loan's terms provided for nonpayment if Jackson remained a Rosenhaus client, which he did not. When Jackson terminated the agency representation relationship with Rosenhaus and failed to repay the loan, Rosenhaus filed a grievance with the National Football League Players Association ("NFLPA") as required by NFLPA Regulations governing contracts between players and sports agents.

Once a grievance is filed with the NFLPA, its regulations provide that the NFLPA "shall select a skilled and experienced person to serve as the outside *impartial* Arbitrator." (Emphasis added.) Those regulations do not, however, elaborate on what is entailed in selecting the "impartial" arbitrator. As it turned out, over the past 20 years, the NFLPA has appointed just one person to serve as arbitrator in virtually all of its proceedings – Roger Kaplan – and according to a House Committee Report, Kaplan has decided in favor of agents over players more than 80 percent of the time.

Kaplan was assigned by the NFLPA as the arbitrator for the dispute between Jackson and Rosenhaus. Kaplan held an evidentiary hearing on the dispute in September 2013. After the hearing but before Kaplan issued an award, Jackson discovered that Kaplan was simultaneously serving as the arbitrator in a private, non-NFLPA dispute between Rosenhaus and one of his former employees (Danny Martoe). Kaplan's appointment to the Rosenhaus-Martoe dispute came about because Rosenhaus included an arbitration clause in his employment agreement with Martoe which

required Martoe to agree to submit any disputes to the NFLPA for resolution. While the NFLPA is not an ADR provider, it nevertheless respected the arbitration clause and sent the matter to its one and only arbitrator – Kaplan.

Upon learning of Kaplan's appointment in the Rosenhaus-Martoe dispute, Jackson asked Rosenhaus to recuse himself for appearance of bias based upon his failure to disclose his engagement in the Rosenhaus-Martoe matter. Kaplan denied Jackson's request and then proceeded to decide the matter, ruling in favor of Rosenhaus and ordering Jackson to $516,415. Rosenhaus filed a petition to confirm the award and Jackson filed a cross-petition to vacate the award.

After briefing by both parties, the district court (Judge Fitzgerald) found that Jackson had failed to demonstrate actual impartiality or bias, but would examine further whether the facts alleged were sufficient to support a claim for vacatur under Section 10(a)(2) of the FAA for nondisclosure.[2] The court found that they were and that in order to succeed on his claim of evident partiality, Jackson would have to demonstrate to the court that Kaplan failed to disclose facts that create a reasonable impression of partiality towards Rosenhaus. Jackson argued that he could meet that burden by demonstrating that (1) Kaplan never disclosed his engagement to arbitrate the Rosenhaus-Martoe dispute or (2) Kaplan had a continuing financial stake in Rosenhaus' employment disputes that was known and never disclosed. On this latter point, Jackson alleged that it was Rosenhaus' practice to includes an NFLPA arbitration clause in all of his employment agreements, thereby creating an additional source of income for Kaplan. According to evidence submitted to the court, Rosenhaus provided Kaplan with the opportunity to make an additional $140,000 in fees as a result of requiring parties who entered into contracts with him to agree to NFLPA arbitration for any disputes. The court found that "Rosenhaus required Martoe to bring his dispute through NFLPA arbitration, and therefore created additional business for Kaplan. Rosenhaus has not shown that there was a disclosure of this important fact." The court stated that an arbitrator's failure to disclose a potentially lucrative source of future income from one of the parties to an arbitration can create a reasonable impression of bias.

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[2] Referring to the decision in *Woods v. Saturn Distrib. Corp.*, 78 F.3d 424 (9th Cir. 1996), the court noted that the Ninth Circuit has identified two categories of evident partiality cases: actual bias cases and nondisclosure cases. The court further noted that nondisclosure cases are "somewhat easier to prove," citing *Nordahl Dev. Corp., Inc. v. Salomon Smith Barney*, 309 F.Supp. 2d 1257, 1266 (D.Or. 2004).

That being said, while the Court concluded that Jackson had presented evidence of a failure to disclose, there were several factual issues that the court wanted to delve into before decided the matter. Accordingly, the court ordered further discovery and a further hearing where evidence would be taken. The discovery ordered by the court included a requirement that Rosenhaus produce all contracts in which he has inserted arbitration provisions, including those that refer disputes to the NFLPA arbitration system, and that Jackson serve discovery on the NFLPA to obtain a list of all non-NFLPA cases over which it has "taken jurisdiction." As of the time these materials went to press (March 31, 2015) that discovery was in progress and the vacatur issue was undecided.

(d) Arbitrators' Pre-Existing Relationships with Party Opponents and Their Counsel Were Disclosed and Were Trivial or Insubstantial, and Would not Support a Challenge to the Award Based on Evident Partiality - *Campbell Harrison & Dagley LLP v. Hill*, 2014 WL 2207211 (N.D.Tex., May 28, 2014) (Slip Opinion)

This case involved a protracted fee dispute between the Hills and their former attorneys. The fee agreements between the Hills and their attorneys contained an arbitration clause whereby claims or disputes arising under or in connection with the legal services provided would be subject to binding arbitration. Approximately one year after the execution of the fee agreements, the Hills terminated their attorney-client relationship with the law firms because of their dissatisfaction with the litigation outcomes during the year. When the parties were unable to reach agreement concerning payment of the outstanding legal fees, the law firms filed a motion to compel arbitration, which was granted. The matter proceeded to arbitration where the parties submitted evidence to a panel of arbitrators regarding the merits of their positions. The arbitrators ruled in favor of the law firms and issued an award of approximately $3.2 million in hourly fees and approximately $25 million in contingent fees. The plaintiff law firms sought to confirm the award, and the Hills filed a motion to vacate contending that the arbitrators' decision was tainted by evident partiality (among other grounds not discussed here).

In what looks like strategic gamesmanship similar to that seen in *Thomas Kinkade Company v.* White, 711 F.3d 719 (6th Cir. 2013) (included in the 2014 Program), after the parties selected three arbitrators, the plaintiff law firms hired new counsel that had connections to all three panelists. The Hills objected and filed motions to disqualify all three arbitrators, which motions were granted by the AAA. The AAA then appointed

three new arbitrators, two of whom made disclosures about their pre-existing relationships with either the law firm defendants or their counsel. For example, one arbitrator had been a summer clerk in 1983 at a law firm founded by one of the defendants and had attended a number of social functions between 1993 and 1998 with one of the plaintiff law firms' attorneys. The other arbitrator disclosed that he knew one of the plaintiff law firms' attorneys through bar activities and had mediated or arbitrated cases in which those firms had represented other clients. The Hills objected to these two new arbitrator appointments, arguing that it had the right to veto candidates after reviewing their disclosures (Texas law is different from California law in this regard). The AAA rejected the Hills' objections and the matter proceeded to evidentiary hearing.

In support of their vacatur request, the Hills argued that the appointment of the new arbitrators who made disclosures about pre-existing relationships itself constituted evident partiality because there was no justification for the AAA to unilaterally impose replacement arbitrators with no pre-existing relationships to the other side. The court rejected the Hills argument, finding that the Hills' argument essentially urged the court to vacate the arbitrators' findings based solely on the appearance of impropriety – which was not the standard applied to disclosed conflicts. Instead, the court noted, "courts have adopted a case-by-case objective inquiry into partiality" in which the party asserting evident had the burden of showing that the alleged partiality is direct, definite and capable of demonstration rather than remote, uncertain or speculative. *5, citing *Mantle v. Upper Deck Co.*, 956 F.Supp. 719, 729 (N.D.Tex. 1997). The court denied the Hills' vacatur request on grounds of evident partiality, finding that the business and social relationships they cited were "tenuous," "minimal" and "remote in time" and noting that there was no evidence to indicate that "any close association ever existed between the two arbitrators and any party or counsel." The court found that the disclosed relationships "were not 'so intimate – personally, socially, professionally, or financially – as to cast serious doubt' on the arbitrators' impartiality." *6, citing *Merit Ins. Co. v. Leatherby Ins. Co.*, 714 F.2d 673, 680 (7th Cir. 1983) and *Sheet Metal Workers Int'l Ass'n Local Union 420 v. Kinney Air Conditioning Co.*, 756 F.2d 742, 746 (9th Cir. 1985).

(e) A Trivial Relationship is Insufficient to Create the Appearance of Impropriety Necessary to Violate Section 10(b) of the FAA – *Postal Industries, Inc. v. Travelers Casualty & Surety Co. of America*, 2014 WL 3594306 (M.D.Fla., Jul. 18, 2014) (Slip Opinion)

With respect to the construction of a VA hospital in Orlando, Florida, the general contractor entered into a subcontract with Postal Industries to fabricate and install the hospital's interstitial steel. As required by the Miller Act, the general contractor contracted with Travelers to furnish a payment bond to guarantee payment to its contractors and suppliers. Before the hospital's completion, a dispute arose between the general contractor and Postal Industries concerning the construction site conditions and the quality and pace of Postal Industries' work. Postal Industries filed suit seeking compensation from the performance bond for its partial performance. The court stayed the case and ordered the matter to arbitration. At the arbitration, the general contractor raised its own claim for recovery of costs incurred to complete the project and correct Postal Industries' incomplete and allegedly non-conforming work. The AAA panel found for the general contractor and awarded it over $4 million, plus the costs of the proceeding. Postal Industries then filed a motion seeking to vacate the arbitration award on the grounds of evident partiality on the part of the arbitration panel.

In support of its vacatur motion, Postal Industries argued that one of the arbitrators was evidently partial because he disclosed that he knew two of the attorneys representing the general contractor from prior social gatherings and had previously mediated cases in which those attorneys were involved; that he knew but did not disclose that his former legal secretary was employed by the law firm representing the general contractor, and that he knew but did not disclose that during the arbitration his former law partner had attended a social gathering at which the general contractor's general counsel was also present. With regard to the arbitrator's prior, professional relationships with his former secretary and with the general contractor's attorneys through the prior mediations, the court held that "[n]o reasonable person would believe" that these prior relationships "would create a potential conflict." *2. With regard to the arbitrator's relationships with his former legal secretary and former law partner and their alleged relationships or dealings with the general contractor's counsel, the court found that Postal Industries has provided no evidence that the arbitrator had knowledge of these relationships and, in any event, the arbitrator's connection to the general contractor by virtue of these relationships was "far too attenuated to reasonably suggest bias;" that there must be a substantial relationship between the arbitrator and a party in order to show a violation of Section 10(b) of the FAA. *3.

(f) Parties are Entitled to Unbiased and Uncorrupted Arbitrators – Not Perfect Arbitrators. Failure to Disclose Serious Medical Condition was not Grounds for Seeking Vacatur – *Zurich American Ins. Co. v. Team Tankers A.S.*, 2014 WL 2945803 (S.D.N.Y., Jun. 30, 2014)

Vinmar chartered a tanker to ship 3,500 metric tons of a liquid chemical from Texas to South Korea where Vinmar hoped to find a purchaser. When the shipment reached port, testing showed that it was contaminated. Vinmar then filed a claim against Team Tankers for the degradation and loss. Under the terms of the charter agreement, each party appointed an arbitrator and then those two arbitrators appointed the chair. That occurred in April 2011. The panel then held ten hearings at which they received testimony, exhibits, and extensive briefing from the parties. In August 2013, the panel issued a 2 to 1 decision in favor of Team Tankers because claimants had not shown that the raw materials shipment had been damaged aboard the ship.

Sometime in 2012, mid-arbitration, the Chair was diagnosed with an inoperable brain tumor. He never informed the parties of his diagnosis. However, in April 2013, he informed other counsel in a separate proceeding of his illness. He then passed away in January 2014. After the award was issued, claimants sought vacatur for manifest disregard of the law. Upon learning of the Chair's death from his undisclosed illness, claimants amended their vacatur petition, claiming that the Chair's failure to disclose his brain tumor amounted to corruption under Section 10(a)(2) and misconduct under Section 10(a)(3) of the FAA. The district court for the Southern District of New York rejected both arguments and affirmed the arbitration award.

With regard to the question of whether the Chair had acted "corruptly" in failure to disclose his brain tumor, the court held that even assuming, arguendo, the legitimacy of claimants' premise that tumors necessarily impair brain function, at most the Chair served as an arbitrator when he had reason to doubt his ability to adequately discharge his responsibilities. The court determined that that was not corruption. *10.

With regard to question of whether the Chair's failure to disclose his brain tumor constituted "misbehavior" that had prejudiced claimants and the claimants' argument that they were entitled to a panel of three arbitrators "of unquestionably sound mind," the court rejected that argument concluding that parties "are entitled to unbiased and uncorrupted arbitrators…, not perfect arbitrators." *10. In this regard, the court noted that "[t]here is no guarantee that an arbitrator is free from conditions from conditions which might affect his abilities. Any number of matters – brain tumors, substance

issues, marital problems, lack of sleep – might affect an arbitrator's concentration or faculties." Id. The court went on to note that one of the party arbitrators had reached the same conclusion as the allegedly impaired Chair, since it was a 2 to 1 decision. The court concluded with a critical comment directed at claimants' "after-the-fact" complaint: "This motion seeks to transform a personal tragedy into a second chance for parties disappointed with the outcome of their arbitration. The 'twin goals of arbitration, namely settling disputes efficiently and avoiding long and expensive litigation,' would not be served by vacating the award here." *11.

(5) <u>Cases - California</u>

(a) The "Professional Relationship" Triggering a Duty of Disclosure Under CCP § 1281.9(a)(6) Requires Some Degree of Significance and Substantiality and Does not Require Disclosure of *Any* Professional Relationship No Matter How Attenuated – *Estate of Mapes*, 2014 WL 2467009 (1st Dist., Jun. 23, 2014) (Not Reported)

This disqualification issues in this case involved the inconsistent wording of an arbitrator's disclosure obligations with regard to past professional relationships, as stated in Code of Civil Procedure section 1281.9(a)(6) and compared and contrasted with Ethics Standards 7(d)(8)(A).

Code of Civil Procedure section 1281.9(a) provides that a proposed neutral arbitrator must disclose "all matters that could cause a person aware of the facts to reasonably entertain a doubt that the proposed neutral arbitrator would be able to be impartial" and sets for a list of nonexclusive matters required to be disclosed. Subdivision (a)(6) requires that a proposed arbitrator disclose "[a]ny professional or significant personal relationship" the arbitrator has or had with any party to the arbitration proceeding or any lawyer for a party without limiting the required disclosure of professional relationships to those that are "significant" or defining what qualifies as a "professional" relationship.

Ethics Standard 7(d) has the same founding premise that a proposed arbitrator is required to disclosure "all matters that could cause a person aware of the facts to reasonably entertain a doubt that the proposed arbitrator would be able to be impartial" and then sets for an extensive list of required disclosures. With regard to the disclosure of prior professional relationships, subdivision (8)(A) requires the proposed arbitrator to make a disclosure if he/she "was associated in the private practice of law with a

lawyer in the arbitration within the last two years." So, it defines professional relationship as the private practice of law and it limits the look-back period to two years. This is consistent with the statutory provisions governing the disqualification of judges. Code of Civil Procedure section 170.1 provides that a judge "shall be disqualified" if the judge "served as a lawyer in the proceedings" and shall be deemed to have so served if he/she a lawyer in the proceeding as associated in the private practice of law with the judge within the past two years.

This underlying dispute which proceeded to arbitration arose from the settlement of a dispute between the trustee of a decedent's trust and its beneficiaries. As part of the settlement, the parties agreed that any future disputes concerning the trust would be submitted to binding arbitration before a specified arbitrator (William Quinby). Such future disputes arose and the matter was submitted to and decided by Arbitrator Quinby. The losing parties then sought to vacate the arbitrator's award on the ground that he had failed to make required disclosures: namely, a prior professional association with one of the party's law firms that had existed four years before his appointment per the settlement agreement, five years before the first arbitration proceeding, ten years before the second arbitration proceeding and 14 years before the third and final arbitration proceeding that resulted in the award being challenged. The trial court denied that vacatur request and the First District Court of Appeal affirmed.

The petitioning parties' argument on appeal was that the use of the word "any" in Code of Civil Procedure Section 1281.9 requires disclosure of any professional relationship, no matter how attenuated." Acknowledging that in deed those are the words used in the statute, it noted that the required disclosure of personal relationships was limited to those that are "significant." The court went on to note that the statute does not define what constitutes a "professional relationship," but that case law has viewed the "professional relationship" triggering a duty of disclosure as one involving some degree of significance and substantiality. *7, citing *Guseinov v. Burns*, 145 Cal. App. 4th 944, 958-959 (2006) (arbitrator having acted as an uncompensated mediator in prior matters where lawyer for party to arbitration represented a party unrelated to the current arbitration was insufficient to constitute a professional relationship within the meaning of the statute). Whether "professional relationship" should be construed as including an arbitrator's past practice in the same law firm as a lawyer representing one of the parties in the arbitration, the court found that the parties had provided no authority on this point and it had found none. The appellate court went on to state that with regard to this particular type of professional relationship – prior association in the practice of law – the Legislature, by incorporation of the Ethics Standards, had limited to one that existed within two years of the arbitrator's appointment as one that would potentially cause a person aware of such facts to reasonably entertain a doubt that the

proposed neutral arbitrator would be able to be impartial. Accordingly, the court concluded that the arbitrator was required to disclose his past association as a member of the same law firm as one of the attorneys to the arbitration only if that association occurred within the two years preceding his appointment – which it had not. *8.

(b) While the Arbitrator may Have Failed to Disclose Significant/Required Relationships, There was no Harm – and Thus no Foul – Because the Complaining Party had Actual Knowledge of Those Relationships and Sat Silent Until the Matter was Decided Before Lodging a Complaint – *Vitale v. Morgan Stanley Smith Barney, LLC*, 2014 WL 2931588 (4th Dist., Jun. 30, 2014)

This matter concerns a FINRA arbitration of a dispute between Morgan Stanley and two former employees who sued for breach of contract, negligent misrepresentation and fraud with respect to promises allegedly made to induce them to leave USB Securities. One of three arbitrators appointed to hear the matter made several disclosures about his industry experience and the fact that he had served on a panel for at least three other FINRA arbitrations involving Morgan Stanley.

At the close of a seven-day arbitration, claimants requested an award of over $6.5 million. The panel unanimously ruled in favor of claimants, but awarded them only $4.9 million. Morgan Stanley then filed a petition to vacate the award, complaining that one of the arbitrators had failed to make disclosures about various family members' alleged relationships with Morgan Stanley: namely, that one of his sons-in-law was an advisor with Morgan Stanley; that another of his sons-in-law worked in the securities business and had been aggressively recruited by Morgan Stanley (albeit unsuccessfully). In opposition to the vacatur petition, claimants submitted declarations showing that Morgan Stanley had actual knowledge of all of the nondisclosures it had complained about. After considering the pleadings, evidence and oral argument, the trial court granted Morgan Stanley's vacatur petition, finding that the arbitrator in question had failed to make required disclosures under FINRA which are consistent with Code of Civil Procedure Section 1281.9, which requires the proposed arbitrator to "disclose all matters that could cause a person aware of the facts to reasonably entertain a doubt that the proposed neutral arbitrator would be able to be impartial." In reaching this decision, the trial court largely disregarded the declarations offered by claimants concerning Morgan Stanley's actual knowledge of the undisclosed facts. Claimants appealed.

On appeal, the Fourth District agreed with the trial court that the arbitrator had failed to completely disclose required information required under the FINRA disclosure checklist. *11. However, it concluded that the arbitrator's failure to disclose that his daughter had worked with him in some capacity 10 years earlier and had maintained investment accounts at Morgan Stanley "would not lead a reasonable observer to perceive [the arbitrator] could not be impartial toward Morgan Stanley in the subject arbitration" and thus did not warrant vacatur of the award. The Fourth District also agreed with Morgan Stanley that a reasonable observer might be concerned about an appearance of bias based on Morgan Stanley's effort to recruit two of the arbitrator's co-workers (his sons-in-law) and that it would have been prudent for the arbitrator to have made the disclosures. However, the court concluded that his failure to make these disclosures did not warrant vacatur because it was clear from the record that Morgan Stanley was aware of these facts and the potential for bias was speculative at best. Ultimately, the court found that Morgan Stanley did not take issue with the arbitrator based upon facts of which it had knowledge until after it lost at the arbitration. Accordingly, the trial court's vacatur order was reversed with instructions to enter an order confirming the award.

(c) Not Every Omission of Information that is Required to be Disclosed Pursuant to Section 1281.9 and the Ethics Rules Constitutes a Ground for Disqualification. A Party May Forfeit His / Her Ability to Vacate an Arbitration Award if the Party had Knowledge of the Omitted or Incomplete Disclosures and Took no Action – *United Health Centers v. Superior Court*, 229 Cal. App. 4th 63 (5th Dist., Aug. 25, 2014)

In this case, the trial court vacated an arbitration award issued in favor of defendant in a wrongful termination case brought against it by a former employee. The basis for the trial court's order was that the arbitrator failed to make disclosures required under the mandatory disclosure requirements set forth in Code of Civil Procedure Section 1281.9 and the ethics standards for arbitrators. Defendant presented evidence from which the trial court could have found that plaintiff had forfeited the right to seek vacatur on that basis because her counsel was aware of the omitted facts – the fact that the arbitrator previously had conducted a mediation in which plaintiff's attorneys were involved – and yet took no action to either disqualify the arbitrator or request more information. Nevertheless, the trial court determined that pursuant to Code of Civil Procedure Section 1285.85, an arbitrator's disclosure obligations were mandatory and could not be waived and, as such, vacatur was required. The question

before the court of appeal was whether the forfeiture principles stated in *Dornbirer v. Kaiser Foundation Health Plan, Inc.*, 106 Cal. App. 4th 831 (2008) remain viable after enactment of Section 1281.85(c).

In *Dornbirer*, the arbitrator in a dispute between a patient and her medical provider (Kaiser) disclosed his prior participation in several matters involving Kaiser and its legal counsel. The disclosure statement omitted multiple pieces of information required under Section 1281.9, including the number of times the arbitrator had presided over arbitrations in which Kaiser was a party, as well as the dates, results, and names of all attorneys involved in those prior arbitrations. The patient did not make further inquiry into these omissions, nor did she serve a disqualification notice or demand pursuant to Section 1281.91. 166 Cal. App. 4th at 836-837. After the arbitrator ruled in Kaiser's favor, the patient petitioned for vacatur on the grounds that the arbitrator's disclosures were incomplete. Vacatur was denied and the court of appeal affirmed the trial court, holding that the statutory scheme does not require an arbitration award to be vacated "when the arbitrator has generally disclosed the grounds for disqualification, i.e., his or her relationships and prior interactions with the parties to the arbitration and/or their attorneys, but has not provided all of the specific details required … and despite the omissions, the parties agreed to go forward with the arbitration." Id at 846.

Based on *Dornbirer*, defendant asserted that the trial court erred in vacating the award because the evidence presented showed that before the arbitration began, plaintiff's attorneys knew that he had had prior engagements with the arbitrator and was put on notice by the arbitrator that he had had prior engagements with defendant's counsel, although his conflicts check system did not contain all of the specifics detailed in the statute. Plaintiff's counsel did not make further inquiry and did not seek to disqualify the arbitrator. "[I]nstead, he chose to wait and see how the arbitration turned out, then challenge the award." While it was clear to the court of appeal that the arbitrator had "willfully failed to comply with his disclosure obligations," it was more bothered by the "wait and see" conduct of plaintiff's counsel and reversed the trial court, finding that "a party aware that a disclosure is incomplete or otherwise fails to meet the statutory disclosure requirements, cannot passively reserve the issue for consideration after the arbitration has concluded;" that *Dornbirer* provides for forfeiture of the right of vacatur for nondisclosure under these circumstances and is still viable.

B. CLASS ACTION ARBITRATION – THE STATUS OF EXPRESS WAIVERS AND CONTRACT SILENCE

(1) Background Statement

The United States Supreme Court has said that consent to class arbitration may not be "read into" agreements covered by the Federal Arbitration Act because requiring class arbitration on a nonconsensual basis would interfere with the Congressional intent behind the Federal Arbitration Act (FAA). *Stolt-Nielsen v. Animal Feeds Int'l Corp.* (2010) 130 S.Ct. 1262 (2010). If an arbitration agreement is silent on whether a class arbitration can be brought under its terms, and there is no evidence that the parties intended to include class actions in the agreement, then a party may not be compelled under the FAA to submit to class arbitration.

In 2011, the Supreme Court expanded on the *Stolt-Nielsen* decision and held that the FAA's overarching purpose is to "ensure the enforcement of arbitration agreements according to their terms." *AT & T Mobility LLC v. Concepcion* (2011) 131 S.Ct. 1740. The arbitration agreement in that case included a class-action waiver in a consumer contract that required the parties to arbitrate only in their "individual capacity, and not as a plaintiff or class member in any purported class or representative proceeding." The arbitration agreement also prohibited the arbitrator from consolidating the claims of more than one person, or from presiding over any form of representative class proceeding. In the lower court proceedings before both the district court and the Ninth Circuit, defendant's motion to compel individual arbitration and stay the class action proceedings was denied based on application of the "Discover Bank Rule" announced by the California Supreme Court in 2005: namely, that when a class action waiver is included in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, such waivers are unconscionable as a matter of law, making the arbitration agreement unenforceable. See, *Discover Bank v. Superior Court*, 36 Cal. 4th 148, 162 (2005). The Supreme Court reversed the Ninth Circuit, finding that because it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress (citation), California's *Discover Bank* rule is preempted by the FAA." 131 S.Ct. 1753.

The majority of federal appeals and district court decisions have followed *Concepcion*. See, e.g., *Cruz v. Cingular Wireless LLC*, 648 F.3d 1205 (11th Cir. 2011) (the FAA preempts a remedial consumer statute on the same grounds that it preempts the *Discover Bank* rule); *Litman v. Cellco Partnership*, 655 F.3d 225 (3rd Cir. 2011) (New Jersey law requiring the availability of class wide arbitration "creates a scheme inconsistent

with the FAA" and therefore the district court properly enforced the class arbitration waiver by compelling individual arbitration); *Green v. Super Shuttle Int'l, Inc.*, 653 F.3d 766 (8th Cir. 2011) (in a class action alleging violations of Minnesota's overtime law, the court held that the *Concepcion* decision foreclosed a state law challenge to the enforcement of class action waivers).

Up until 2014, there was uncertainty in California with regard to the enforceability of class action waivers in general and with regard to the application of such waiver provisions to "representative actions" brought under California's Private Attorney General Act ("PAGA"). In *Brown v. Ralph's Grocery, Inc.*, 197 Cal. App. 4th 489 (2011), the Second District Court of Appeal held that *Concepcion* did not apply to PAGA claims and suggested that the four-factor test established by *Gentry v. Superior Court*, 42 Cal. 4th 443 (2007) governed that determination.[3] That being said, the *Brown* majority did not reach the issue regarding the invalidity of the class action waiver because it found that the plaintiff had failed to satisfy *Gentry*'s four-factor test. On the flip side, several California federal courts have held that *Concepcion* overruled *Gentry*. See, *Steele v. American Mortg. Management Servs.*, 2012 WL 5349511 (E.D.Cal. Oct. 26, 2012); *Sanders v. Swift Transp. Co. of Ariz., LLC*, 834 F.2d 1033 (N.D.Cal. 2012); *Lewis v. UBS Fin. Servs*, 818 F.2d 1161 (N.D.Cal. 2011); *Valle v. Lowe's HIW, Inc.*, 2011 WL 3667441 (N.D.Cal. Aug. 22, 2011); Murphy v. DIRETV, Inc., 2011 WL 3319574 (C.D.Cal. Aug. 2, 2011). And at least two California federal courts have questioned the *Brown* court's holding that the right to bring a PAGA claim cannot be waived in an arbitration agreement. See, *Quevedo v. Macy's, Inc.*, 798 F.Supp. 2d 1122 (C.D.Cal. 2011); *Grabowski v. C.H. Robinson Co.*, 817 F.Supp. 2d 1159 (S.D.Cal. 2011).

As discussed below, the California Supreme Court revisited the viability of *Gentry* after *Concepcion* and held that it is no longer good law, thereby eliminating the ability of California courts to invalidate class action waiver provisions contained in employment agreements on what amounted to "public policy" grounds in the labor setting. *Iskanian v. CLS Transp. Los Angeles LLC*, 59 Cal. 4th 348 (2014). While the demise

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[3] *Gentry* directed trial courts to consider four factors in deciding whether to enforce class action waivers in wage and hour cases: "[1] the modest size of the potential individual recovery, [2] the potential retaliation against members of the class, [3] the fact that absent members of the class may be ill informed about their rights, and [4] other real world obstacles to the vindication of class members' right to overtime pay through individual arbitration." *Gentry* then directed trial courts to invalidate class arbitration waivers if they found that a class arbitration was likely to be significantly more effective in vindicating employee rights than an individual arbitration or litigation, and if disallowing class arbitration would likely lead to less comprehensive enforcement of overtime laws.

of *Gentry* and *Discover Bank* is a boon to employers wishing to avoid class actions by including class action waivers in their arbitration provisions of their employment agreements, the California Supreme Court specifically held in *Iskanian* that waivers of PAGA claims are not enforceable. While one would think that forbidding the enforcement of PAGA claim waivers would, like prohibiting class action waivers, run up against FAA preemption, the California Supreme Court said otherwise:

> "Simply put, a PAGA claim lies outside the FAA's coverage because it is not a dispute between an employer and an employee arising out of their contractual relationship. It is a dispute between an employer and the state, which alleges directly or through its agents – either the Labor and Workforce Development Agency or aggrieved employees – that the employer has violated the Labor Code."

59 Cal. 4th at 386-387.

CLS Transportation petitioned for review by the United States Supreme Court with respect to the determination that PAGA claim waivers remained enforceable in light of the FAA and the holding in *Concepcion*. The legal community expected that certiorari would be granted because, in the months after *Iskanian*, several federal district courts in California issued decisions rejecting *Iskanian*.[4] In essence, these decisions found that while California is entitled to interpret California statutes, such as PAGA, such decisions are not binding on federal courts who have jurisdiction to interpret federal statutes such as the FAA. Thus, given the holding in *Concepcion*, these courts held that the FAA preempts the issue concerning the enforceability of PAGA waivers. It was thus a surprise when, on January 20, 2015, the Supreme Court denied certiorari. 2015 WL 231976.

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[4] See, e.g., *Lucero v. Sears Holdings Mgmt. Corp.*, 2014 WL 6984220 (S.D.Cal., Dec. 2, 2014); *Mill v. Kmart Corp.*, 2014 WL 6706017 (N.D.Cal., Nov. 26, 2014); *Langston v. 20/20 Companies, Inc.*, 2014 WL 5335734 (C.D.Cal., Oct 17, 2014) (concluding that the FAA preempts California's rule against arbitration agreements that waive an employee's right to bring representative PAGA claims and that the reasoning in *Iskanian* is inconsistent); *Chico v. Hilton Worldwide, Inc.*, 2014 WL 5088240 (C.D.Cal., Oct 7, 2014) (noting that "numerous federal courts have determined that the FAA preempts California's rule prohibiting waiver of representative PAGA claims" and "agree[ing] and adopt[ing] the reasoning of these cases"); *Ortiz v. Hobby Lobby Stores, Inc.*, 2014 WL 4691126 (E.D.Cal., Oct 1, 2014) ("It is clear that the majority of federal district courts find that PAGA action waivers are enforceable because a rule stating otherwise is preempted by the FAA and *Conception."); Fardig v. Hobby Lobby Stores*, 2014 WL 4782618 (C.D.Cal., Aug. 11, 2014) ("Even in light of *Iskanian*, the Court continues to hold that the ruling making PAGA waivers unenforceable is preempted by the FAA).

As much as the *Concepcion* and *Iskanian* decisions changed how arbitration agreements are read and enforced in California, the denial of certiorari in *Iskanian* will be just as impactful. Because *Iskanian* remains the law in California state courts, while federal courts seem disinclined to follow that decision and instead apply *Concepcion*, there is much potential for mischief, conflicting opinions and forum shopping in employment disputes. Employers will naturally continue to include arbitration agreements that contain PAGA waivers as part of their employment contracts. Employees faced with such PAGA claim waivers will bring suit in state court so *Iskanian*'s invalidation of such waivers will control. At the same time, such plaintiffs will make every possible effort to avoid asserting federal claims, as well as to defeat diversity, so that employers cannot remove such suits to federal court and there seek to invoke FAA preemption to enforce the PAGA waiver and compel individual arbitration.

2. <u>Cases</u>

(a) Class Action Waivers Are Enforceable, but Waivers of Representative Claims Under PAGA Are Not - *Iskanian v. CLS Transp. Los Angeles, LLC*, 59 Cal. 4th 348 (Jun. 23, 2014), cert denied, 2015 WL 231976 (Jan. 20, 2015).

This case has quite a history and is one that we started watching as part of our 2013 recent developments program.

In 2006, plaintiff Arkshavir Iskanian filed a class action on behalf of himself and other current and former employees of defendant CLS Transportation alleging the company had failed to pay overtime and provide required rest and meal period, among other claims. In connection with his employment, plaintiff signed a Proprietary Information and Arbitration Policy/Agreement providing that "any and all claims" arising out of his employment were to be submitted to binding arbitration before a neutral arbitrator. The arbitration agreement included an express waiver of class and representative claims, meaning that he waived the right to class proceedings and agreed to arbitrate any disputes he had with the company on an individual basis.

CLS Transportation moved to compel arbitration of the plaintiff's claims and to dismiss the class/representative claims. That motion was granted based upon the trial court's finding that the arbitration agreement was neither procedurally nor substantively unconscionable. Plaintiff appealed. The California Supreme Court

decided *Gentry v. Superior Court*, 42 Cal. 4th 443 (2007) after the trial court granted defendant's motion, so the Second District Court of Appeal issued a writ of mandate directing the superior court to reconsider its ruling "in light of the new authority." *Gentry* directed trial courts to consider four factors in deciding whether to enforce class action waivers in wage and hour cases: "[1] the modest size of the potential individual recovery, [2] the potential retaliation against members of the class, [3] the fact that absent members of the class may be ill informed about their rights, and [4] other real individual arbitration." *Gentry* then directed trial courts to invalidate class arbitration waivers if they found that a class arbitration was likely to be significantly more effective in vindicating employee rights than an individual arbitration or litigation, and if disallowing class arbitration would likely lead to less comprehensive enforcement of overtime laws.

Following remand, the employer voluntarily withdrew its motion to compel arbitration making it unnecessary for the trial court to reconsider its prior order. The parties proceeded to litigate the case in court, and on a class was certified in October 2009. Nearly four years later, in April 2011, the United States Supreme Court issued its decision in *AT&T Mobility LLC v. Concepcion*, 131 S.Ct. 1740 (2011), which overturned the California Supreme Court's decision in *Discover Bank v. Superior Court*, 36 Cal. 4th 148 (2005). *Discover Bank* held that class action waivers in consumer contracts effectively exculpated a defendant from liability and were unconscionable unless the defendant could show individual arbitration provided an adequate substitute for the deterrent effects of a class action. *Concepcion* found that *Discover Bank* stood as an obstacle to and frustrated the purposes of the FAA. Requiring class arbitration "sacrifices the principal advantage of arbitration – its informality – and makes the process slower, more costly, and more likely to generate a procedural morass than final judgment." It also "great increases the risks to defendants."

Shortly after *Concepcion* was issued, CLS Transportation renewed its motion to compel arbitration, arguing that *Concepcion* had invalidated *Gentry*. The trial court agreed and ordered plaintiff to arbitrate his individual claims and dismissed the class claims with prejudice. Plaintiff appealed. The Second District Court of Appeal affirmed the trial court, holding that the FAA preempts California law as to the unenforceability of employees' waiver of their right to representative action under PAGA and to the extent California law holds that the PAGA rights are unwaiveable because such waiver is contrary to public policy. *Iskanian v. CLS Transp. Los Angeles LLC*, 206 Cal. App. 4th 949 (2012). Plaintiff petitioned for review by the California Supreme Court. That petition was granted on September 19, 2012, and on June 23, 2014, the California Supreme Court issued its ruling.

The California Supreme Court revisited the viability of *Gentry* after *Concepcion* and held that it is no longer good law, thereby eliminating the ability of California courts to invalidate class action waiver provisions contained in employment agreements on what amounted to "public policy" grounds in the labor setting. 59 Cal. 4th 362-366. However, on the issue of PAGA claim waivers, the Court held that such waivers are not enforceable.

> "Simply put, a PAGA claim lies outside the FAA's coverage because it is not a dispute between an employer and an employee arising out of their contractual relationship. It is a dispute between an employer and the state, which alleges directly or through its agents – either the Labor and Workforce Development Agency or aggrieved employees – that the employer has violated the Labor Code."

59 Cal. 4th at 386-387.

As discussed above, CLS Transportation petitioned for review by the United States Supreme Court with respect to the determination that PAGA claim waivers remained enforceable in light of the FAA and the holding in *Concepcion*. That petition was denied on January 20, 2015.

As the law currently stands, employers cannot require employees to waive the right to pursue PAGA claims in state court on a representative basis. This means that an employer may find itself litigating claims in two forums, the employee's individual claims in arbitration and the employee's representative claims in state court. Because PAGA claims have a one-year statute of limitations, compared to up to four years for many claims typically included in such wage claim cases, the risks associated with litigating potential class claims may outweigh the potential convenience of litigating representative PAGA claims in a separate forum.

(b) California Supreme Court Orders the Court of Appeal to Vacate its Earlier 2012 Ruling and to Issue a Ruling Consistent with *Iskanian*. On February 26, 2015, the Second District Ruled that While PAGA are not Subject to Arbitration, They Must be Stayed Until Arbitration Claims are Resolved - *Franco v. Arakelian Enterprises, Inc.*, 2015 WL 798692 (2d Dist., Feb. 26, 2015)

Like *Iskanian*, this case also has quite a history and is one that we started watching as part of our 2013 recent developments program.

In April 2007, employee filed a class action against employer for failure to pay overtime and provide meal and rest periods. The complaint alleged that the employer trucking company engaged in a systematic course of illegal of payroll practices that applied to all employees and that the potential class was so significant in size that individual joinder would be impractical. In June 2007, the employer filed a petition to compel arbitration of the employee's claim and to dismiss or stay the civil action. That petition was granted and the employee appealed. In *Franco v. Athens Disposal Co., Inc.*, 171 Cal. App. 4th 1277, 1290-1294 (2009) (*Franco I*), the court of appeal found that the trial court had erred and held that *Gentry* invalidated a class action waiver of PAGA rights. In *Franco I*, the court of appeal also concluded that *Gentry* invalidated an arbitration clause that prohibited an employee from acting as a private attorney general under the Labor Code. The employer petitioned for review in both the California and United States Supreme Courts. Both petitions were denied and the case was returned to the trial court in January 2010.

After the United States Supreme Court's decision in *Stolt-Nielsen*, the employer filed a second petition to compel arbitration of the individual employee's claim, arguing that a change in the law rendered the class action waiver enforceable. In September 2010, the trial court denied the petition and in April 2011 issued a comprehensive order. Employer against appealed, and six days after filing its appeal, the United States Supreme Court issued its decision in *Concepcion*. The central question in this second appeal was whether the decision of the California Supreme Court in *Gentry v. Superior Court*, 42 Cal. 4th 443 (2007) – on which the court's decision in *Franco I* had relied – remained good law after *Stolt-Nielsen* and *Concepcion*. The court of appeal affirmed the trial court's denial of the defendant's second petition to compel arbitration, holding that the *Stolt-Nielsen* and *Concepcion* decisions did not overrule the *Gentry* decision, and that the agreement to forego class actions and PAGA actions was unenforceable. *Franco v. Arakelian Enterprises, Inc.*, 211 Cal. App. 4th 314 (2012) (*Franco II*). The appellate court

reasoned in *Franco II* that under *Concepcion*, Federal Arbitration Action preemption occurs only if a state law automatically holds all class action waivers unconscionable. As *Concepcion* requires, *Gentry* does not establish a categorical rule against class action waivers. Instead, *Gentry* offers several factors to apply ad hoc to determine whether a class action waiver precludes employees from vindicating non-waivable statutory rights (i.e., overtime pay and rest and meal periods).

Following on the heels of the *Franco II* decision, the court of appeal in *Truly Nolan of America v. Superior Court*, 208 Cal. App. 4th 487 (2012) held that *Gentry* remained good law pending guidance from a higher court because, while *Concepcion* implicitly disapproved of the reasoning behind *Gentry*, it did not directly address the precise issue presented in *Gentry*. On February 13, 2013 the California Supreme Court granted review of the *Franco II* decision and ordered the court of appeal decision superseded pending its disposition in *Iskanian*. 132 Cal. Rptr. 3d 422. After deciding *Iskanian*, in which it ruled that the *Gentry* rule was no longer good law, the Supreme Court transferred *Franco II* back to the court of appeal with instructions to vacate its earlier decision and to reconsider in light of the *Iskanian* decision. 176 Cal. Rptr. 3d 265.

On February 26, 2015, the court of appeal issued its awaited decision and put arbitration before litigation of PAGA claims. *Franco v. Arakelain Enterprises, Inc.*, 2015 WL 798692. The court held that the rulings in *Concepcion* and *Iskanian* required that it reverse and remand to the trial court the orders denying the employer's petition for arbitration with directions to grant the petition for arbitration of the employee's individual claims, and respecting the employee's right to have his PAGA claims determined in a court of law. That being said, the court of appeal ordered that the PAGA claims must be stayed until the arbitration claims were resolved "[b]ecause the issues subject to litigation under the PAGA might overlap those that are subject to arbitration …. The stay's purpose is to preserve the status quo until the arbitration is resolved, preventing any continuing trial court proceedings from disrupting and rendering ineffective the arbitrator's jurisdiction to decide the issues that are subject to arbitration." * 10, citing *Federal Ins. Co. v. Superior Court*, 60 Cal. App. 4th 1370, 1374 (1998).

(c) Trial Court Improperly Sent Employee's Entire Action to Arbitration Despite Unenforceable PAGA Waiver Which This Court Determined Rendered the *Entire* Arbitration Agreement Unenforceable – *Securitas Security Services USA, Inc. v. Superior Court*, ___ Cal. App. 4th ____, 2015 WL 848954 (4th Dist., Feb. 27, 2015)

Securitas provides security services throughout the United States. Denise Edwards became an employee of Securitas in 2011, at which time she signed an acknowledgment of receipt of Securitas's dispute resolution agreement. That agreement provided for binding arbitration of a broad range of disputes, stating that it was "intended to apply to the resolution of disputes that otherwise would be resolved in a court of law, and therefore this Agreement requires all such disputes to be resolved only by an arbitrator through final and binding arbitration and not by way of court or jury trial." The company's dispute resolution agreement also expressly provided that "there will be no right or authority for any dispute to be brought, heard or arbitrated as a class, collective or representative action," which provision was specifically denoted as a "Class Action Waiver." The company's dispute resolution agreement included a "boilerplate" severability provision stating that in the event any portion of said agreement was deemed unenforceable, the remainder of the agreement would nevertheless be enforceable, and expressly stated that if the Class Action Waiver provision was deemed to be unenforceable, the parties expressly agreed that their agreement was silent as to any party's ability to bring a class, collective or representative action in arbitration. However, included within the Class Action Waiver provision was a sentence providing that the waiver sentence "shall not be severable from this Agreement in any case in which the dispute to be arbitrated is brought as a class, collective or representative action." Finally, the dispute resolution agreement contained a 30-day opt-out provision, meaning that it was not mandatory or "forced" upon Edwards, but Edwards did not opt out.

In 2013, Edwards filed a putative class action in state court for wage and hour violations and also sought civil penalties under PAGA. In response, Securitas moved to compel arbitration of Edwards' individual claims and to dismiss or sever and stay her class/representative claims. The trial court granted Securitas's motion to compel arbitration of Edward's individual claims. It also ruled that Edward's PAGA claim could not be waived and, because the dispute resolution agreement sought to eliminate or abridge Edward's right to litigate her PAGA claim, that provision was invalid. The trial court further ruled that because the PAGA claim waiver was unenforceable as a

matter of California law, the severability clause of the dispute resolution agreement applied. It then ordered the parties to proceed with arbitration as to Edward's *entire* complaint – including her PAGA claims – observing that Edwards had voluntarily agreed to resolve her PAGA claims in arbitration, along with her class action claims, by not opting out within the allotted 30-day period. Securitas filed a petition for peremptory writ of mandate, which was granted.

In reviewing the matter, the Fourth District Court of Appeal started with the enforceability of the Class Action Waiver provision as pertained to Edward's PAGA rights. Securitas argued that the trial court erred by refusing to enforce this provision because both *Iskanian* and *Concepcion* required it to conclude that it was valid and enforceable because Edwards voluntarily consented to the dispute resolution agreement containing the Class Action Waiver, which included the PAGA waiver. Securitas cited the appellate court to the Ninth Circuit's decision in *Johnmohammadi v. Bloomingdale's, Inc.*, 755 F.3d 1072 (9th Cir. 2014) and urged the court to follow that decision. The appellate court declined, noting that it would not hold that Edwards had entered into an enforceable waiver of her PAGA rights just because she was not required or compelled to agree to the waiver provision as a condition of employment. The appellate court went on to say that, in its view, the California Supreme Court had "broadly stated the question before it" and had answered broadly that "'an employee's right to bring a PAGA action is unwaivable'" as a matter of public policy. *7, citing *Iskanian v. CLS Transportation*, 59 Cal. 4th 348, 383 (2014).

After concluding that the PAGA waiver within the dispute resolution agreement was not enforceable and upholding the trial court's ruling on this point, the appellate court next turned to the question of whether the trial court had correctly severed the class action waiver and enforced the remainder of the agreement. Focusing on the non-severability sentence mentioned above, the court concluded that it unambiguously reflected the parties' intent that the offending PAGA waiver could not be severed from the Class Action Waiver provision and, as such, the unenforceable PAGA waiver rendered the entire agreement unenforceable. "The dispute resolution agreement … is not divisible, but presents an all-or-nothing proposition: when a Securitas employee asserts class, collective or representative claims, either the employee foregoes his or her right to arbitrate such claims, or the entire agreement to arbitrate disputes is unenforceable and the parties must resolve their disputes in superior court." *10.

(d) Ninth Circuit Upholds Arbitration Agreements Including Class Action Waivers in Two Actions Alleging Violations Under California's Employment Laws on the Same Day the California Supreme Court Issued its Decision in *Iskanian* – *Johnmohammadi v. Bloomingdale's, Inc.*, 755 F.3d 1072 (9th Cir., Jun. 23, 2014) and *Davis v. Nordstrom, Inc.*, 755 F.3d 1089 (9th Cir., Jun. 23, 2014)

On the same day that the California Supreme Court issued its decision in *Iskanian* (discussed above) breathing life into unenforceability of class action waivers as applied to representative actions brought under California's PAGA statute, the Ninth Circuit rejected two employees' efforts to challenge to the enforceability of class action waivers in lawsuits alleging overtime and other employment law violations.

In separate suits – one alleging that Bloomingdale's had violated California wage law and the second alleging that Nordstrom had violated various federal and state employment laws – the Ninth Circuit sided with the two retailer defendants and ordered plaintiffs to arbitration with respect to their individual claims only.

In the *Bloomingdale's* case, the Ninth Circuit affirmed the district court's order granting the employer's motion to compel arbitration of plaintiff's individual claims and dismissing the class action claims without prejudice, holding that plaintiff – a former sales associate who lodged a putative class action to recover allegedly unpaid overtime – had entered into a valid arbitration agreement under which she had forfeited her class action rights with respect to employment disputes. The arbitration agreement in question was an "opt out," meaning one in which the new-hire documents informed plaintiff that she agreed to resolve all employment-related disputes through arbitration unless she expressly opted out by signing and returning an enclosed form within 30 days of her hire date. Plaintiff did not return that opt-out form and did not contest the district court's findings that she made a fully informed and voluntary decision, and that no threats of termination or retaliation were made to influence her decision. "By not opting out within the 30-day period, [plaintiff] became bound by the terms of the arbitration agreement." 755 F.3d at 1073, citing *Circuit City Stores, Inc. v. Ahmed*, 283 F.3d 1198, 1199-1200 (9th Cir. 2002).

The *Nordstrom* case presented a different set of facts and involved an arbitration policy that the employer had revised after the U.S. Supreme Court ruled in 2011 that the FAA preempted a California state rule that banned class action waivers. Following Nordstrom's revision of its arbitration policy, requiring employees to arbitrate most

employment disputes on an individual basis, Faine Davis filed a putative class action in federal court alleging that Nordstrom had violated federal and state employment laws. Nordstrom sought to compel Ms. Davis to arbitrate her claims on an individual basis, but that motion was denied.

In the *Nordstrom* case, the Ninth Circuit reversed the district court's decision, finding that the company had met the minimum requirements under California state law for giving notice to employees before implementing a change in its arbitration policy. Although Nordstrom did not explicitly tell workers that the arbitration policy would change 30 days after the notice, it refrained from enforcing the new policy until after the required 30-day period. "While the communications with its employees were not the model of clarity, we find that Nordstrom satisfied the minimal requirements under California law for providing employees with reasonable notice of a change to its employee handbook." 755 F.3d at 1094.

The Ninth Circuit also reversed the district court's ruling that Nordstrom was required to inform its employees that continuing their employment would, by default, result in their acceptance of the new arbitration policy. In reaching this decision, the district court chiefly relied upon the decision in *Morvant v. P.F. Chang's China Bistro, Inc.*, 870 F.Supp. 2d 831 (N.D.Cal. 2012). The district court read *Morvant* as holding that an employer who unilaterally changes terms of employment must inform its employees that continued employment will constitute acceptance of the new terms of employment. The Ninth Circuit rejected this reasoning because "[i]f *Morvant* were read in that manner … it would be inconsistent with the holding of the California Supreme Court in *Asmus [v. Pac. Bell*, 23 Cal. 4th 1 (2000)]. In *Asmus*, the court held that an employer seeking to terminate a unilateral contract must provide reasonable notice and refrain from interfering with vested rights. 23 Cal. 4th at 18. This requirement also applies to unilateral contract modifications. Id. "Nowhere in *Asmus* did the California Supreme Court require that employees must be expressly told that continued employment constitutes acceptance, nor have any California state appellate court decisions imposed such a requirement." 755 F.3d at 1094.

C. ARBITRABILITY – SUBJECT MATTER JURISDICTION

(1) Background Statement

In civil litigation, the power of the court over the parties and the subject matter of the dispute are both discussed under the general topic of "jurisdiction." In arbitration, "jurisdiction" is generally used to discuss the power of the arbitrator over the parties and "arbitrability" is used to discuss the power of the arbitrator to hear and decide particular issues or claims in a dispute. A challenge to arbitrability raises the question of whether the claim is within the scope of disputes the parties agreed to have determined through arbitration. Arbitration is a matter of contract and, as such, the parties may freely delineate the area of its application. *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Jr. Univ.*, 489 U.S. 468, 478 (1989). An arbitrator's authority over the parties and the subject matter of the dispute is consensual and must find its source in the parties' agreement. *Steelworkers v. Warrier & Gulf Nav. Co.*, 363 U.S. 574, 582 (1060). Accordingly, as a preliminary matter, before parties are ordered to arbitration, a valid agreement to arbitrate must exist and the particular dispute must fall within the scope of the agreement. *Volt*, supra, 489 U.S. at 479; *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995); see also *Trippe Mfg Co. v. Niles Audio Corp.*, 401 F.3d 529, 532 (3d Cir. 2005). In construing the parties' agreement to determine arbitrability, the law requires that questions of arbitrability "be addressed with a healthy regard for the federal policy favoring arbitration," and that "any doubts concerning . . . scope . . . be resolved in favor of arbitration." *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 631 (1985); *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983); *Moses H. Cone*, supra, 460 U.S. at 24-25. Where arbitrable claims are combined with non-arbitrable claims, the court must separate the two and compel arbitration of the pendent arbitrable claims even though the result might lead to parallel proceedings between the disputants in different forums. *KPMG LLP v. Cocchi*, ___ U.S. ___, 132 S.Ct. 23 (2011).[5]

[5] In *Cocchi*, the Supreme Court reversed the Fourth Circuit Court of Appeals, which had refused to compel arbitration on a complaint as a whole because the arbitral agreement did not apply to direct claims, and two of the four claims were direct. Id. at 26. The Fourth Circuit said nothing about the other two claims. Id. at 25. The Supreme Court held that "[a] court may not issue a blanket refusal to compel arbitration merely on the grounds that some of the claims could be resolved by the court without arbitration." Id. at 24.

(2) Cases

(a) FAA Preempts Prohibition of Arbitration of "Patient's Bill of Rights" Claims – *Valley View Health Care, Inc. v. Chapman*, 992 F.Supp.2d 1016 (E.D.Cal., Jan. 16, 2014)

California statutes, among them the so-called "Patient's Bill of Rights" contained in the California Health and Safety Code, prohibit any person or organization from requiring a patient to waive rights to sue in court for violations covered by the statutes. Moreover, the law requires that arbitration clauses be segregated out from the rest of the admission documents, that they be in a specified font and size, and that they are presumptively invalid unless specific measures are taken to ensure a voluntary and knowing waiver of rights to sue in court.

Licensed skilled nursing facilities (SNFs) and their nonprofit professional association brought suit against the Department of Public Health and its director, seeking declaratory and injunctive relief relating to California statutes and regulations restricting arbitration of claims arising out of the California "Patient's Bill of Rights" on the grounds that such laws are preempted by the FAA. In an exhaustive 42-page opinion, the district court found that the laws in question did conflict with the FAA as they picked out an arbitration clause and treated it differently than they did any other contract. In particular, two parts of the law were found defective in this regard. Those parts read:

> "A current or former resident or patient of a skilled nursing facility … may bring a civil action against the licensee of a facility who violates any rights of the resident or patient as set forth in the Patient's Bill of Rights …. **An agreement by a resident or patient of a skilled nursing facility or intermediate care facility to waive his or her rights to sue pursuant to this subdivision shall be void as contrary to public policy.**" (Bold added by the Court.)
>
> And
>
> "The licensee shall not present any arbitration agreement to a prospective resident as part of the Standard Admission Agreement. Any arbitration agreement shall be separate from the Standard Admission Agreement and shall contain the following advisory in a prominent place at the top of the proposed arbitration agreement …. '**Residents shall not be required to**

sign this arbitration agreement as a condition of admission to this facility, and cannot waive the ability to sue for violation of the Resident Bill of Rights.'" (Bold in original statute.)

The district court granted summary judgment and, in so doing, declared the challenged arbitration laws invalid, unlawful and preempted by the FAA to the extent they bar arbitration of Patient's Bill of Rights claims and enjoined enforcement of the challenged laws to the extent they bar arbitration of Patient's Bill of Rights claims.

(b) So Much for *Functus Officio* – Arbitration Tribunal Allows SCA Promotions to Re-Open an Arbitration Concluded in 2005 and then Hit Armstrong with a Record-Breaking $10 Million in Sanctions – *Armstrong v. SCA Promotions* (JAMS 2005 and 2015), Associated Press, "Armstrong must pay $10 million in fraud case," (wire service report, Feb 17, 2015), Juliet Macur, "Lance Armstrong's that it Had Lost with Lance Armstrong's Ugly Detour from Road to Redemption," (New York Times, Feb. 16, 2015)

On February 4, 2015, an arbitration panel ordered Lance Armstrong to pay $10 million in sanctions to his former promotions company, SCA Promotions, Inc. According to the arbitrators' written ruling, the sanctions award punishes Armstrong for engaging in "an unparalleled pageant of international perjury, fraud and conspiracy" that covered up his use of performance-enhancing drugs. The award was made public when SCA filed a motion in a Dallas state district court seeking to have the award confirmed as a judgment against Armstrong.

The arbitration panel issued the award after holding a multi-day evidentiary hearing during which Armstrong himself testified. During the hearing, the arbitrators considered whether Armstrong should be punished for his wrongful conduct in connection with his original dispute with SCA. That dispute, which took place in 2005, involved whether SCA owed Armstrong bonus payments after he had won a series of Tour de France races. Armstrong swore under oath on numerous occasions in that proceeding that he had never used performance-enhancing drugs during his career. Given that sworn testimony, SCA settled the matter for $7.5 million in 2006.

Armstrong later confessed in 2013 that he had cheated during every Tour de France race that he had won. He also acknowledged that he had committed perjury during the arbitration of his dispute with SCA. As a result, SCA re-convened the

arbitration proceeding and sought sanctions against Armstrong based on his prior wrongful conduct. After an evidentiary hearing, the arbitrators found that Armstrong had "used perjury and other wrongful conduct to secure millions of dollars of benefits" from SCA. According to the arbitrators, Armstrong's wrongful conduct was not limited to perjury, In addition to committing "perjury on every issue" in the earlier case, the arbitrators also found that Armstrong had "intimidated and pressured other witnesses to lie" and had even "used a false personal and emotional appeal to perpetuate" his lies. While Armstrong acknowledged during the hearing that he had been untruthful about his prior cheating, the arbitrators found that he "expressed no remorse to the Panel for his wrongful conduct."

What is curious about the award, from an arbitration law standpoint, is that SCA was allowed to "re-open" an arbitration that had been concluded many years earlier. The general rule is that arbitrators lose jurisdiction once they issue the final award – *functus officio* doctrine. Other than the short period within which parties may request that arbitrators correct a clerical or computational error under the arbitral rules (AAA gives 20 days; JAMS gives only 7), the arbitrators turn into pumpkins for all practical purposes after the final award is issued. The arbitral rules do not have any equivalent to Rule 60, which in federal courts allows a judge to re-do a judgment or order based on newly discovered evidence, fraud, or mistake. However, even Rule 60 sets a deadline of one year after the judgment is entered to request that the judgment be vacated.

The doctrine of *functus officio* was avoided in the SCA/Armstrong dispute because the settlement agreement expressly stated that the same panel of three arbitrators who heard the 2005 evidence "shall have exclusive jurisdiction over the parties" with respect to any "any dispute or controversy [between the parties] arising under or in connection with" the settlement agreement. In ruling on the jurisdiction issue raised in the re-convened proceedings, the panel found that the provisions of the settlement agreement gave it "the exclusive authority to interpret and define its own jurisdiction," which the panel found was "entitled to appropriate deference," citing *Oxford Health Plans LLC v. Sutter*, 133 S.Ct. 2064 (2013). While recognizing that arbitration tribunals "are not common law courts of general jurisdiction" and that they had "no roving commission to determine or vindicate public policy," the panel nevertheless determined that "arbitration Tribunals must have the authority to regulate, control and, if necessary, sanction parties for conduct in connection with the proceedings before them."

This case will most certainly be the subject of future "recent developments" programs as it makes its way through the Texas court system.

(c) Presumption in Favor of Arbitrability Trumped by Forum Selection Clause – *Goldman, Sachs & Co. v. City of Reno*, 747 F.3d 733 (9th Cir., Mar. 31, 2014)

In 2005 and 2006, the City of Reno issued approximately $211 million in complex securities and employed Goldman Sachs as its sole underwriter and broker-dealer. Years after the City's financial collapse, it initiated an arbitration before FINRA to resolve its claims against Goldman Sachs arising out of their contractual relationship. Goldman Sachs then filed suit in the federal district court to enjoin the FINRA arbitration arguing that the City was not a "customer" entitled to arbitrate under FINRA, and had disclaimed any right to arbitrate by agreeing to forum selection clauses in the contracts entered into between the parties. The City responded that FINRA – not the court – should determine arbitrability. The district court agreed with the City and denied Goldman Sachs motion for injunctive relief and entered final judgment in favor of the City. Goldman Sachs appealed. On review, the Ninth Circuit reversed.

The Ninth Circuit had little difficulty determining that the City was Goldman Sachs "customer" as defined by the FINRA Rules. However, the court found that there was a second question – whether the forum selection clauses superseded Goldman Sachs' obligation to arbitrate – and that that question has been the subject of litigation in many circuits "with decidedly mixed results." 747 F.3d at 736. The court agreed with the decisions and analysis coming out of the Southern District of New York and found that the forum selection clauses in the parties' contracts superseded any right to FINRA arbitration.

Guided by the "first principle" of Supreme Court jurisprudence that arbitration is strictly a matter of consent, the court held that the presumption in favor of arbitrability is not applied where the existence of an arbitration agreement is contested; that the presumption applies "only where the *scope* of the agreement is ambiguous as to the dispute at hand." 747 F.3d at 742, citing *Granite Rock Co. v. Int'l Brotherhood of Teamsters*, 561 U.S. 287 (2010). In this case, the parties did not include an express arbitration clause in the Underwriter or Broker-Dealer Agreements. As a FINRA member, Goldman Sachs had a default obligation to arbitrate at the request of a "customer." The court concluded that the City stood to benefit from this default obligation, provided that the parties did not contract around it. The court found that that was precisely what the parties had done when they agreed to the forum selection clauses included in the aforementioned agreements; that the City had disclaimed any right to arbitrate that it might otherwise have had and, by agreement to the forum selection clauses, the parties had agreed not to arbitrate any claims that might arise out

of their relationship at the time their relationship was formed. "[W]e will give full effect to the all-inclusive breadth of the forum selection clauses ("all actions and proceedings"), their mandatory nature ("shall"), and their reference to a judicial forum ("the United States District Court for the District of Nevada")." 747 F.3d at 746.

(d) What Happens to Non-Arbitrable Claims After Ordering Arbitration of the Rest? This Court Says Non-Arbitrable Claims are Not Stayed Pending the Outcome of the Arbitration – *Global Live Events v. JA-Tail Enterprises, LLC*, 2014 WL 1830998 (C.D.Cal., May 8, 2014)

Plaintiff retained Valensi Rose, a Los Angeles law firm, to represent it in connection with the production of a Michael Jackson tribute concert in Britain. The retained agreement included an arbitration clause. Subsequently, plaintiff entered into a contract with an entity affiliated with Michael Jackson's sister, La Toya, to produce a concert in Wales. Plaintiff filed this action against Valensi Rose and others alleging various torts. With respect to Valensi Rose, plaintiff alleged that it had several undisclosed conflicts of interest and engaged in a variety of financial transactions to defraud plaintiff, including setting up a secret account in a name remarkably similar to plaintiff's into which it allegedly transferred roughly $1 million for the purposes of financing the firm's expenses related to the representation. This lawsuit was filed in federal court based on diversity jurisdiction. Valensi Rose responded by filing a motion to compel arbitration pursuant to the arbitration clause contained in the retainer agreement.

The arbitration clause contained in the retainer agreement is what some courts have held is a "limited scope" clause, providing for arbitration of any claim or controversy "arising under" the retainer agreement or any claimed breach thereof (but not arising or related to the relationship created thereby). Accordingly, the court ruled that the reference to claims "arising under" the retainer agreement applied to plaintiff's claim for breach of fiduciary duty, but not to its claims for fraud, money had and received and fraudulent transfer. The court then ordered plaintiff to submit the breach of fiduciary duty claim to JAMS, per the arbitration clause in the retainer agreement, and then set a jury trial for the remaining claims for July 2014.

Valensi Rose filed a motion seeking a stay of further judicial proceedings *as to it* pending the outcome of the arbitration. The district court denied that motion because the nonarbitrable claims were asserted not only against Valensi Rose but the other defendants as to whom trial was scheduled for July 2014. Those defendants did not seek a stay. Accordingly, the court found that it would be inefficient for the court and for witnesses to stay the trial as to Valensi Rose, but allow it to go forward as to the other defendants. *6-7.

(e) The FAA – Per *Concepcion* - Preempts State Law Rule Prohibiting Arbitration of Injunctive Relief Claims – *McGill v. Citibank, N.A.*, 232 Cal. App. 4th 753 (4th Dist., Dec. 18, 2014)

In this case, a credit card holder filed a class action against the issuing bank for unfair competition and false advertising in offering credit insurance plan that plaintiff purchased to protect her credit card account. Plaintiff sought monetary damages, restitution and injunctive relief. In response to the lawsuit, the bank filed a motion to compel arbitration pursuant to the arbitration clause contained in the customer agreement. The trial court granted the bank's motion in part and denied it in part. Specifically, the trial court severed and stayed the claims for injunctive relief under California's unfair competition law, false advertising law and Consumer Legal Remedies Act. Despite finding that the arbitration agreement applied to all of plaintiff's claims, the trial court refused to order arbitration of the injunctive relief claims based upon the California Supreme Court's *Broughton-Cruz* rule prohibiting arbitration of injunctive relief claims brought under public-interest statutes. Citibank appealed and the Fourth District Court of Appeal reversed and remanded for the trial court to order all claims to arbitration.

On appeal, plaintiff argued that the California Supreme Court's decision in *Iskanian v. CLS Transportation Los Angeles, LLC*, 59 Cal. 4th 348 (2014) had "reaffirmed" the *Broughton-Cruz* rule established in 1999 and 2003 respectively.[6] The court of appeal rejected this argument, finding that the Federal Arbitration Acts' displacement of state laws that interfere with its purpose is well-established and has been repeatedly affirmed. 232 Cal. App. 4th at 761, citing *Preston v. Ferrer*, 552U.S. 346, 353 (2008). In this

[6] See, e.g., *Broughton v. Cigna Healthplans*, 21 Cal. 4th 1066 (1999) and *Cruz v. PacifiCare Health Systems, Inc.*, 30 Cal. 4th 303 (2003). Under the state-law rule created by these two case precedents, arbitrations provisions were unenforceable as against public policy if they required arbitration of injunctive relief claims brought for the public's benefit under California's unfair competition law, false advertising law and/or consumer legal remedies law.

regard, the court noted that the purpose underlying a state statute or rule is irrelevant; that according to the United States Supreme Court's decision in *AT&T Mobility LLC v. Concepcion*, ___ U.S. ___, 131 S.Ct. 1740 (2011), if the state law interferes with the FAA's purpose of enforcing arbitration agreements according to their terms, the state law is preempted "no matter how laudable its objective."

D. ARBITRABILITY – WHO DECIDES THE ISSUE?

(1) Background Statement

The Federal Arbitration Act declares "a national policy favoring arbitration." *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984). The FAA provides that covered arbitration agreements shall be enforced except "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. When parties commit to arbitrate contractual disputes, it is a mainstay of the FAA's substantive law that attacks on the validity of the contract, as distinct from attacks on the validity of the arbitration provision itself, are to be resolved "by the arbitrator in the first instance, not by a federal or state court." *Preston v. Ferrer*, 552 U.S. 346, 349 (2008); see also *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967). For these purposes, an arbitration provision is severable from the remainder of the contract. *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 445 (2006).

Arbitration is a matter of contract. *American Express Co. v. Italian Colors Restaurant*, ___ U.S. ___, 133 S.Ct. 2304, 2306 (2013); accord *Oxford Health Plans LLC v. Sutter*, ___ U.S. ___, 133 S.Ct. 2064, 2077 (2013). As with any contract, the parties may structure their arbitration agreement as they see fit. They may limit the issues they choose to arbitrate, define the rules under which arbitration will proceed, designate who will serve as the arbitrator and even limit with whom they choose to arbitrate. *Stolt-Nielsen S.A. v. Animalfeeds International Corp.*, 559 U.S. 662, 683-684 (2010). "[A]s with any other contract, the parties' intentions control." *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985); *City of Los Angeles v. Superior Court*, 56 Cal. 4th 1086, 1096 (2013). In this regard, a clause that delegates disputes relating to enforceability of the arbitration agreement will be respected and enforced. *Rent-A-Center West, Inc. v. Jackson*, 561 U.S. 63 (2010) (held: a delegation provision requiring that the arbitrator decide issues of arbitrability was severable from a standalone arbitration agreement and enforceable unless the party specifically challenged the enforceability of the delegation provision).

Under the FAA, the issue of "whether the parties have a valid arbitration agreement at all" is to be decided by the courts. *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444, 452 (2003). However, because arbitration is a matter of contract, questions relating to arbitrability may be delegated to an arbitrator, provided that the delegation is clear and unmistakable. *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S. 643, 649 (1986); *First Options v. Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944-945 (1995); *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 83 (2002); *City of Los Angeles v. Superior Court*, supra, 56 Cal. 4th at 649. "Linguistically speaking, one might call any potentially dispositive gateway questions a 'question of arbitrability….'" *Howsam v. Dean Witter Reynolds, Inc.*, supra, 537 U.S. at 83. However the United States Supreme Court has made clear that phrase is applicable only in the "kind of narrow circumstances where contracting parties would like have expected a court to have decided the gateway matter, where they are not likely to have thought that they had agreed that an arbitrator would do so, and, consequently, where reference of the gateway dispute to the court avoids the risk of forcing parties to arbitrate a matter that they may well not have agreed to arbitrate." Id.

Questions of arbitrability include such "gateway issues" as the validity of the arbitration agreement, its scope and who is bound by its terms. 537 U.S. at 84. Otherwise, "subsidiary matters," those "'procedural' questions which grow out of the dispute and bear on its final disposition' are presumptively *not* for the judge, but for an arbitrator to decide. Id; see *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543, 546-547 (1964) (arbitrator should decide whether the first two steps of a grievance procedure were completed where exhaustion was a precondition to arbitration); *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24-25 (1983) (issues of waiver, delay or defense to arbitrability are presumptively for the arbitrator to decide).

As demonstrated by the cases discussed below, the courts continue to struggle and disagree with respect to where and how to draw the line between "procedural" issues for the arbitrator to decide and "gateway" issues for the courts to decide, in general and with specific regard to class arbitration.

(2) Cases - Generally

(a) Arbitrators are to Decide Disputes About the Meaning and Application of Procedural Preconditions for the Use of Arbitration, Including Claims of Waiver, Delay or a Like Defense to Arbitrability – *BG Group, PLC v. Republic of Argentina*, ___ U.S. ___, 134 S.Ct. 1198 (Mar. 5, 2014)

This matter concerned an arbitration clause contained in a bilateral investment treaty between the United Kingdom and Argentina for the resolution of disputes between one of those nations and an investor from the other. Specifically, the treaty provided for arbitration, but only after first submitting the matter to the local courts and then only if such tribunal had not given its final decision within 18 months of submission.

In this case, BG Group sought arbitration of a dispute with Argentina concerning returns it claimed were due on its controlling investment interest in MetroGAS, a gas distribution company created under Argentine law that distributed natural gas in Buenos Aires. BG Group's investment was made in the early 1990's, at which time Argentina had statutes in place which provided for calculation of gas "tariffs" in U.S. dollars and set those tariffs at levels sufficient to assure a reasonable rate of return to privatized gas distribution firms such as MetroGAS. In the early 2000's, Argentina, faced with an economic crisis, enacted new laws which changed the basis for calculating gas tariffs from dollars to pesos and also set the rate of exchange at one peso per one U.S. dollar (even though the exchange rate at the time was roughly three pesos to one U.S. dollar). The result was that MetroGAS's profits were quickly transformed into losses. BG Group claimed that the new laws enacted by Argentina violated the bilateral investment treaty and sought damages through arbitration.

In response to BG Group's petition for arbitration, arbitrators were appointed and between 2004 and 2006, the panel decided motions, received evidence and conducted evidentiary hearings. In December 2007, the arbitration panel reached a final decision. Among the matters decided was Argentina's challenge to the jurisdiction of the arbitrators to hear or decide the matter because BG Group had failed to first bring its grievance to Argentina's courts and wait 18 months for a decision before commencing the arbitration. The arbitration panel concluded that it had jurisdiction, finding, among other things, that Argentina's conduct in enacting new laws that hindered recourse to its judicial system had excused BG Group from the obligation to seek relief in the local courts before initiating the arbitration. The panel then turned to

the merits of the dispute and awarded BG Group damages. Both sides sought review in federal district court: BG Group to confirm the award and Argentina to vacate the award, in part on the ground that the arbitrators lacked jurisdiction to decide the threshold issue concerning the "local litigation" provision as a precondition to arbitration.

The district court confirmed the award and denied Argentina's vacatur petition. The Court of Appeals for the District of Columbia then reversed the district court. BG Group petitioned the Supreme Court for certiorari, which was granted. The Supreme Court then reversed the Court of Appeals, finding that the arbitrators' interpretation and application of the "local litigation" requirement was a matter of procedure concerning *when* the contractual duty to arbitrate arises, not *whether* there is a contractual duty to arbitrate at all (because clearly there was under the treaty, subject to certain pre-conditions being met). The Supreme Court held that the "local litigation" provision was a "claims processing" rule analogous to other procedural provisions which have been found to be for arbitrators primarily to interpret and apply.

The Supreme Court viewed the issue before it as one of who – the court or the arbitrator – is responsible for interpreting and applying the "local litigation" provision contained in the investment treaty. Put in terms of standards of judicial review, the question was whether the arbitrators' interpretation and application of the "local litigation" provision should be reviewed *de novo* or with the deference that courts ordinarily show arbitral decisions on matters the parties have committed to arbitration. The Court stated that the general rule is that courts presume that the parties intend courts – not arbitrators – to decide arbitrability unless the parties clearly and unmistakably agree otherwise. Likewise, the courts presume that the parties intend for arbitrators – not the courts – to decide disputes about the meaning and application of particular procedural preconditions for the use of arbitrations. See *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 85-86 (2002).

The Court ruled that the provision before it was of the "procedural" variety because the text and structure of the provision made it clear that it operated as a procedural condition precedent to the contractual duty to arbitrate at all (as distinguished from the substantive inquiry concerning whether a particular type of dispute falls without the scope of the arbitration clause). 134 S.Ct at 1207. The Court held that the "local litigation" requirement was "highly analogous" to procedural provisions that the Court and other have found are for arbitrators, not courts, to interpret and apply. Id., citing *Howsam*, supra, 537 U.S. at 85 (whether a party filed a notice of arbitration within the time limit provided by the rules of the chosen arbitral forum "is a matter presumptively for the arbitrator, not for the judge"); *John Wiley &*

Sons, Inc. v. Livingston, 376 U.S. 543, 555-557 (1964) (same, in respect to a mandatory pre-arbitration grievance procedure that involved holding two conferences); see also *Dialysis Access Center, LLC v. RMS Lifeline, Inc.*, 638 F.3d 367, 383 (1st Cir. 2011) (same, in respect to a pre-arbitration "good faith negotiations" requirement); *Lumbermens Mut. Cas. Co. v. Broadspire Management Services, Inc.*, 623 F.3d 476, 481 (7th Cir. 2010) (same, in respect to a pre-arbitration filing of a "Disagreement Notice"). "[C]ourts presume that the parties intend arbitrators, not the courts, to decide disputes about the meaning and application of particular procedural preconditions for the use of arbitration." Id.

(b) Delegation Clause in Employment Arbitration Agreement is Valid and Enforceable, Meaning that the Arbitrator, not the Court, Determines the Conscionability Challenge to Enforcement of the Arbitration Agreement – *Tiri v. Lucky Chances, Inc.*, 226 Cal. App. 4th 231 (1st[t] Dist., May 15, 2014)

In this case, a unanimous First Appellate District panel reversed a trial court and enforced a provision delegating authority to resolve disputes concerning enforceability of an arbitration agreement to an arbitrator.

Lourdes Tiri was employed as a cook by Lucky Chances, a card-club casino in Colma, During her employment, Tiri signed a mutual agreement to arbitrate claims which contained a "delegation clause." This clause provided that an arbitrator, and not a court, would decide any dispute as to whether the arbitration agreement was enforceable: "The Arbitrator, and not any federal, state, or local court or agency, shall have the exclusive authority to resolve any dispute relating to the interpretation, applicability, enforceability, or formation of this Agreement, including, but not limited to, any claim that all or any part of this Agreement is void or voidable."

Five years after signing the agreement, Tiri alleged that she was wrongfully terminated while on medical leave. Tiri filed a civil action for wrongful discharge and Lucky Chances brought a motion to compel arbitration. The trial judge did not separately decide whether the delegation clause was enforceable. Rather, the judge decided that the agreement as a whole was unconscionable and thus unenforceable. In support of its decision, the trial court found that the agreement had been provided to Tiri on a "take it or leave it" basis and did not attach the governing American Arbitration Association Rules referenced in the arbitration clause.

The Court of Appeal reversed and determined that the trial court's analysis of the entire agreement was improper because the delegation clause was valid. Thus, it was for the arbitrator, not the court, to determine the conscionability of the arbitration agreement as a whole. The court explained that, based upon United States and California Supreme Court precedent, the delegation clause must be reviewed separately from the entire agreement. While the delegation clause was a contract of adhesion and thus procedurally unconscionable, the court concluded that it was nonetheless valid because both parties were "bound by it equally." As such, the clause did not lack mutuality and was thus not substantively unconscionable. "The delegation clause is not overly harsh, and does not sanction one-sided results." 226 Cal. App. 4th at 246, citing *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal. 4th 83, 120 (2000).

In reaching its decision in this matter, the court expressly declined to follow two earlier decisions from the First District which had refused to enforce delegation clauses in employment arbitration contracts on unconscionability grounds. See, e.g., *Ontiveros v. DHL Express (USA), Inc.*, 164 Cal. App. 4th 494 (2008); *Murphy v. Check'N Go of California, Inc.*, 156 Cal. App. 4th 138 (2007). In the court's view, these holdings had been undermined by the more recent United States Supreme Court decisions in *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63 (2010) and *AT&T Mobility LLC v. Concepcion*, __ U.S. ___, 131 S.Ct. 1740 (2011). *Rent-A-Center* held that delegation clauses are valid absent a challenge specific to the delegation clause. 561 U.S. at 73-74. *Concepcion* held that courts may not issue categorical rulings that interfere with fundamental aspects of arbitration. 131 S.Ct. at 1748.

The Court of Appeal took time to specifically address a concern that motivated the *Ontiveros* and *Murphy* decisions – namely, that allowing arbitrators to decide enforceability issues was unfair because an arbitrator has an interest in deciding that a dispute is arbitrable. The court disagreed, noting that such concerns, as reasonable as they may be, "are virtually *always* present with delegation clauses." 226 Cal. App. 4th at 249. However, "to conclude that they signify substantive unconscionability would be tantamount to concluding that delegation clauses in employment arbitration agreements are categorically unenforceable," and would run afoul of the holding in *Rent-A-Center.* Id.

(c) Earlier Cases that Invalidated Delegation Clauses as Substantively Unconscionable due to the Financial Interest of the Arbitrators who Would be Deciding the Delegated Issues No Longer Valid Because Such an Analysis Discriminates Against Arbitration and is Therefore Preempted – *Malone v. Superior Court*, 226 Cal. App. 4th 155 (2d Dist., Jun. 17, 2014)

Under facts similar to those encountered by the First Appellate District in *Lucky Chances* (discussed above), the Second Appellate District affirmed the trial court's holding that *Murphy*, *Ontiveros* and other similar cases were no longer good law and that the delegation clause in plaintiff's employment agreement was enforceable – leaving it to the arbitrator, not the court, to resolve plaintiff's claim that the arbitration agreement was unconscionable and thus unenforceable.

Plaintiff was employed by California Bank & Trust as a "wires specialist" from 2007 to 2010. After plaintiff's employment was terminated, she brought suit against the bank complaining of wage and hour violations under the Labor Code. Plaintiff's suit was filed as a putative class action. In response, the bank moved to compel arbitration, relying on the arbitration provisions included in its employee handbook. Plaintiff opposed the motion on the grounds that the arbitration agreement, specifically including the delegation clause, was unconscionable and thus unenforceable. In this regard, plaintiff argued that the trial court was required to consider her argument that the delegation clause itself was unconscionable before enforcing the agreement and delegating the other issues of enforceability to the arbitrator. This argument led to extensive briefing. First, the trial court asked for briefing on the relevant standard to apply in determining whether the delegation clause was unconscionable. After those supplemental briefs were filed, the California Supreme Court decided *Sonic-Calabasas A. Inc. v. Moreno*, 57 Cal. 4th 1109 (2013), the first California Supreme Court to discuss the impact of *Concepcion* on California arbitration law. The trial court then invited further briefing as to what effect, if any, *Sonic-Calabasas* had on the issue. In both briefs, plaintiff argued that the delegation clause was unconscionable and thus unenforceable, paying particular note to the arbitrator's self-interest in deciding delegated issues, which was the basis for the substantive unconscionability rulings in *Murphy* and *Ontiveros*. The trial judge rejected plaintiff's arguments based on its finding that *Sonic-Calabasas* had held that per se unconscionability rules were preempted by the FAA. The trial judge limited its ruling to enforcing the delegation clause and compelling arbitration, leaving it to the arbitrator to address plaintiff's challenges to the existence and enforceability of the arbitration agreement.

The Court of Appeal affirmed the trial court and determined that the trial court's conclusion was correct - the delegation clause was not unconscionable and, as such, was valid and enforceable. Thus, it was for the arbitrator, not the court, to determine plaintiff's conscionability and other challenges to the existence and enforceability of the arbitration agreement as a whole. Like the First District in *Lucky Chances*, the Second District rejected the substantive unconscionability argument that arbitrators would be biased in their decision making on the delegated issues because of their financial self-interest, but the Second District went a little bit further in rejecting this type of analysis as being "nothing more than an expression of judicial hostility to arbitration."

> "[T]his analysis of bias questions the objectivity of arbitrators as a whole, as the very same argument can be made that an arbitrator will tend to rule *on the merits* in favor of an employer who is a 'repeat player,' as opposed to an employee who is not. It is not merely that we disagree with this negative view of arbitrators' ability to set aside their financial interests and resolve cases without bias; the FAA prevents us from accepting that view, without any evidence that the specific arbitrator to whom the decision-making is delegated is biased. The analysis discriminates against arbitration, putting agreements to arbitrate on a lesser footing than agreements to select any judicial forum for dispute resolution, and it is therefore preempted."

Note: According to an article that appeared in the Daily Journal on September 22, 2014, the California Employment Lawyers Association petitioned the California Supreme Court to depublish this decision and the *Lucky Chances* decision (both of which were denied). The article quoted Cliff Palefsky, counsel for the California Employment Lawyers Association, as saying, "No matter what anyone thinks, there is an economic conflict of interest…. It's real and it's significant…. And even if the arbitration can be fair, the perception of fairness governs all of those ethical issues."

(d) Trial Court, Not the Arbitrator, Had Authority to Resolve the Issue of Whether Collective Bargaining Agreement Created a Duty to Arbitrate – *Knutson v. KTLA, LLC*, 228 Cal. App. 4th 1118 (2d Dist., Sep. 4, 2014)

In this case, defendant KTLA appealed from an order denying its motion to compel arbitration. Plaintiffs, Kurt Knutson and his company, Woojivas, Inc., entered into a personal services agreement to act as a technology reporter with defendant, a television broadcaster. The personal service agreement was subject to a three-step

grievance and arbitration provision in a collective bargaining agreement entered into between Mr. Knutson's union, the American Federation of Television and Radio Artists Los Angeles Local, and defendant KTLA.

After plaintiffs' personal service agreement was terminated, plaintiffs filed suit in state court alleging breach of contract, age discrimination, unfair business practices and other torts. In response to plaintiffs' complaint, defendant filed a motion to compel arbitration based upon the arbitration provisions contained in the collective bargaining agreement. There was no arbitration clause or provision in the personal services agreement entered into between plaintiff and defendant. The court denied the motion to compel. Defendant then appealed, complaining that the trial court erred in denying the motion and in deciding the issue of whether the dispute was arbitrable.

The Second District Court of Appeal affirmed the trial court's denial of the motion to compel arbitration because, under the facts of this case, plaintiffs and defendant never agreed to arbitrate any dispute between them. The collective bargaining agreement expressly stated that only the union and the defendant could require arbitration of the other party. It did not grant a union member the power to compel defendant to arbitrate, and the court held that the converse was also true. This the court held was consistent with the "two core principles" that apply in the collective bargaining context as announced by the United States Supreme Court: First, that arbitration is a matter of contract. As such, a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit and an arbitrator's authority is derived solely from the parties' agreement. Second, whether a collective bargaining agreement creates a duty for the parties to arbitrate the particular grievance is an issue for judicial determination. 228 Cal. App. 4th at 1130, citing *Granite Rock Co. v. International Brotherhood of Teamsters*, 561 U.S. 287, 299 (2010) ("arbitration is strictly a matter of consent"); *AT&T Technologies v. Communications Workers of America*, 475 U.S. 643, 648-649 (1986); *Nolde Bros., Inc. v. Local No. 358, Bakery and Confectionary Workers Union*, 430 U.S. 243, 250-251 (1977) ("a party cannot be compelled to arbitrate any matter in the absence of a contractual obligation to do so").

The Second District rejected defendant's argument that the arbitrator, not the court, should have decided whether the dispute was arbitrable. The court noted that the United States Supreme Court has spoken on the specific issue of whether a collective bargaining agreement creates a duty for the parties to arbitrate and held that that issue is for the court to decide. 228 Cal. App. 4th at 1131, citing *AT&T Technologies*, supra, 475 U.S. at 649; *United Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582-583 (1960). The only exception to this rule is when the parties clearly and unmistakably agree that the arbitrator is to decide the arbitrability issue. Id., citing *Granite Rock*, supra,

561 U.S. at 299. The appellate could explained that because there is no arbitration agreement between plaintiffs and defendant, "defendant cannot compel plaintiffs to arbitrate anything." Id. at 1134. On if there was an enforceable arbitration agreement might there be "procedural" issues for an arbitrator to decide, but that situation did not exist in this case.

(3) Cases – Class Arbitration Issue

It is now settled that "a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party *agreed* to do so." *Stolt-Nielsen*, supra, 559 U.S. at 684. What remains a matter of dispute in the federal and California appellate courts is who decides – the court of the arbitrator – whether the parties have agreed to arbitrate claims on a class wide basis when the agreement itself does not expressly mention class actions. In *Bazzle*, supra, 539 U.S. 444, a plurality of four Justices determined the question is a subsidiary matter for the arbitrator when the arbitration agreement itself is valid and the underlying dispute falls within its terms. Id. at 452. However, to date, no majority opinion by the United States Supreme Court has decided the issue.

In *Bazzle*, the parties' agreement required arbitration of "[a]ll disputes, claims or controversies arising from or relating to this contract or the relationships which result from this contract" but did not specifically mention class claims. 539 U.S. at 448. The South Carolina Supreme Court held state law controls when the contract is silent on class arbitration and then interpreted the contract as permitting class arbitration. The United States Supreme Court granted certiorari to determine whether that holding was consistent with the FAA. With a plurality opinion by Justice Breyer (joined by Justices Scalia, Souter and Ginsberg), the Court vacated the judgment of the South Carolina Supreme Court. Because there was no question as to the validity of the agreement or the applicability of the dispute to its terms, Justice Breyer explained that there was no gateway issue requiring a judicial determination. The only relevant question in those circumstances was "what kind of arbitration proceeding" the parties had agreed to." Id. at 452. That question, Justice Breyer wrote, "concerns contract interpretation and arbitration procedures" that arbitrators "are well situated to answer." Id.

United States Supreme Court decisions since *Bazzle* have explained the issue of who determines the class arbitration question remains undecided. See *Stolt-Nielsen*, supra, 559 U.S. at 680 ("[T]he parties appear to have believed that the judgment in *Bazzle* requires an arbitrator, not a court, to decide whether a contract permits class arbitration. [Citation.] In fact, however, only the plurality decided that question. [W]e need not revisit that question here because the parties' supplemental agreement

expressly assigned this issue to the arbitration panel, and no party argues that this assignment was impermissible."); *Oxford Health*, supra, 133 S.Ct. at 2068 ("*Stolt-Nielsen* made clear that this Court has not yet decided whether the availability of class arbitration is a question of arbitrability" and "this case gives us no opportunity to do so").

(a) Deciding Whether the Parties' Arbitration Agreement Authorized Class Arbitration Requires a Determination of Whose Claims the Parties Agreed to Arbitrate. Accordingly, Class Arbitration is a Gateway Issue to be Decided by the Court. - *Network Capital Funding Corp. v. Papke,* 230 Cal. App. 4th 503 (4th Dist., Oct. 9, 2014)

In connection with his employment with Network Capital, Erik Papke signed an employment agreement that included provisions requiring the parties to "utilize binding arbitration to resolve all disputes that may arise out of or be related to [his] employment in any way." The agreement was silent on the subject of class and/or representative action arbitration. After a dispute arose between Papke and Network Capital, Papke filed a demand for arbitration and did so for himself individually and as a putative class action. In response to the demand, Network Capital initiated a declaratory relief action alleging that the arbitration agreement required Papke to arbitrate his wage and hour claims on an individual basis. Papke responded by filing a motion to compel in the state court action seeking an order requiring Network Capital to arbitrate its declaratory relief claims. The trial court denied Papke's motion to compel, holding that the court, not an arbitrator, should decide whether the parties' arbitration agreement authorized class arbitration. The trial court then determined that the parties' agreement did not allow class arbitration. Papke appealed and challenged both of the trial court's conclusions.

The Fourth District affirmed the trial court, finding that the United States Supreme Court has held on numerous occasions that the presumption of "who decides" runs in favor of the courts; that "absent a clear and unmistakable agreement to the contrary, it is presumed the parties intended courts, not arbitrators, to decide whether the parties agreed to submit a particular dispute to arbitration." 230 Cal. App. 4th at 511, citing *Howsam v Dean Witter Reynolds, Inc.*, 537 U.S. 79, 83 (2002); *AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 649 (1986). The Fourth District was not persuaded by *Sandquist v. Lebo Automotive, Inc.*, 228 Cal. App. 4th 65 (2014) (published just two days before oral argument in this case) that the class arbitration raises a procedural question for arbitrators to decide. Instead, the Fourth

District agreed with the Third and Sixth Circuit Courts of Appeals that the class arbitration question is for the courts to decide because it determines whose claims the parties must arbitrate and thereby fundamentally affects both the nature and scope of the arbitration. See, e.g., *Opalinski v. Robert Half International, Inc.*, 761 F.3d 326, 335 (3rd Cir. 2014) ("express contractual language unambiguously delegating the question of arbitrability to the arbitrator" is required to overcome the presumption that courts are to decide arbitrability questions; see also *Huffman v. Hilltop Companies, LLC*, 747 F.3d 391, 398-399 (6th Cir. 2014); *Reed Elsevier, Inc. ex rel. LexisNexis Div. v. Crockett*, 734 F.3d 594, 597-599 (6th Cir. 2013).

> "Whether the parties' arbitration agreement authorizes class arbitration does *not* pose a procedural question under the above standard because it does not grow out of the parties' underlying dispute and does not bear on the final disposition of their claims. Here, the Class Arbitration Question arises out of an ambiguity in the Arbitration Agreement, not Papke's wage and hour claims against Network Capital. Similarly, the Class Arbitration Question does not bear on the final disposition of Papke's wage and hour claims; he is entitled to continue pursuing those claims regardless of how the Class Arbitration Question is resolved."

230 Cal. App. 4th at 514.

The Fourth District went on to note that there are fundamental differences between class and individual arbitration, as discussed in the *Stolt-Nielsen* and *AT&T Mobility* cases. Those fundamental differences are "not merely procedural because the issue of whose claims the parties agreed to arbitrate is essentially a question of what the parties agreed to, a gateway issue that determines the scope of the parties' arbitration proceedings." Id. at 516. The Fourth District concluded that questions of arbitrability "concern whether the contracting parties agreed to arbitrate their disputes and the scope of that agreement," both of which the contracting parties would likely have expected a court to decide in the event of a disagreement. Id.

(b) The "Who Decides" Question is a Gateway Question of Arbitrability for the Court to Decide in the Absence of a Clear Indication that the Parties Intended Otherwise – *Garden Fresh Restaurant Corp. v. Superior Court*, 231 Cal. App. 4th 678 (4th Dist., Nov. 17, 2014)

Plaintiff was a former employee of Garden Fresh who sued for various Labor Code violations individually and on behalf of a putative class. Also included within her complaint was a claim for representative relief under PAGA. During her employment, plaintiff had signed two arbitration agreements. Based on those agreements, Garden Fresh moved to dismiss plaintiff's class and representative claims and to compel arbitration of her individual claims, arguing that the arbitration agreements in question did not contemplate and were silent on the matter of class- or representative-based arbitration. The trial court granted the motion to compel arbitration, but specifically left it to the arbitrator to decide the question of whether the class and/or representative claims were arbitrable, thereby denying Garden Fresh's request that only plaintiff's individual claims be sent to arbitration.

Garden Fresh petitioned for writ of mandate requesting that the court of appeal direct the trial court to vacate that portion of its order leaving it to the arbitrator to decide whether the parties' arbitration agreements contemplated class and/or representative arbitration. Garden Fresh argued that where an arbitration agreement is silent on the issue of class and/or representative arbitration, the court – not the arbitrator – should decide that issue. The court of appeal agreed with Garden Fresh and granted the writ petition directing the trial court (1) to vacate that portion of its order leaving it to the arbitrator to determine whether the parties agreed to class and/or representative arbitration, and (2) to conduct further proceedings as necessary to determine whether the parties' arbitration agreement contemplates class and/or representative arbitration and whether plaintiff's PAGA claim may be arbitrated.

The court of appeal reasoned that while federal policy favors arbitration agreements, an arbitrator only has the power to decide those issues which the parties have agreed to submit to arbitration. The court noted that because parties frequently disagree as to whether a particular dispute is arbitrable, the courts play "a threshold role" in determining whether a particular dispute is subject to arbitration. 231 Cal. App. 4th at 684. After surveying recent Supreme Court case precedent, the court held that the issue that Garden Fresh raised – whether class and/or representative arbitrability is presumptively for an arbitrator to decide or, rather, presumptively for the court to decide – "remains an open one." See *Oxford Health Plans LLC v. Sutter*, ___ U.S. ___, 133

S.Ct. 2064 (2013) (the Court stated that it "has not yet decided whether the availability of class arbitration" is a question for a court or for an arbitrator to resolve). In *Oxford Health*, the parties agreed that the arbitrator should determine whether the contract authorized class procedures. Based upon the appellate court's reading of recent United States Supreme Court precedent, the court felt comfortable decided that open issue and held that "the availability of class and/or representative arbitration is a question of arbitrability, and is therefore a gateway issue for the court to decide, in the absence of a clear indication that the parties intended otherwise, rather than a subsidiary one for an arbitrator to decide." Id. at 686. "The fact that parties have entered into an arbitration agreement does not mean that they have necessarily agreed to arbitrate class and/or representative claims. Id., citing *Stolt Nielsen S.A. v. AnimalFeeds International Corp.*, 559 U.S. 662, 685 (2010).

(c) Agreement Between Employer and Employee to Follow the AAA Rules Was Unambiguous and Thus Gave the Arbitrator the Power to Decide Whether the Parties' Arbitration Agreement Permits Class Arbitration – *Universal Protection Service, L.P. v. Superior Court*, 2015 WL 851090 (4th Dist., Feb. 27, 2015)

In 2008, Floridalma Franco, then an employee of Universal Protection, signed an arbitration agreement providing that she and Universal would submit to arbitration "any and all disputes or claims" between them, specifically including disputes relating to their employment relationship and its termination and disputes over wage and hour violations. The arbitration agreement further provided that the arbitration is to be conducted in accordance with the AAA Rules.

In 2014, Franco filed a claim for arbitration with the AAA on behalf of herself and other similarly situated employees complaining about Universal's alleged violations of the Labor Code for not paying overtime, not providing meal and rest breaks and not reimbursing for employment related expenses. Included in Franco's claim was a request for civil penalties under PAGA.

Universal responded by filing an action in state court seeking declaratory relief that (1) the court, not the arbitrator, should decide whether class, collective or other representative arbitration is available under the arbitration clause contained in the complaining employee's employment agreement, and (2) the arbitration agreement required the complaining employee to arbitrate her claims on an individual basis only. Franco then petitioned the court to compel arbitration of Universal's declaratory relief

claim, arguing that the parties' designation of the AAA Rules in the arbitration agreement demonstrated the parties' agreement that any issue of arbitrability would be decided by the arbitrator and that the court was thus precluded from deciding those issues. Universal opposed Franco's petition and argued that the choice to use the AAA Rules was not clear and unmistakable evidence of an agreement to delegate class arbitrability issues to the arbitrator. Universal also argued that under the California Supreme Court's recent decision in *Iskanian v. CLS Transportation Los Angeles, LLC*, 59 Cal. 4th 348 (2014), Franco's PAGA claims were not arbitrable.

Relying on *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003), the state court granted Franco's motion to compel arbitration. Universal petitioned for writ of mandate, which was granted along with an order staying the trial court's order and the pending arbitration.

The Fourth District held that the trial court's reliance on *Green Tree* was in error because it was a nonbinding plurality opinion that several courts had said cast doubt on whether it should be accorded any deference. See *Garden Fresh Restaurant Corp. v. Superior Court*, 231 Cal. App. 4th 678, 685 (2014) (U.S. Supreme Court has not yet decided whether availability of class arbitration is a question for the court or for an arbitrator to decide); *Truly Nolan of America v. Superior Court*, 208 Cal. App. 4th 487, 515, fn. 4 (2012) (*Green Tree*, was a nonbinding plurality decision on this point). That conclusion, however, was not the end of the appellate court's inquiry because its job is to "review the correctness of the court's order, not its reasoning." *4. On this score, the court found that the trial court's decision was correct and denied Universal's petition.

In denying Universal's petition, the appellate court found that the parties' arbitration agreement unambiguously stated that disputes "shall be resolved" by arbitration conducted in accordance with the AAA Employment Rules, which rules expressly prescribe that an arbitrator's power includes "the power to rule on his or her own jurisdiction." *5. More specifically, the court found that an agreement to arbitrate in accordance with the AAA's Employment Rules "necessarily includes an agreement to the AAA Supplementary Rules for Class Arbitrations," which expressly state that the arbitrator "shall engage in 'construction' of the arbitration clause as to whether it permits the arbitration to proceed on behalf of or against a class." *6. Under the circumstances presented, the appellate court concluded that the parties' agreement to arbitrate their disputes under a specifically designated set of rules, which in turn provided that the arbitrator shall decide arbitrability of class and/or representative arbitration, was clear and unmistakable evidence of their intent to delegate the determination of arbitrability to the arbitrator. Id., accord, *Greenspan v. LADT, LLC*, 185 Cal. App. 4th 1413, 1442 (2010) (incorporation of rules that empower an arbitrator to

decide issues of arbitrability serves as clear and unmistakable evidence of the parties' intent to delegate such issues to an arbitrator); *Gilbert Street Developers, LLC v. La Quinta Homes, LLC*, 174 Cal. App. 4th 1185, 1193 (2009) (incorporation of AAA rules by reference was sufficient delegate arbitrability jurisdiction to the arbitrator, but the AAA Rule in question was not in existence at the time of contracting); *Dream Theater, Inc. v. Dream Theater*, 124 Cal. App. 4th 547, 557 (2004) (parties' agreement to conduct arbitration in accordance with the AAA Commercial Rules was clear and unmistakable evidence of their intent to have the arbitrator decide disputes over the scope of the arbitration clause); *Yahoo! Inc. v. Iversen*, 836 F.Supp. 2d 1007, 1012 (N.D.Cal. 2011) (incorporation by reference to the AAA Supplementary Rules constituted clear and unmistakable evidence of the parties' agreement to have the arbitrator decide questions regarding the arbitrability of class wide claims).

(d) Trial Court Erred in Deciding the Arbitrability of the Class Action and Was Ordered to Vacate its Order Dismissing Class Claims and Enter a New Order Submitting the Issue of Whether the Parties Agreed to Arbitrate Class Claims to the Arbitrator - *Sandquist v. Lebo Automotive, Inc.*, 228 Cal. App. 4th 65 (2d Dist., Jul. 22, 2014), review granted, 180 Cal. Rptr. 3d 1 (Nov. 12, 2014)

When plaintiff began working at defendant as a car salesman, he was given over 100 pages of paperwork to review and complete quickly so that he could get to work on the sales floor. Due to the imposed time constraints, plaintiff did not review the documents and did not notice that among the documents he signed were multiple arbitration agreements, all of which were broadly stated and specifically included any and all claims "which would otherwise require or allow resort to any court or other governmental dispute resolution forum." Plaintiff resigned in 2011 and subsequently filed suit, complaining that he had been forced to resign after suffering through four years of ongoing discrimination and hostile work environment. Plaintiff's action was filed as a putative class action. Defendant responded with a motion to compel individual arbitration and to stay or dismiss the court proceedings with regard to the class claims. The trial court granted defendant's motion to compel arbitration of the individual claims and dismissed the class claims as "irrelevant, false or an improper matter … because there's no … contractual basis to compel [class] arbitration." 228 Cal. App. 4th at 72. The trial court further ruled that since plaintiff was going to be subject to individual arbitration, there would be no representative to pursue the class claims in court. The trial court dismissed the class claims without prejudice and set a time limit of 60 days for plaintiff to amend. If within that time frame plaintiff did not amend to bring

forth a new class representative, then the dismissal would be with prejudice. An amended complaint was not filed, and an order dismissing the action with prejudice was then entered.

Plaintiff appealed. The order granting defendant's motion to compel arbitration was not appealable, so the court of appeal limited its review to the trial court's order dismissing the class claims. On this issue, the appellate court agreed with plaintiff that the trial court erred by deciding the issue of whether the parties had agreed to class arbitration and reversed, holding held that the trial court should have submitted that issue to the arbitrator because a class action is a procedural device, and a majority of the United States Supreme Court stated that "'procedural questions which grow out of the dispute and bear on its final disposition' are presumptively *not* for the judge, but for an arbitrator, to decide." 228 Cal. App. 4th at 78, citing *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 84 (2002). The appellate court went on to note that "[a] majority of the United States Supreme Court has yet to decide whether the determination of whether the parties agreed to class arbitration is a gateway question for the court or a question for the arbitrator where, as here, the arbitration agreement is silent on the issue of class arbitration." Id. at 76, citing *Oxford Health Plans LLC v. Sutter*, ___ U.S. ___, 133 S.Ct. 2064 (2013).[7]

[7] The Supreme Court's decision in *Oxford Health* was included in last year's materials. We noted that that time that the circumstances presented to the Court were somewhat unique because the parties had submitted to the arbitrator the task of interpreting their arbitration agreement for the purpose of determining whether or not it included class actions. Justice Kagan tacitly acknowledging the arbitrator's potentially erroneous interpretation, but then made clear that section 10(a)(4) of the FAA provides that the "arbitrator's construction holds, however good, bad, or ugly." Accordingly, the Court upheld the arbitrator's decision to permit class arbitration under the unique facts of the case (discussed above) in terms of how that issue was teed up for the arbitrator to decide. In so holding, the Court limited the scope of *Stolt-Nielson*, explaining that it applies only where the parties' agreement lacks *any* basis for allowing class proceedings. Citing *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003), the Court stated that the issue would have been different had Oxford Health challenged the availability of class arbitration as a "question of arbitrability." Such questions include preliminary matters such as whether the parties have a valid agreement and are presumptively decided by the courts unless the parties' agreement clearly and unmistakable commits such matters to the arbitrator. Consequently, the Court did not reach the question of whether class arbitration is a gateway question of arbitrability for the court to decide.

In making its decision, the appellate court looked at a number of recent lower court decisions that have decided the "who decides" question of class arbitrability and found that those courts "have reached conflicting conclusions," with most concluding that the question of class arbitration is for the arbitrator. Id. at 78. The court was particularly impressed with the reasoning of two district court cases, one out of the Central District of California – *Lee v. JP Morgan Chase & Co.*, 982 F.Supp. 2d 1109 (C.D.Cal. 2013) – and one out of the Eastern District of New York - *Guida v. Home Savings of America, Inc.*, 793 F.Supp. 2d 611 (E.D.N.Y. 2011). In the *Lee* case, the district court stated that the only question "is the interpretive one of whether or not the agreements authorize Plaintiffs to pursue their claims on a class, collective or representative basis," and that question "concerns the procedural arbitration mechanisms available to Plaintiffs, and does not fall into the limited scope of this Court's responsibilities in decide a motion to compel arbitration." 982 F.Supp. 2d at 1113-1114. In the *Guida* case, the court stated that in light of the Supreme Court's decisions in *Stolt-Nielsen* and *Bazzle*, "the ability of a class to arbitrate a dispute where the parties contest whether the agreement to arbitrate is silent or ambiguous on the issue is a procedural question that is for the arbitrator to decide." 793 F.Supp. 2d at 616.

(e) Whether the Parties to an Arbitration Agreement Agreed to Arbitrate Class Claims is a Procedural Question for the Arbitrator – not the Court – to Decide – *Rivers v. Cedars-Sinai Medical Care Foundation*, 2015 WL 166867 (2d Dist., Jan. 13, 2015) (Not Reported)

Plaintiff was employed by Cedars-Sinai. As a condition of her employment, plaintiff signed a two-page document entitled "Mutual Agreement to Arbitrate claims," which provided that both plaintiff and Cedars-Sinai agreed to submit to arbitration "all claims or controversies in any way relating to or associated with" plaintiff's employment or the termination of her employment. The agreement was silent with regard to class action claims.

After her employment was terminated, plaintiff filed a putative class action complaining about wage and hour violations, as well as other violations of the Labor Code and Business and Professions Code. Cedars-Sinai responded by filing a petition to compel arbitration of plaintiff's individual claims and to dismiss her class claims that fell outside the scope of the arbitration agreement. Plaintiff opposed the motion contending that when an arbitration agreement contains no express provision either permitting or restricting arbitration of class claims, the determination of whether the agreement includes such claims is a question properly reserved for the arbitrator, not

the court. The trial court ruled that the question of arbitrability of class claims was for the trial court to decide absent a clear expression of contrary intent in the agreement. The trial court then interpreted the agreement and determined that the parties did not intend to arbitrate a dispute on a class wide basis and dismissed the class claims with prejudice. Plaintiff appealed.

The Court of Appeal noted that it "is now settled that 'a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party agreed to do so." *3, citing *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*, 559 U.S. 662, 684 (2010). The court then went on to note that what remains a matter of dispute in both the federal and California courts is the issue of who decides – the court or the arbitrator – whether the parties have agreed to arbitrate on a class wide basis when the agreement itself does not expressly mention class actions. Id. The appellate court referred to the plurality opinion in *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444, 452 (2003) where the Court determined that the question of class action arbitrability is a subsidiary matter for the arbitrator when the arbitration agreement itself is valid and the underlying dispute falls within its terms, and that "no Supreme Court majority opinion has decided the issue." Id. The appellate court further noted that the issue of "who decides" class arbitrability remains undecided in terms of any binding precedent from the United States Supreme Court. Id. at *4, citing *Stolt Nielsen*, supra, 559 U.S. at 680 ("[T]he parties appear to have believed that the judgment in *Bazzle* requires an arbitrator, not a court, to decide whether a contract permits class arbitration…. In fact, however, only the plurality decided that question. [W]e need not revisit that question here because the parties' supplemental agreement expressly assigned this issue to the arbitration panel, and no party argues that this assignment was impermissible.") and *Oxford Health Plans LLC v. Sutter*, ___ U.S. ___, 133 S.Ct. 2064, 2068 (2013) ("*Stolt-Nielsen* made clear that this Court has not yet decided whether the availability of class arbitration is a question of arbitrability" and "this case gives us no opportunity to do so.").

The appellate court surveyed a number of lower court decisions that have decided the arbitrability issue, including its earlier decision in *Sandquist v. Lebo Automotive, Inc.*, 228 Cal. App. 4th 65 (2014) (discussed above), and concluded that the issue – "[p]roperly framed" – "is whether permitting or prohibiting class arbitration is dispositive of whether the arbitration proceeds at all – the essence of the 'narrow gateway' issue." Id. at *5. The court reached this conclusion based upon its analysis of the Supreme Court's holdings in *Bazzle* and *Stolt-Nielsen*, which it summed up as follows:

> "As the *Stolt-Nielsen* Court strongly implied … it is one thing for a court to decide whether the parties consented to class arbitration, as the FAA requires …, and quite a different matter to hold the interpretation of the parties' intent on that question is somehow a gateway issue for the court, even when the underlying dispute plainly falls within the scope of a valid arbitration agreement."

The appellate court then held that if the parties bargained for arbitration in accordance with a valid arbitration agreement and the dispute falls within that agreement, it is not unreasonable under such circumstances for the arbitrator to decide whether the matter may proceed on a class wide basis in accordance with the arbitration agreement. "In that case, the question of class arbitration effectively 'grow[s] out of the dispute and bear[s] on its final disposition,' making it a question for the arbitration to determine, not the court." Id.

The Second District's decision in *Sundquist* and this case are at odds with the Fourth District's earlier decisions in *Garden Fresh Restaurant Corp. v. Superior Court*, 231 Cal. App. 4th 678 (2014) (discussed above) and *Network Capital Funding Corp. v. Papke*, 230 Cal. App. 4th 503 (2014) (discussed above) and in this decision, the Second District took the time to criticize the Fourth District's decisions. With regard to *Network Capital*, the Second District said that the Fourth District had "painted what is supposed to be a narrow question of arbitrability with too broad a brush," by casting the class arbitration question is one requiring a determination as to who is bound by the arbitration agreement and holding that a plaintiff bound by a valid arbitration agreement may only be a proper representative in arbitration for those similarly bound by the same arbitration agreement. *5. Contrary to *Network Capital*, the Second District stated that its holding was that class arbitrability issue does not involve whether the arbitration proceeds or against whom it proceeds, but only in what manner does it proceed. Id.

With regard to *Garden Fresh*, the Second District said that the Fourth District relied "too heavily on the Court's identification of the differences between bilateral and class arbitration, reading the Supreme Court cases since *Bazzle* as indicating, just short of an outright holding, that class arbitrability is a gateway question rather than a subsidiary one. *6. The Second District stated that it did not share the Fourth District's view; that it felt that "[a]ny due process concerns as to the effect of [the] differences between bilateral and class arbitration are resolved by requiring the parties' consent to class arbitration." Id. Additionally, the Second District took issue with the Fourth District's observation that the "high stakes" of class arbitration are simply too significant to entrust to an arbitrator without the benefit of judicial review. Id.

E. ARBITRATION AGREEMENTS – ENFORCEABILITY AND CHALLENGES TO ENFORCEMENT

(1) Background Statement

Under Section 2 of the Federal Arbitration Act ("FAA"), an arbitration agreement is "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. This statutory provision states a rule of federal substantive law which makes arbitration agreements enforceable both in state and in federal courts. *Southland Corp. v. Keating*, 465 U.S. 1 (1984). Any state law that attempts to render unenforceable an arbitration agreement which is enforceable under the FAA is preempted by the FAA. Id.; *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996). This rule of federal substantive law applies if the transaction in question is a transaction "involving commerce" or a maritime transaction. The "involving commerce" requirement is to be construed broadly so as to reach the limits of the Commerce clause power of Congress. *Allied-Bruce Terminix Companies, Inc. v. Dobson*, 513 U.S. 265 (1995).

The FAA mandates that trial courts "shall" compel arbitration and stay litigation involving disputes subject to an arbitration agreement. 9 U.S.C. §§ 3, 4. In this regard, the United States Supreme Court repeatedly has stated that the FAA manifests "a liberal federal policy favoring arbitration agreements." *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625 (1985); *Moses H. Cone Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983). The liberal policy favoring arbitration requires courts to "rigorously enforce agreements to arbitrate." *Mitsubishi*, supra, 473 U.S. at 625-626; *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 221 (1985).

The court's analysis in deciding whether to compel arbitration is generally devoted to a determination of three issues: (1) whether a valid arbitration agreement exists; (2) whether the issues sought to be arbitrated fall within the scope of the arbitration agreement; and (3) whether the party against whom enforcement is sought has failed or refused to arbitrate. If the court determines that these conditions have been met, it is required to direct the parties to arbitrate their dispute. The cases discussed in this section concern enforcement issues and look at the courts' treatment and reasoning concerning defenses to the enforceability of an arbitration agreement.

(2) Cases

(a) The Lack of an Express Provision for Discovery and the Failure to Attach a Copy of the AAA Rules did not Render the Arbitration Agreement Unconscionable – *Lane v. Francis Capital Management, LLC*, 224 Cal. App. 4th 676 (2d Dist., Mar. 11, 2014)

In connection with his employment, plaintiff employee executed a two-page agreement. That agreement provided for arbitration according to the applicable dispute resolution rules of the AAA for employment disputes. When employee sued for wrongful termination, the defendant employer moved to compel arbitration. That motion was denied on the grounds that the arbitration agreement was unconscionable and thus void. Defendant employer appealed and the court of appeal reversed.

The appellate court started its analysis by noting that the party resisting arbitration bears the burden of proof and that both procedural and substantive unconscionability must be shown to exist, although not in the same degree. 224 Cal. App. 4th at 689, citing *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal. 4th 83, 114 (2000). "The more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa." Id., citing *Pinnacle Museum Tower Ass'n v. Pinnacle Market Development (US), LLC*, 55 Cal. 4th 223, 247 (2012).

With regard to procedural unconscionability, plaintiff argued that the arbitration agreement at issue was a contract of adhesion. The trial court made no finding on this issue. The appellate court found that even assuming the agreement was one of adhesion, "courts have consistently held that that fact alone is insufficient to invalidate an arbitration agreement ;" that the agreement remains full enforceable unless the provision falls outside the reasonable expectations of the weaker party. 224 Cal. App. 4th at 689, citing *Fittante v. Palm Springs Motors, Inc.*, 105 Cal. App. 4th 708, 722 (2003). The appellate reasoned that because the arbitration agreement was just two pages and contained no hidden terms and expressly referenced "wage, hour and benefit claims," its application to plaintiff's claims was "clearly within the reasonable expectations of the parties." Id.

Similarly, the court found that the trial court erred in its determination that the contract was procedurally unconscionable because it referenced, but did not attach a copy of, the AAA rules that would govern any arbitration dispute. The court of appeal

acknowledged that the failure to attach a copy of arbitration rule could be a factor supporting a finding of procedural unconscionability, that was only true where the failure would result in surprise to the party opposing arbitration. Here, the court concluded, the failure to attach a copy of the AAA rules did not render the agreement procedurally unconscionable because the AAA rules were easily accessible to the parties via the Internet. 224 Cal. App. 4th at 691, citing *Boghos v. Certain Underwriters at Lloyds of London*, 36 Cal. 4th 495, 505, fn. 6 (2005) (full, up-to-date text of AAA rules is available on AAA's Internet site). With regard to the plaintiff employee, in particular, the court of appeal noted that Lane was a professional analyst and did "not appear to lack the means or capacity to locate and retrieve a copy of the referenced rules." Id. at 692, citing *Dotson v. Amgen, Inc.*, 181 Cal. App. 4th 975, 981 (2010).

With regard to substantive unconscionability, the trial court found that the agreement was unconscionable because it incorporated by reference the AAA rules. The court of appeal disagreed, finding that like any other contract, an arbitration agreement may incorporate other documents by reference. 224 Cal. App. 4th at 692, citing *Wolschlager v. Fidelity National Title Ins. Co.*, 111 Cal. App. 4th 784, 790; *Tutti Mangia Grill, Inc. v. American Textile Maintenance Co.*, 197 Cal. App. 4th 733, 736 (2011).

The trial court also found that the arbitration agreement was substantively unconscionable because the agreement contained no express provision for discovery. Again, the court of appeal disagreed because the agreement incorporated the AAA rules, which give the arbitrator the authority "to order such discovery, by way of deposition, interrogatory, document production or otherwise, as the arbitrator considers necessary to a full and fair exploration of the issues in disputes, consistent with the expedited nature of arbitration." 224 Cal. App. 4th at 692. With regard to the issue of discovery sufficient to vindicate unwaivable statutory rights, the appellate court noted that in *Armendariz*, the California Supreme court concluded that by agreeing to arbitrate statutory claims, the employer impliedly agreed to all discovery necessary to adequately arbitrate the claims. Id. at 693, citing *Roman v. Superior Court*, 172 Cal. App. 4th 1461, 1475 (2009). "Thus, whether implied or in fact, the discovery permitted by the expressly referenced AAA rules satisfied the requirements of *Armendariz* for arbitration of statutory claims…. [T]he lack of an express provision for discovery did not render the arbitration agreement substantively unconscionable." Id., citing *Sanchez v. Western Pizza Enterprises, Inc.*, 172 Cal. App. 4th 154, 177 (2009).

(b) Parties' "High-Low" Agreement to Arbitration of Personal Injury Claim Was Implicitly, if not Expressly, Clear with Respect to the Outcome Restrictions to Which They Both Agreed – *Horath v. Hess*, 225 Cal. App. 4th 456 (4th Dist., Apr. 10, 2014)

Plaintiff was injured with defendant's car struck the rear end of her vehicle. Plaintiff then filed a personal injury action against defendant. The parties, through their respective attorneys, agreed to submit the dispute to an arbitrator for private, binding arbitration subject to a "high-law" bracket capping the both the "high" and the "low" of plaintiff's recovery and defendant's exposure. Under the terms of their stipulation, the parties agreed that defendant would pay the award of the Arbitrator or $44,000, whichever is greater, and that plaintiff would accept the award of the Arbitrator or $100,000, whichever is less but in no event less than $44,000.

The matter then proceeded to arbitration and, presumably, the Arbitrator was not informed of the parties' "high-low" agreement. The Arbitrator ruled in favor of plaintiff and awarded plaintiff $329,644 in damages and $36,882 in costs. Plaintiff then sought to confirm the award in the total amount of $366,527 as a judgment against defendant. Defendant countered by filing a motion to limit the amount of the judgment to $100,000, citing the parties' pre-arbitration "high-law" stipulation. The trial court granted plaintiff's motion to confirm the award as a judgment in the total amount of $366,527 and denied defendant's motion, stating that it was essentially a motion to vacate or correct the award and was not filed within the 100-day limit under Code of Civil Procedure Section 1288. Defendant appealed this decision of the trial court (the "D063124 Appeal").

In a separate action, defendant filed a motion seeking an order acknowledging satisfaction of judgment, arguing that he had paid plaintiff $100,000, plus costs, and was therefore entitled to an acknowledgment of full satisfaction pursuant to the terms of the parties' stipulation. Defendant stated that he was not challenging the award or the judgment, but was only seeking to enforce the terms of the parties' pre-arbitration "high-low" stipulation. The trial court denied this mooring and defendant took an appeal of this order as well (the "D063709 Appeal").

On appeal, the Fourth District determined that its disposition of the D063709 Appeal would make the D063124 Appeal moot and thus decided to first address defendant's appeal of the trial court's post-judgment order denying his motion for an acknowledgment of satisfaction of judgment under Code of Civil Procedure Section 724.050. With regard to this matter, the appellate court found that the crux of the issue

presented to it concerned the proper interpretation of the parties' pre-arbitration "high-low" stipulation. The court held that the stipulation was subject to the general rules of contract enforcement and interpretation and, as applied to the undisputed facts of the case, "there [could] be only one reasonable interpretation;" that the stipulation's "high-low" agreement "implicitly, if not expressly, prohibited [plaintiff] from challenging the amount of the Award or the judgment." The court noted that in order to enforce the "high-low" stipulation, defendant necessarily had to satisfy (pay) the compromise number agreed to. Similarly, once tendered, the plaintiff was contractually obligated to accept the $100,000 plus costs in full satisfaction of any judgment entered. The court thus reasoned that when plaintiff refused to file an acknowledgment of full satisfaction of judgment, defendant properly filed his motion requiring her to do so, and was not required to first file a motion to vacate or correct the award.

> "[B]oth parties benefited by the Stipulation's 'high-low' provision. If the amount of the Award and judgment was less than $44,000, [plaintiff] would benefit by requiring [defendant] to pay her $44,000 plus any costs awarded by the arbitrator. On the other hand, if the amount of the Award and judgment was more than $100,000, [defendant] would benefit by having to pay [plaintiff] only $100,000 plus costs … When the latter scenario ultimately resulted and the amount of the Award and judgment exceeded $100,000, [plaintiff's] agreement to accept payment from [defendant] of only $100,000 plus costs remained enforceable …."

225 Cal. App. 4th at 469.

(c) When an Arbitration Agreement Contains Multiple Unconscionable Provisions, the Arbitration Agreement is Permeated by an Unlawful Purpose and Thus Unenforceable – *Carmona v. Lincoln Millennium Car Wash, Inc.*, 226 Cal. App. 4th 74 (2d Dist., Apr. 21, 2014)

In connection with their employment by defendant car wash companies, each plaintiff signed an employment agreement containing an arbitration clause. When plaintiffs brought a putative class action against the car wash companies for wage and hour violations, defendants moved to compel arbitration. The trial court denied that motion, finding that the arbitration agreements were procedurally and substantively unconscionable and were so permeated with illegality that the unconscionable provisions could not be severed. Defendants appealed. The Second District affirmed the trial court on all grounds.

While defendants conceded that the arbitration agreements in question were procedurally unconscionable, the appellate court nevertheless addressed this issue because the circumstances were somewhat extreme and contributed to the finding of substantive unconscionability. In this case, the undisputed evidence showed that the car wash companies drafted the agreements and required plaintiffs to sign them as a condition of employment. No one described the agreement's contents to the plaintiffs (who did not read English) and only parts of the agreement were translated into Spanish – the arbitration and confidentiality clauses not being among those parts. The appellate court concluded that both oppression and surprises were present, making the arbitration agreements procedurally unconscionable.

Adopting the sliding scale approach to unconscionability, the court noted that given the high degree of procedural unconscionability found to exist in this case, even a low degree of substantive unconscionability would render the arbitration agreements unconscionability. That being said, the court found that the degree of substantive unconscionability here "was not particularly law," starting with the lack of mutuality. The arbitration agreement in question required arbitration only for the claims of the weaker party, but provided a choice of forums for the claims of the stronger party. While the arbitration clause provided for arbitration of "any dispute," only the employee signed and initialed the agreement. Nowhere did the car wash companies indicate that they were bound by the clause. Moreover, the enforceability clause gave the car wash companies the choice of either court or arbitration when pursuing breaches of the confidentiality subagreement (defining confidential information and imposing a duty on the employees not to disclose such information). The court concluded that this type of one-sided provision – where the employer exempts claims only it would bring from arbitration, while restricting employee claims to arbitration – to be substantively unconscionable.

The court of appeal also took issue with the unilateral "free peek" provision contained in the confidentiality subagreement. In this regard, the court found that the confidentiality clause required employees to discuss with management of the car wash companies "any problems or concerns with anything related to" their employment before disclosing any information to outsiders, including attorneys, courts or arbitration organizations. Notably, the cash wash companies had no corresponding obligation under the agreement to discuss its disputes with employees before taking action in court or through arbitration.

Having found that the arbitration agreement in question was both procedurally and substantively unconscionable, consistent with the trial court's decision, the only remaining issue for the court of appeal was whether the court abused its discretion in determining that the agreement was so permeated by unconscionability that it could not sever the offending provisions and still enforce arbitration. The defendants argued that the trial court erred because all of the provisions found to be unconscionable were contained in one clause – the enforceability clause – and that clause, they argued, could be easily severed while still preserving the agreement to arbitrate. The court of appeal concluded that the trial court did not err. "When an arbitration agreement contains multiple unconscionable provisions, '[s]uch multiple defects indicate a systematic effort to impose arbitration on an employee not simply as an alternative to litigation, but as an inferior forum that works to the employer's advantage.'... Under such circumstances, a trial court does not abuse its discretion in determining the arbitration agreement is permeated by an unlawful purpose."

(d) Answering a Complaint and Participating in Litigation, on Their Own, do not Waive the Right to Arbitrate Especially if, Along the Way, Defendant Repeatedly Asserts its Right to Arbitrate -– *Gloster v. Sonic Automotive, Inc.*, 226 Cal. App. 4th 438 (1st Dist., Apr. 23, 2014)

Plaintiff filed an employment-related lawsuit against his former employer, the parent company and other employees. Although defendants warned plaintiff prior to his filing of the lawsuit that they would insist on arbitration under his employment agreement, the defendants waited a full year before petitioning the trial court to compel arbitration and then coupled that motion with a motion for summary judgment. The trial court denied both motions. With regard to the motion to compel arbitration, the trial court reasoned that defendants had waived the right to arbitration by their delay. Defendants appealed and, on appeal, the First District reversed.

The court of appeal stated its analysis by noting that under both state and federal law, "no single test delineates the nature of the conduct that will constitute a waiver of arbitration." 226 Cal. App. 4th at 447, citing *St. Agnes Medical Center v. PacifiCare of California*, 31 Cal. 4th 1187, 1195-1196 (2003). In this regard, the court found that waiver of the right to demand arbitration has been found in a variety of contexts, ranging from situations in which the party seeking to compel arbitration has previously taken steps inconsistent with an intent to invoke arbitration to instances in which the petitioning party has unreasonably delayed in undertaking the procedure. Id. at 448. The court also found that whether litigation results in prejudice to the party opposing arbitration "is

critical in waiver determinations." Id., citing *Hon v. CJCGV American Holdings, Inc.*, 222 Cal. App. 4th 240, 249 (2013). While the appellate court recognized that the defendants in this action had delayed for an extended period of time in taking affirmative steps to enforce their right to arbitration, the plaintiff failed to carry his "'heavy burden' of demonstrating this delay was unreasonable and prejudicial." Id. at 449, citing *St. Agnes*, supra, 31 Cal. 4th at 1195. "Importantly, the … defendants consistently asserted their intention to arbitrate, insisting on the requirement of arbitration in communications with [plaintiff] and his counsel even before the litigation was filed. They reflect that intent in pleading an appropriate affirmative defense and consistently asserted their intent to seek arbitration in a series of case management statements." Throughout the period of delay, there was no question that the … defendants wanted to arbitrate; the only question was when they would get around to enforcing their right."

Under the circumstances presented in this case – i.e., defendants' repeated assertions of their right to arbitration - the court of appeal found that defendants delay and participation in the litigation was not sufficient to support a finding of waiver; that answer the complaint and participating in the litigation, on their own, would not constitute waiver of the right to arbitrate. 116 Cal. App. 4th at 449, citing *Hoover v. American Income Life Ins. Co.*, 206 Cal. App. 4th 1193, 1204 (2012). The appellate court recognized that the filing of a dispositive motion has been found to constitute a waiver, but noted that such a motion ordinarily must involve the merits of arbitrable issues. In this case, the court reasoned, the defendants' summary judgment motion raised only procedural issues and did not otherwise address the merits of plaintiffs' claims. Id. at 450. Accordingly, given this circumstances, defendants' summary judgment motion would not be construed as being inconsistent with an intent to arbitrate.

(e) Employee Handbook Arbitration Provision can be Modified and Still be Binding Because Employer Provided Employees with 30-Day Opt-Out Notice and Employee did not Opt Out, so Deemed to have Accepted by Conduct – *Davis v. Nordstrom*, 755 F.3d 1089 (9th Cir., Jun. 23, 2014) ***[Digest provide by Chris Blank]***

Davis filed a class action suit on behalf of employees of Nordstrom for violations of various state and federal employment laws. Nordstrom moved to compel arbitration and dismiss. The trial court denied Nordstrom's motion holding that Nordstrom's unilateral change in the terms of the arbitration provisions appended to its employee manuals was ineffective. The trial court found that Nordstrom did not give 30 days notice of the change as required by its employee manual. The trial court also found that

Nordstrom gave the employees no notice that their continued employment could be construed as consent to the changed terms.

The 9th Circuit disagreed on both points. While accepting that Nordstrom's notice was not a model of clarity, the fact that it appeared to suggest that the new policy was immediately effective was not a violation of the 30 day notice requirement because it did not actually attempt to enforce the changes within the 30 days, and none of the employees objected within the 30 days. This seems awfully lenient. Imagine other contracts or laws that require a certain amount of notice, such as the foreclosure laws that require 21 days notice of sale. Would a court accept a notice that says the property will be sold immediately as long as the actual sale did not take place within 21 days?

The 9th Circuit also held that California law does not require an employer warn employees that continuing to come to work will be construed as consent to changes in the terms of employment. The 9th Circuit did not reach the question of whether the employment contract and its arbitration provision that prohibited class action suits was unconscionable. Rather, it remanded to the District Court to pass on that issue.

On remand, the District Court cited the U.S. Supreme Court case of *Concepcion*, and the California Supreme Court case of *Iskanian* in holding that the waiver of the right to vindicate wage and hour claims by class action was not unconscionable. The District Court does not appear to have addressed general California law on procedural and substantive unconscionability. Although granting Nordstrom's motion to compel arbitration of Davis's individual claims, the court allowed Davis to litigate her PAGA claims. The District Court held the PAGA claims involve public, not private, rights. Therefore, the Federal Arbitration Act does not govern them and they can be maintained on a representative basis in the District Court. Shortly after making that decision the parties settled and the case was dismissed.

(f) One-Sided Option to Elect Arbitration is Substantively Unconscionable – *Sabia v. Orange County Metro Realty, Inc.*, 227 Cal. App. 4th 11 (2d Dist., Jun. 18, 2014), reviewed granted (Not Citable)

Plaintiffs were clients of a mortgage foreclosure consultant. They filed suit against the consultant and affiliated persons and entities, alleging fraud, breach of contract and other statutory and common law claims, claiming that they were duped into signing agreements and lost money for services they paid for but were never rendered. Those agreements contained an arbitration provision. Defendants moved to compel arbitration and the trial court granted that motion. Plaintiffs appeal and, on

appeal the Second District reversed finding that the arbitration provision was both procedurally and substantively unconscionable. While ordinarily an order compelling arbitration is not appealable, an exception to this rule exists when an order compelling arbitration effective acts as the "death knell" for any class claims by effectively terminating them. 227 Cal. App. 4th at 21, citing *Elijahjuan v. Superior Court*, 210 Cal. App. 4th 15, 19 (2012), That was the case here because the trial court ordered the plaintiff to arbitrate their individual claims and found that under *Stolt-Nielsen*, the arbitration provision's silence on the issue of class-wide proceedings precluded any class-wide dispute resolution.

With regard to the attack on the enforceability of the arbitration provision as substantively unconscionable, the court noted that the provision in this case gave defendant the option of "insist[ing] on arbitration" when a client files suit complaining about defendant's actions in any court other than small claims court. The court found that the net effect of this provisions was that it created a "two-pronged form of one-sidedness" that had soundly been rejected by the courts. First, by its terms, only plaintiff must arbitrate their superior court claims if defendant so chooses, leaving defendant free to sue its clients in court for any claims it might have against them. Second, the provision was aimed at limiting a client's access to the courts to the $10,000 small claims threshold of recovery, so that plaintiffs who sustain anything more than a relatively modest amount of damages above and beyond the fees they paid – i.e., such as the loss of their home due to inaction or improper action by defendant – must arbitrate. 227 Cal. App. 4th at 496-498.

Defendants argued that even if the provision was otherwise unconscionable, the *Armendariz* rule of mutuality is no longer good law after *Concepcion.* The court rejected that argument, finding that "[t]ime will tell whether the United States Supreme Court addresses the unconscionability defense; until then we are duty bound to follow recent decisions by the California Supreme Court that reaffirm that unconscionability, including the *Armendariz* bilaterality rule, survives *Concepcion* and are applicable here." Id. at 498. For present purposes, the court reasoned that it was sufficient to its decision in this case that the California Supreme Court has affirmed the continued viability of the unconsionability defense in general and the bilaterality doctrine in particular. Id. at 501. That being said, the court of appeal noted in footnote 14 that the California Supreme court has granted review of numerous appellate court decisions that have tackled several issues left by *Concepcion*'s wake, including some that have found and rejected unconscionability." Id. at 503.

The court of appeal also addressed procedural unconscionability, which was found to exist under the rather unique facts of this case. Basically, plaintiffs were Spanish-speaking and were presented with a stack of English language documents and told not to read them because they reflected what one of defendant's employees had explained to them in Spanish. The court found that the form contract containing the arbitration provision, presented under these circumstances, was adhesive. "Given plaintiffs' economic circumstances and their preference for dealing with Viveros based on either past experience or Flores's referral, we conclude there was sufficient oppression and surprise to create more than a minimum of procedural unconscionability." 227 Cal. App. 4th at 507.

(g) Simply Requiring the Other Party to Agree to Arbitration as Part of the Overall Contract Relationship Without Evidence of Undue Pressure, Threat or Coercion, does not Amount to Procedural Unconscionability – *Galen v. Redfin Corp.*, 227 Cal. App. 4th 1525 (1st Dist., Jul. 21, 2014)

Pursuant to a three-page, form contract drafted by defendant, defendant engaged plaintiff as a Contract Field Agent and the parties agreed that plaintiff would perform services as an independent contractor. Plaintiff later filed suit against defendant on behalf of himself and other similarly situated individuals, claiming that defendant had improperly classified him and other Contract Field Agents as independent contractors when they were actually serving as employees under California law. In response, defendant filed a motion to compel arbitration. That motion was denied on several grounds, including the finding by the trial court that the evidence was unrebutted that the agreement to arbitrate was procedurally and substantively unconscionable. Defendants appealed and the trial court was reversed with the First District finding that the arbitration agreement was not so unconscionable as to be unenforceable.

With regard to procedural unconscionability, the appellate court found that there must be something more than simply requiring a party to a contract to agree to arbitration as part of the overall contract relationship. There must be evidence of surprise or oppression in addition to the unequal bargaining power. In this case, the court of appeal found that the record was "bereft" of such evidence. "While plaintiff might personally have felt pressured to sign the Agreement in order to begin earning money, there is no evidence that defendant required him to sign the document in an unreasonably short period of time" and "did not state that it would withdraw its offer if plaintiff did not return the signed contract immediately." 227 Cal. App. 4th at 1541.

With regard to substantive unconsionability, plaintiff made two arguments: One, that the prevailing party attorney's fees provision in the agreement was unconscionable because plaintiff could be liable for defendant's fees and costs in the event of a loss in arbitration. Two, that the forum selection clause requiring the arbitration to be venued in the state of Washington was unreasonable. The court of appeal rejected both arguments. With regard to the attorney fee and cost shifting provision, the court noted that it was mutual and not one-sided. Additionally, fee- and cost-shifting awards are permissive and are available to be awarded consistent with applicable law. 227 Cal. App. 4th at 1542-1543. With regard to the forum selection clause, the court noted that contractual forum-selection clauses are usually enforced in California regardless of the inherent additional expense and inconvenience of litigating claims in a distant forum unless the part challenging enforcement can show it is unreasonable to do so. The court reasoned that in this case, the plaintiff had failed to show that the forum selection clause was so one-sided as to "shock the conscience" or that it imposed harsh or oppressive terms. Id. at 1543-1544.

(h) Where a Website User Did Not Receive Sufficient Notice of the Terms in a "Browserwrap" - Versus a "Clickwrap" – Agreement in Connection with a Web-Based Transaction, the Arbitration Clause was Unenforceable – *Nguyen v. Barnes & Noble, Inc.*, 763 F.3d 1171 (9th Cir., Aug. 18, 2014)

The United States Supreme Court repeatedly has stated that the FAA manifests a liberal federal policy favoring arbitration, and that agreements to arbitrate are to be rigorously enforced. *Moses H. Cone Memorial Hospital v. Mercury Construction Corporation*, 460 U.S. 1, 24-25 (1983); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625-626 (1985); *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 221 (1985). That being said, arbitration is a creature of contract, and no party may be required to submit to arbitration "any dispute which he has not agreed so to submit." *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 79 (2001), quoting *United Steelworkers of Am. v. Warrier & Gulf Navigation Co.*, 363 U.S. 574, 582 (1960); see also *Volt Info. Sciences, Inc. v. Bd of Trustees of Leland Stanford Junior University*, 489 U.S. 468, 478 (1989) ("[T]he FAA does not require parties to arbitrate when they have not agreed to do so."). A party cannot be ordered to arbitration unless there is "an express, unequivocal agreement to that effect." *Samson v. NAMA Holdings, LLC*, 637 F.3d 915, 923 (9th Cir. 2011), quoting *Par-Knit Mills, Inc. v. Stockbridge Fabrics Co., Ltd.*, 636 F.2d 51, 54 (3d Cir. 1980). So, the question in this matter is whether Claimant and Respondent, as part of their commercial dealings with regard to the production and sale of the customized

goods described above, entered into a pre-dispute agreement to resolve by binding arbitration any disputes arising from or related to such dealings.

Sales contracts are governed by the California Commercial Code. "A contract for the sale of goods may be made 'in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.'" *C9 Ventures v. SVC-West, L.P.*, 202 Cal. App. 4th 1483, 1492 (2012), quoting Cal. Com. Code § 2204(1). In general, "[a]n offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances." Cal. Com. Code § 2206(1)(a). Whether governed by the common law or by Article 2 of the Commercial Code, a transaction, in order to be recognized as a binding contract, requires manifestation of agreement between the parties. *Specht v. Netscape Communications Corp.*, 306 F.3d 17, 28-29 (2d Cir. 2002) (applying California law). Even in the context of a commercial transaction, "consent to, or acceptance of, the arbitration provision [is] necessary to create an agreement to arbitrate." Id., quoting *Windsor Mills, Inc. v. Collins & Aikman Corporation*, 25 Cal. App. 3d 987, 991 (1972).

Mutual manifestation of assent, whether by written or spoken word or by conduct, is the touchstone of contract. *Binder v. Aetna Life Ins. Co.*, 75 Cal. App. 4th 832, 848 (1999). In California, a party's intent to contract is judged objectively, by the party's outward manifestation of consent. *Cedars Sinai Medical Center v. Mid-West Nat'l Life Ins. Co.*, 118 F.Supp.2d 1002, 1008 (C.D.Cal. 2000). The test is whether a reasonable person would, from the conduct of the parties, conclude that there was a mutual agreement. *Hilleary v. Garvin*, 193 Cal. App. 3d 322, 327 (1987); *Meyer v. Benko*, 55 Cal. App. 3d 937, 943 (1976). California's common law is clear that "an offeree, regardless of apparent manifestation of his consent, is not bound by inconspicuous contractual provisions of which he is unaware, contained in a document whose contractual nature is not obvious." *Windsor Mills*, supra, 25 Cal. App. 3d at 992 (no valid agreement for arbitration where the clause was buried in small print on the reverse side of an "Acknowledgment of Order" sent to plaintiff after placing the order).

In this case, Nguyen was a consumer who purchased goods using the Barnes & Noble website. The underlying facts were not in dispute. In August 2011, Barnes & Noble along with other retailers across the county, liquidated its inventory of discontinued Hewlett-Packard Touchpads, an unsuccessful competitor to Apple's iPad. Nguyen purchased two such units on Barnes & Noble's website and received an email confirming the transaction. The following day, Nguyen received another email informing him that his order had been cancelled due to unexpectedly high demand. Nguyen alleges that as a result of Barnes & Noble's representations, as well as the delay in informing him it would not honor the sale, he was unable to obtain an HP Tablet

during the liquidation period for the discounted price and was thus damaged because he was forced to rely on substitute tablet technology and to pay a considerably higher price. Nguyen filed suit in a California Superior Court on behalf of himself and a putative class of like-situated consumers. Barnes & Noble removed the action to federal court and then moved to compel arbitration under the FAA, arguing that Nguyen was bound by the arbitration agreement contained in the website's Terms of Use. The trial court denied that motion because there was no evidence that Nguyen had actual notice of the Terms of Use or was required to affirmatively acknowledge the Terms of Use before completing his online purchase.

The Ninth Circuit affirmed and in so doing, noted that contracts formed on the Internet come primarily in two flavors: "clickwrap" agreements in which website users are required to click on an "agree" box after being presented with a list of terms and conditions of use, and "browsewrap" agreements, where a website's terms and conditions of use are generally posted on the website via a hyperlink at the bottom of the screen, but are not visible to the user unless clicked and do not require the user to "accept" or "agree" to the terms before consummating a transaction on the website. Instead, the Terms of Use simply provide that a party gives assets simply by using the website. See, *Register.com, Inc. v. Verio, Inc.*, 356 F.3d 393, 428-430 (2d Cir. 2004); *Hines v. Overstock.com, Inc.*, 668 F.Supp. 2d 362, 366-367 (E.D.N.Y. 2009); *Fteja v. Facebook, Inc.*, 841 F.Supp. 2d 829, 837 (S.D.N.Y. 2012). "Because no affirmative action is required by the website user to agree to the terms of a contract other than his or her use of the website, the determination of the validity of the browsewrap contract depends on whether the user had actual or constructive knowledge of the website's terms and conditions." *Van Tassell v. United Mktg. Group, LLC*, 795 F.Supp. 2d 770 790 (N.D.Ill. 2011).

In this case, there was no evidence that Nguyen had any actual notice of the Terms of Use or that he was required to affirmatively acknowledge the Terms of Use before completing his online purchase. In such a circumstance, the Ninth Circuit held that the validity of the browsewrap agreement turns on whether the website owner puts a reasonably prudent user on inquiry notice of the terms of the contract. 763 F.3d at 1177, citing, *Specht v. Netscape Communications Corp.*, supra, 306 F.3d at 30-31; see also *In re Zappos.com, Inc. Customer Data Sec. Breach Litig.*, 893 F.Supp. 2d 1058, 1064 (D.Nev. 2012). The court held that the proximity or conspicuousness of the hyperlink alone is not enough to give rise to constructive notice. "While failure to read a contract before agreeing to its terms does not relieve a party of its obligations under the contract (citations), the onus must be on website owners to put users on notice of the terms to which they wish to bind consumers…. Consumers cannot be expected to ferret out

hyperlinks to terms and conditions to which they have no reason to suspect they will be bound." Id. at 1179.

(i) Arbitration Clause in Trial Subscription Agreement was Unenforceable Because There was no Direct Relationship Between the Customer and Vendor and no Evidence that the Customer had Knowledge of the Existence of the Proposed Contract – *Knutson v. Sirius XM Radio, Inc.*, 771 F.3d 559 (9th Cir., Nov. 10, 2014)

In November 2011, plaintiff purchased a Toyota that included a 90-day trial subscription to Sirius XM satellite radio through a marketing and promotional arrangement between Toyota and Sirius. Sirius mailed plaintiff a "welcome kit" that arrived over one month after the satellite receiver was activated. The "welcome agreement contained a copy of Sirius' customer agreement which, in turn, contained an arbitration agreement that bound the customer unless the customer opted out within three days of the satellite receiver being activated.

A dispute arose - the basis of which has of no meaning - other than to say that in response to plaintiff's complaint, Sirius filed a motion to compel arbitration, which was granted by the trial court based on a finding that both parties consented to enter into the customer agreement and the arbitration clause was valid and enforceable. Plaintiff appealed and the Ninth Circuit reversed finding there was no manifestation of mutual assent. Of particular significance to the court was the fact that when plaintiff purchased his vehicle from Toyota, he did not receive any documents from Sirius and did not know that he was entering into a contractual relationship with Sirius by using the satellite radio service that was activated when he purchased the vehicle. Instead, what the plaintiff believed was that the trial subscription was a complimentary service provided for marketing purposes. The only contractual relationship plaintiff was aware of was that he formed with Toyota with he purchased the vehicle.

In ruling for plaintiff, the court distinguished the situation presented in this case (no direct contact between the plaintiff customer and the defendant merchant) from those cases where a customer purchased goods or services and was later sent the contract terms. The court found that the decisions in those cases turned "on crucial facts not present here.... the customer specifically elected to receive the service directly from the service provider." 771 F.3d at 567. Accordingly, the court determined that the arbitration clause/agreement was unenforceable for lack of mutual assent.

(j) Challenge to Enforceability of Arbitration Agreement was Successful Because There was Insufficient Evidence to Authenticate Employee's Alleged Electronic Signature – *Ruiz v. Moss Bros. Auto Group, Inc.*, 2014 WL 7334221 (4th Dist., Dec. 23, 2014) (Not Reported)

After an automotive service technician filed a putative class action complaint against his employer, alleging various wage and hour violations, defendant employer filed a motion to compel arbitration pursuant to the arbitration agreement employee purportedly signed at the time he was hired. The trial court denied the employer's motion, finding that it had failed to establish that the employee had in fact signed the arbitration agreement in question. Defendant employer appealed and the Fourth District affirmed, finding that the motion was properly denied.

Code of Civil Procedure Section 1281.2 requires a court to order arbitration if it determines that an agreement to arbitrate exists. The party seeking to compel arbitration has the initial burden of proof to establish by a preponderance of the evidence the existence of a valid arbitration agreement. In this case, the defendant employer presented a written agreement which it contended plaintiff had electronically signed. While statutory law recognizes that an electronic signature has the same legal effect as a handwritten signature, Civil Code § 1633.7, the proponent of the electronic signature must still show that the signature is, in fact, the signature of the person the proponent claims it to be. Civil Code § 1633.9. "An electronic record or electronic signature is attributable to a person if it was the act of the person. The act of the person may be shown in any manner, including a showing of the efficacy of any security procedure applied to determine the person to which the electronic record or electronic signature was attributable." Id. For example, there is a record of the email address having been provided as that person's contact for email purposes, and then the exchange of the signed document is both to and from that person's verified email address. In this case, the defendant employer did not explain how the electronic signature made it onto the agreement and only offered the testimony of an employee that the electronic signature belonged to the plaintiff employee. "This was not a difficult evidentiary burden to meet, but it was not met here." 232 Cal. App. 4th at 844.

(k) Party to Arbitration Agreement May not Compel Arbitration Where Its Conduct in Litigating the Dispute was Contrary to the Right to Demand Arbitration – *Bower v. Inter-Con Security Systems*, 232 Cal. App. 4th 1035 (1st Dist., Dec. 31, 2014) ***[Digest provided by Chris Blank]***

The trial court held that defendant waived the right to compel arbitration by engaging in class oriented discovery and settlement discussions. The appellate court affirmed. Although the facts were not in dispute, more than one inference from those facts could be drawn. Therefore, the court applied a deferential standard of review.

Plaintiff had worked for defendant as an armed security guard. After his employment was terminated he brought a putative wage and hour class action. The defendant did not immediately petition for arbitration. Rather, it responded to some of the plaintiff's class oriented discovery, propounded some of its own class oriented discovery, and entered into an informal stipulation to stay discovery while attempting to settle the class claims.

The trial court found this conduct inconsistent with an intent to arbitrate. It and the appellate court used the word "tactical" many times. The court also found that time, expense and in particular delay all worked to prejudice plaintiff's right to a speedy and inexpensive resolution of his individual claims if arbitration were to be imposed.

On the discovery issue, defendant argued that their arbitration agreement allowed for reasonable discovery. They argued that the questions they asked about other employees with similar claims could have been asked in that forum, and was therefore not discovery aimed at class claims, to which the appellate court responded "[w]e will simply reiterate the trial court's response to Inter-Con's claim 'Come on. Of course it is.' Discovery concerning individuals who may support a plaintiff's factual claims is distinct from class-wide discovery."

Regarding Inter-Con's objection that the content of settlement discussions (that they involved class settlement) should be confidential the court responded that Inter-Con's own counsel admitted as much at the trial court hearing. Additionally, there was other non-confidential evidence that the parties had agreed to stay the action briefly to engage in class-wide settlement discussions.

One additional aspect of the case is noteworthy. Initially the plaintiff defined the class as armed security guards employed by the company. When settlement negotiations broke down, he attempted to amend his complaint to broaden the class to include unarmed security guards employed by the company. The trial court held that it was this potential expansion of the class that caused the defendant to abandon its attempt to settle or litigate the initial class claims. While this fact supported its conclusion that the defendant's waiver or arbitration was tactical, it also held that the waiver did not apply to the expanded class. Therefore, on remand if the trial court granted the motion to amend, it might also reconsider whether arbitration should be compelled.

(l) Where an Agreement Provided for Arbitration, but Specified no Procedures, the California Arbitration Act Controlled the Process and Because that Process is Established by Law, it Could not be Deemed Unconscionable – *Cruise v. Kroger Co.*, 233 Cal. App. 4th 390 (2d Dist., Jan. 20, 2015)

At the time plaintiff applied for employment with defendant, she completed and signed an employment application which contained an arbitration clause which stated that the company had a dispute resolution program in place that required final and binding arbitration of any and all disputes arising the prospective employee's employment with the company. That policy was referred to and incorporated by reference into the employment application. When plaintiff employee later sued the company for discrimination, the defendant employer moved to compel arbitration based on the arbitration provision contained in the employment application. The trial court denied defendant's motion, ruling that the defendant had failed to meet its burden of proving the existence of an arbitration agreement. Defendant appealed and the Second District Court of Appeal reversed and remanded with instructions to grant the motion to compel arbitration.

Unlike the trial court, the court of appeal found that the employment application – standing alone – was sufficient to establish that the parties had agreed to arbitrate their employment-related disputes. The trial court had ruled otherwise because it was not persuaded that the undated, four-page arbitration policy attached to defendant's moving papers was extant at the time plaintiff read and signed the employment application. The problem created by defendant employer's inability to establish the contents of the 2007 Arbitration Policy was that it failed to establish that the parties agreed to a certain set of procedures different from those prescribed by the California Arbitration Act ("CAA"). The court ruled that unless the parties otherwise agree, the

conduct of an arbitration is controlled by the CAA. That being the case, plaintiff's attack on the enforceability of the arbitration agreement on unconscionability grounds was found to be meritless.

(m) New Exception to the Rule that Arbitration Agreements do not Bind Non-Signatories – DirecTV Allowed to Compel Arbitration Based on Arbitration Clause in Employment Agreement Entered Into Between Employee and Company that DirecTV Acquired – *Marenco v. DirecTV LLC*, 233 Cal. App. 4th 1409 (2d Dist., Feb. 5, 2015)

Before it was acquired by DirecTV, 180 Connect entered into an employment arbitration agreement with Marenco that required both parties to submit all claims arising from and related to the employment relationship to binding arbitration. contained an arbitration clause. After acquiring 180 Connect, DirecTV retained Marenco and other 180 Connect employees. After Marenco left DirecTV, he sued for various wage and hour violations on behalf of himself and a putative class of similarly situated employees. As successor to 180 Connect's rights and obligations under the written employment arbitration agreement, DirecTV moved to compel arbitration of Marenco's individual claims and to stay the litigation of the class claims. In opposition to the motion, Marenco argued that as a nonsignatory, DirecTV lacked standing to enforce the arbitration agreement. The trial court granted DirecTV's motion, finding that as successor to 180 Connect's rights and obligations, DirecTV had standing to enforce the arbitration agreement. Plaintiff appealed.

At the outset, the court of appeal noted that the issue presented was whether a non-signatory defendant may enforce an arbitration agreement between a signatory plaintiff and a corporation that was acquired by the non-signatory defendant, and that it had found no California cases on point. The court affirmed the trial court, finding that although DirecTV was not a signatory to the employment arbitration agreement between Marenco and 180 Connect, the evidence was undisputed that at least some of the terms of Marenco's employment with DirecTV were formed by said agreement. Referring to *Boucher v. Alliance Title Company, Inc.,* 127 Cal. App. 4th 262, 271-272 (2005), which held that by relying on contract terms in a claim against a non-signatory defendant, a plaintiff may be equitably estopped from repudiating the arbitration clause contained in that agreement. The court found that the same conclusion was in order in this case because Marenco had offered no persuasive authority to refute the general contract law principal that his continued employment provided implied consent to maintaining the existing terms of employment, including the arbitration agreement.

(n) Contractual Right to Compel Arbitration Lost Where Parties Delayed and Engaged in "Tons of Litigation" Before Requesting Arbitration – *Eagan Avenatti LLP v. Stoll*, 2014 WL 793136 (4th Dist., Feb. 28, 2014) (Not Reported)

In 2008, former clients entered into a contingent fee agreement with three law firms to represent them as plaintiffs in a malicious prosecution action. The fee agreement contained an arbitration provision for any dispute arising under the contract. The law firms had a separate fee-sharing agreement, which did not contain an arbitration provision. In May 2011, the malicious prosecution action was settled for $39 million. A dispute then arose between two of the three law firms concerning the allocation of the contingent fee portion of the settlement proceeds. In June 2011, Eagan Avenatti ("EA") filed a complaint for declaratory relief, seeking a ruling that Stoll Nussbaum & Polakov ("SNP") was not entitled to any recovery from the settlement. What happens during the course of 2011 and 2012 is a litany of pleadings, discovery, law and motion, and appellate writs between the two sides. In January 2013, the former clients – represented by EA - filed a motion to compel arbitration. That motion was scheduled for hearing in March 2013, along with seven discovery motions, SNP's motion for summary judgment and the former clients' demurrer to SNP's first amended cross-complaint. The motion to compel arbitration was denied as untimely because it was made "after tons of litigation." This appeal followed.

At the outset, the Court of Appeal noted that whether a party has waived the right to compel arbitration is a question of fact, to be affirmed if the trial court's findings are supported by sufficient evidence. *4, citing *St. Agnes Medical Center v. PacifiCare of California*, 31 Cal. 4th 1187, 1196 (2003). It also noted that the case before it closely resembled a case it decided in 2010 – *Burton v. Cruise*, 190 Cal. App. 4th 939 (2010) – and quoted at length from that reported decision.

While California law favors arbitration, Code of Civil Procedure section 1281.2(a) provides a statutory exception where the right to compel arbitration has been waived. Waiver does not require a voluntary relinquishment of a known right. "[T]o the contrary, a party may be said to have 'waived' its right to arbitrate by untimely demand, even without intending to give up the remedy. In this context, waiver is more like a forfeiture arising from the nonperformance of a required act." *5, citing *Burton.* Citing *St. Agnes*, the Court noted that the California Supreme Court has cautioned that waiver of the right to arbitration must be examined in the context of each case. Citing *Wagner Construction Co. v. Pacific Mechanical Corp.*, 41 Cal. 4th 19 (2007), the Court noted

that the Supreme Court has observed that a party's unreasonable delay in demanding or seeking arbitration, in and of itself, may constitute a waiver of the right to arbitrate. "We are loathe to condone conduct by which a [litigant] repeatedly uses the court proceedings for its own purposes … all the while not breathing a word about the existence of an arbitration agreement, or a desire to pursue arbitration …." Id., citing *Adolph v. Coastal Auto Sales, Inc.*, 184 Cal. App. 4th 1443, 1452 (2010).

In final analysis, the Court concluded that substantial evidence supported the trial court's determination that the former clients had waived their right to arbitrate under the attorney-fee contract; that their delay "was considerably more egregious than that in *Burton*" because the facts demonstrated that for an 18-month period, the parties had engaged in litigation before moving to compel arbitration. "Hardly a month went by without motions being filed, opposed, replied to, or heard and ruled on. On March 7, 2013, the date of the hearing on the petition to compel arbitration, there were 10 other motions on calendar - …. And for all this time – through trial setting conference, the posting of jury fees, and an answer the former clients never 'breathed a word' about arbitration under the attorney-client fee contract." *6.

(o) Unconscionable Attorney's Fees and Costs Provision of Arbitration Clause Severed and Arbitration Agreement Enforced as to Employee's Individual Claims – *Avelar v. Seven Fifty-Four, Inc.*, 2015 WL 326719 (4th Dist., Jan. 26, 2015) (Not Reported) ***[Digest provided by Chris Blank]***

Regarding an employment arbitration agreement, the appellate court finds procedural unconscionability, but not substantive unconscionability, except with respect to the waiver or attorneys' fees. The court also determines that the employee had not agreed to arbitrate class claims, and that any waiver of Private Attorney General Act Claims (PAGA) was unenforceable.

Mr. Avelar worked as a waiter for an IHOP in Riverside County. His manager put a one page agreement to arbitrate in front of him while he was working, stated "you need to sign this for work," and stood over him with his hand out until Mr. Avelar signed the agreement. The trial court found both procedural and substantive unconscionability in the transaction and refused to compel arbitration. The appellate court upheld the procedural unconscionability finding, but disagreed that the agreement was substantively unconscionable except with respect to the provision that all parties bear their own costs and attorneys' fees. As to that provision, the appellate court noted that certain of Avelar's claims carried statutory requirements for awarding

fees to a successful plaintiff. Moreover, at least one of those statutes provided that the fee provision was unwaivable. Finding that severance was possible and appropriate, that's what the appellate court ordered.

As to the class and PAGA claims, the court held that the class claims do not arise out of a "dispute between the employee and employer." Therefore, the arbitration agreement does not apply to those claims and the employee cannot be compelled to arbitrate them. Presumably, neither can the employer be compelled to arbitrate them. The appellate court ordered the trial court to allow Avelar to conduct limited discovery to determine if another class representative could be found. The opinion is unclear about what is to happen if no other representative can be found. Presumably, Avelar would be free to arbitrate his individual claims and proceed to litigate his class action.

The court gave a little more useful direction regarding the PAGA claims. As to those claims, the court held that the employer would be required to respond to the claims, but left open whether the parties would prefer to have those claims consensually arbitrated, or litigated in court.

(p) Arbitration Provision Creating an Exception to the Binding and Final Nature of Arbitration Awards is Unconscionable, but Severable – *Trabert v. Consumer Portfolio Services, Inc.*, 234 Cal. App. 4th 1154 (4th Dist., Mar. 3, 2015) ***[Digest provided by Chris Blank]***

Exceptions to finality in a arbitration agreement governing automobile sales can be severed and the balance of the arbitration agreement enforced. This issue and the enforceability of this arbitration agreement which is contained in an industry drafted contract has been pending before the California Supreme Court for three years. See, *Sanchez v. Valencia Holding Co., LLC*, 201 Cal. App. 4th 74 (2011), *review granted and opinion superseded,* 272 P.3d 976 (Cal. 2012). Nevertheless, this particular case has proceeded before the Superior Court and the District Court of Appeals since it was filed in 2010.

At issue is a consumer's claims that repossession and default notices used by the creditor-assignee of his purchase contract were defective under consumer protection statutes. Previously the trial court refused to enforce the arbitration agreement, but the appellate court remanded for a determination of whether the unconscionable provisions of the arbitration agreement could be severed. On remand, the trial court concluded that they could not be severed without augmenting the agreement. In this second

appeal, the appellate court disagreed. The appellate court held that a provision that provided that awards of $0 or more than $100,000.00 would be appealable was unconscionable, but the provision could be excised and the balance of the arbitration agreement enforced.

(q) Arbitration Provision Calling for Each Party to Bear Their Own Fees was Unconscionable, but Severable – *Serafin v. Balco Properties, Ltd.*, 2015 WL 1143126 (1st Dist., Mar. 16, 2015) ***[Digest provided by Chris Blank]***

Appellate Court upholds trial court's decision to stay employment litigation pending completion of arbitration. Provision in arbitration agreement calling for each party to bear their own fees was unconscionable and severable.

This case provides a good catalogue of the current jurisprudence on the topic of arbitration agreements in employment contracts. In particular, the discussion of the plaintiff's argument that the contract was not mutual and therefore illusory may have broader implications than in the arbitration context. The plaintiff argued that the employee policy manual she was given, of which the arbitration agreement was a part, provided that the employer had the unilateral right to change the conditions of employment at any time. This is an axiomatic corollary of California's at-will employment laws. If the employer can terminate employment at any time and for virtually any reason, then the employer may change the conditions of employment as well. The only limits on this principal are contractual, or based on public policy, such as the prohibition of taking adverse employment action in retaliation for asserting statutory rights.

In the past, many courts have held that an arbitration agreement in an at-will employment contract that specifically gives the employer the right to unilaterally modify the contract does not make the contract illusory. Rather, the present court followed previous courts that have held that any modification of the arbitration agreement would be constrained by the covenant of good faith and fair dealing. Therefore, it is mutual and not illusory. This raises the question of whether all modifications of the conditions of employment are also subject to the covenant of good faith and fair dealing.

As a practical matter, any proposed unilateral modification of the arbitration provisions of an employment agreement would be the utmost example of procedural unconscionability. One party not just presenting a contract on a take or leave it basis, but changing the agreement after it had been taken. If the modification were the least bit

disadvantageous to the employee it would almost certainly be struck down as substantively unconscionable. How then does the covenant of good faith and fair dealing constrain the employer any more than it is already constrained.

Perhaps it is time to take another look at this analysis. If employers want completely free rein to modify at-will employment, what consideration are they giving in return for the employee's agreement to arbitrate, certainly not mutuality. The court in this case also mentions several times that the employer was insisting on arbitration, as a basis for concluding that the employer was bound to arbitrate. The conclusion does not follow from the premise.

(r) Court Refuses to Enforce Arbitration Provision Contained in "Click Wrap" Terms – *Merin v. Vonage America, Inc.*, 2014 WL 457942 (C.D.Cal. Feb. 3, 2014), on appeal to the Ninth Circuit ***[Digest provided by Chris Blank]***

This is an unpublished decision that is on appeal to the 9th Circuit. Briefing in the appeal was completed on January 7, 2015. As of March 20, 2015, a hearing has not yet been set.

Plaintiffs sued Vonage as representatives of a purported class of customers who had been charged a "mandatory 911" charge. They alleged that no such mandate existed and Vonage should have to refund the $5 per month that it fraudulently charged its customers. Vonage sought to compel arbitration and also sought to enforce the portion of its terms of service that prohibited either party from suing as a class representative. One might ask when Vonage might find it useful to file a class action suit, but that was not addressed by the court. In fact the court did not address the class action waiver at all. Rather, it refused to compel arbitration on the grounds that the terms of service were unconscionable.

The court found procedural and substantive unconscionability in Vonage's "click-wrap" terms and conditions and refused to enforce the arbitration clause of the agreement. The court found a high degree of procedural unconscionability because the terms and conditions were presented on a take it or leave it basis. They gave Vonage the unilateral right to change them at will. They also provided that changes were effective upon Vonage posting them on its website without giving notice to its customers.

Between 2004, when one of the plaintiff's became a Vonage subscriber, and the 2013 start of the lawsuit, Vonage had actually changed the terms of service 36 times. If printed, those contracts would be a total of 720 pages long. At Vonage's request, the court based its analysis on the last version of the terms of service. The arbitration clause in that version, although purportedly bilateral, actually gave Vonage its choice of forum for different types of claims. Finding the arbitration provision "lacks the requisite 'modicum of bilaterality'" the court found the provision to be substantively unconscionable. The court also refused to sever the offensive material.

F. CHALLENGES TO THE ARBITRATION AWARD

(1) Background Statement

An arbitration proceeding is concluded by the issuance of an award. The only statutory requirements concerning the form of the award is that it must be in writing, signed by the arbitrator, and include a determination of all questions submitted to the arbitrator that must be decided in order to determine the controversy. Cal. Civ. Proc. Code § 1283.4. There are, however, rules governing the award process that have been adopted by various provider organizations.

As a matter of statutory law, the arbitrator is not required to issue formal findings of fact or conclusions of law. *Cothron v. Interinsurance Exchange*, 103 Cal. App. 3d 853, 861 (1980). Likewise, the arbitrator is not required to disclose his or her rationale or reasons for the award. *Arco Alaska v. Superior Court*, 168 Cal. App. 3d 139, 148 (1985); *Baldwin Co. v. Rainey Const. Co.*, 229 Cal. App. 3d 1053, 1058 n. 3 (1990).[8] However, some provider organizations require that the arbitrator issue an award that includes a statement of the reasons for the award, unless the parties agree otherwise. See, e.g., JAMS Rules, Rule 24. Other provider organizations give the parties the option of requesting a "reasoned award" as part of the process. See, e.g., American Arbitration Association Commercial Rules, Rule R-42. Beyond what is stated in the arbitrator's award, parties may not depose the arbitrator to establish and then challenge his or her reasoning. *Hoeft v. MVL Group, Inc.*, 343 F.3d 57, 66-68 (2d Cir. 2003).

[8] For cases governed by the FAA, see *Bosack v. Soward*, 586 F.3d 1096, 1102 (9th Cir. 2009) ("Arbitrators are not required to set forth their reasoning supporting an award. An arbitrator's award may be made without explanation of their reasons and without a complete record of their proceedings. [But, if] they choose not to do so, it is all but impossible to determine whether they acted with manifest disregard for the law.").

An arbitrator's award is not directly enforceable. Until it is confirmed, an award has no more force or effect than a written contract between the parties to the arbitration. Cal. Civ. Proc. Code § 1287.6; *Jones v. Kvistad*, 19 Cal. App. 3d 836, 840 (1971). However, unless vacated or corrected by the court, an arbitration award is entitled to res judicata and collateral estoppel effect in any subsequent proceedings. *State Farm Mut. Auto. Ins. Co. v. Superior Court*, 211 Cal. App. 3d 5, 14 (1989) (collateral estoppel effect as to issues "actually, necessarily, and finally" resolved in the arbitration proceeding); *Thibodeau v. Crum*, 4 Cal. App. 4th 749, 755 (1992) (res judicata doctrine applies to an arbitration award, even though unconfirmed, and bars subsequent assertion of claims falling within the scope of the arbitration).

In order to enforce an arbitration award, the prevailing party must ask a judge to confirm the award. Cal. Civ. Proc. Code §§ 1285, 1287.4. That request is made by filing a petition with the court. For purposes of creating a record in these court proceedings, the petition must name as respondents all parties to the arbitration. Cal. Civ. Proc. Code § 1285; see *Walter v. National Indem. Co.*, 3 Cal. App. 3d 630, 634 (1970). The petition must also set forth the substance of the arbitration agreement or have a copy attached, it must identify the arbitrator; and it must set forth or have attached a copy of the award and the arbitrator's written opinion, if any. Cal. Civ. Proc. Code § 1285.4. The petition must be served on all respondents and a noticed hearing must be held similar to the type of proceeding had with respect to a petition to compel arbitration. Cal. Civ. Proc. Code §§ 1290, et seq. Once confirmed, the arbitration award becomes a judgment of the court, has the same force and effect as a judgment in a civil action, and may be enforced like any other judgment of the court in which it is entered. Cal. Civ. Proc. Code § 1287.4; see *Britz, Inc. v. Alfa-Laval Food & Dairy Co.*, 34 Cal. App. 4th 1085, 1106 (1995).

An award reached by an arbitrator pursuant to a contractual agreement to arbitrate is not subject to judicial review, except on statutory grounds. See, 9 U.S.C. § 10(a)(1)-(4); Cal. Civ. Proc. Code § 1286.2(a)(1)-(6); *Moncharsh*, supra, 3 Cal. 4th at 33. Courts may not act *sua sponte*. Cal. Civ. Proc. Code §§ 1286.4, 1286.8; *Valsan Partners Ltd. P'ship v. Calco Space Facility, Inc.*, 25 Cal. App. 4th 809, 818 (1994). Such relief is sought by petitioning to vacate the award and may be filed by any party. *Baldwin v. Rainey Const. Co.*, supra, 229 Cal. App. 3d at 1058. The scope of judicial review of arbitration awards is extremely narrow and is limited to the specific grounds defined by statute, which are directed at the process, not the substance of the award or the merits of the dispute. Generally speaking, an arbitrator's decision is not reviewable for errors of fact or law. *Moncarsh*, supra, 3 Cal. 4th at 6; *City of Palo Alto v. Service Employees Int'l Union*, 77 Cal. App. 4th 327, 333 (1999). Code of Civil Procedure section 1286.2 provides the limited exceptions to this general rule and sets forth the grounds for vacating an award, which include: the arbitrator exceeded his powers and the award cannot be corrected

without affecting the merits of the decision;[9] the award was procured by corruption, fraud or other undue means or corruption in any of the arbitrators;[10] the award was issued by an arbitrator required to disqualify himself or herself;[11] the rights of the parting challenging the award were substantially prejudiced by the arbitrator's refusal to postpone the hearing despite sufficient cause shown for a postponement, his or her refusal to hear evidence material to the controversy or other misconduct.[12] Additionally,

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[9] 9 U.S.C. § 10(a)(4); Cal. Civ. Proc. Code § 1286.2(a)(4). An arbitrator derives his power solely from parties' arbitration agreement or the stipulation of submission and he has no legal right to decide issues not submitted by the parties. *Moncharsh*, supra, 3 Cal. 4th at 8; *O'Malley v. Petroleum Maintenance Co.*, 48 Cal. 2d 107, 110 (1957); *Luster v. Collins*, 15 Cal. App. 4th 1338, 1346 (1993). A party's failure to request the arbitrator to determine a particular issue within the scope of the arbitration is not a basis for vacating or correcting an award. *Corona v. Amherst Partners*, 107 Cal. App. 4th 701, 706 (2003). Arbitrators do not exceed their powers because they assign erroneous reasons for their decision. *Moncharsh*, supra, 3 Cal. 4th at 28. The focus of this inquiry is on whether arbitrators had the power, based on the parties' submissions, to reach a certain issue, not whether the arbitrator correctly decided the issue. *DiRussa v. Dean Witter Reynolds, Inc.*, 121 F.3d 818, 824 (2d Cir. 1997).

[10] 9 U.S.C. § 10(a)(1); Cal. Civ. Proc. Code §§ 1286.2(a)(1), 1286.2(a)(2). This ground for vacatur applies to extrinsic fraud perpetrated by the arbitrator or a party (i.e., fraud which deprives the party of a fair hearing). *Pacific Crown Dist v. Brotherhood of Teamsters, Etc.*, 183 Cal. App. 3d 1138, 1147 (1986). It also applies to "undue" behavior which deprives a party of a "hearty 'first bite'." *Pour Le Bebe, Inc. v. Guess? Inc.*, 112 Cal. App. 4th 810, 831 (2003).

[11] 9 U.S.C. § 10(a)(2); Cal. Civ. Proc. Code § 1286.2(a)(6). Arbitrators conducting arbitrations in California must comply with the Judicial Council ethics standards which require that an arbitrator make extensive conflict disclosures to the parties before accepting the appointment and hearing the dispute. Cal. Civ. Proc. Code §§ 1281.85, 1281.9 and 1281.91. An arbitrator's failure to comply with the disclosure requirements may be ground for disqualification of the arbitrator and for vacatur of any award issued. *Ovitz v. Schulman*, 133 Cal. 4th 830 (2005). Likewise, an arbitrator's failure to honor a demand for disqualification after making the required conflict disclosures mandates vacatur of any award issued. *Azteca Const., Inc. v. ADR Consulting, Inc.*, 121 Cal. App. 4th 1156, 1168-1169 (2004). An arbitrator's mere failure to disclose a conflict is not a basis for vacatur under the FAA. Proof of evident partiality is required under the FAA. 9 U.S.C. § 10(a)(2); *ANR Coal Co., Inc. v. Cogentrix of North Carolina, Inc.*, 173 F.3d 493, 499-500 (4th Cir. 1999).

[12] 9 U.S.C. § 10(a)(3); Cal. Civ. Proc. Code § 1286.2(a)(5). Arbitrators are required to decide all questions submitted that are necessary to determine the controversy. Cal. Civ. Proc. Code § 1283.4. Failure to do so may constitute "other conduct" for vacatur. *Muldrow v. Norris*, 12 Cal. 331 (1859). A party challenging an award on this ground bears the a "heavy burden" because it is presumed that all issues submitted have been decided. *Rodrigues v. Keller*, 113 Cal. App. 3d 838, 841 (1980). To overcome that presumption, the party challenging the award must show that its claims were expressly raised and not decided by the arbitrator. Id. This is difficult to do because findings are usually not required or part of the award. Id. In the case of a monetary

both state and federal common law recognize a "public policy" exception to confirmation of an award, which allows courts to refuse to enforce an arbitration award that violates well-defined public policy.[13]

For arbitrations governed by the FAA, there are two additional, common law grounds for seeking vacatur of an award, which are quite narrow. The first is the "manifest disregard" of the law exception and allows the award to be vacated where the arbitrator knew applicable law but ignored or refused to apply it,[14] or where an

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award without findings, the decision that one of the parties should pay the other a sum of money "is sufficiently determinative of all items embraced in the submission." *Sapp v. Barenfeld*, 34 Cal .2d 515, 522-523 (1949).

[13] In 1987, the United States Supreme Court held that courts can decline to enforce an arbitrator's award where enforcement "would violate 'some explicit public policy' that is 'well defined and dominant, and is to be ascertained by reference to the laws and legal precedents and not from general considerations of supposed public interests.'" *United Paperworkers' Int'l Union, AFL-CIO v. Misco, Inc.*, 484 U.S. 29, 43 (1987); see also *Exxon Shipping Co. v. Exxon Seamen's Union*, 11 F.3d 1189, 1191-1192 (3d Cir. 1994) (vacating labor arbitration award that required the reinstatement of a seaman who was found to be highly intoxicated while on duty), or a party's statutory rights. *Board of Education, Etc. v. Round Valley Teachers Ass'n*, 13 Cal. 4th 269, 277 (1996) (vacating arbitration award that required school district to comply with collective bargaining agreement procedure for termination a probationary teacher which was preempted by conflicting Education Code provisions). This exception arises out of the contract defense to enforcement where a contract is found to violate public policy. *Vimar Sequros y Reaseguros S.A. v. M/V Sky Reefer*, 515 U.S. 528, 540 (1995). This exception derives legitimacy from the public's interest in having its views represented in matters to which it is not a party but which could harm the public interest. *Seymour v. Blue Cross/Blue Shield*, 988 F.2d 1020, 1023 (10th Cir. 1993); see also *Di Russa v. Dean Witter Raynolds, Inc.*, supra, 121 F.3d at 824-825.

[14] Under Section 10 of the FAA, vacatur is appropriate where it is evident that "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. "[A]rbitrators exceed their powers in this regard not when they merely interpret or apply the governing law incorrectly, but when the award is completely irrational, or exhibits a manifest disregard of the law." *Kyocera Corp. v. Prudential Bache Trade Serv. Inc.*, 341 F.3d 987, 997 (9th Cir. 2003) (en banc). "Manifest disregard of the law means something more than just an error in the law or a failure on the part of the arbitrators to understand or apply the law." *Lagstein v. Certain Underwriters at Lloyd's, London*, 607 F.3d 634, 641 (9th Cir. 2010), citing *Mich. Mut. Ins. Co. v. Unigard Sec. Ins. Co.*, 44 F.3d 826, 832 (9th Cir. 1995). See, e.g., *Comedy Club, Inc. v. Improv West Assoc.*, 553 F.3d 1277, 1287 (9th Cir. 2009) (vacatur for manifest disregard of the law where injunction award included collateral relatives not in privity who, under California law, the arbitrator lacked authority to enjoin); see also *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056 (9th Cir. 1991) (vacatur allowed for arbitrator's manifest disregard of the law).

obvious error of law exists.[15] "For an arbitrator's award to be in manifest disregard of the law, it must be clear from the record that the arbitrator recognized the applicable law and then ignored it …." *Matthews v. Nat'l Football League Mgmt. Council*, 688 F.3d 1107, 1115 (9th Cir. 2012). The second additional common law ground is the "arbitrary and capricious" exception, which allows the award to be vacated where no ground for the decision can be inferred from the facts, which is not yet uniformly accepted.[16]

For arbitrations governed by the FAA, Section 10 provides the exclusive means by which a court reviewing an arbitration award may grant vacatur. While arbitration is a creature of contract, the United States Supreme Court ruled in 2008 that Section 10 provides the exclusive grounds for vacatur; that parties may not contract between themselves for an expanded scope of review. See, *Hall St. Assoc., LLC v. Mattel, Inc.*, 552 U.S. 576, 584 (2008).

The rule is different for arbitrations governed by the California Arbitration Act. In 2008, the California Supreme Court relied on the United States Supreme Court's statement in *Hall Street* that "[t]he FAA is not the only way into court for parties wanting review of arbitration awards: they may contemplate enforcement under state statutory or common law, for example, where judicial review of different scope is arguable," 552 U.S. at 552, to conclude that *Hall Street* did not foreclose a more searching merits review of arbitral awards when done so under authority other than the FAA. See, *Cable Connection, Inc. v. DirecTV, Inc.*, 44 Cal. 4th 1334, 1354-1355 (2008). The California Supreme Court went on to hold that "the CAA established the statutory grounds for judicial review with the expectation that arbitration awards are ordinarily final and

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[15] See, e.g., *International Telepassport Corp. v. USFI, Inc.*, 89 F.3d 82 (2d Cir. 1996) (vacatur allowed for error of law which is obvious and capable of being instantly perceived by the average arbitrator); *Roadway Package System, Inc. v. Kayser*, 257 F.3d 287 (3d Cir. 2000), cert. denied, 534 U.S. 1020 (2001) (same); see also *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995); *Halligan v. Pipe Jaffray, Inc.*, 148 F.3d 197 (2d Cir. 1998); *Tanoma Mining Co. v. Local Union No. 1269*, 896 F.2d 745 (3d Cir. 1990); *Bowen v. Amoco Pipeline Co.*, 254 F.2d 925 (10th Cir. 2001).

[16] See, e.g., *Montes v. Shearson Lehman Bros., Inc.*, 128 F.3d 1456, 1458 (11th Cir. 1997). If no ground for the decision can be inferred from the facts, the award may be vacated as arbitrary and capricious. *Brown v. ITT Consumer Fin. Corp.*, 211 F.3d 1217, 1223 (11th Cir. 2000). Likewise, if an award is "so palpably faulty that no judge . . . could ever conceivably have made such a ruling," the award may be vacated as arbitrary and capricious. *Safeway Stores v. Am. Bakery & Confectionary Workers*, Local 111, 390 F.2d 79, 82 (5th Cir. 1968). The award may also be vacated if it is found to be "completely irrational." *French v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 784 F.2d 902, 906 (9th Cir. 1986); *G.C. & K.B. Investments, Inc. v. Wilson*, 326 F.3d 1096 (9th 2003) (same).

subject to a restricted scope of review, but that parties may . . . provid[e] for review of the merits in the arbitration agreement." 44 Cal. 4th at 1364.

In addition to judicial review at the trial court level through the petition to confirm or vacate process, any judgment entered on the award is appealable and is subject to the rules and procedures applicable generally to appeals of civil judgments. Cal. Civ. Proc. Code § 1294(d). Likewise, an order denying a petition to confirm the award is appealable. Cal. Civ. Proc. Code § 1294(c); *Ray Wilson Co. v. Anaheim Mem. Hosp. Ass'n*, 166 Cal. App. 3d 1081, 1085 n. 1 (1985). The scope of this appellate review is limited, however, to whether the trial court erred in granting or denying a petition to confirm or vacate the arbitration award. It does not extend to a review of the merits of the arbitration award or to de novo review of the arbitration proceedings. The appellate court must accept the trial court's findings of fact if substantial evidence supports them and must draw every reasonable inference to support the award. *Alexander v. Blue Cross of Calif.*, 88 Cal. App. 4th 1082, 1087 (2001); *Pierotti v. Torian*, 81 Cal. App. 4th 17, 24 (2000). On issues concerning whether the arbitrator exceeded his or her powers, the appellate court reviews the trial court's decision de novo, but must give substantial deference to the arbitrator's assessment of his or her contractual authority. *Alexander v. Blue Cross of Calif.*, supra, 88 Cal. App. 4th 1082; *California Faculty Assn. v. Superior Court*, 63 Cal. App. 4th 935, 944-945 (1998); *Advanced Micro Devices, Inc. v. Intel Corp.*, 9 Cal. 4th 362, 373, 376 fn. 9 (1994).

(2) <u>Cases</u>

(a) No Vacatur Even if the Arbitrator Applied the Wrong Legal Standard Because that Mistake was not Prejudicial to the Petitioning Party - Arbitrator's Award will Stand – *Richey v. AutoNation, Inc.*, 60 Cal. 4th 909 (Jan. 29, 2015)

This is an interesting case from both an arbitration and employment law perspective, and both need to be discussed in order to understand the Supreme Court's reasoning in rejecting the petitioning plaintiff's vacatur request.

Richey was an at-will employee of a Toyota dealership owned by AutoNation, a consortium of automobile dealerships. The dealership's stated policy said that outside work while an employee was on medical leave was prohibited. There was also a general understanding at the dealership that outside employment of any kind, including self-employment while on approved leave, was against company policy and that others had been fired for violating this rule.

Richey was employed by the dealership in 2004. In October 2007, Richey began work on plans to open a local seafood restaurant – i.e., to engaged in self-employment concurrent with his job at the dealership. He bought equipment and leased a site for the restaurant, which opened in February 2008. Richey was open and notorious about his side-business and marketed his restaurant while at work at the dealership. Richey's supervisors expressed concerns about the restaurant distracting him from his job responsibilities and met with him in February 2008 to discuss performance and attendance issues. In March 2008, Richey injured his back while moving furniture at home. He then presented the dealership with a doctor's note stating that Richey was medically unable to work. Richey then filed for medical leave under the CFRA and FMLA. That leave was granted and then extended on multiple occasions.

In April 2008, Richey's supervisor sent him a letter advising him that employees were not allowed to pursue outside employment while on leave. In response to information that Richey was working in his restaurant, the company dispatched an employee to observe the restaurant, where he saw Richey working the front counter and doing various types of physical labor. Armed with this information, the dealership terminated Richey on May 1, 2008 – 27 days before his approved medical leave was set to expire. In its termination letter, the dealership stated that Richey was being dismissed for engaging in outside employment while on a leave of absence, in violation of company policy.

Richey then sued the dealership for wrongful termination, racial discrimination, retaliation for taking approved medical leave and for failure to reinstate following CFRA leave. The dealership moved to compel arbitration based upon an agreement Richey signed at the time of his employment requiring that any employment disputes be settled by arbitration. That motion was granted and the matter then proceeded to arbitration before a retired judge who conducted an 11-day evidentiary hearing. The arbitrator ruled in favor of the dealership. With regard to Richey's claims under the CFRA and FMLA, the arbitrator framed the legal issue as "whether the law provides a protective shell over [plaintiff] that bars his termination until he is cleared to return to work … or does the law allow an employer to let an employee go, while on approved leave, for other non-discriminatory reasons." The arbitrator found that although the employee manual was "poorly written," there was a general understanding that outside employment was against company policy and that others had been terminated for violating this rule. The arbitrator concluded that "case law" allowed the dealership to terminate Richey if it had an "honest belief" that he was abusing his medical leave.

Richey sought to vacate the award on the ground that the arbitrator had exceeded his powers when he accepted defendant's "honest belief" defense. The trial court confirmed the award over Richey's objection, finding that the fact that the arbitrator may have applied the wrong legal standard did not constitute grounds to vacate the award. The court of appeal reversed the trial court's judgment, concluding that the arbitrator had violated plaintiff's right to reinstatement under the CFRA when he applied the "honest belief" defense to plaintiff's claim. Defendant's petition for review was granted and the California Supreme Court reversed the court of appeal, thus reinstating the trial court's judgment for defendant based upon the arbitrator's award.

Without deciding the issue, the Supreme Court noted that while the "honest belief" equitable defense may not have been available with respect to Richey's alleged right to reinstatement under the CFRA, the Court held that even if the arbitrator erred, and even if such an error would serve as a basis for vacating an arbitration award, Richey had not shown that the error was prejudicial. 60 Cal. 4th at 920. Moreover, the Court found it significant that the arbitrator's award had indicated that Richey "blatantly ignored his superiors' clear instructions not to work at the restaurant while in CFRA leave" and that to ignore this fact and to hold that the dealership could not have fired plaintiff under any circumstance for violating company policy while on leave "would ignore the rule that plaintiff had 'no greater right to reinstatement or to other benefits and conditions of employment than if [he] had been continuously employed' during the statutory leave period." The Court found that the arbitrator had found that Richey's firing was based on a clear violation of company policy and that was "a legally sound basis for upholding the arbitrator's award," and that the arbitrator would likely have made that finding regardless of the evidence or findings as to the "honest belief" defense. "Thus, even if the arbitrator was mistaken in relying on the honest belief defense, plaintiff was not prejudiced thereby and the arbitrator's award in defendants' favor will stand." Id. at 921.

(b) Appeal Not Available from Order Compelling Arbitration – *MediVas, LLC v. Marubeni Corp.*, 741 F.3d 4 (9th Cir., Jan. 27, 2014)

MediVas is a small biomedical company based in San Diego that specializes in developing new methods for pharmaceutical drug delivery. Marubeni is a Japanese multinational trading corporation. MediVas and Marubeni executed various contracts in connection with a $5 million loan from Marubeni to MediVas. One of these contracts required the parties to submit contractual disputes to international arbitration venued

in Tokyo, Japan, whereas another designated the courts of San Diego as the exclusive forum for such disputes.

After MediVas defaulted on the loan, Marubeni foreclosed on promissory notes held by MediVas and threatened to foreclose on additional MediVas assets. In response, MediVas and several individual plaintiffs filed suit against Marubeni in San Diego Superior Court raising numerous state law claims arising out of this series of transactions. Marubeni removed the action to federal court and then moved to compel arbitration. MediVas opposed arbitration, relying on the forum selection clause, and moved to remand the matter back to state court.

The district court ruled that many of MediVas' claims against Marubeni were subject to the arbitration clause and ordered arbitration of those claims. Because it concluded that federal jurisdiction rested solely on the New York Convention, the court remanded the remaining claims, including all claims brought by the individual plaintiffs, to state court. Neither order explicitly stayed or dismissed the arbitrable claims, and no judgment was entered in the action.

The arbitration panel ruled in favor of Marubeni on all claims save one, which the panel concluded fell outside its jurisdiction. Marubeni then filed a second action in federal district court to confirm the arbitration award. A few days later, MediVas filed a notice of appeal in the original action seeking review of the district court's earlier order granting Marubeni's motion to compel arbitration.

The Ninth Circuit dismissed the appeal finding that while the FAA permits immediate appeals of final decisions with respect to arbitration, an order compelling arbitration does not fall into this category where the underlying action is stayed (versus being dismissed with prejudice). The Court found that the district court's order showed that the arbitrated claims were implicitly stayed pending the conclusion of the arbitration. "[W]e adopt a rebuttable presumption that an order compelling arbitration but not explicitly dismissing the underlying claims stays the action as to those claims pending the completion of the arbitration." Accordingly, the Ninth Circuit found that because the district court's order was not a "'final decision' with respect to an arbitration," it was without jurisdiction to review it. 741 F.3d at 9-10.

(c) Ninth Circuit Affirms Trial Court's Denial of Vacatur and Restates the General Guidelines Under Section 10(a)(4) of the FAA, but Does so Without Much in the Way of Analysis or Factual Context – *Scripps Health v. Blue Cross and Blue Shield of Kansas, Inc.*, 577 Fed. Appx. 672 (9th Cir., May 30, 2014)

This case does not provide much in the way of analysis or factual context, but has been included in the materials because it contains a good summary recitation of the general guidelines and case precedent concerning vacatur under Section 10(a)(4) of the FAA.

This case arose out of a dispute over payment for hospital services provided to a Kansas Blue Cross member treated at a Scripps hospital in California. Scripps sued Blue Cross for breach of contract and other claims in district court. Blue Cross moved to dismiss both claims or, in the alternative, to compel arbitration. The motion to dismiss was denied. The motion to compel arbitration of the breach of contract claim and to stay the remaining claims was granted. After arbitration, the arbitrator's final award stated that Blue Cross had breached an express and implied contract between it and Scripps, that Blue Cross owed Scripps damages based on that breach, and that Blue Cross owed Scripps interest on those damages. Blue Cross then moved to vacate the award. The district court confirmed the award and denied vacatur. The Ninth Circuit affirmed. In so ruling, the Ninth Circuit held as follows:

- A district court's decision to vacate or confirm an arbitration award is subject to *de novo* review. *New Regency Prods., Inc. v. Nippon Herald Films, Inc.*, 501 F.3d 1101, 1105 (9th Cir. 2007)

- A party seeking relief under Section 10(a)(4) – arbitrator exceeded his/her power – bears a heavy burden. *Oxford Health Plans LLC v. Sutter*, ___ U.S. ___, 133 S.Ct. 2064, 2068 (2013).

- An arbitrator's interpretation of the scope of his/her powers is entitled to the same level of deference as his/her determination of the merits. *Schoenduve Corp. v. Lucent Techs., Inc.*, 442 F.3d 727, 733 (9th Cir. 2006)

- An arbitrator exceeds his/her powers not when he/she merely interprets or applies the governing law incorrectly, but when the award is completely irrational or exhibits a manifest disregard of the law. *Biller v. Toyota Motor Corp.*, 668 F.3d 655, 665 (9th Cir. 2012).

- To vacate an arbitration award based on manifest disregard of the law, it must be clear from the record that the arbitrator recognized the applicable law and then ignored it. Id. at 665. The arbitration must do more than simply interpret or apply the law incorrectly. Id.

(d) Arbitration Award of Dismissal Vacated Because the Court that Ordered the Matter to Arbitration Lacked Subject Matter Jurisdiction Over the Dispute – *Saffer v. JP Morgan Chase Bank*, 225 Cal. App. 4th 1239 (2d Dist., Apr. 29, 2014)

In this case, a relatively small dispute – a mole hill – grew into a mountain of litigation in both the state court and before the AAA only to end in dismissal five years later due to the of subject matter jurisdiction because the plaintiff failed at the outset to exhaust her administrative remedies.

Saffer began working for WaMu in 2007. In connection with her employment, Saffer signed a binding arbitration agreement covering "any and all lawsuits or other civil legal proceedings relating to [his] employment." In connection with the 2008 melt down of Wall Street, the Office of Thrift Supervision seized WaMu and appointed the FDIC as the bank's receiver. Soon thereafter, certain of WaMu's assets and liabilities were sold to JP Morgan. Saffer lost his job in the process and in 2009 filed suit against WaMu, "Chase Manhattan Bank" and former executives of WaMu. JP Morgan answered the complaint, identifying itself as "JP Morgan Chase Bank" and as the acquirer of certain assets and liabilities of WaMu. It then filed a petition to compel arbitration which was granted in 2010.

The parties proceeded to arbitration before the AAA. After spending more than two years in the arbitral process, JP Morgan moved to dismiss the action arguing that Saffer's failure to exhaust administrative remedies with the FDIC in accordance with FIRREA barred him from pursuing his claims in the arbitration or in any court. In November 2012, the arbitrator concluded that the court and the arbitrator lacked subject matter jurisdiction to hear Saffer's claims and dismissed the case. Saffer sought to vacate and JP Morgan sought to confirm the arbitrator's dismissal award. The trial court

confirmed the arbitrator's dismissal award and a judgment of dismissal was entered. Saffer appealed.

After a lengthy discussion about FIRREA, the Second District agreed that Saffer's failure to exhaust FIRREA administrative remedies before filing suit prevented the trial court from acquiring subject matter jurisdiction over his claims in the first place, and that in the absence of subject matter jurisdiction, the trial court had no power to hear or determine the case. The court acknowledged that "it would have been preferable" for JP Morgan to raise the subject matter jurisdiction issue "earlier in the process, rather than compelling the case to an unauthorized arbitration," but the fact remained that FIRREA imposes an absolute and unwaivable jurisdiction requirements that the court has no power to excuse. 225 Cal. App. 4th at 1262. It therefore vacated the judgment of dismissal that had been entered in favor of JP Morgan and remanded the matter to the trial court with directions to enter an order of dismissal for lack of subject matter jurisdiction.

(e) Trial Court's Order Vacating Arbitrator's "Clause Construction Award" was not Appealable Because it was not an "Award" Within the Meaning of CCP § 1283.4 – *Judge v. Nijjar Realty, Inc.*, 228 Cal. App. 4th 619 (2d Dist., Dec. 17, 2014)

This case is an example of the litigation over process which sometimes occurs when more than one dispute resolution process is in play.

Plaintiff worked for defendant for about six months as a property manager. After plaintiff was fired, she sued defendant for unpaid compensation, meal and rest period premiums, waiting time penalties and wrongful termination. Under PAGA, plaintiff alleged similar and related causes of action on behalf of herself and other aggrieved employees. In a separate action, plaintiff filed a class action alleging basically the same employment and Labor Code claims on behalf of herself and other class members. Defendant filed petitions in both actions seeking to compel arbitration of plaintiff's individual claims and to stay the PAGA and class actions pending completion of the arbitration. The trial court granted both requests and expressly ruled that arbitration could not be compelled on a class-wide basis.

For reasons that are not made clear in the statement of decision, when the arbitration was convened, the arbitrator appointed to hear the individual claims arbitration issued a "clause construction award" as part of her scheduling order. In that "award," the arbitrator concluded that the arbitration agreement permitted arbitration of class and representative claims. Defendants then petitioned the trial court to vacate the "clause construction award." The court granted that petition on the grounds that the arbitrator had exceeded her powers by deciding the issue of whether the parties agreed to arbitrate class or representative claims because the parties had submitted that issue to the court for determination and the court had already ruled on this issue. The court noted that defendants petitioned the court to compel arbitration of plaintiff's claims on an individual and not a class-wide basis pursuant to *Stolt-Nielsen*. In opposition to the petition, plaintiff argued that if the court ordered arbitration, it must order arbitration of all plaintiff's claims, including the PAGA and class claims. The court then ruled on the issue of class and representative arbitration by granting the petition to compel arbitration as to plaintiff's individual claims only. "The Court had the authority to address the issue because the parties expressly and specifically submitted the matter for determination *by the Court*…. Once the Court ruled on the issue of class and representative arbitration, the Arbitrator lost authority, even under the AAA rules, to decide the issue." 232 Cal. App. 4th at 628.

On appeal, the Second District ruled that the trial court's order vacating the arbitrator's "clause construction award" was not appealable because it was not an "award" within the meaning of Code of Civil Procedure section 1283.4, which provides that an arbitration award must "include a determination of all the questions submitted to the arbitrators the decision of which is necessary in order to determine the controversy." The court found that the "clause construction award" did not determine all of the questions necessary for the arbitrator to determine the controversy; that the award only resolved what the arbitrator herself described as a "threshold matter." Under Section 1283.4, "appealable arbitration orders require finality and that requirement is consistent with the language of Section 1294 and the general prohibition of appeals from interlocutory, nonfinal judgments." See *Otay River Constructors v. San Diego Expressway*, 158 Cal. App. 4th 796, 803 (2008), citing *Vivid Video, Inc. v. Playboy Entertainment Group, Inc.*, 147 Cal. App. 4th 434, 442 (2007); see also *Kurwa v. Kislinger*, 57 Cal. 4th 1097, 1100 (2013) ("a judgment that fails to dispose of all the causes of action pending between the parties is generally not appealable").

The appellate court explained that "[t]here are good reasons for applying a finality requirement to orders listed in section 1294," chief among them being that without such a requirement the efficient streamlined procedure that is arbitration's fundamental attribute would be disrupted. 232 Cal. App. 4th at 634. "Aggrieved parties

could appeal orders vacating interim arbitration awards resolving discovery disputes, sustaining or overruling demurrers, granting summary adjudication on certain claims, ruling on liability but not damages in a bifurcated proceeding, and denying motions for a new arbitration hearing. It would be anomalous to allow parties participating in an arbitration to appeal orders vacating interim arbitration awards when the underlying orders are not appealable in non-arbitration cases." Id. That being said, the court drew a distinction with respect to "partial final awards" sometimes issued in arbitration to resolve certain critical areas of a dispute, but reserving jurisdiction to later decide, by a final award, issues which arise as a result of the implementation of that remedy. See, e.g., *Hightower v. Superior Court*, 86 Cal. App. 4th 1415, 1419 (2001).

(f) Arbitrator's Denial of Claimant's Motion to Compel Additional Discovery Was Not Reviewable for Error and Was Not Grounds for Vacatur – *Cortina v. Wells Fargo Advisors, LLC*, 2014 WL 2854808 (4th Dist., Jun. 24, 2014) (Not Reported)

During his employment as a financial advisor with Wells Fargo, Cortina signed three promissory notes. Under the terms of the notes, Cortina agreed to pay any remaining balances due on the notes upon termination of his employment with Wells Fargo. Cortina resigned from his position with Wells Fargo in 2011, at which time the balances on the three notes totaled in excess of $1.4 million. Wells Fargo filed a demand for arbitration to enforce collection on the notes. As part of his defense, Cortina claimed that argued that he had attempted to restructure payment on the promissory notes before resigning, but the parties had reached an impasse. Cortina contended that there were emails that would corroborate his restructuring efforts and filed a motion to compel Wells Fargo to produce the email communications. The arbitrators denied the motion and, ultimately, Wells Fargo prevailed in the arbitration and was awarded $1.5 million (the sum due on the three promissory notes), plus attorneys fees of $15,000. Cortina moved to vacate the award on the grounds that in denying his motion to compel, the arbitration panel had effectively refused to hear material evidence. The trial court denied Cortina's motion to vacate and the Fourth District affirmed.

After discussing the basic "black letter" guidelines for vacatur as announced by the California Supreme Court in *Moncharsh v. Heily & Blasé*, 3 Cal. 4th 1 (1992), the court found that discovery in arbitration "is generally limited." *3, citing *Berglund v. Arthroscopic & Laser Surgery Center of San Diego, L.P.*, 44 Cal. 4th 528, 534 (2008). It further found that it is "[t]he arbitrator, and not the court, decides questions of procedure and discovery." Id., citing *Briggs v. Resolution Remedies*, 168 Cal. App. 4th 1395, 1400 (2008). In this regard, the court explained that arbitrators do not exceed their

powers by rendering an erroneous decision on a legal or factual matter so long as the issue was within the scope of the controversy submitted to them. In this case, the court held that Cortina was, in effect, asking the court to review the arbitration panel's ruling regarding his discovery motion by contending that the arbitration panel's decision prevented the panel from reviewing evidence material to the arbitration. The court concluded that "rulings regarding discovery and procedure are within the arbitration panel's authority, and we are without power to review those rulings, even if erroneous…. The arbitration panel did not refuse to 'hear material evidence' in denying Cortina's motion to compel…" *4.

(g) Arbitrator's Attorney Fee Award is Proper Even Though Arbitrator Applied "Prevailing Party" Definition Under Civil Code and not as Defined Under the Parties' Arbitration Agreement – *Safari Associates v. Superior Court,* 231 Cal. App. 4th 1400 (4th Dist., Dec. 2, 2014)

Alan Tarlov is the former managing partner of Safari Associates. The parties entered into a Release Agreement to resolve certain claims relating to Tarlov's management of Safari. The agreement specified that Safari's claims for reimbursement of monies it had paid for Tarlov's personal expenses were not subject to the release and that the dispute would be arbitrated if the parties were unable to resolve this matter amicably. The parties were unable to resolve all of their disputes concerning Safari's reimbursement claims and submitted those claims to arbitration. In its arbitration brief, Safari contended that Tarlov was required to pay, at a minimum, in excess of $750,000 as reimbursement for personal expenses that had been paid by Safari. After conducting an evidentiary hearing, the arbitrator issued an interim award determining that Tarlov owed Safari a little more than $150,000. Both Safari and Tarlov then filed motions for their attorney's fees, each arguing that it was the prevailing party. In its brief, Safari explained that Civil Code Section 1717(b)(1) provides that "the party prevailing on the contract shall be the party who recovered a great relief in the action on the contract." Tarlov argued the language of the Release Agreement, which provided that "'prevailing party' means the party, if any, that obtains substantially the relief sought in the arbitration." Tarlov contended that since Safari had recovered only a small amount on its alleged claim that he was the prevailing party and should be awarded his fees. The arbitrator ruled in favor of Safari and awarded it approximately $250,000 in attorney fees and costs," finding that Safari recovered a greater relief on the contract and was thus the prevailing party.

Tarlov petitioned the trial court to modify or correct the arbitration award with respect to the attorney fee and costs aspects on the ground that the arbitrator had exceeded his jurisdiction by applying and awarding fees and costs pursuant to the prevailing party definition contained in Civil Code Section 1717(b)(1) instead of utilizing the definition provided by the Release Agreement. The trial court agreed with Tarlov and ruled that the arbitrator had erred in finding that Section 1717 was applicable to the arbitration and remanded the matter back to the arbitrator to determine who the prevailing party was under the definition provided by the Release Agreement and to then determine the amount of attorney fees and costs to be award, if any. Safari petitioned the court of appeal for review, which was granted.

On review by the Fourth District, the court found that the trial court had erred in correcting the arbitrator's award of attorney fee and costs because it did not have the authority to review the award for error. The court found that the arbitration provision in this case expressly provided that the arbitrator was empowered to award attorney fees to the prevailing party. Further the record demonstrated that Safari and Tarlov had both extensively briefed and argued the issue, including that pertaining to which definition should be utilized. Having submitted the fees issue to arbitration, the court concluded that Tarlov could not maintain that the arbitrator had exceeded his powers within the meaning of Code of Civil Procedure Section 1286.6(b) by deciding that issue, even if the arbitrator had decided it incorrectly. 231 Cal. App. 4th at 1410-1411, citing, *Moore v. First Bank of San Luis Obispo*, 22 Cal. 4th 782, 787 (2000). "Contrary to Tarlov's contention … the definition of 'prevailing party' contained in the Agreement is not a 'contract[ual] limitation on arbitral powers' of any kind, …much less an 'explicit and unambiguous' limitation on the arbitrator's power to award attorney fees." Id.

(h) No Public Policy Violation Established by Defendant to Warrant Vacatur of $2.1 Million Attorney's Fees Award in Favor of Law Firm Against Former Client – *Quinn Emanuel Urquhart & Sullivan v. Kurtin*, 2014 WL 3707163 (2d Dist., Jul. 28, 2014) (Not Reported)

This case is a further chapter in the dispute between Todd Kurtin and Bruce Elieff who had been equal business partners in a real estate development business before disagreements between them led Kurtin to sue Elieff in 2003 to separate their intertwined business interests. That litigation led to a mediation, which in turn led to a settlement agreement signed in 2005. Kurtin had to sue Elieff a second time to enforce the mediated settlement and, in response, Elieff contended that the terms of the settlement were ambiguous and sought to introduce evidence of what was said during

the mediation to explain the ambiguities. Kurtin objected and asserted the "mediation privilege," which objection was sustained. On appeal, Elieff claimed that he had been deprived of a fair trial; that just as an attorney is allowed to use confidential information that is otherwise protected by the attorney-client privilege when sued by a former client, the mediation privilege must yield when there is an ambiguity in the mediated settlement agreement; that he should have been allowed to present evidence otherwise precluded by the mediation privilege to defend himself or Kurtin should have been required to drop his claims. At the 2014 Recent Developments Program, we reviewed the Fourth District's reported decision in *Kurtin v. Elieff*, 215 Cal. App. 4th 455 (2013), which affirmed the trial court and specifically held that Kurtin's invocation of the mediation privilege did not deny Elieff a fair trial.

Quinn Emanuel represented Kurtin in the first lawsuit against Elieff and was Kurtin's counsel at the 2005 mediation which led to the settlement that later became the subject of the second set of Kurtin-Elieff legal proceedings. Quinn Emanuel did not represent Kurtin in those proceedings. By that point in time, a dispute had arisen between Kurtin and Quinn Emanuel: namely, Kurtin sued Quinn Emanuel for legal malpractice and breach of contract (another "settle with your adversary / sue your lawyer" case).

At the start of Quinn Emanuel's representation of Kurtin, the parties executed a contingent fee agreement. That agreement included an arbitration clause covering "[a]ny dispute regarding or arising out of [the firm's] representation." Accordingly, Kurtin asserted his claims against Quinn Emanuel in an arbitration demand. Quinn Emanuel prevailed at the arbitration and requested that it be awarded over $2.1 million in attorney's fees for work performed by its employees in defending the arbitration. That request was granted based upon the very specific provision included in the arbitration clause that allowed Quinn Emanuel, if it was the prevailing party, to recover compensation for the work performed by its employees in defending or prosecuting any dispute in arbitration or litigation. The trial court confirmed the award and, in so doing, denied Kurtin's vacatur petition in which he argued that the attorney's fees award violated a fundamental public policy against pro se lawyers recovering their fees. Kurtin appealed.

On appeal, the Second District affirmed the trial court and rejected Kurtin's argument that attorney's fees should never be recoverable by attorneys representing themselves. Kurtin's argument relied on the California Supreme Court's holding in *Trope v. Katz*, 11 Cal. 4th 274 (1995), which involved a collection action between a law firm and its former client to recover fees. The narrow issue presented to the Court in that case was whether an attorney who chooses to represent himself/herself can recover

"reasonable attorney's fees" under Code of Civil Procedure Section 1717 "as compensation for the time and effort expended and the professional business opportunities lost as a result." While the Court answered that question in the negative, its holding was squarely limited to actions on contracts and attorney fee requests made under Section 1717. That was not the case or the issue presented in this case where Kurtin sued Quinn Emanuel for legal malpractice, which the Second District noted is not an action founded on a contract. *4, citing *Loube v. Loube*, 64 Cal. App. 4th 421, 430 (1998) ("[A]lthough the parties had a contractual relationship, and appellant's claim for legal negligence arose from the relationship between them, which relationship was founded on a contract, the cause of action sounded in tort and was no more 'on the contract' that a claim for breach of fiduciary duty or for fraud involving a contract.").

The Second District held that the attorney's fees clause in the parties' contingent fee agreement was subject to Code of Civil Procedure Section 1021 and that it was quite clear from the case law interpreting that code section "that parties may validly agree that the prevailing party will be awarded attorney fees incurred in any litigation between themselves, whether such litigation sounds in tort or contract." *5, citing *Xureb v. Marcus & Millichap, Inc.*, 3 Cal. App. 4th 1338, 1341 (1992); see also *Brown Bark III, L.P. v. Haver*, 219 Cal. App. 4th 809, 818 (2013); *Maynard v. BTI Group, Inc.*, 216 Cal. App. 4th 984, 989-990 (2013). Because the attorney's fees clause in the parties' contingent fee agreement "clearly encompassed recovery" of attorney's fees incurred in a tort action, the law allowed Quinn Emanuel to recover compensation for the work done by its attorneys and there was thus no public policy violation to be rectified. Id.

(i) Arbitration Award Vacated Because Arbitrators Were Too Impartial – *Americo Life, Inc. v. Myer*, 440 S.W.3d 18 (Tex., Jun. 20, 2014)

Although we usually expect arbitrators to be impartial, the Supreme Court of Texas vacated an arbitration award because the chosen arbitrators were too impartial.

The case stemmed from Myer's sale of a collection business to Americo Life in 1998. The arbitration agreement in the sale document stated that any disputes should be decided by a panel of three arbitrators, with each party appointing one arbitrator and those two selecting the third. The agreement provided that the arbitration would be governed by AAA's commercial rules. Critically, the arbitration agreement provided that "[e]ach arbitrator shall be a knowledgeable, independent business person or professional." A dispute about the meaning of that sentence caused the arbitration and its appeals to last nine years. So much for economy and efficiency by utilizing "ADR"!

In 2005, buyer demanded arbitration. At that time, the AAA rules explicitly required all arbitrators – even "party-selected" arbitrators - to be "impartial and independent." Therefore, when Americo (twice) chose an arbitrator that was partial towards it, the AAA disqualified those arbitrators. After a panel of three impartial arbitrators heard the evidence, they ruled in favor of Myer and awarded it over $26 million in damages.

Americo moved to vacate the award, arguing that the arbitrators were not selected in accordance with the parties' agreement. The trial court agreed and vacated the award. The court of appeals reversed the trial court and un-vacated the award. Then on appeal to the Texas Supreme Court, the court of appeal was reversed, meaning that the award was again ordered vacated. The high court's analysis emphasized the fact that "arbitrators must be selected pursuant to the method specified in the parties' agreement." Because the touchstone is the agreement, the court had to interpret whether the contractual requirement that the arbitrator be "independent" mean that he or she also had to be impartial. The court concluded that it did not, in part because the AAA rules in existence at the time the arbitration agreement was entered into allowed parties to appoint arbitrators who would serve as their advocates. Therefore, the court interpreted "independent" to mean only that the arbitrators would not actually be employed by a party or under its control. It also concluded that the modified AAA rules could not trump the terms in the agreement itself.

Once the court concluded that the parties' arbitration agreement allowed them to appoint biased arbitrators, but the AAA had disqualified those arbitrators for being biased, its decision to vacate became unavoidable. "[T]he arbitration panel was formed contrary to the express terms of the arbitration agreement. The panel therefore, exceeded its authority when it resolved the parties' dispute." Notably, four justices dissented from the opinion, arguing that the AAA rules in effect in 2005 demanded impartial arbitrators unless the parties specifically agreed otherwise and the language of the parties' agreement did not abrogate those rules or specifically allow non-neutral arbitrators.

This case shows why arbitration law is so hard for people to grasp. Essentially, this case says that an award reached by three impartial arbitrators has to be reversed because two of those arbitrators should have been biased. That's a head-scratcher, but then the court deciding this matter was not in California. Seriously, though, only when you appreciate that the FAA emphasizes

G. MISCELLANEOUS

(1) The Unsettled State of Confidentiality in Commercial Arbitration and a Quick Look at Two Different Views Coming Out of Texas and New York in 2014 – *Decapolis Group v. Mangesh Energy*, Case No. 3:13-cv-01547 (N.D.Tex. 2014) and *Veleron Holding v. Morgan Stanley*, 2014 WL 1569610 (S.D.N.Y. 2014).

One of the perceived virtues of ADR, in general, is that it offers disputants a place to resolve their disputes in private. Privacy has long been mistaken for a right of confidentiality. Confidentiality in mediation has been the subject of intense scrutiny, research and debate in recent years – as we have studies and discussed in our recent developments programs. Confidentiality in arbitration has not yet received similar scrutiny,[17] but its time may have come. Like mediation, arbitration is often promoted as a "private" or "confidential" process, raising the specter of some type of moral and perhaps ethical obligations on the part of the profession to be candid with consumers as to the meaning and limitations of arbitration confidentiality.

While commercial arbitration proceedings are private in terms of who may attend the hearing and there being no record of the proceedings available to the public, neither the Federal Arbitration Act nor the California Arbitration Act provide for arbitration confidentiality. About the closest the California Arbitration Act comes to addressing the subject is Code of Civil Procedure Section 1283.05, which gives arbitrators the authority to impose discovery terms and conditions, including protective orders.

The AAA does not have rule dealing with arbitration confidentiality, but Rule R-25 does impose upon the AAA and the arbitrator the responsibility for maintaining "the privacy of the hearings unless the law provides to the contrary. JAMS does have a specific rule on confidentiality – Rule 26 – but it does not do much more than the R-25. JAMS Rule 26 AAA requires that JAMS and the arbitrator "maintain the confidential nature of the Arbitration proceeding and the Award, including the Hearing, except as necessary in connection with a judicial challenge to or enforcement of an Award, or unless otherwise required by law or judicial decision." All provider rules contemplate

[17] Prior to a symposium held at the University of Kansas School of Law in 2006, there was not a single law review article dedicated to the discussion of arbitration confidentiality. See, Richard C. Reuben, *Confidentiality in Arbitration: Beyond the Myth*, 54 U. Kan L. Rev. 1255 (2006)

that parties being able to go to court to confirm the award, and no provider rules speak to any affirmative duty of confidentiality on the part of parties, counsel or witnesses.

Where we are seeing the issue arise concerning arbitration confidentiality is with regard to sealing the arbitration award that is the subject of court confirmation. Code of Civil Procedure Section 1285.4 requires that a petition to confirm an arbitration award "set forth or have attached a copy of the award and the written opinion of the arbitrator, if any." Similarly, under the FAA, a party seeking to confirm, modify or correct an arbitration award must file the award with the court. 1 U.S.C. § 13(b). There is no California case on this issue. However, in a number of other state and federal courts, parties seeking to enforce or vacate arbitration have moved to seal the awards with mixed results.[18] Two such cases decided in 2014 are discussed below.

Decapolis Group, LLC v. Mangesh Energy, Ltd., 2014 WL 702000 (N.D.Tex., Feb 24, 2014). Mangesh entered into a consulting contract with The Decapolis Group. The contract contained an arbitration provision that included the statement that the arbitrator's decision would be final and binding on the parties and that a judgment could be rendered upon the arbitration award in a court of law having jurisdiction thereof. The contract also contained a confidentiality provision in which the parties agreed that they would not disclose "confidential information," which was defined as "information … relating to the business, products, affairs and finances of a Party." A dispute arose regarding Decapolis's compensation under the contract and, in 2010, Decapolis requested arbitration through the International Chamber of Commerce Court of Arbitration. The arbitration took place in 2012 and the parties agreed that the

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[18] Decisions where courts have ordered arbitration awards sealed: *Century Indemnity Co. v. Certain Underwriters of Lloyd's*, 592 F.Supp. 2d 825 (E.D.Pa. 2009); *DiRussa v. Dean Witter Reynolds, Inc.*, 121 F.3d 818 (2d Cir. 1997). Decisions where courts have refused to seal arbitration awards: *American Central Eastern Texas Gas Co. v. Union Pacific Resources Group, Inc.*, 2000 WL 33176064 (E.D.Tex. 2000); *Global Reinsurance Cor.-U.S. Branch v. Argonaut Ins. Co.*, 2008 WL 1805459 (S.D.N.Y. 2008). Decisions where courts have issued protective orders covering arbitration documents, the award and/or testimony about the arbitration in a subsequent matter: *Fireman's Fund Ins. Co. v. Cunningham Lindsey Claims Management, Inc.*, 2005 WL 1522783 (E.D.N.Y. 2011); *ITT Educational Services, Inc. v. Arce*, 533 F.3d 342 (5th Cir. 2008); *Group Health Plan, Inc. v. BJC Health Systems, Inc.*, 30 S.W.3d 198 (Mo. Ct. App. E.D. 2000). Decisions where courts have declined to issue or recognize a protective order covering arbitration documents, the award and/or testimony from a prior arbitration matter: *Gotham Holdings, LP v. Health Grades, Inc.*, 580 F.3d 664 (7th Cir. 2009); *United States v. Panhandle Eastern Corp.*, 118 F.R.D. 346 (D.Del. 1988); *Contship Containerlines, Ltd. v. PPG Industries, Inc.*, 2003 WL 1948807 (S.D.N.Y. 2003); *A.T. v. State Farm Mut. Auto. Ins. Co.*, 989 P.2d 219 (Colo. Ct. App. 1999); *Baxter Int'l, Inc. v. Abbott Laboratories*, 297 F.3d 544 (7th Cir. 2002).

proceedings would be confidential. An arbitration award was issued in favor of Decapolis finding that the contract was valid and binding, awarding Decapolis its attorney's fees and expenses, and ruling that Decapolis was entitled to the compensation described in the contract, some of which had yet to be earned and involved future "milestone events."

Mangesh paid Decapolis on the award of attorney's fees and costs and also made the first payment called for under the contract with respect to a "milestone event." Nevertheless, Decapolis filed a motion seeking to confirm the award. Mangesh opposed that motion on the grounds that there was no case or controversy since it had performed per the award. Mangesh also moved to seal the award on the grounds that it contained extensive findings of fact that revealed sensitive information about its business strategies and the developmental progress of its oil and gas exploration. The court confirmed the award, finding that the parties' agreement provided for confirmation and the FAA mandates that courts confirm such awards except in limited circumstances. The court granted Mangesh's motion to seal. The court acknowledged that while there is a presumption of open access to court files, the public's interest in the award was "minimal" and was counter balanced by the parties' interest in confidentiality as expressed in their agreement.

Veleron Holding, B.V. v. Morgan Stanley, 2014 WL 1569610 (S.D.N.Y. 2014). This case involves a rather complicated set of background facts. The Reader's Digest version is this: Veleron sued Morgan Stanley and its related entities for securities fraud in violation of United States securities laws. The alleged violations related to the sale of certain stock in a margin call situation where the price of the subject stock plummeted in September 2008 (like the price of just about everything else as a result of the 2008 financial crisis) and resulted in a $92 million margin call and was not met. Before this litigation was filed, there was an arbitration in London under the rules of the London Court of International Arbitration (LCIA). The LCIA rules are all but guaranteed to cloak any proceeding conducted there in the utmost secrecy. As the district court noted, Article 30.1 of those rules states as follows:

> "Unless the parties expressly agree in writing to the contrary, the parties undertake as a general principle to keep confidential all awards in their arbitration, together with all materials in the proceedings created for the purpose of the arbitration and all other documents produced by another party in the proceeding not otherwise in the public domain – save and to the extent that disclosure may be required of a party by legal duty, to protect or pursue a legal right or to enforce or challenge an award in bona fide legal proceedings before a state court or other judicial authority."

Plaintiff's parent was a party to the London arbitration, but Veleron and the Morgan Stanley entities were not. Plaintiff's parent secretary released the entire arbitration file to Veleron, and that was the catalyst for the district court proceedings and for a motion Veleron filed early on in the case requesting a temporary order sealing the pleading file. That motion was granted. Morgan Stanley then subpoenaed from Bank Paribas, a party to the London arbitration, a copy of the arbitration award and moved for summary judgment on collateral estoppels grounds based on the earlier arbitration rulings. Veleron then moved to unseal the file.

Morgan Stanley's summary judgment motion was denied because the allegation of securities fraud in violation of U.S. law was not pleaded or resolved in the London arbitration, which the district court noted was a proceeding in which neither Veleron nor Morgan Stanley was a party.

The district court noted that in the action pending before it, Veleron had charged "a major American investment bank with insider trading and market manipulation in violation of United States law." The court went on to note that Morgan Stanley was not a party to any private arbitration agreement providing for these serious charges to be resolved in a private forum, and found that there was no principle of international comity requiring the court to conduct a proceeding to enforce the securities laws of the United States in secret simply because a related proceeding was cloaked in confidentiality.

> "Litigation in an American court is not governed by the principle that 'what happens in Vegas stays in Vegas' – or in this case, in London. Private agreements cannot be used to circumvent United States courts' policy in favor of open litigation, and private parties cannot unilaterally keep information that is relevant to a lawsuit properly before a United States court out of public view, even if that same information is materials to a private dispute resolution that is subject to confidentiality. Put otherwise, a private agreement to arbitrate a dispute does not cloak documents and other evidence relevant to that dispute with a 'shield of invisibility,' or immunize them either from public disclosure in connection with other, related proceedings or from publication in connection with those other proceedings."

*1. Veleron's motion to unseal was granted, with the court stating that Veleron's motion (which sought an order unsealing only certain documents) "does not go far enough;" that the entire file would be unsealed unless some party could

explain why a particular page or document in the record qualifies as something deserving of confidentiality protection from public view. In that regard, the district court concluded that it – not the LCIA – "will decide what stays secret and what is disclosed to the public in a securities fraud litigation in New York." *2.

(2) Arbitrator's Award and Findings were Entitled to Preclusive Effect in Establishing Indebtedness Eligible for Exception from Discharge under 11 U.S.C. § 523(a)(6) – *Coastal Industrial Partners, LLC v. Lawson*, 2014 WL 1017908 (Bnkr. C.D.Cal., Mar. 14, 2014) (Slip Copy)

In this case, plaintiff Coastal Industrial Partners sought to establish a nondischargeable debt pursuant to Section 523(a)(6) of the Bankruptcy Code due to willful and malicious pre-petition conduct of the Chapter 7 debtor John Lawson as found by an arbitrator in a pre-petition arbitration that was determined against Lawson and resulted in a judgment against him for $222,164. After examining the facts as set out in the arbitrator's decision, the Bankruptcy Court agreed in part with Coastal that the judgment was entitled to preclusive effect in establishing a nondischargeable debt against Lawson. The facts as found by the arbitrator were as follows:

This dispute arose from what started out as a fairly traditional, commercial relationship. Lawson sold bulk wine that he had custom bottled. Coastal Industrial placed orders to purchase such wine. Coastal made two purchases from Lawson without problem. Coastal placed a third order for merlot, for which it paid a deposit, and then negotiations with Lawson for an order of cabernet. During those negotiations, Lawson pressed aggressively for his terms and became ever more aggressive, strident and unreasonable in his tone. When Coastal failed to agree to Lawson's terms concerning the cabernet, Lawson told Coastal "You can pay the balance on your [merlot] order and pick up the wine when full payment is received. You will not be getting any cabernet or any more wine in the future from me." Coastal paid for the balance owed on the merlot order, but Lawson refused to release it, claiming that Coastal owed him $45,443 for "incurred expenses" relating to the cancelled cabernet order, plus $21,000 for "incorrect pricing" on past orders, plus another $10,150 for "excess expenses." The arbitrator found that these claims/assertions by Lawson were false and wrongful because it was established that Lawson had not paid the bottler for Coastal's third order of merlot even though Coastal had paid for that wine order in full.

After multiple unsuccessful demands by Coastal to Lawson for release of the merlot, Coastal was granted a writ of possession by the Napa County Superior Court and finally obtained the merlot. The arbitrator found that title to the merlot had passed to Coastal when it paid for it in full, that Lawson had converted the merlot by refusing to deliver it, and that the refusal was part of Lawson's "fraudulent scheme" to "extort" money from Coastal. The arbitrator found that Lawson deliberately withheld the merlot in order to give him leverage in his unjustified claims regarding the cabernet and that this conduct "constituted legal malice and oppression, justifying an award of punitive damages." The arbitrator awarded $26,799 to Coastal in legal fees and other expenses incurred in recovering the merlot, plus $25,000 in punitive damages.

Based upon the foregoing facts, the Bankruptcy Court agreed with Coastal that principles of issue preclusion (collateral estoppel) make the conversion damages nondischargeable. The court noted that not every conversion results in a nondischargeable debt. *2, citing *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 332 (1934). However, the arbitrator's findings of fraudulent conduct, malice and oppression were necessary to the award of punitive damages and thus justified a determination of nondischargeability, but only as to the damages awarded relating to the conversion ($26,799 in legal fees and expenses to recover the merlot and $25,000 in punitive damages). The court held that "nothing else in the arbitrator's decision justifies any further determination of nondischargeability." Id. There was no breakdown of what comprised the $222,164 judgment, but the assumption is that it was made up primarily of attorney's fees and costs incurred in the breach of contract arbitration (in addition to and separate from the writ of possession fees and costs).

(3) The Fact that an Insurer May Have a Right to Arbitrate a Coverage Claim with its Insured Does not Relieve the Insurer of its Statutory and Common Law Duties to Fairly Investigate, Evaluate and Process the Insured's Claim in the First Place – *Maslo v. Ameriprise Auto & Home Insurance*, 227 Cal. App. 4th 626 (2d Dist., Jul. 22, 2014)

Ted Maslo was the insured on an automobile insurance policy issued by Ameriprise Auto and Home Insurance. After sustaining bodily injuries as a result of an accident caused by an uninsured motorist, Maslo filed a claim seeking the $250,000 limit on the policy's uninsured motorist coverage. In response, Ameriprise demanded arbitration. Maslo prevailed at arbitration and was awarded $164,120. Maslo then filed a complaint against Ameriprise complaining of bad faith insurance practices because its insurer had forced him to arbitrate his claim under the policy without fairly

investigating, evaluating and attempting to resolve it. The trial court sustained the insurer's demurrer to Maslo's complaint and this appeal followed.

On appeal, the Second District reversed the trial court, finding that the complaint adequately stated a claim for bad faith when it alleged that the insurer, after being presented with evidence of a valid claim, failed to investigate or evaluate the claim, insisting instead that its insured proceed to arbitration. In so holding, the court rejected the insurer's argument that its right to resolve a disputed claim through arbitration relieved it of its statutory and common law duties to fairly investigate, evaluate and process the claim. It further rejected the suggestion that in the absence of a genuine dispute arising from an investigation and evaluation of the insured's claim, the insurer may escape liability for bad faith simply because the amount ultimately awarded in arbitration was less than the policy limits or the insured's initial demand.

(4) The Contagion Theory of Arbitration has no Basis in Law. Res Judicata does not Apply to an Arbitration Award that has not Been Confirmed as a Judgment by the Court – *W. J. O'Neil Company v. Shepley Bulfinch Richardson & Abbott, Inc.*, 765 F.3d 625 (6th Cir., Aug. 28, 2014)

After losing millions of dollars because of delays and coordination failures in building a hospital, W.J. O'Neil Company sued its construction manager. The two ended up in arbitration. The defendants in this case – Shepley Bulfinch Richardson & Abbott, Inc. and Smith Seekman Reid, Inc. – were added to the arbitration on indemnity claims. In the arbitration, O'Neil did not assert claims against Shepley and Smith, but its claims against the construction manager arose from said defendants' defective and inadequate design of the hospital that was the subject of the construction project. O'Neil won the arbitration against its construction manager, but the construction manager did not establish its indemnity claims against Shepley and Smith, so the defendants were not held liable. No party sought judicial confirmation or review of the arbitration award.

O'Neil then sued Shepley and Smith in federal district court. The district court dismissed the claims as barred by Michigan's doctrine of res judicata based upon the prior arbitration proceedings in which the construction manager had failed to establish its claims against defendants. On review, the Sixth Circuit found that the district court had erred and that the res judicata doctrine had not been invoked properly.

The Full Faith and Credit Act requires federal courts to give state court "judicial proceedings" the same preclusive effect those proceedings would receive in courts of the same state. 28 U.S.C. § 1738; *Kremer v. Chemical Construction Corp.*, 456 U.S. 461 (1982). Arbitration is not a "judicial proceeding" and therefore Section 1738 does not apply to arbitration awards that have not been reviewed and confirmed by a court. See *McDonald v. City of W. Branch, Michigan*, 466 U.S. 284, 288 (1984); *Cadeira v. County of Kauai*, 866 F.2d 1175, 1178 (9th Cir. 1989) (explaining that the Supreme Court "has consistently held that an *unreviewed* arbitration decision does not preclude a federal court action). Against this backdrop, the Sixth Circuit noted that it was aware of no case authority holding that an unreviewed arbitration award will bar the later litigation of a claim not subject to arbitration. 765 F.3d at 630, citing *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 222 (1985) ("[I]t is far from certain that arbitration proceedings will have any preclusive effect on the litigation of nonarbitrable federal claims.").

The Sixth Circuit found "good reason" for not according res judicata effect to an unappealed arbitration award in a case where the claims sought to be precluded were not subject to arbitration, noting that an arbitrator's authority derives solely from, and is limited by, the contract between the parties. 765 F.3d at 631, citing *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 682 (2010). The court found that ruling in favor of defendants on their motion to dismiss would effectively force O'Neil, through the doctrine of res judicata, to arbitrate a claim it had not agreed to arbitrate or give up that claim. 765 F.3d at 631. "We think it unwise to apply res judicata in a way that subverts basic contract principles." Id.

In this case, the court found that O'Neil's claims were for professional negligence, tortuous interference and innocent misrepresentation and that there was no evidence that O'Neil had agreed to arbitrate any of those claims against Shepley or Smith. In this regard, both defendants conceded that O'Neil did not contract with either of them and thus O'Neil did not have an explicit agreement with either to arbitrate any claims it might have against them. Defendants referred and relied on the arbitration agreement which existed between O'Neil and the construction manager (Barton Malow), which agreement included a provision whereby O'Neil agreed to consent to be joined in any arbitration that might occur between the project owner and any member of the construction team and to be bound by the "procedures, decisions and determinations" resulting from such arbitration. The Sixth Circuit construed this provision as requiring O'Neil to participate in an arbitration involving the construction manager and project owner and any member of the construction team, but not requiring it to raise and arbitrate (or forever lose) its own claims that it might have against other construction team members such as defendants. On this point, the court noted that one of the defendants had conceded that it would not be forced to arbitrate

O'Neil's claims. Ultimately, the court concluded that "It is not the case that O'Neil must arbitrate its claims against the defendants simply because O'Neil had an arbitration agreement with one company, that company had arbitration agreements with the defendants, and the disputes among the parties arose from the same circumstances…. This contagion theory of arbitration has no basis in law or the relevant contracts." 765 F.3d at 633.

(5) Denial of Stay Pending Arbitration Because Defendant Never Moved to Compel Arbitration – *Wells Fargo Bank, N.A. v. The Best Service Co.*, 232 Cal. App. 4th 650 (2d Dist., Dec. 17, 2014)

In this case, the court of appeal held that the trial court's order denying a motion for stay of litigation pending arbitration was not directly appealable because the stay motion was not accompanied by a motion to compel arbitration. When plaintiff resisted defendant's demand for arbitration, the defendant moved to stay plaintiff's lawsuit pending arbitration. The trial court denied the motion, and defendant appealed, arguing that the court's order was the equivalent of an order refusing to compel arbitration which is directly appealable under CCP § 1294(a). The court of appeal disagreed and dismissed the appeal, noting that the defendant never moved to compel arbitration and, as such, the trial court never ruled that plaintiff's claims were not subject to arbitration.

(6) CCP § 1281.2 Does not Include a Formal Demand Requirement Before Seeking to Compel Arbitration – *Hyundai AMCO America, Inc. v. S3H, Inc.*, 232 Cal. App. 4th 5720 (4th Dist., Dec. 17, 2014)

In this case, Hyundai sued S3H after first writing to S3H notifying it of its alleged breach of their agreement and demanding a cure. S3H responded by petitioning to compel arbitration. In response to Hyundai's lawsuit, S3H petitioned to compel arbitration. The trial court denied the petition, holding that S3H was first required to demand arbitration, relying on a 2010 decision by the Third District Court of Appeal in *Mansouri v. Superior Court*, 181 Cal. App. 4th 633 (2010) in which the court held that a party seeking to compel arbitration must first make a formal demand for same. The Fourth District Court of Appeal reversed in this case, noting that CCP §1281.2 does not include any formal demand requirement and that Hyundai's filing of a lawsuit showed that it refused to arbitrate. The appellate court distinguished the *Mansouri* case because there the party seeking to compel arbitration had made that petition on different terms than the agreement provided and even on different terms than the party's own demand. In this case, the appellate court reasoned, S3H merely sought to compel arbitration per the agreement's terms.

(7) Motion to Compel Arbitration of Dispute Between Trust Beneficiary and Trustee-Beneficiary Denied Because There was no Evidence that the Beneficiaries of the Trust Gave Either Their Consent to or Consideration for the Arbitration Provision – *McArthur v. McArthur*, 224 Cal. App. 4th 651 (1st Dist., Mar. 11, 2014)

In *Diaz v. Bukey*, 195 Cal. App. 4th 315 (2011), the Court of Appeal for the Second District held that the trust beneficiary was not required to submit disputes with the trustee concerning administration of the trust to arbitration because, while the trust instrument contained an arbitration provision, the trustee did not establish the existence of a contract binding the beneficiary to participate in arbitration. On August 10, 2011, the California Supreme Court granted review (Case No. S194150), but then deferred action in the matter "pending consideration and disposition of a related issue in *Pinnacle Museum Tower Ass'n v. Pinnacle Market Development* (then pending before the Court as Case No. S186149). On August 16, 2012, the Supreme Court issued its decision in the *Pinnacle* case, in which it enforced an arbitration provision contained in CC&R's against non-signatory members of a condominium association. 55 Cal. 4th 223 (2012). Thereafter, in the *Diaz* case, the Supreme Court transferred the cause back to the Court of Appeal with directions to vacate its decision and to reconsider the cause in light of the *Pinnacle* decision. The parties in the *Diaz* case then stipulated and requested dismissal of the appeal, which was granted on December 5, 2012. This set of circumstances caused one commentator to remark that on the issue of whether trust beneficiaries can be required to arbitrate based on the inclusion of an arbitration provision in the trust instrument (to which they are not signatories): "We will now never know what the Court of Appeal would have done, but its original decision is no longer good law." Richard J. Collier, *"So – Can Trust Beneficiaries be Required to Arbitrate?"* Cooper Alerts (Dec. 13, 2012), www.cwlaw.com/publications/alertDetail.aspx?id=679.

In *McArthur v. McArthur*, decided by the Court of Appeal for the First Circuit on March 11, 2014, we now have a post-*Pinnacle* decision on the enforceability of arbitration provisions contained in trust instruments to which the beneficiaries are not signatories, and that decision agrees with the analysis offered by Richard J. Collier in December 2012 as to why the *Pinnacle* holding should not apply to the enforcement of arbitration provisions against non-signatories in the context of wills and trusts disputes. The following is a discussion of the *McArthur* case and holding.

In 2001, Frances McArthur created an inter vivos trust naming her three daughters – Deborah, Kristi and Pamela – as coequal beneficiaries. In 2011, Frances amended the trust instrument to allocate a greater portion of the trust property to Kristi and add a provision requiring arbitration of disputes. After Frances's death, Pamela sued Kristi, alleging financial elder abuse and claiming that the 2011 amendment was invalid due to Kristi's undue influence and Frances's lack of testamentary capacity. Kristi moved to compel arbitration of Pamela's claims under the terms of the 2011 trust amendment. The trial court denied the motion because Pamela was not a signatory to the arbitration agreement. Kristi appealed and the Court of Appeal affirmed.

The Court of Appeal viewed its job in deciding the issues raised on appeal as that of completing "the assignment originally given by the Supreme Court to our colleagues in *Diaz v. Bukey*" to consider the enforceability of an arbitration clause included in a trust instrument against non-signatory beneficiaries. *5. The Court of Appeal agreed with the trial court that *Pinnacle* "is materially distinguishable." Id. In so ruling, the court noted that the agreement in *Pinnacle* was a recorded declaration establishing a common interest development and governing its operation subject to an extensive statutory scheme which, among other things, establishes that the terms of the recorded CC&R's are "enforceable equitable servitudes, unless unreasonable, and shall inure to the benefit of and bind all owners of the separate interests in the development." 55 Cal. 4th at 238-239, citing Cal. Civ. Code [former] § 1354(a). That same statutory scheme provides "various protections to help ensure that condominium purchasers know what they are buying into." Id. Critically, in the *Pinnacle* decision, the Supreme Court stated: "In light of the foregoing, it is no surprise that courts have described recorded declarations as contracts," Id. at 240, thus conforming to California Arbitration Act's treatment of arbitration as a creature of contract. See, Cal. Code Civ. Proc. § 1281. In the *McArthur* case, the Court of Appeal found that "there is no similar statutory scheme that would require that a trust beneficiary be bound by an arbitration clause in a trust instrument," specifically noting that unlike probate statutes in other states, "our Probate Code contains no specific legislative authorization for predispute trust arbitration provisions, despite otherwise establishing specific remedies and procedures for trust beneficiaries." *6. The court thus concluded that the doctrine of delegated authority to consent articulated in *Pinnacle* was inapplicable in the context of a trust. Id.

On appeal, Kristi also argued that California courts have characterized trusts as contracts between settlers and trustees, and contends that because the trusts are formed for the benefit of the trust beneficiaries they should be enforceable against non-signatory beneficiaries as with other third-party beneficiary contracts. The Court of Appeal rejected this argument because "the case law in fact requires that the third party *claim* benefits or rights under the contract before he or she will be bound to arbitrate."

*6. In this case, Pamela had not accepted benefits under the 2011 trust and had not attempted to enforce rights under the amended trust instrument. Instead, Pamela claimed that the 2011 trust was invalid and was seeking to have it set aside.

H. STATUTES AND RULES

(1) Amendments to Ethics Standards for Neutral Arbitrators in Contractual Arbitration Became Effective July 1, 2014

Effective July 1, 2014, several of the Ethics Standards for Neutral Arbitrators in Contractual Arbitration were amended. Among the amendments were the following:

- Standard 3(b)(2)(I) was added to codify the holdings in numerous court decisions on the inapplicability of the standards to arbitrators servicing in securities arbitrations.

- Standard 7(e)(1) was added to require disclosure about any disciplinary action taken against an arbitrator by a professional or occupational licensing agency or board, whether in California or elsewhere.

- Standard 12(b) was amended and 12(d) was added to require arbitrators in consumer arbitrations to inform the parties in a pending arbitration of any offer of employment or new professional relationship from a party or attorney for a party in that arbitration.

- Standard 16(b) was amended to require a specific disclosure regarding the arbitrator's requirements regarding the advance deposit of fees and his/her practice concerning situations where a party fails to timely pay the arbitrator's fees or requested advance deposits, including whether the arbitrator will or may suspend the arbitration proceedings.

- Standard 17(c) was added to expressly prohibit arbitrators from soliciting appointment soliciting appointment as an arbitrator in a specific case or specific cases.

(2) California Enacts New Laws Attacking Arbitration and Arbitration Agreements – AB 2617 (Amending Civil Code §§ 51.7 and 52.1) and AB 802 (Amending Code of Civil Procedure § 1281.96)

On the last day to sign or veto bills during the 2014 legislative session, the Governor signed into law two bills clearly aimed at attacking and limiting arbitration and arbitration agreements in California. The first, AB 2617 prohibits mandatory, pre-dispute arbitration agreements in contracts for the provision of goods or services, to the extent an individual is required to waive the right to bring a civil action for violation of civil rights relating to hate crimes or political activity. The statute does not expressly state that it applies to employment arbitration agreements and is instead specifically tied to the Ralph Civil Rights Act (Civil Code section 51.7), which prohibits violence or threat of violence against a person because of a person's protected characteristics (e.g. political affiliation, sex, race, color, religion, marital status, etc.), and the Bane Civil Rights Act (Civil Code section 52.1), which prohibits interference by intimidation or coercion with a person's constitutional or statutory rights.

AB 2617 was inspired by the case of *D.C. v. Harvard-Westlake School*, 176 Cal. App. 4th 836 (2009). In that case, the plaintiff minor was attending the exclusive Los Angeles private school when he received online death threats with anti-homosexual slurs from fellow students who believed the plaintiff was gay. The student and his parents sued the school for various causes of action, including hate crime claims. The court action was stayed pending arbitration, which the judge ruled was required by the Enrollment Agreement signed by the minor's father. The arbitrator subsequently found in favor of the school and ordered the students parents to pay more than $521,000 in arbitration fees, attorney fees and costs, which award was confirmed by the state court. The court of appeal vacated the award because, citing to *Armendarizi*, "the parents could not be required to pay any type of arbitral expense that would not be imposed were the dispute adjudicated in court." Significantly (and probably prompting the legislation, at least in part), the court of appeal declined to find that mandatory arbitration of hate crime claims was "unconscionable."

AB 2617 prohibits a person or business entity from requiring an individual to waive the rights provided by these statutes, including the right to pursue a civil action for a violation of these statutes. The new law applies to contracts entered into, modified, renewed or extended on or after January 1, 2015. Any person seeking to enforce an arbitration provision waiving the right to bring a civil action under these statutes will bear the burden of proving that the waiver was entered into knowingly and voluntarily and not as a condition of the contract or of providing or receiving the goods or services.

Although AB 2617 is tied specifically to hate crime statutes, there is some potential for the law to impact arbitration agreements in the employment arena. In some instances, courts have held that certain types of employment discrimination and harassment claims may also constitute hate crimes within the meaning of Civil Code sections 51.7 and 52.1. These statutes are very broadly and poorly worded, leaving some room for differing interpretations by courts. The new law may also be held to apply to arbitration provisions in independent contractor agreements. While the scope of the new law and its impact is far from clear, it does seem clear that the new law is contrary to the Federal Arbitration Act and would be deemed preempted as to agreements governed by the FAA. There almost certainly will be many legal challenges to the legality of this new law.

Also in an effort to decrease the attractiveness of arbitration as a forum for dispute resolution, Governor Brown signed into law AB 802, which requires major arbitration providers such as JAMS and AAA to publish at least quarterly on their websites (beginning in January 2015) detailed information concerning arbitrations they have handled, including (1) the name of any non-consumer party involved in the arbitration (i.e. the name of the employer), (2) the nature of the dispute (e.g. employment), (3) where the non-consumer party is an employer, whether the employer was the initiating or responding party, (4) the annual wage (in a range) earned by the involved employee, (5) the amount of the claim, which party prevailed, and the amount of any award, including attorneys' fees, (6) whether the employee was represented by an attorney and, if so, the name of the attorney and the law firm, (7) the name of the arbitrator and the amount of the arbitrator's fees, and (8) the total number of times the employer previously has been a party in arbitration or mediation before the dispute resolution provider. This new law has the obvious (and likely intended) effect of destroying the usual benefit of privacy that arbitration and mediation provide.

(3) The International Centre for Dispute Resolution ("ICDR") Revises its Rules Effective June 1, 2014 to Increase Efficiency and Reduce Costs

ICDR is the international arm of the American Arbitration Association. In response to growing complaints that international arbitration has come to resemble litigation in U.S. courts, particularly with respect to costs and delays associated with discovery, the ICDR revised its rules effective June 1, 2014. Some of the noteworthy changes include:

- The ability to consolidate arbitration proceedings
- Procedures to encourage mediation
- Designation of the ICDR list method as the default method of appointment of arbitrators when the parties do not agree on another method of appointment
- Adoption of the international approach to discovery where discovery is essentially limited to an exchange of documents and depositions, interrogatories and requests for admissions are declared inappropriate
- Adoption of expedited procedures which automatically apply to any case where no claim or counterclaim exceeds $250,000 (unless the parties agree otherwise) and are available in all other cases upon agreement of the parties.

II.
MEDIATION – SIGNIFICANT CASES

A. MEDIATION CONFIDENTIALITY & MEDIATION PRIVILEGE

(1) Background Statement

In opening a mediation session, it is fairly routine for the mediator to promise comprehensive confidentiality to the participants. While there are a number of statutes, rules, and cases that support confidentiality in mediation, a certain amount of skepticism and concern exists regarding the scope of protection that actually exists. The uncertainty about the nature and extent of what confidentiality protections exist for things said in mediation is especially apparent in federal court litigation disputes. See DWIGHT GOLANN, MEDIATING LEGAL DISPUTES 218-220 (2009); Dennis Sharp, *The Many Faces of Mediation Confidentiality*, *in* HANDBOOK ON MEDIATION 223-236 (2d ed. 2010). Both state and federal courts recognize that a theoretical component of mediation is confidentiality, but while California has express statutory provisions that provide for confidentiality protections, and numerous California Supreme Court decisions endorsing those protections, no similar protections are available under federal law. The scope of protection available under federal law is unclear and minimal at best. A detailed discussion of the statutory and case law governing mediation confidentiality protection under California law as compared to federal law can be found in Rebecca Callahan's recent article, *Mediation Confidentiality: For California Litigants, Why Should Mediation Confidentiality be a Function of the Court in Which the Litigation is Pending?* 12 Pepp. Disp. Resol. L.J. 63 (2012).

(2) Federal Perspective – Ninth Circuit

(a) Background Statement

As a matter of federal common law, the Supreme Court has emphasized that testimonial privileges are not favored.

> "The common-law principles underlying the recognition of testimonial privileges can be stated simply. 'For more than three centuries it has now been recognized as a fundamental maxim that the public . . . has a right to every man's evidence. When we come to examine the various claims of exemption, we start with the primary assumption that there is a general duty to give what testimony one is capable of giving,

and that any exemptions which may exist are distinctly exceptional, being so many derogations from a positive general rule.'"

Jaffee v. Redmond, 518 U.S. 1, 9 (1923), citing *United States v. Bryan*, 339 U.S. 323, 331 (1950). So, the starting place for understanding the federal perspective on mediation confidentiality is the common law rule that (a) the public is entitled to every person's evidence, and (b) testimonial privileges are disfavored. Fed. R. Evid. 408(b)(1)-(2).

There is no federal statute, rule of procedure, or rule of evidence that expressly recognizes or provides confidentiality protection for communications during or in connection with a mediation. The only express protection for settlement discussions is provided by Rule 408 of the Federal Rules of Evidence, which makes "conduct or statements made in compromise negotiations regarding the claim" inadmissible to prove liability. Thus, Rule 408 provides an admission standard for proof offered at trial to prove liability or invalidity of a claim and speaks in terms of *relevancy*. Its purpose is "to encourage the compromise and settlement of existing disputes," *Josephs v. Pac. Bell*, 443 F.3d 1050, 1064 (9th Cir. 2006), so as to avoid "the chilling effect" that potential disclosure might have on a party's willingness to make a compromise offer for fear of jeopardizing its case or defense if the matter is not settled. *Molina v. Lexmark Int'l, Inc.*, No. CV 08-04796 MMM (FMx), 2008 WL 4447678, at *11-12 (C.D. Cal. Sept. 30, 2008).

It is important to note that, by its terms, Rule 408(a) applies only to the *admissibility* of evidence at trial and does *not* apply to *discovery* of settlement negotiations or settlement terms. On this issue, the courts are split as to whether Rule 408 precludes discovery.[19] Moreover, Rule 408(b) expressly provides that exclusion is not required if the "offer and compromise" evidence is offered for a purpose that is not expressly prohibited by Rule 408(a). Fed. R. Evid. 408(b). Among the "permitted uses" delineated in Rule 408(b) are evidence of settlement and compromise negotiations offered (1) to prove bias or prejudice on the part of a witness; (2) to prove that an alleged wrong was committed during the negotiations (e.g., libel, assault, unfair labor practice, etc.); (3) to negate a claim of undue delay; or (4) to prove obstruction of a criminal investigation or prosecution. Additionally, a number of courts, including the Ninth Circuit, have concluded that Rule 408 does not make settlement offers inadmissible in the removal context where such offers represent evidence of the amount

[19] Compare *Bottaro v. Hatton Assocs.*, 96 F.R.D. 158, 160 (E.D.N.Y. 1982) (barring discovery of settlement terms), with *Bennett v. La Pere*, 112 F.R.D. 136, 139-40 (D.R.I. 1986) (allowing discovery of settlement discussions), and *NAACP Legal Def. & Educ. Fund, Inc. v. U.S. Dep't of Justice*, 612 F. Supp. 1143, 1146 (D.D.C. 1985) (allowing discovery if information is relevant to other issues in the pending action).

in controversy for the purpose of establishing the date on which such information was first made available to the defendant and thus started the thirty-day time period for removing a state court action to federal court. See, *Babasa v. LensCrafters, Inc.*, 498 F.3d 972 (9th Cir. 2007) (holding that a letter sent by plaintiffs estimating the amount alleged put defendant on notice of the amount in controversy); *Cohn v. Petsmart, Inc.*, 281 F.3d 837 (9th Cir. 2002) ("A settlement letter is relevant evidence of the amount in controversy if it appears to reflect a reasonable estimate of the plaintiff's claim."). Numerous district court decisions have used the settlement letter to establish the amount in controversy.[20]

In sum, Rule 408 is keenly focused on offers of compromise and negotiations involved in making, accepting, or rejecting such offers. As such, Rule 408 appears *not* to provide protection of any sort for prenegotiation communications or exchanges of information that parties might have with or through a mediator, even though the goal of those discussions is to open settlement dialogue.

The only other source of confidentiality protection in federal cases is Rule 501 of the Federal Rules of Evidence. Rule 501 empowers the holder of a recognized privilege to use the legal process to prevent others from disclosing protected communications. It also vests the holder with the right to refuse to produce otherwise relevant evidence. What qualifies as a "recognized privilege" is *not* detailed in Rule 501. In federal question cases under 28 U.S.C. § 1331, the extent to which a privilege exists is governed by federal common law[21] and may not be augmented by local court rules.[22] In diversity

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[20] See *Munoz v. J.C. Penny Corp.*, No. CV09-0833 ODW (JTLx), 2009 WL 975846 (C.D. Cal. Apr. 9, 2009) (settlement proposal letter was admissible to establish that the jurisdictional amount in controversy had been met for purposes of removing the case to federal court); see also *Ray v. Am. Airlines, Inc.*, No. 08-5025, 2008 WL 3992644, *4 (W.D. Ark. Aug. 22, 2008) (settlement letter used to establish the amount in controversy); *Haydel v. State Farm Mut. Auto. Ins. Co.*, No. CIVA 07-939-C, 2008 WL 2781472, *8, n.8 (M.D. La. July 10, 2008); *Finnegan v. Wendy's Int'l, Inc.*, No. 2:08-cv-185, 2008 WL 2078068, *3 (S.D. Ohio May 13, 2008); *Sulit v. Slep-Tone Entm't*, No. C06-00045 MJJ, 2007 WL 4169762, *3, n.1 (N.D. Cal. Nov. 20, 2007); Turner v. Baker, No. 05-3298-CV-S-SWH, 2005 WL 3132325, *3 (W.D. Mo. Nov. 22, 2005); *LaPree v. Prudential Fin.*, 385 F. Supp. 2d 839, 849, n.9 (S.D. Iowa Aug. 17, 2005).

[21] Id. See also *Religious Tech. Ctr. v. Wollersheim*, 971 F.2d 364, 367, n.10 (9th Cir. 1992).

[22] See *Facebook, Inc. v. Pac. Nw. Software, Inc.*, 640 F.3d 1034, 1040-41 (9th Cir. 2011) ("A local rule, like any court order, can impose a duty of confidentiality as to any aspect of litigation, including mediation. . . . But privileges are created by federal common law.") In *Facebook*, the Winklevosses sought to avoid enforcement of the settlement agreement between ConnectU and Facebook which was negotiated and entered into during a private mediation. Id. at 1040. The Winklevosses proffered evidence of what was and was not said during the mediation. Id. The District Court for the Northern District of California excluded this evidence under its local rule

cases under 28 U.S.C. § 1332, where state law provides the rule of decision, the existence of a privilege is a matter of applicable state law. FED. R. EVID. 501. See also *Olam v. Cong. Mortg. Co.*, 68 F. Supp. 2d 1110, 1124-25 (N.D. Cal. 1999). That being said, federal law governs whether a case exceeds the amount in controversy requirement. See *Molina v. Lexmark Int'l, Inc.*, No. CV 08-04796 MMM (FMx), 2008 WL 4447678, at *6 (C.D. Cal. Sept. 30, 2008) (citing *Horton v. Liberty Mut. Ins. Co.*, 367 U.S. 348, 352 (1961)).

Rule 501 raises a difficult question regarding which law shall apply in federal question cases with pendent state law claims. In the Ninth Circuit, that question has been resolved so that the law of privilege is governed by federal common law.[23] That being said, the Ninth Circuit has also held that "[i]n determining the federal law of privilege in a federal question case, absent a controlling statute, a federal court may consider state privilege law." See, *Lewis v. United States*, 517 F.2d 236, 237 (9th Cir. 1975) (citations omitted).

The federal cases discussed in this section of the materials are a continuation of the dialogue being had in the federal courts in an effort to understand mediation as a dispute resolution process distinguishable from a settlement negotiation between the parties and a settlement conference presided over by the court. What we see is a growing appreciation of mediation, but resistance to the notion of blanket privilege or any type of "protection" that would operate to bar material evidence from being offered and heard by the decider of fact at trial. A case in point is *Milhouse v. Travelers Commercial Ins. Co.*, 982 F.Supp. 2d 1088 (C.D.Cal. 2013), where the trial court allowed

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that protected such communications as "confidential information," which the court read as creating a "privilege" for "evidence regarding the details of the parties' negotiations in their mediation." Id. at 1040. While the Ninth Circuit found that the district court's reason for excluding the evidence was wrong, it concluded that the court was nevertheless correct in excluding the proffered evidence because the parties had engaged with a private mediator and had signed an express written confidentiality agreement before the mediation commenced. Id. at 1041. Accordingly, the Ninth Circuit held that the confidentiality agreement signed by the Winklevosses precluded them from introducing "any evidence of what Facebook said, or did not say, during the mediation." Id.

[23] Id. at n.10 (court refused to apply California litigation privilege in copyright action with pendent state law claims); *Folb v. Motion Picture Indus. Pension & Health Plans*, 16 F. Supp. 2d 1164, 1169-70 (C.D. Cal. 1998) (stating that the federal common law of privileges governs both federal and pendent state law claims in federal question cases); see also *Hancock v. Hobbs*, 967 F.2d 462, 467 (11th Cir. 1992) (per curiam) (the federal law of privilege is paramount in federal question cases even if the witness testimony is relevant to a pendent state law count which may be controlled by a contrary state law privilege); *Hancock v. Dodson*, 958 F.2d 1367, 1373 (6th Cir. 1992) (holding that the federal law of privilege is paramount to federal question cases).

testimony of what the plaintiffs' settlement demands were at mediation because to deem such evidence inadmissible at trial would violate the due process rights of defendant to provide a defense to its alleged liability for bad faith and punitive damages. "To exclude this crucial evidence would have been to deny Travelers of its due process right to present a defense." Id. at 1108.[24]

(b) Cases

(i) Federal Privilege Law Governs Admissibility of Documents and Testimony Regarding Enforceability of Alleged Settlement Where Both Federal and State Law Claims are Involved – *Wilcox v. Arpaio*, 753 F.3d 872 (9th Cir., Jun. 2, 2014)

In consolidated cases, members of the county board of supervisors, county staff and judges of the county's courts brought suit against certain present and former members of the county's sheriff's office and attorney's office, alleging that officials had wrongfully investigated, prosecuted and harassed plaintiffs in retaliation for plaintiffs' opposition to defendants' actions.[25] Concerned about the propriety, cost and pace of the

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[24] The *Milhouse* case is on appeal to the Ninth Circuit (Case No. 13-57029), involving both an appeal and cross-appeal and an amicus appearance by the Southern California Mediation Association. It is anticipated that the issues raised will invite the Ninth Circuit to construe Evidence Code § 1119 as providing something less than blanket confidentiality protection based upon the California Supreme Court's statement in *Cassel v. Superior Court*, 51 Cal. 4th 113, 119 (2011) that the plain terms of the mediation confidentiality statutes must be applied "*unless* such a result would violate due process, or would lead to absurd results that clearly undermine the statutory purpose." Based upon this quoted language in Judge Carney's published decision, there does appear to be a basis for the courts to recognize exceptions to mediation confidentiality where the facts of the case so require in order to afford due process in the courts or avoid harsh results at odds with the statutory purpose of providing mediation confidentiality protections in the first place."

[25] In 2013, our program materials included discussion about *Donahoe v. Arpaio*, 872 F.Supp. 2d 900 (D.Az. 2012), in which the district court ruled that post-mediation offers carried between the parties by a mediator were not protected under Arizona's mediation confidentiality statute. In this earlier case, the district court rejected the argument that the offers were inadmissible under the state's mediation confidentiality statute because the matters testified to were not communications had *during* a mediation. Because the mediation had been concluded, the district court reasoned that when the mediator stepped back in to carry the settlement offer exchanges, "the parties had passed into conscious and formal contract formation." Id. at 911. "'Written offers and acceptances of settlement, on their face expressing intent to be bound, fall outside the mediation privilege, even if the person who was the mediator is a witness to or conduit for them…. A mediator cannot by his presence purvey immunity from contract law when the prelude of negotiation has passed and the deal is made." Id., citing *Folb v. Motion Picture Indus.*

litigation, the County adopted a resolution directing the County Manager to establish a dispute resolution program to resolve these claims and giving him the authority to enter into "binding arbitration/mediation agreements with claimants." The County Manager appointed a retired judge to help resolve the claims. Multiple claims were settled through this program. Plaintiffs in this action asserted that their claims were among those that were settled and alleged that the County agreed to pay them $975,000 in settlement. Plaintiffs filed a motion to enforce the alleged settlement and in support of that motion submitted an email from the mediator who wrote to them confirming the settlement. The district court then conducted an evidentiary hearing and accepted the emails plaintiffs offered as evidence, as well as the testimony of the County Manager and other evidence pro and con. At the end of the hearing process, the district court granted plaintiffs' motion to enforce the settlement.

The County appealed and argued that the mediator's emails and the County Manager's testimony were privileged under Arizona's mediation privilege statute and thus inadmissible as evidence. Plaintiffs responded that federal privilege law governs because any settlement agreement concerned both plaintiffs' federal and state law claims. The Ninth Circuit agreed with plaintiffs and concluded that where the same evidence relates to both federal and state law claims, the federal court is not bound by state privilege law. 753 F.3d at 876, citing *Agster v. Maricopa County*, 422 F.3d 836, 839 (9th Cir. 2005). Rather, federal privilege law governs. Id., citing *Religious Tech Ctr. v. Wollersheim*, 971 F. 2d 364, 367 n. 10 (9th Cir. 1992) (per curiam); *Facebook, Inc. v. Pac. Nw. Software, Inc.*, 640 F.3d 1034, 1041 (9th Cir. 2011). Having determined that federal privilege law applied to the issue of admissibility regarding the mediation communications at issue, the Ninth Circuit then dodged the issue of whether a mediation privilege is recognized under Federal Rule of Evidence 501 by concluding that the County had waived an argument that the contested evidence should be privileged under federal law. Id. at 877, citing *Babasa v. LensCrafters, Inc.*, 498 F.3d 972, 975 n.1 (9th Cir. 2007).

Pension & Health Plans, 16 F.Supp. 2d 1164 (C.D. Cal. 1998). See also *United States Fid. & Guar. Co. v. Dick Corp./Barton Malow, et al.*, 215 F.R.D. 503 (W.D.Pa. 2003) ("The mere fact that discussions subsequent to a mediation relate to the same subject as the mediation does not mean that all documents and communications related to that subject are 'to further the mediation process' or prepared for the purpose of, in the course of, or pursuant to a mediation.").

(ii) District Court Holds that the Circumstances Concerning the Mediation Are Privileged, but the Facts Concerning When the Mediation Ended and What the Settlement Terms Were Are Not - *State Nat'l Ins. Co. v. Khatri*, 2014 WL 1877618 (N.D.Cal., May 9, 2014) (Not Reported)

During the mediation in the underlying state court action, the mediator made a Mediator's Proposal, which required the parties to (1) agree to a full and final settlement of the action for $125,000, and (2) agree to a mutual release of all claims. State National and the defendant insureds agreed that the Mediator's Proposal was a reasonable sum to pay to settle the state court action, but they could not agree on how payment of the settlement should be apportioned between them for the covered and uncovered claims being settled. After the Mediator's Proposal was accepted, the attorneys representing the state court plaintiffs and the defendant insureds mutually drafted a written settlement agreement, but only the plaintiffs signed it. Even though the defendant insureds did not sign the settlement agreement, they demanded that State National pay the entire settlement amount to the plaintiffs and also caused a notice of settlement to be filed in the state court action. A month later, the state court plaintiffs complained that they had not received defendants' signatures on the written settlement agreement and would void the settlement if those signatures were not received by December 4, 2012. Defendants refused and a negotiation then ensued between State National and the plaintiffs, which resulted in State National paying an additional $12,500 to resolve the signature issue with the plaintiffs so as to keep the settlement in place.

State National then filed suit against its insureds (VNS Hotels and Pradeep Khatri) seeking reimbursement of the amounts it paid to defend the defendants in a state court action under a reservation of rights (approximately $67,000) and to fund defendants' settlement with the state court plaintiffs ($137,500). In connection with motions attacking the sufficiency of State National's pleading, one argument the defendant insureds made was that State National had not sufficiently alleged the existence of a binding settlement agreement between the plaintiffs and the defendant insureds; that the Mediator's Proposal was merely an agreement regarding the fairness of an amount to pay to settle the case and that the terms of the settlement needed to be incorporated into a later written agreement and signed by all parties at some future date and time. To the extent that the court was inclined to allow State National's complaint to stand, the defendant insureds asked for an order allowing them to depose the attorneys who represented the state court plaintiffs (Paul Scheele) and State

National (Lane Orloff) in the underlying action, arguing that they needed that discovery to learn the facts, circumstances and terms of the alleged settlement agreement which served as the basis for State National's indemnification claim in this matter. The district court granted defendants' motion, finding that no other means existed to obtain the information about the settlement, the information was necessary to the preparation of the case, and the information sought was relevant and nonprivileged. On the latter item, the district court ruled that California's mediation confidentiality statutes applied because this was a diversity jurisdiction case. It also ruled that while the facts and circumstances concerning the mediation were privileged, the facts concerning when the mediation ended, how the underlying lawsuit was settled, what the terms were, who agreed to such terms, how the agreement was made, the amount of the settlement, to whom payments were made were relevant and thus the depositions would be allowed. Anticipating that there might be further privilege issues, the court encouraged the parties to try to resolve them between themselves, but left the door open for them to file letter briefs and obtain the court's assistance about the application of the mediation privilege to specific information sought by the defendant insureds.

(3) <u>California Perspective</u>

(a) <u>Background Statement</u>

California has long favored private negotiation and settlement of civil disputes. The state legislature has expressly stated that "[t]he peaceful resolution of disputes in a fair, timely, appropriate, and cost-effective manner is an essential function of the judicial branch of state government." Cal. C. Civ. Proc. § 1775(a). To effectuate this policy, the state legislature has expressly validated mediation as a process that "provides parties with a simplified and economical procedure for obtaining prompt and equitable resolution of their disputes and a great opportunity to participate directly in resolving those disputes." Cal. C. Civ. Proc. § 1775(c). Because mediation provides a simple, quick, and economical means of resolving disputes, and because it may also help reduce the court system's backlog of cases, California has recognized that the public has an interest in protecting not only the mediation participants, but the mediation process itself. *Rojas v. Superior Court*, 33 Cal. 4th 407, 415 (2004).

The starting point for California's mediation confidentiality scheme is Evidence Code Section 1115 which defines the processes that qualify for confidentiality protection. That protection extends to "mediations" and "mediation consultations." A "mediation consultation" is defined a "a communication between a person and a mediator for the purpose of initiating, considering, or reconvening a mediation or retaining the mediator." Cal. Evid. C. § 1115(c). A "mediation" is defined as a process in

which "a neutral person or persons facilitate communication between the disputants to assist them in reaching a mutually acceptable agreement." Cal. Evid. C. § 1115(a). The comments to Section 1115 make it clear that what qualifies as a mediation is to be determined by "the nature of a proceeding, not its label," and that a proceeding might qualify as a mediation for purposes of the confidentiality protections "even though it is denominated differently." The fact that a court may use the terms "mediation" and "settlement" interchangeably when referring to the process taking place or that a judicial officer might be assigned to preside over the talks will not transform the proceeding into a mandatory settlement conference without a clear record that such a conference was ordered. *Doe I v. Superior Court*, 132 Cal. App. 4th 1160, 1166-1167 (2005) (the "*Archdiocese Case*") ("Except where the parties have expressly agreed otherwise, appellate courts should not seize on an occasional reference to 'settlement' as a means to frustrate the mediation confidentiality statutes." This is an important distinction because Evidence Code Section 1117(b)(2) provides that the confidentiality protections afforded communications in mediation do not apply to communications had during a mandatory settlement conference convened pursuant to Rule 3.1380 of the California Rules of Court.

Under California law, confidentiality protection is provided in the form of an evidence exclusion provision. It does not provide for an evidentiary privilege. Evidence Code Section 1119 bars – as evidence in a court or other adjudicatory proceeding – disclosures of (a) anything said or any admission made for the purpose of, in the course of, or pursuant to, a mediation or mediation consultation (Cal. Evid. C. § 1119(a)); (b) any writing prepared for the purpose of, in the course of, or pursuant to, a mediation or mediation consultation (Cal. Evid. C. § 1119(b)); and (c) all "communications, negotiations, or settlement discussions" by and between participants in the course of a mediation or mediation consultation (Cal. Evid. C. § 1119(c)). The California Supreme Court has confirmed on several occasions that the "any" and "all" provisions of Section 1119 are to be interpreted quite literally and made it clear that the scope of protection intended by the statute is unqualified, clear and absolute, and is not subject to judicially crafted exceptions or limitations. See, *Foxgate Homeowners Ass'n v. Bramalea Calif., Inc.*, 26 Cal. 4th 1, 14 (2001); *Rojas*, supra, 33 Cal. 4th at 424; *Fair v. Bakhtiari*, 40 Cal. 4th 189, 197 (2006); *Simmons v. Ghaderi*, 44 Cal. 4th 570, 588 (2008); *Cassel v. Superior Court*, 51 Cal. 4th 113, 124 (2011). The facts of the cases in which the California Supreme Court has been called upon to rule about the scope of protection afforded by Section 1119 have been somewhat extreme and serve to illustrate the breadth of what will be held as confidential if the communications (and sometimes conduct) occurred during a mediation.

Absent an agreement to the contrary, a mediation does not end until and unless "[f]or 10 calendar days, there is no communication between the mediator and any parties to the mediation relating to the dispute." Cal. Evid. Code § 1125(a)(5). Where the parties convene a mediation and commence settlement negotiations in that environment, their post-mediation negotiations will be protected for the ten-day period following the mediation. See, *Rodriquez v. United Nat'l Ins. Co.*, 2012 WL 541512 (2012) (when a mediation ends is defined by statute and does not occur when one party walks out of the mediation).

(b) Cases

(i) By Agreement of the Parties a Mediation Confidentiality Agreement may be Disclosed and Parties may Waive the Automatic Mediation Termination Provisions of Evidence Code § 1125(a)(5) - *Wyner v. Porter*, 2014 WL 6667745 (2d Dist., Jan. 14, 2014) (Not Reported)

This very convoluted case arose out of a dispute between clients ("Porters") and their lawyer ("Wyner"). The underlying case involved a lawsuit to obtain special education services for the Porters' minor child. After a mediation conference, the underlying case settled on favorable terms to the Porters and their son. Then the Porters sued Wyner on various claims, and Wyner countersued the Porters. At trial, Wyner conceded that certain evidence that might be covered by the mediation privilege could be admitted. The jury rendered verdicts in favor of the Porters.[26] One month later, the California Supreme Court issued its opinion in *Simmons v. Ghaderi* (2008) 44 Cal.4th 570, which held that waivers of mediation confidentiality by either implication or estoppel were not permitted. Based on *Simmons,* Wyner moved for a new trial which was granted. The trial court held that Wyner's oral waiver of confidentiality at trial was ineffective, meaning that the jury should never have heard the mediation related evidence. The Porters appealed and that led to the Court of Appeal's first decision in this matter: *Porter v. Wyner*, 183 Cal. App. 4th 989 (2010) ("*Porter I*").

[26] Given the number of times this case has been on appeal, it is perhaps of interest to note the amount of the verdict in favor of the Porters that was the subject of "*Porter I*." The jury found that Wyner owed the Porters $51,000 for breach of the fee agreement and owed Deborah Porter $211,000 for paralegal services she had rendered in connection with the case Wyner had handled on her behalf.

In *Porter I*, the Court of Appeal ruled that the *Simmons* rule regarding no implied waivers of mediation confidentiality did not apply because the mediation confidentiality rules did not apply to communications between a party and his/her own lawyer. The Supreme Court granted review of *Porter I* and referred the case back to the Court of Appeal to reconsider in light of its 2011 decision in *Cassel v. Superior Court*, 51 Cal. 4th 113 (2011), which held that the mediation confidentiality protections were to be broadly construed to apply to all communications occurring during or pursuant to a mediation, even those between a disputant and his/her own lawyer. 51 Cal. 4th at 128. On remand from the Supreme Court, the Court of Appeal affirmed the trial court's order granting Wyner's motion for a new trial and remanded the matter with directions that the trial court rule on Wyner's motion for judgment notwithstanding the verdict. Court of Appeal Case No. B211398 ("*Porter II*"). In so doing, the court of Appeal noted that "evidence potentially subject to mediation confidentiality is so interwoven with otherwise admissible evidence as to require the particularized determination of admissibility that the trial courts, rather than a reviewing court, are more suited to address."

The trial court did just that. For the most part, the trial court decided that the evidence raised in support of the motion for JNOV was inadmissible, even though that very same evidence had been used to support the original jury verdict. The appellate court, in this its third opinion in the same case, affirmed. Step by step, it reviewed several questions regarding mediation confidentiality. For example, Wyner contended that mediation confidentiality ended for all communications that took place more than 10 days after the last communication with the mediator pursuant to Evidence Code Section 1125(a)(5). The Porters contended that mediation confidentiality did not conclude until a settlement was reached pursuant to Section 1125(a)(1) because, in advance of the mediation, the parties had signed a confidentiality agreement which expressly waived Section 1125(a)(5). Wyner contended that the mediation confidentiality agreement itself was inadmissible as it was not signed by the mediator or one of the other parties. The Court of Appeal concluded that it would be absurd to exclude an agreement that was signed by all of the parties presently before it, because that agreement provided the only evidence available on which to test the Porters' contention about waiver.

The appellate decision provides analysis of several other mediation confidentiality and JNOV issues. It also notes that although the Supreme Court decision in *Cassel* holds that the mediation privilege extends to communications between a client and lawyer, it did not reach the question of whether any particular communication between client and lawyer might be subject to the privilege.

(ii) Evidence of Negotiations at Mediation Excluded as Privileged - *Kim v. Lim Ruger & Kim*, 2014 WL 470422 (2d Dist., Feb. 6, 2014) (Not Reported)

This is a spectacularly cautionary tale about making sure you carefully craft release provisions in settlement agreements. However, it says very little regarding confidential mediation discussions, other than to uphold the trial court's exclusion of such evidence.

Plaintiff Kim hired the law firm of Lim, Ruger & Kim ("LRK") to prepare an estate plan. The lawyers who worked on that plan left the firm after completing that work. Subsequently, Kim was sued by a bank for breach of various loan guarantees for defaulted loans $12 million. The bank was represented by LRK, who was of several law firm's on the bank's "approved counsel" list and who had represented the bank in other matters. Kim moved to disqualify LRK. Kim lost the motion at the trial level, but prevailed on an extraordinary writ. Eventually, Kim and the bank (now with new counsel) participated in a mediation conference that yielded a settlement agreement. The settlement agreement included a broad general release provision that contained what some might view as "standard" language which provided for a release by Kim of the bank and "*each of its* agents, employees, *attorneys*, officers, directors …from any and all claims, actions, causes of action, demands, … *liabilities* whatsoever (contingent, accrued, matured, direct, derivative, personal, individual, collective, assigned, *discovered, undiscovered, known, unknown, inchoate or otherwise)*.

After the settlement of the guaranty action, Kim sued LRK for damages alleging various theories of liability for recovery of the attorney's fees incurred related to the disqualification motion. LRK defended on the basis that Kim's settlement agreement with the bank provided for a complete release of LRK because the release included the banks attorneys of which LRK was one of many and thus provided a release by Kim of any claims it had against LRK. The trial court agreed with LRK and found that the release in the settlement agreement unambiguously applied to LRK. In so ruling, it declined to allow Kim to introduce evidence of the negotiations with the bank or what the parties contemplated/discussed with respect to the release provision because those negotiations were excluded by virtue of the mediation confidentiality provisions in the Evidence Code. The appellate court affirmed. The appellate decision includes a brief section affirming the trial court's decision to exclude certain evidence of the negotiations that took place during the mediation. The irony is that had the negotiations between Kim and the bank occurred privately (i.e., without facilitation through mediation), the parties negotiations would have been fair game as evidence.

Unfortunately for Kim, not only was he found to have released LRK in the settlement agreement between him and the bank, LRK also received an award of attorneys' fees of more than $230,000.00 as prevailing party pursuant to Civil Code Section 1717. Ouch!

(iii) Trial Court Upheld in its Exclusion of Evidence Based on a Finding that There was a Presumption of Confidentiality with Respect to Documents and Communications Created During the Time Period When Mediation and Settlement Negotiations were Held Such that the Burden was on Plaintiff to Show that Particular Documents were not Subject to Mediation Confidentiality or were Erroneously Excluded – *Syers Properties III, Inc. v. Rankin*, 2014 WL 1761923 (1st Dist., May 5, 2014) (Not Reported)

The defendants in this case are attorneys who represented the plaintiff in a construction defects case concerning a new shopping center that had been purchased by plaintiff. The shopping center was developed by Regency in the early 2000's, who engaged general contractors to build various sections of the center. The two anchor tenants each retained their own general contractors to build their stores. Syers purchased the shipping center in December 2002. Two months later, during the first rainy season for the newly constructed center, Syres was advised of significant water intrusion, leaks and cracks. Syres then hired Ann Rankin and Terry Wilkens to represent it in prosecuting a construction defect action.

The construction defect action was filed in April 2004. Litigation spanned several years and, for case management purposes, was divided into three parts: the Shops, the Ralphs building and the Longs building. After multiple mediations and settlement conferences, staggered settlements were achieved with respect to the Shops, the Ralph's building and the Longs building between late 2008 and October 2009. The settlements totaled $2,635,000. Syres paid approximately $1.8 million in attorney fees and costs, leaving a net recovery of only $829,000 to cover repairs that would cost about $3.2 million (of which Syres had already paid out about $1.2 million). Needless to say, Syres was not very happy with the outcome and, in June 2010, filed a malpractice action against Rankin and Wilkens.

The malpractice action proceeded to trial in October 2011, at the start of which defendants made several motions to exclude evidence. Among the motions was a motion in limine seeking an order excluding expert witness depositions and reports created during the construction defect litigation on the grounds that such evidence was inadmissible under the mediation confidentiality statutes. The trial court granted the motion, finding that the case management orders issued by the court in the construction defects action from December 2005 through October 2009 provided the framework under which the court was required to consider which communications and documents were covered by the mediation confidentiality statutes. In particular, the trial court noted that the December 2005 case management order provided that Evidence Code Sections 1119, et seq. and 1152 "apply to all mediation sessions, settlement conferences, and formal or informal expert meetings." Based upon that order, the trial court excluded 46 specific documents, including the deposition transcript of an expert witness and that expert's cost of repair estimate which was marked "FOR MEDIATION PURPOSES ONLY."

Subject to the prescribed limitations of the various motion in limine orders, plaintiff gave its opening statement in the malpractice action on June 5, 2012, at the conclusion of which defendants moved for nonsuit on the ground that the statement did not mention or even allude to any recoverable damages. That motion was granted, but on the grounds that the court had previously determined that during the time defendants had represented plaintiff, plaintiff never had a claim against Ralphs or Longs under the lease agreements. This conclusion by the trial court made it unnecessary to decide plaintiff's claim that the trial court erred in granting the motion in limine excluding documents on the ground that they were protected by the mediation confidentiality statutes, but the court of appeal nevertheless addressed the issue anyway.

On appeal, plaintiff took issue with the trial court's handling of the motion in limine. Rather than reviewing each document individually, the trial court had found that the December 2005 case management order (discussed above) created a presumption that documents and communications created during the time period during which mediation and settlement negotiations were held were covered by mediation confidentiality, and invited plaintiff to show that the presumption was incorrect or that particular documents did not fall within it. Plaintiff's counsel was unable to do so and conceded that the entire case was part of the mediation and that the mediations involved the exchange of information and communications about damages. The court of appeal did not weigh in on whether the presumption applied by the trial court was in error or not. Rather, it held that even assuming that the trial court had

erred in applying the presumption, plaintiff had failed to demonstrate that it had been prejudiced by the exclusion of any evidence.

(iv) Something Less Than a "B-E-E-F" Provision in a Mediated Settlement Agreement Will Qualify as "Words to that Effect" for Purposes of Being Admissible in Later Court Proceedings – *Marriage of Daly and Oyster*, 228 Cal. App. 4th 505 (2d Dist., Jul. 29, 2014)

The scope of mediation confidentiality is so broad in California that even a term sheet or memorandum of understanding setting forth the terms of an agreement reached during the mediation is protected and thus inadmissible. Evidence Code Section 1123 provides a statutory exception to confidentiality for written settlement agreements prepared in the course of, or pursuant to, a mediation if any one of four stated conditions is satisfied. Those enumerated conditions include when the agreement in question expressly states that it is that parties' intent that the writing be enforceable or binding or "words to that effect."

In *Fair v. Bakhtiari*, 40 Cal. 4th 189 (2006), the California Supreme Court had occasion to construe Evidence Code Section 1123 and interpreted it quite strictly and literally. In *Fair*, the parties to a civil dispute mediated their disputes over the course of a two-day period. At the end of the second day, the parties signed a handwritten memorandum which set forth the settlement terms the parties had agreed to. Those terms included a provision requiring the parties to arbitrate any future disputes arising from or related to the settlement. Post-mediation, the parties exchanged formal settlement agreements, but were ultimately unable to reach agreement on the terms for a formal, written settlement agreement, and a dispute arose as to whether there was indeed a settlement. Plaintiff filed a motion seeking to compel arbitration pursuant to the term sheet memorandum. Defendant opposed the motion, arguing that there was no binding agreement to arbitrate, and objected to the admission of the term sheet memorandum on the grounds that it was inadmissible under Evidence Code Section 1119(b) because it represented a writing prepared in the course of a mediation. The trial court sustained defendant's objection and denied plaintiff's motion to compel arbitration of the dispute. The court of appeal reversed, holding that the inclusion of the provision providing for any and all disputes to be submitted to arbitration could only mean that the parties intended the term sheet to be enforceable and binding. On further appeal to the California Supreme Court, the Supreme Court reversed and held that the court of appeal had erred by concluding that the inclusion of an arbitration clause satisfied the requirements of Evidence Code Section 1123(b). The Court noted that

although the Legislature had not provided the courts with a "bright line" concerning what words will qualify as "words to that effect," a narrow interpretation of this clause was required. 40 Cal. 4th at 197. The Supreme Court concluded that in order to fit within the exception to confidentiality provided by Evidence Code Section 1123(b), a settlement agreement must include an affirmative statement using words that connote the intention for it to be "enforceable" or "binding." Id. at 199. This decision gave rise to the ADR slogan "Don't forget the BEEF in your mediated settlement agreement," encouraging disputants to include the words "binding, enforceable, effective and final" in any settlement agreements / term sheets prepared at mediation if the parties want such writings to be admissible in any later proceedings for purposes of enforcement.

Interesting facts make for interesting outcomes and, against the backdrop of the *Fair* case, the *Daly and Oyster* case is no exception. In this case, Joanne Daly and David Oyster separated in 2004 after a 23-year marriage. In 2005, Daly filed a petition for dissolution of marriage in superior court. The petition was never served on Oyster and no other documents were ever filed by either party in the court proceedings. In 2006, the parties attended a mediation and at the conclusion of the mediation, they signed a "proposed stipulated judgment" that resolved all issues regarding child custody and support, spousal support and division of the community property. The terms of the stipulated judgment provided, in part, that it constituted a "marital settlement agreement which will be conformed as a Stipulated Judgment of the court." Another provision stated that it "shall be the operable court judgment with relation to the Stipulated Judgment." It also stated that the court would "reserve jurisdiction to supervise the payment of any obligation ordered paid or allocated in this Stipulated Judgment; supervise the execution of any documents required or reasonably necessary to carry out the terms of this Judgment; and supervise the overall enforcement of this Judgment."

The stipulated judgment was never filed in the dissolution action and in 2011 the superior court dismissed Daly's divorce petition for lack of prosecution. Two weeks later, Daly filed a second petition for dissolution and moved to have the stipulated judgment entered as a judgment, nunc pro tunc, in the dismissed proceedings, and also incorporated into a judgment in the 2011 dissolution action. Oyster opposed Daly's motions and argued that the 2006 stipulated judgment was not a final agreement, but merely the first round of negotiations. The trial court denied Daly's motions without prejudice and set the matter for trial on the enforceability of the stipulated judgment. At trial, Oyster objected to the admission of the stipulated judgment on the grounds that it was protected by Evidence Code Section 1119. The trial court overruled Oyster's objections and found that the stipulated judgment was an enforceable contract and that

judgment would be entered based on the judgment and the provision reserving jurisdiction to the court to so act. Oyster appealed.

On appeal, Oyster again argued that the stipulated judgment was inadmissible under Evidence Code Section 1119. The court of appeal disagreed and affirmed the trial court's decision, finding that the judgment provided "words to that effect" for purposes of satisfying the requirements of Evidence Code Section 1123(c) because (1) the parties agreed that the stipulated judgment would be the "operable" judgment, and (2) the court would "reserve jurisdiction to supervise," among other specific provision of the judgment, the overall enforcement of the judgment. "Use of such language clearly reflected the parties' agreement that the stipulated judgment be subject to disclosure and be enforceable. The parties agreed the court would enforce the document, which it could not do unless the document was disclosed to it. It was therefore admissible…" 228 Cal. App. 4th at 511. While the court of appeal quoted extensively from the *Fair* decision, it did not explain why it felt that the provision reserving jurisdiction to the courts for enforcement satisfied the strict wording requirements of *Fair* when, in that case, the reservation of jurisdiction to an arbitral forum for enforcement was deemed to not be a sufficiently clear statement of the parties' intent to be bound.

One "take away" from *Daly and Oyster* decision with respect to drafting mediated settlement agreements or term sheets is that it is a good idea to include a provision regarding how the agreement may be enforced, but a "BEEF" statement is still advisable, especially if the fact circumstances are less compelling than those the court encountered in *Daly and Oyster*.

(v) Financial Disclosures that Spouses are Required to Exchange During Divorce Proceedings are not Subject to Mediation Confidentiality Just Because those Disclosures were First Made at Mediation – *Lappe v. Superior Court*, 232 Cal. App. 4th 774 (2d Dist., Dec. 19, 2014)

What can a party to a mediated settlement do when he/she discovers that a material fact was omitted/concealed/purposely withheld by the other side? In 2011, the Ninth Circuit was faced with precisely that fact situation and determined that while there was no mediation privilege provided by federal law, the parties had signed an express written confidentiality agreement as part of their mediation and were thus precluded from introducing evidence of what the other party "said, or did not say, during the mediation" in support of the challenge to the enforceability of the settlement

agreement. See, *Facebook, Inc. v. Pac. Nw. Software, Inc.*, 640 F.3d 1034, 1041 (9th Cir. 2011). In this case, we have a very different result and the reasoning is instructive for those practitioners concerned about settlements produced through mediation where lies, partial information, misinformation and other forms of deception have occurred.

In this case, Gilda initiated divorce proceedings against her husband Murray. The parties then agreed to resolve their property and support issues through mediation. In connection with the mediation, the parties exchanged certain financial disclosure declarations as are mandated by the Family Code, but these declarations were not otherwise formally served as part of the divorce proceedings. The mediation was a success and ended with the parties signing a marital settlement agreement, the terms of which were incorporated into a stipulated judgment. Shortly after the judgment was entered, Gilda discovered that Murray had sold a company he had founded during the marriage. As part of the marital settlement agreement, Gilda had relinquished her share of the company for $10 million. Gilda had just learned that Murray received $75 million from the sale.

Following the revelation about the sale of the company, Gilda filed an application to set aside the judgment (and the settlement on which it was based) on the grounds of fraud and duress. She also served discovery on Murray seeking the financial disclosure declarations that were exchanged as part of the negotiations at mediation. Murray refused to produce the declarations on the grounds that they were confidential and inadmissible as evidence under Evidence Code § 1119(b) because they constituted writings "prepared for the purpose of, in the course or, or pursuant to, a mediation." Gilda then moved to compel production of the declarations (which she of course needed to prove her fraud and duress allegations). The Court denied the motion on mediation confidentiality grounds. Gilda then petitioned the Court of Appeal for a writ of mandate in which she contended that the mediation confidentiality statutes do not apply because the financial disclosure declarations the parties exchanged were necessarily prepared pursuant to and for the purpose of complying with the Family Code's statutory mandate.

The Court of Appeal granted Gilda's petition and held that Evidence Code § 1119 does not apply to disclosures made pursuant to and for the purpose of complying with the Family Code's statutory mandates. As noted in the decision, before judgment may be entered, Family Code §§ 2104 and 2105 requires that divorcing parties exchange declarations of disclosure that "shall include" "[a]ll material facts and information" regarding the existence and value of community property assets, and Family Code § 2106 mandates that before judgment may be entered, each party must file with the Court a declaration attesting under penalty of perjury that the required financial

disclosure declaration was served on the other party. See, *Elden v. Superior Court*, 53 Cal. App. 4th 1497, 1511 (1997); *In re Marriage of Woolsey*, 220 Cal. App. 4th 881, 892 (2013). Accordingly, the Court of Appeal concluded that the declarations exchanged between Gilda and Murray were not prepared "for the purpose of" mediation but, rather, were prepared for the purpose of complying with their statutory duties under the Family Code. Even if the declarations were exchanged during the mediation, the Court of Appeal reasoned that the declarations were otherwise admissible and subject to discovery outside of mediation and did not become protected from disclosure solely by reason of their introduction or use in a mediation. Evidence Code § 1120(a).

(vi) Mediation Confidentiality Statutes Bar Malpractice Claim Where Former Attorney's Alleged Misconduct Occurred During the Mediation – *Amis v. Greenberg Traurig LLP*, 2015 WL 1245902 (2d Dist., Mar. 18, 2015) (Not Reported)

In this case, plaintiff John Amis is the former client of defendant Greenberg Taurig. After agreeing to the settlement of a litigation matter in which Greenberg Taurig represented Amis, Amis then sued the firm alleging that it had committed attorney malpractice by causing him to execute a settlement agreement that converted his company's corporate obligations into Amis' personal obligations without advising Amis that he had little to no risk of personal liability in the underlying lawsuit. Greenberg Taurig moved for summary judgment citing Amis' undisputed admission that all advice he received from the firm regarding the settlement was given during a mediation. Based on this undisputed fact, Greenberg Taurig argued that Amis could not maintain the lawsuit because he had no admissible evidence to support and prove his claims and Greenberg Taurig, on the other hand, could not produce evidence to defend itself, because the disclosure of what happened in the mediation was barred by the mediation confidentiality statutes. The trial court agreed with Greenberg Taurig and entered summary judgment for the firm. Plaintiff appealed. To the surprise of no one, given the California Supreme Court's near categorical prohibition against judicially crafted exceptions to the mediation confidentiality statutes "even in situations where justice seems to call for a different result," the Second District Court of Appeal affirmed the trial court. *4, citing *Cassel v. Superior Court*, 51 Cal. 4th 113, 118 (2011); *Foxgate Homeowners' Ass'n v. Bramalea California, Inc.*, 26 Cal. 4th 1, 15 (2001); *Rojas v. Superior Court*, 33 Cal. 4th 407, 416 (2004); *Fair v. Bakhtiari*, 40 Cal. 4th 189, 194 (2006); *Simmons v. Ghaderi*, 44 Cal. 4th 570, 582-583 (2008). "The Supreme Court's holding in *Cassel* dictates the result we reach in this case." Id. Namely, lawyers behaving badly in mediation ….

B. BINDING MEDIATION

A disagreement becomes a dispute when two or more parties are no longer willing to accept the status quo or to accede to the demand or the denial of a demand by the other. When disputes arise, people have a number of procedural options to choose from to resolve their differences. These options range from informal, private procedures that involve only the disputants to coercion and often public action to force the opposing party into submission. This range of options is frequently referred to as the dispute resolution continuum.

At the collaborative end of the continuum is negotiation, which is a private and voluntary bargaining relationship designed to educate each other about their respective needs and interests, to exchange specific resources and to resolve less tangible issues. A step away from negotiation is mediation, which has been defined as "the intervention in a negotiation . . . of an acceptable third party who has limited or no authoritative decision-making power, who assists the involved parties to voluntarily reach a mutually acceptable settlement of the issues in dispute." Christopher W. Moore, The Mediation Process / Practical Strategies for Resolving Conflict (3d ed. 2003), p. 15.

At the collaborative end of the continuum is litigation, which involves the intervention of an institutionalized and socially recognized authority in a dispute. This approach shifts the resolution process from the private domain to the public and gives full decision-making authority to make a decision that will be binding and enforceable against the parties. A step away from litigation is arbitration, which is a private, adjudicative proceeding in which the parties give full decision-making authority to a third party via contract.

Against the backdrop of the dispute resolution continuum that ranges from processes that enable party self-determination to those that empower a third-party to decide the dispute, there is an incongruity in coupling "mediation" with "binding." Nevertheless, the term "binding mediation" entered our vocabulary in 2006 when the mediator in *Lindsay v. Lewandowski*, 139 Cal. App. 4th 1618 (2006) issued a "binding mediation ruling" that he said was a procedure he regularly used. Honorable Robert Polist (ret.), the mediator in question, defined the process as one where the parties "agreed in advance that in the event [they failed] to agree, I then decide [the] terms and conditions, typically by asking the parties to each submit . . . their final offers, accompanied by their oral argument as to why I should select their version over all others." Id. at 1621 The trial court's confirmation of the binding mediation award as a judgment was reversed by the Fourth District Court of Appeal as unenforceable – not

on any procedural grounds (like lack of due process because the mediator's decision is made without benefit of evidence and is based on confidential information shared with only the mediator), but because the process as expressed by the parties in their agreement was ambiguous. Id. at 1624. In a concurring opinion, two Justices found the term "binding mediation" to be "deceptive and misleading" and the concept to be "oxymoronic" because mediations "are supposed to reflect a truly voluntary process" that, by definition, "reflect[s] the consent of the parties." Id. at 1625-1628.

When presented with a similar "binding mediation" situation in 2012, this time the Fourth District Court of Appeal affirmed the trial court's judgment on the mediator's binding mediation award. See, *Bowers v. Raymond J. Lucia Companies, Inc.*, 206 Cal. App. 4th 724 (2012). In *Bowers*, the parties submitted their dispute to binding arbitration. After several days of evidentiary hearing, the parties agreed to settle the dispute by defendant dismissing all claims asserted against plaintiffs in the arbitration proceeding and by plaintiffs submitting their claims in the state court lawsuit to "mediation/binding baseball arbitration." With regard to the latter process, the parties agreed to participate in a full day mediation, and if they were unable to reach agreement at the end of the mediation, they agreed that the mediator was empowered to set the amount of the judgment in favor of plaintiffs and against defendant "at some amount between $100,000 and $5,000,000" based upon the parties' respective last and final offers, and that "mediator judgment" could then be entered as a judgment in the state court proceedings without objection of any party. As agreed, the parties participated in a full-day mediation, but were unable to reach an agreement. Plaintiffs' last and final demand was $5 million and defendant's last and final offer was $100,000. Ultimately, the mediator selected the $5 million number and plaintiffs petitioned to confirm the mediator's award as a judgment. The trial court declined to confirm the award as an arbitration award, but enforced the settlement agreement and mediator award under Code of Civil Procedure Section 664.6. The trial court explained:

> "Despite their use of undefined legal terms such as 'mediation with a binding arbitration component' and 'mediation/binding baseball arbitration,' the parties clearly agreed in writing that the mediator would decide the amount of the judgment with the 'binding mediator judgment to then be entered as a legally enforceable judgment . . . ."

The Court of Appeal affirmed the judgment entered by the trial court on the "mediator award," and rejected each of the three attacks waged by defendant. With regard to mutual consent, the Court of Appeal found that there was substantial evidence in the transcript of the arbitration agreement and the parties' written settlement agreement showing that the parties agreed to a full-day mediation, at the

end of which the mediator could make a binding award if the mediation was not successful. Moreover, the Court of Appeal found that "most supportive of the trial court's finding" was the absence of any indication by the defendant or its counsel that they ever requested the arbitrator to conduct an arbitration after the full-day mediation ended.

With regard to defendant's contention that the settlement agreement was unenforceable because "binding mediation" is an inherently uncertain term, the Court of Appeal disagreed and found that the term was sufficiently certain to be specifically enforceable. Of critical importance to the court was the fact that the parties – both in their agreement and in recorded statements made on the record in the arbitration proceeding – had elaborated on what they meant by the alternative dispute resolution method they had chosen, as well as the fact that defendant never objected or insisted on a post-mediation arbitration hearing until after the mediator made an award in plaintiffs' favor.

With regard to defendant's contention that the settlement agreement was unenforceable because "binding mediation" was not among the constitutionally and statutorily permissible means of waiving jury trial rights, the Court of Appeal disagreed. Although "binding mediation"' is not among the methods listed in Code of Civil Procedure Section 631 for waiving a jury trial, the Court of Appeal found that that did not preclude enforcement of the settlement agreement because section 631 relates only to the manner in which a party to a pending court action can waive his right to a jury trial instead of a court trial. It does not prevent parties from avoiding jury trial by not submitting their controversy to a court of law in the first instance. Therefore, while section 631 applies to the validity of a pre-dispute jury trial wavier in a judicial forum, it does not invalidate a post-dispute jury trial waiver in an agreement to settled in a non-judicial forum.

There were no case developments in 2014 concerning binding mediation. Nevertheless, this section of the 2012 recent developments materials was included in the 2013 materials as a placeholder for future developments concerning this important issue in alternative dispute resolution.

C. MISCELLANEOUS

(1) Mediators Have Disclosure Obligations Which are Similar to the Recusal Requirements Imposed on Judges, but the Undisclosed Conflict Must Amount to an "Extraordinary Circumstance" to Support Relief – *CEATS, Inc. v. Continental Airlines, Inc.*, 755 F.3d 1356 (Fed. Cir., Jun. 24, 2014)

After losing at trial, plaintiff filed a motion for relief from the judgment pursuant to FRCP 60(a) based on an alleged relationship between the court-appointed mediator (retired Magistrate Judge Robert Faulkner) and the law firm representing most of the defendants (Fish & Richardson P.C.). The undisclosed conflict relationships came to light as the result of a news article about a state appellate court decision in which an arbitration award issued by the neutral in question (Faulkner) was vacated based upon the neutral's failure to disclose his business and social relationships with Fish & Richardson (the "Fish Firm") and one of its attorneys, Brett Johnson ("Johnson").

The prior litigation was referred to as the *Karlseng l*itigation. It began in 2007, three years before the CEATS litigation was filed. In the *Karlseng* case, the Fish Firm represented a party in a partnership dispute pending before a Texas state court. The parties agreed to arbitration and the state court appointed Faulkner to serve as the arbitrator. Faulkner made a general disclosure that he had participated previously in arbitrations and mediations with the Fish Firm, but made no specific disclosures about the extent of that business relationship or about having a close friendship with Johnson, one of the attorneys appearing in the case (Brett Johnson). In January 2008, Faulkner ruled in favor of the Fish Firm's client for $22 million, including a $6 million attorney's fees award. Thereafter, the attorney for the losing party learned that Faulkner and Johnson were in fact previously acquainted and, in connection with a petition to vacate the award, sought leave to conduct discovery to get more specifics about the nature and extent of that relationship. After a series of proceedings that included two appeals and spanned several years, the arbitration award was vacated based upon the court of appeal's finding that Faulkner's failure to disclose his relationships with the Fish Firm and with Johnson, in particular, violated his disclosure obligations and tainted the award in question. In an opinion published in June 2011, the Texas appeals court detailed an active business relationship between Faulkner and the Fish Firm and an enduring social relationship between Faulkner and Johnson, which included expensive outings and gifts. *Karlseng v. Cooke*, 346 S.W.3d 85, 87-94 (Tex.App. 2011).

The CEATS litigation was filed in April 2010 and the Fish Firm represented the lead group of defendants, with Johnson appearing as one of the attorneys in the case. In November 2010, the district court ordered the matter to mediation and appointed Faulkner as the mediator. Faulkner then presided over two mediations – one that occurred before and one that occurred after the appeals court decision in the *Karlseng* litigation – that representing a point in time when Faulkner most certainly should have been aware that he had relationship conflicts with the Fish Firm and Johnson that a reasonable person would want to know about before submitting to him as a neutral. Faulkner made no disclosures. Plaintiff's counsel in the CEATS litigation claimed that he did not learn of the fact of Faulkner's undisclosed relationships until after judgment was entered in March 2012 when he read a news article about the appeal court decision in the *Karlseng* litigation. Immediately after learning of the relationships, CEATS filed a motion for relief from the final judgment under FRCP 60(b), which gives federal courts authority to relieve a party from a final judgment on various grounds, including a "catch-all" provision if "such action is appropriate to accomplish justice." 755 F.3d 1361, citing *Liljeberg v. Health Servs. Acquisition Corp.*, 486 U.S. 847, 863-864 (1988).[27] CEATS argued that mediators are bound by the same neutrality requirements as judges and arbitrators. The trial court rejected that argument and denied CEATS' motion.

On appeal, the appellate court held that the district court erred in finding that a reasonably objective person would not have wanted to consider circumstances surrounding the *Karlseng* litigation when deciding whether to object to Faulkner's appointment as mediator in the case. The court went on to rule that "[m]ediators are required to disclose not only financial interests, but all potential conflicts of interests as well," and that "a mediator's duty to disclose potential conflicts where impartiality might be questioned is analogous to a judge's duty to recuse under § 455(a)." 755 F.3d

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[27] In *Liljeberg*, the Supreme Court vacated a judgment for failure to recuse himself. The plaintiff in *Liljeberg* sued for declaratory relief that it owned a hospital then under construction. While the case was pending, the defendant in the case engaged in negotiations with a third party to purchase the hospital. The presiding judge sat on that third party's board of trustees. The Supreme Court held that a reasonable observer would have questioned the judge's impartiality and have expected him recuse himself. Because he failed to recuse himself, he violated 28 U.S.C. § 455(a), providing that "[a]ny justice, judge, or magistrate … shall disqualify himself in any proceeding in which his impartiality might reasonably be questioned." 486 U.S. 852-861. That violation, however, did not automatically entitle the plaintiff/movant to relief from judgment under Rule 60(b)(6). Id. at 863-864. The Supreme Court set forth three factors to consider "in determining whether a judgment should be vacated for a violation of 28 U.S.C. § 455(a): (1) "the risk of injustice to the parties in the particular case;" (2) "the risk that the denial of relief will produce injustice in other cases; and (3) "the risk of undermining the public's confidence in the judicial process." Id at 864.

at 1362, citing the ABA Standards for Mediators, § III.C (adopted by the United States District Court for the Eastern District of Texas as the governing standards for mediators serving in district court cases). As applied to the case at hand, the appellate court was disturbed that at the same time Faulkner served as the court-appointed mediator, his relationship with the Fish Firm and Johnson was directly at issue in the *Karlseng* vacatur proceedings and appeals. "Importantly, this meant that Fish, as a firm, was actively defending Faulkner's personal disclosure decisions while he was mediating this case." Id. at 1364. The appellate court was also disturbed by the fact that the Texas appeals court's decision holding that Faulkner had breached his disclosure obligations in the *Karlseng* litigation and detailing the extent of his relationship with Johnson and the Fish Firm, was released between the first two mediation sessions in the CEATS case and well before the third. Finally, the appellate court was disturbed by the fact that Faulkner had been compelled to provide testimony in the *Karlseng* litigation vacatur proceedings in support of the arbitration award. The appellate court declined to say whether any one of the facts regarding Faulkner's relationships with the Fish firm or its attorneys required disclosure on its own, stating instead that based on the totality of the facts and circumstances presented in the *Karlseng* litigation, Faulkner had breached his duty as a mediator to disclose actual and potential conflicts of interest that were reasonably known to him and could reasonably be seen as raising a question about his impartiality.

After going through the lengthy analysis described above and holding that Faulkner had breached his disclosure obligations as mediator and that the trial court had erred in finding that the circumstances surrounding the *Karlseng* litigation did not rise to the level of requiring disclosure, that appellate court affirmed the trial court's denial of CEATS' Rule 60(b) motion. Applying the three factors in *Liljeberg*, the court held that the mediator's failure to disclose potential conflicts was not an "extraordinary circumstance" supporting relief from judgment. Although the court concluded that Faulkner should have disclosed the circumstances surrounding the *Karlseng* litigation and his relationship with the Fish Firm relating thereto, it found that CEATS ultimately was able to fully and fairly present its case before an impartial judge and jury. Nevertheless, the appellate court expressed its concerns about the lack of a remedy for a mediator's non-compliance with his or her disclosure obligations as compared to the availability of vacatur in the arbitration context when an arbitrator fails to make required disclosures:

> "We certainly do not want to encourage similar non-disclosures. On this record, however, we do not believe there is a sufficient threat of injustice in other cases to justify the extraordinary step of setting aside a jury verdict. We find it unlikely that mediators will simply ignore their disclosure obligations if we deny relief here. To the contrary, our decision

> serves to reinforce the broad disclosure rules for mediators by holding that Faulkner had a duty to disclose in this case. The mere fact that the final judgment after a full jury trial will not be overturned very time a mediator fails to disclose a potential conflict is not likely to affect the disclosure decisions of other mediators."

755 F.3d at 1366.

(2) Mediation Provision in Contracts and CC&R's is Enforced and Attack Based on Unconscionability is Rejected – *The McCaffrey Group, Inc. v. Superior Court*, 224 Cal. App. 4th 1330 (5th Dist., Mar. 24, 2014)

Homeowners brought suit against builder to recover damages allegedly suffered due to defective construction of their homes. In response, the builder filed a motion to compel the homeowners to submit their construction defect claims to nonadversarial prelitigation procedures before proceeding with the lawsuit based upon provisions in their respective purchase agreements. Those procedures included providing the builder with notice of the claimed defect, giving the builder the right to inspect and correct it, and if the homeowner is still unsatisfied, engaging in non-binding mediation. The homeowners opposed the motion, contending that it was procedurally and substantively unconscionable because it had no deadline for completion of the mediation, and required the homebuyers to pay half of the mediator's fees. The trial court agreed with the homeowners, and denied the builder's motion on the grounds that the mediation clause was unconscionable and thus unenforceable. The trial court held the mediation provision was unconscionable because, among other things, "the provision permits the builder to unilaterally delay the submission of the issue brief and therefore the entire procedure. It also noted that there is no time specified within which the mediator must be selected" to the mediation could be delayed indefinitely.

The builder filed a writ petition, which was granted. The Court of Appeal reversed the trial court and held that reasonable deadlines for the completion of the mediation were implied as a matter of law in the mediation provision through the implied covenant of good faith and fair dealing. The Court also held that even if it was assumed that the mediation clause was presented on a "take it or leave it" basis by the builder, it showed only a low level of procedural unconscionability, and that requiring homebuyers to pay half of a mediator's fees to not render the provision substantively unconscionable.

(3) The Monetary Consequences of One Party's Breach of the Confidentiality Clause in a Mediation Agreement, by Litigating the Mediation Phase of the Proceedings, is an Award of Fees and Costs Incurred by the Party Put in the Position of Having to Defend the Mediated Settlement Agreement – *Estate of Floyd*, 2014 WL 2979448 (4th Dist., Jul. 3, 2014) (Not Reported)

The backdrop of this dispute is a probate dispute. Floyd and Donna Buser established a trust for the distribution of their assets upon their death to their three sons. One son – Martin – was named as successor trustee upon the parents' death or incapacity. The trust provided for the distribution of trust assets in equal shares to the three sons. The primary assets of the trust were five real estate properties. Before the parents' death, one son – Douglas – moved into one of the residential properties with his wife. In 2010, Martin and Douglas became involved in litigation concerning the administration of the trust. Those disputes started when Martin filed an unlawful detainer action seeking to reclaim possession of the residence where Douglas and his wife were residing. They then escalated into a petition by Douglas complaining of Martin's breach of his duties as trustee and seeking his removal as trustee.

In 2011, the parties mediated their claims and achieved a negotiated settlement, which was confirmed in a written agreement. As part of the settlement, the parties agreed to submit any dispute regarding the interpretation or enforcement of the settlement agreement to "mandatory mediation" and then to arbitration. Thereafter, disputes arose between Douglas and Martin, a failed mediation occurred, and Martin then petitioned the court to appoint an arbitrator. The arbitration was concluded in June 2012 and the arbitrator ruled in Martin's favor on all counts, including Douglas' breach of the settlement agreement, as well as the confidentiality clause contained in the mediation agreement. The arbitrator determined that Martin was entitled to recover from Douglas all attorney fees and costs incurred by the trust in defense of the settlement from the date of its execution, totaling $90,848.

Douglas appealed and, on appeal, claimed that the bills for the proceedings that took place between the signature date and the date the Probate Court approved the settlement amounted to a new claim arising from the settled transactions and was thus subject to the general release provision. The court of appeal rejected that argument, finding that under the parties' settlement agreement, they had agreed that any and all disputes regarding its interpretation or enforcement would be referred to "mandatory mediation, and if not resolved at mediation, to … binding arbitration." The settlement agreement then went on to provide that all costs and reasonable attorney fees incurred by the prevailing party in proceedings arbitration were to be assessed against the

unsuccessful party. While Douglas objected to the arbitrator's power to award fees incurred after the settlement but before court approval, he did not otherwise address the source of the arbitrator's power in resolving the controversy. The court of appeal found that both parties had forfeited any objections on this legal point and that the scope of the settlement agreement was broad enough to include arbitral authority over trust administration issues concerning the settlement and its enforcement. "Under the agreement, the parties released each other from all claims, known or unknown …, which included the claims and allegations in the legal matters pending in court. The arbitrator was therefore justified in interpreting the scope of the submission as including trust administration matters."

(4) Mediation Expenses Associated with Voluntary Mediations are Recoverable in the Trial Court's Discretion Because Encouraging Parties to Resolve Lawsuits is Recognized as a Necessary Part of Litigation in California – *Taylor v. Long Beach Memorial Medical Center*, 2014 WL 1255314 (2d Dist., Apr. 23, 2014) (Not Reported)

This is an employment dispute in which an employee prevailed after a jury trial and then filed a memorandum of costs seeking recover of over $90,000. Included in plaintiff's costs was approximately a $7,000 item representing plaintiff's share of the expenses incurred in two voluntary mediations – one conducted prior to filing the lawsuit and the second conducted prior to the trial. Defendant sought to tax these costs on the grounds that they are not specifically allowed under Code of Civil Procedure Section 1033.5 and are not the type of expenses "reasonably necessary to the conduct of the litigation." The trial court denied defendant's motion to tax these costs and defendant appealed. The court of appeal affirmed, finding that the trial court did not abuse its discretion in allowing plaintiff to recover her mediation expenses as part of her "prevailing party" costs award. Citing *Gibson v. Bobroff*, 49 Cal. App. 4th 1202 (1996), the court of appeal noted that the court in *Gibson* had allowed recover of expenses associated with court-ordered mediation and expressly declined to decide whether voluntary mediation expenses should be similarly recoverable. Id. at 1209, fn. 7. "As in *Gibson*, shifting voluntary mediation expenses would encourage early mediations and settlements just as shifting costs for court-ordered mediations would." The court further agreed with *Gibson* "[e]ncouraging the parties to resolve lawsuits at the earliest time and before a costly and time-consuming trial, is a necessary part of litigation as conducted in this state."

(5) Trial Court Refused to Award Mediation Fees as Prevailing Party Costs – *Berro v. County of Los Angeles*, 2014 WL 7271181 (2d Dist., Dec. 22, 2014) (Not Reported) ***[Digest provided by Chris Blank]***

This is an employment lawsuit under the Fair Employment and Housing Act (FEHA). Plaintiff was a firefighter alleging that the Los Angeles County Fire Department and various of its employees had improperly discriminated against him and subjected him to disparate treatment. He lost at trial and that decision was upheld by the appellate court. For our purposes, the interesting aspect of the case relates to LACOFD's request for reimbursement of $1,750.00 in mediation fees. The court refused that request and the appellate court affirmed, holding that mediation fees are not prohibited by CCP § 1033.5, but nor are they mandatory. Therefore, it was within the trial court's discretion to award or refuse to award them.

(6) <u>Exception to Mediation Confidentiality for Attorney Misconduct / Malpractice During Mediation – AB 2025 (Gorell) (2011-12 Reg Session) – Referred to CLRC for Study</u>

As part of the 2012 Recent Developments Program, we looked at AB 2025 (Gorell), which had passed the Assembly and then been stalled in the Senate. The purpose of AB 2025 was to negate the *Cassel* decision[28] by amending Evidence Code

[28] In *Cassel*, plaintiff alleged that in connection with a mediation of a dispute with his former co-business owner over a license to sell clothing, he met with his attorneys and it was agreed that Cassel would not accept less than $2 million to release his claims to the license and settle the lawsuit. During the mediation, Cassel alleged that his attorneys informed him that the other side would not pay more than $1.25 million for the license and demanded that he accept the offer. When he refused, Cassel alleged that his attorneys threatened to withdraw from the case which was scheduled to begin trial a few days later. He further alleged that they refused to allow him to eat or to call his family and, after 14 hours of mediation, presented him with a complicated settlement document that they insisted he sign on the spot. Cassel alleged that he signed the document because he felt he had no choice under these circumstances.

Post-settlement, Cassel sued his attorneys for malpractice. The attorneys filed a motion in limine to prevent the admissibility of any communications between Cassel and them that occurred both during the mediation and the mediation prep session, including those that occurred outside the presence of the mediator and the adverse parties. The trial court granted that motion. On appeal, the court of appeal reversed, holding that the client and his attorneys were a single participant for purposes of the mediation. The California Supreme Court reversed the court of appeal, ruling that the attorneys and Cassel were separate participants and, as such, all oral and written communications between them were covered by the confidentiality statutes,

Section 1120 to create a statutory exception to mediation confidentiality to allow communications had between an attorney and client during or in connection with a mediation to be admissible as evidence in a later attorney malpractice lawsuit. Objections were raised to the bill because, although the bill was designed to eliminate the unfairness of preventing clients from suing their attorneys for malpractice committed during a mediation, it shifted the unfairness to the attorney defendant. As proposed, the mediation confidentiality provisions of the Evidence Code still barred the attorney from introducing testimony by other participants in the mediation (such as the adverse party and the mediator). As such, the attorney could not show that the ultimate settlement was the result of information obtained from the mediator or the adverse party because these communications remained inadmissible. Ultimately, Assemblyman Gorell was unable to come up with a bill that satisfied everybody.[29] Consequently, his solution was to refer the problem to the California Law Revision Committee ("CLRC").

The CLRC is currently studying the controversial question of whether to weaken the legislative promise of mediation confidentiality and, if so, in what way. The general thought in the ADR community is that the CLRC will not leave the current mediation confidentiality statutes intact, but no one knows whether it will recommend minor tweaking, a major change or something in between. The following are some of the questions that ADR authority (Paul J. Dubow) believes "could very well be on the minds of the CLRC members."

> 1. Should confidentiality be eliminated completely, leaving only actual settlement offers to be inadmissible? [Note: Without the blanket confidentiality that presently exists, the Superior Court would have been aware of the alleged lack of good faith by one of the *Foxgate* attorneys; the crucial photographs in *Rojas* would have been subject to discovery by the building occupants in their lawsuit; the Simmons family might have been able to enforce the settlement agreement entered into by Dr. Ghaderi; the dispute over the mediated settlement agreement in *Fair v. Bakhtiari* might have been arbitrated; and Mr. Cassel might have been able

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notwithstanding that the conversations at issue occurred outside the presence of the mediator and the adverse parties.

[29] See final amendment at http://www.leginfo.ca.gov/pub/11-12/bill/asm/ab_2001-2050/ab_2025_bill_20120510_amended_asm_v98.pdf. The measure passed the Assembly Judiciary Committee 10-7, the Assembly Appropriations Committee 17-0, and the Assembly 76-1. The bill moved to the Senate Rules Committee for assignment, where no further action was taken.

to introduce evidence that would have demonstrated his attorneys' alleged malpractice.]

2. Should a statutory exception be enacted for attorney malpractice? If so, should other participants in the mediation be allowed to testify? Should the mediator be allowed to called as a witness?

3. Should an exception for attorney malpractice be limited to State Bar proceedings?

4. Should there be an exception for insurance bad faith lawsuits so that the insurer could show that it made a reasonable settlement offer during the mediation? [Note: This is consistent with what at least one federal district court has ruled. See, *Milhouse v. Travelers Commercial Ins. Co.*, 982 F.Supp. 2d 1088 (C.D.Cal. 2013)]

5. Should there be an exception that would allow a party to introduce documents produced during a mediation that were developed for the purpose of justifying a party's position concerning its claims or defense, such as was the case in *Rojas*?

6. What other exceptions are necessary to eliminated perceived unfairness caused by mediation confidentiality? Is there any amendment that will be perceived as "fair" by everyone?

7. If no exception of attorney malpractice is enacted, should there be a provision for a cooling off period during which mediation parties can withdraw from their agreement to settle? If so, how long should that period be?

8. If no exception to attorney malpractice is enacted, should attorneys be required to inform clients in advance of mediation that any communications between them that occur during or in connection with the mediation will not be admissible in any malpractice lawsuit that the client might later bring against the attorney?

9. Should mediators be required to advise mediation participants that the confidentiality rules extend to communications between attorney and client that are had during the mediation – even if no others are present – and hence they would not be admissible in a

malpractice lawsuit that the clients might later bring against their respective attorneys?

10. Should mediation participants be allowed to sue the mediator for engaging in coercive tactics in order to get the party to agree to accept a settlement?

11. Should Evidence Code Section 703.5 be amended to allow mediators to be competent to testify? If so, should such an amendment be limited to cases where "good cause" is shown? And what qualifies as "good cause" – the need for a tie-breaker between contesting parties?

(7) <u>"ADR" in the Context of Criminal Law: Public Shame in Lieu of Incarceration</u>

In a February 2, 2015 Daily Journal article Arthur Gilbert (Judge, Second District Court of Appeal) discussed the "au courant practice of avoiding traditional avenues to seek justice" in criminal sentencing and stated that some are calling this practice "alternative dispute resolution" in the criminal law context. What Judge Gilbert was talking about are the "novel sentencing techniques" being employed by some judges in an effort to reduce the prison population. Public shaming of defendants for their wrongdoing is one such technique and Judge Gilbert offered the sentencing in *United States v. Gementera*, 379 F.3d 596 (2004) as an example. In *Gementera*, the defendant was convicted of stealing mail. As part of his punishment, he was ordered to stand in front of a post office for a day wearing a sandwich board sign that said, "I stole mail. This is my punishment." On appeal, Gementera argued that the sentence was not legitimate because it violated contemporary standards of decency and humiliated him. The Ninth Circuit saw it differently and affirmed the sentence. The majority acknowledged that the sign condition likely will cause Gementera humiliation or shame, but the condition is reasonably related to rehabilitation, a goal of the Sentencing Reform Act. [Judge Gilbert Note: "Apparently it did not occur to Gementera that his pilfering letters violated contemporary standards of decency."]

Another sentencing example discussed by Judge Gilbert concerned a state trial judge's order requiring a beer thief to wear for one year a T-shirt on which was boldly written: "I am on felony probation / My record plus two six packs equals four years." The Court of Appeal in *People v. Hackler*, 13 Cal. App. 4th 1049 (1993) disallowed that order, finding that the T-shirt probably would not favorably impress prospective employers and would thus work to defeat the defendant's rehabilitation efforts.

III.
SETTLEMENT – SIGNIFICANT CASES

A. LEGAL STANDARD FOR EVALUATING APPROVAL OF *CY PRES* DISTRIBUTIONS IN CLASS ACTION SETTLEMENTS

(1) Background Statement

The term "*cy pres*" comes from the old French phrase "*cy pres comme possible*," meaning "as near as possible." The legal doctrine of *cy pres* originated in the charitable trusts context. If a charitable trust's funds could not be distributed according to the precise terms of the trust because the trust's objective had become impossible or illegal to carry out, the *cy pres* doctrine allowed a court to modify the trust so that the money was distributed in a manner that came "as near as possible" to the testator's original intent.

Class action settlements often present the court and parties with the practical problem of disposing of funds that remain after distributions to class members or involve millions of potential class members, making the cost of claims administration prohibitively high in relation to the very small payments to be paid out to individual class members.[30] The *cy pres* doctrine is a well-recognized device that permits the court to designate suitable charitable organizations to receive such settlement funds. *Six Mexican Workers v. Ariz. Citrus Growers*, 904 F.2d 1301, 1305 (9th Cir. 1990). The other alternatives are escheat to the government or reversion to the defendants. Id. at 1307. As to this latter option, the Ninth Circuit has held that it is an indication of self-interest on the part of class counsel when "the parties arrange for fees not awarded to revert to defendants rather than be added to the class fund." *In re Bluetooth Headset Products Liab. Litig.*, 654 F.3d 935, 946-947 (9th Cir. 2011); see also *Dalton v. Lee Publications, Inc.*, 2014 WL 5325698 at *4 (S.D.Cal., Oct. 17, 2014) (noting that "[w]hile the presence of a reversion clause is not *per se* unreasonable … the possibility of reversion is an area of particular concern to the court.").

In the context of class action settlements, a *cy pres* provision allows the distribution of funds to a charitable organization to indirectly benefit the entire class "where the proof of individual claims would be burdensome or distribution of damages

[30] See., e.g., Martin H. Redish et al., *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 Fla. L. Rev. 617, 620 (2010 (discussing the "dramatic turn in modern class actions toward the use of *cy pres* relief").

costly" or to deal with the circumstance where there are unclaimed funds. *Six Mexican Workers*, supra 904 F.2d at 1305. Used in lieu of direct distribution of damages to silent class members, this alternative allows for "aggregate calculation of damages, the use of summary claim procedures, and distribution of unclaimed funds to indirectly benefit the entire class." Id. at 1305. To ensure that the settlement retains some connection to the plaintiff class and the underlying claims, however, a *cy pres* award must qualify as "the next best distribution" to giving the funds directly to class members. Id. at 1308; see also *Nachshin v. AOL, LLC*, 663 F.3d 1034, 1036 (9th Cir. 2011); *Lane v. Facebook*, 696 F.3d 811, 819 (9th Cir. 2012); *Dennis v. Kellogg Co.*, 697 F.3d 858, 865 (9th Cir. 2012). The Ninth Circuit has ruled that "*[c]y pres* distributions must account for the nature of the plaintiffs' lawsuit, the objectives of the underlying statutes, and the interests of the silent class members, including their geographic diversity. *Nachsin*, 663 F.3d at 1036. The Ninth Circuit has also warned that to effectively use the *cy pres* doctrine, the distributions must be related to the purposes of the underlying lawsuit or the class of plaintiffs involved. Id. at 1039. "Not just any worthy charity will qualify as an appropriate *cy pres* beneficiary[,]" there must be "a driving nexus" between the plaintiff class and the *cy pres* beneficiary. "A *cy pres* award must be guided by (1) the objectives of the underlying statute(s) and (2) the interests of the silent class members, and must not benefit a group too remote from the plaintiff class." *Dennis*, 697 F.3d at 865. One district court has held that a "driving nexus" "is more than a simple alignment of interest. Nexus implies that there be an actual connection …." *In re Groupon, Inc. Mktg. & Sales Practices Litig.*, Case No. 11-MD-2238 DMS (RBB), Docket No. 97, at *15 (S.D.Cal., Sep. 28, 2012).

In state court class action settlements, California Code of Civil Procedure section 384 specifically authorizes the distribution of unpaid residuals from class action litigation to be paid to nonprofit organizations or foundations or a designated list created by the State Bar. The legislature's stated goal was to ensure that such funds "are distributed, to the extent possible, in a manner designed either to further the purposes of the underlying causes of action, or to promote justice for all Californians." The statute requires distribution "to nonprofit organizations or foundations to support projects that will benefit the class or similarly situated persons, or that promote the law consistent with the objectives and purposes of the underlying cause of action, to child advocacy programs, or to nonprofit organizations providing civil legal services to the indigent."

The cases discussed in this section of the materials are a continuation of the Ninth Circuit's statement/development of the legal standard to be used in evaluating approval of distributions of *cy pres* awards. This year, there are no Ninth Circuit decisions, only district court cases showing how the – most of which were unreported.

(2) Cases

(a) A Settlement Providing for *Cy Pres* Payments Rather Than Direct Payments to Class Members is the Next Best Remedy Given the Millions of Class Members – *In re Google Referrer Header Privacy Litigation*, 2014 WL 1266091 (N.D.Cal., Mar. 26, 2014) (Not Reported)

"Searching" is one of the most basic activities performed on the Internet and Google offers the most-used search engine in the world. In this case, a class action was filed in which plaintiff alleged that Google operated its search engine in such a way that their Internet privacy rights were violated because personal information was disclosed to third parties. The issue presented to the court was whether to grant preliminary approval of the class action settlement achieved between Google and the representative plaintiffs. The parties' proposed settlement consisted purely of payments to cy pres recipients without direct payments of any kind going to the class members. Basically, Google agreed to pay the total amount of $8.5 million, from which fund incentive awards to the named plaintiffs, attorney's fees and costs, administration costs and distributions to the cy pres recipients would be made. The district court approved of this provision as being consistent with the Ninth Circuit's decision in *Lane v. Facebook, Inc.*, 696 F.3d 811, 819 (9th Cir. 2012) because such a distribution was the "next best" remedy to direct payment to the class because proof of individual claims would be burdensome and the cost of distributing small checks to millions of class members would exceed the total monetary benefit obtained by the class. *6.

The parties proposed the following entities as potential cy pres recipients: World Privacy Forum, Carnegie-Mellon, Chicago-Kent College of Law Center for Information, Society and Policy; Berkman Center for Internet and Society at Harvard University; Stanford Center for Internet and Society; and AARP, Inc. The court approved all of these recipients because the parties demonstrated how payments to the proposed cy pres recipients "accounts for the nature of the suit, meets the objectives of the [claim}, and furthers the interests of class members." Id. Moreover, the court noted that all of the cy pres recipients were chosen "only after they met certain qualifying criteria tailored to the claims in this case and submitted detailed proposals aimed at resolving issues in the area of Internet privacy." Id.

(b) Court Rejects Sesame Street as a Proposed *Cy Pres* Recipient Because It Had No Relation to the Proposed Class – *Johnson v. Metlife, Inc.*, 2014 WL 2881530 (C.D. Cal., Jun. 3, 2014) (Not Reported)

In this case, plaintiff brought suit on behalf of himself and other similarly situated individuals employed by MetLife as Financial Service Representatives seeking damages for uncompensated overtime, unreimbursed expenses and improper operating expenses deducted from their pay. Plaintiff filed a motion asking the district court to conditionally certify the settlement class and preliminarily approve a proposed settlement. The motion was denied on several grounds, including the court's determination that the proposed *cy pres* beneficiary – Sesame Workshop, the nonprofit educational organization behind the production of Sesame Street - was "improper" because it had no apparent relation to the proposed class. *2. Given that this action was filed *after* the Ninth Circuit's decisions in *Dennis v. Kellogg*, 697 F.3d 858 (9th Cir. 2012) and *Lane v. Facebook*, 696 F.3d (9th Cir. 2012), it is rather surprising that the parties in this case selected such an off-the-mark recipient as their proposed *cy pres* beneficiary for purposes of trying to achieve a settlement of this class action.

(c) Court Approves Settlement with *Cy Pres* Distribution Provision, but no Named Beneficiary, Accepting Instead a Proposed Restriction on Use of the Settlement Funds – *State of California v. eBay, Inc.*, 2014 WL 4273888 (N.D.Cal., Aug. 29, 2014) (Not Reported)

This case is probably more noteworthy because of the subject matter of the dispute than the terms of the settlement. This case concerned an alleged "handshake agreement" entered into between senior executives of eBay and Intuit in which they basically agreed to keep their "hands off" each other's employees by not recruiting or hiring such employees. As a result, employees working for these two companies were deprived of better job opportunities at the other company, and their compensation and benefits was negatively impacted because the most logical competing employer for their special services and talents was eliminated from the pool of potential employers by this agreement. Of course, the employees had no idea about the existence of the "no poach" / "no hire" agreement and, as a result, employees from both companies approached the other one company about possible employment. There's no such thing as a secret, and eventually the Department of Justice got involved with an investigation into the agreements between the two technology giants that were restricting hiring practices. That investigation became public in 2009. In 2011, Intuit entered into several consent

decrees preventing it from entering into or enforcing any agreement that improperly limits competition for employee services. *United States v. Adobe Systems, Inc.*, No. 20-01629 (D.D.C., Mar. 17, 2011). The State of California filed this action against eBay in November 2012 complaining that eBay's no-solicitation / no-hire agreement with Intuit was anti-competitive and an unfair business practice. While battling it out at the pleading stage, the parties agreed to terms for a settlement.

Under the terms of the proposed settlement, eBay would pay $3.75 million, of which $1.375 million would be paid to California for civil penalties, attorney's fees and claims administration costs. The balance would be distributed to employees or prospective employees at eBay and Intuit who were affected by the "handshake agreement." The settlement provided that any amount remaining after the claims of claimants were redeemed would be distributed by California for *cy pres* purposes to one or more charitable organizations. Those organizations were not identified in the settlement. Instead, the settlement agreement simply provided that each *cy pres* recipient must agree to use the funds for public education and/or to support research, development and initiatives related to promoting employment mobility in the high-tech industry. It also provided for the State of California to make the decision as to who qualifies, noting that California stated that "it will strive to select local non-profit organizations that work directly to advance the causes of employment mobility and employee rights … mainly within the San Francisco Bay Area." *6.

(d) Use of a Reversionary Clause In Lieu of a *Cy Pres* Distribution is not *Per Se* Unreasonable, but Nevertheless Draws the Court's Concern – *Dalton v. Lee Publications, Inc.*, 2014 WL 5325698 (S.D.Cal., Oct. 17, 2014) (Not Reported)

Plaintiffs are individuals who contracted with defendant to deliver newspapers to home subscribers. This lawsuit concerned various alleged violations of the California Labor Code, applicable Wage Orders, and the California Unfair Competition Law based on a liability theory of misclassification of the newspaper carriers as independent contractors. A settlement was reached wherein defendant agreed to establish a Maximum Settlement Fund in the amount of $3.2 million, from which a Net Settlement Fund would be made available to class members after deductions for attorney's fees, costs, claims administration and service awards to the named plaintiffs. The proposed settlement agreement provided that in the event that the value of the total amount of claims timely and validly submitted is less than the Net Settlement Fund, "then any unclaimed portion shall not be paid by Defendant" and "[t]here will be no *cy pres* or other distribution of any unclaimed portion of the Net Settlement Fund," meaning in

effect a reversion to defendants. The district court noted that it had concerns about this provision because "[t]he Ninth Circuit has held that it is an indication of self-interest on the part of class counsel when 'the parties arrange for fees not awarded to revert to defendants rather than be added to the class fund." *4, citing *In re Bluetooth Headset Products Liab. Litig.*, 654 F.3d 935, 946-947 (9th Cir. 2011). That being said, the district court noted that the presence of a reversion clause is not *per se* unreasonable. Id., citing, *Navarro v. Servisair*, 2010 WL 1729538 *1 (N.D.Cal., Apr. 27, 2010) (final class action settlement approved despite retention of a substantial portion of the common fund by the defendant).

B. STATUTORY OFFERS

(1) State Law - CCP § 998

Under California law, the right to recover costs is derived solely from statutes. In the absence of statutory authority, each party must pay his or her own costs. *Davis v. KGO-TV, Inc.*, 17 Cal. 4th 436, 439 (1998). The general statutory rule allowing recovery of costs is found in Code of Civil Procedure Section 1032. *Scott Co. v. Blount, Inc.*, 20 Cal. 4th 1103, 1108 (1999); *Guerrero v. Rodan Termite Control, Inc.*, 163 Cal. App. 4th 1435, 1439 (2008). Section 1032 requires the trial court to award costs to the prevailing party, except as otherwise provided by statute, and Section 1033.5 identifies the costs that are recoverable under Section 1032.

Code of Civil Procedure Section 998 modifies the general rule set forth in Section 1032, and is designed to encourage the settlement of lawsuits before trial. *Scott Co., v. Blount, Inc.*, supra, 20 Cal. 4th at 1112; *Regency Outdoor Advertising, Inc. v. City of Los Angeles*, 39 Cal. 4th 507, 528 (2006). "Its effect is to punish the plaintiff who fails to accept a reasonable offer from a defendant." *Culbertson v. R.D. Werner Co., Inc.*, 190 Cal. App. 3d 704, 711 (1987). However, a good faith requirement is read into Section 998, requiring that the settlement offer be "realistically reasonable under the circumstances of the particular case" and that there be "some prospect of acceptance." *Bates v. Presbyterian Intercommunity Hospital, Inc.*, 204 Cal. App. 4th 210, 220 (2012); see also *Adams v. Ford Motor Co.*, 199 Cal. App. 4th 1475, 1483 (2011); *Wear v. Calderon*, 121 Cal. App. 3d 818, 821 (1981); *Elrod v. Oregon Cummins Diesel, Inc.*, 195 Cal. App. 3d 692, 698 (1987). A party having no expectation that his offer will be accepted "will not be allowed to benefit from a no-risk offer made for the sole purpose of later recovery large expert witness fees." *Jones v. Dumrichob*, 63 Cal. App. 4th 1258, 1263 (1998). That being said, "[e]ven a modest of 'token' offer may be reasonable if an action is completely lacking in merit." *Nelson v. Anderson*, 72 Cal. App. 4th 111, 134 (1999); see also,

Culbertson v. R. D. Werner Co., Inc., supra, 190 Cal. App. 3d 704, 710-711. Whether a Section 998 offer qualifies as reasonable and in good faith is left to the sound discretion of the trial court. *Adams v. Ford Motor Co.*, supra, 199 Cal. App. 4th at 1484. Where the defendant obtains a judgment more favorable than its offer, "'the judgment constitutes prima facie evidence showing the offer was reasonable. . . ." *Santantonio v. Westinghouse Broadcasting Co.*, 25 Cal. App. 4th 102, 117 (1994). The reasonableness of a defendant's Section 998 offer is evaluated in light of what the offeree knows or does not know at the time the offer is made. *Bates v Presbyterian Intercommunity Hospital, Inc.*, supra, 204 Cal. App. 4th at 221.

Subdivision (a) of Section 998 states that "costs allowed under Sections 1031 and 1032 shall be withheld or augmented as provided in this section." Costs are augmented pursuant to Section 998 when an offer to compromise is rejected and the rejecting party fails to achieve a better outcome at trial. In this situation, Section 998 establishes a procedure for shifting the costs upon a party's refusal to settle and by expanding the type of recoverable costs and fees over and above those permitted by Section 1032. See, *Murillo v. Fleetwood Enterprises, Inc.*, 17 Cal. 4th 985, 1000 (1998); *Westamerica Bank v. MBG Industries, Inc.*, 158 Cal. App. 4th 109, 128 (2007). To be effective, the technical requirements must be satisfied. See., e.g., *Boeken v. Philip Morris USA, Inc.*, 217 Cal. App. 4th 992, 1004 (2013) (failure to include an acceptance provision invalidated plaintiff's offer).

Section 998 authorizes any party to make a statutory offer to settle an action by allowing a judgment or dismissal to be entered based on the offer's terms and conditions. Cal. Code Civ. Proc. § 998(b). The statute seeks to encourage settlement by providing parties a financial incentive to make and accept reasonable settlement offers before trial. *Martinez v. Brownco Const'n Co.*, 56 Cal. 4th 1014, 1019 (2013); *Chaaban v. Wet Seal, Inc.*, 203 Cal. App. 4th 49, 54 (2012). If a plaintiff rejects a defendant's section 998 offer and thereafter fails to obtain a more favorable judgment, (1) "the plaintiff shall not recover his or her post offer costs and shall pay the defendant's costs from the time of the offer," and (2) the trial court may, in its discretion, require the plaintiff to pay the reasonable expert witness fees the defendant incurred. Cal. Code Civ. Proc. § 998(c)(1). If a defendant does not accept a plaintiff's section 998 offer and thereafter fails to obtain a more favorable judgment, (1) the trial court may, in its discretion, require the defendant to pay the reasonable post offer expert witness fees incurred by the plaintiff in preparing for trial and at trial, Cal. Code Civ. Proc. §998(c), and (2) the judgment against the defendant in any personal injury action shall accrue prejudgment interest at the rate of 10 percent per annum from the date of the offer. Cal. Civ. Code §3291.

The policy behind section 998 is "to encourage the settlement of lawsuits prior to trial." *T.M. Cobb Co. v. Superior Court*, 36 Cal. 3d 273, 280 (1984). To effectuate this policy, section 998 provides "a strong financial disincentive to a party – whether it be a plaintiff or a defendant – who fails to achieve a better result than that party could have achieved by accepting his or her opponent's settlement offer." *Bank of San Pedro v. Superior Court*, 3 Cal. 4th 797, 804 (1993). At the same time, the potential for statutory recovery of expert witness fees and other costs provides parties with "a financial incentive to make reasonable settlement offers." Id. Section 998 aims to avoid the time delays and economic waste associated with trials and to reduce the number of meritless lawsuits. *Culbertson v. R.D. Werner Co., Inc.*, 190 Cal. App. 3d 704, 711 (1987); *Wilson v. Wal-Mart Stores, Inc.*, 72 Cal. App. 4th 382, 390 (1999).

The cases discussed below show how fact-specific the courts' application of Section 998 in terms of technical compliance and how significant the cost shifting might be in a case involving numerous experts.

(2) <u>Cases</u>

(a) Revocation of a Section 998 Offer Before Expiration of the 30-Day Acceptance Period Operates as a Forfeiture of its Status as a Statutory Offer for Purposes of Shifting Costs – *Taylor v. Long Beach Memorial Medical Center*, 2014 WL 1255314 (2d Dist., Apr. 23, 2014) (Not Reported)

In this matter, an employee sued her employer and received a jury verdict of approximately $600,000, a statutory attorney's fees award of almost $500,000 and a cost award of approximately $88,000, which included expert witness fees of almost $22,000 under. Plaintiff based this cost shifting request based upon the fact that she had made a 998 offer prior to trial, which was not accepted by defendant. The court of appeal found that the trial court had erred in awarding these costs to plaintiff because she revoked the offer during the 30-day acceptance period. The court of appeal ruled that the revocation of a Section 998 offer before expiration of the 30-day acceptance period operates as a forfeiture of its status as a statutory offer for purposes of shifting costs. *16, citing *Marcey v. Romero*, 148 Cal. App. 4th 1211, 1215-1217 (2007); *One Star, Inc. v. STAAR Surgical Co.*, 179 Cal. App. 4th 1082, 1091 (2009); *Marina Glencor, L.P. v. Neue Sentimental Film AG*, 168 Cal. App. 4th 874, 880 (2008).

(b) Plaintiff Over-Estimated the Value of Her Case and Got Hit With a Cost Bill that Was Almost Seven Times Greater Than the Jury Verdict in Her Favor, Resulting in an Amended Judgment in Favor of the Defendants – *Dubord v. Deluca*, 2014 WL 1677986 (4th Dist., Apr. 29, 2014) (Not Reported)

The Delucas owned real property that included a main house and a guest house. They leased the property to Cedric Crespo and, without the Delucas; permission, Crespo sublet the guest house to Dubord. As a result of a fire that occurred in the guest house, Dubord sustained various injuries. She then sued the Delucas and Crespo for damages. Prior to the trial, the Delucas made two written offers to compromise pursuant to Section 998: one for $12,001 and the second for $40,001. Dubord did not accept either one and proceeded to trial against only the Delucas. The jury returned a special verdict finding the Delucas' negligence was a substantial factor in causing harm to Dubord. The jury awarded Dubord damages of $13,100 and, as between the Delucas, Crespo and Dubord assigned the Delucas with 20% of responsibility for Dubord's harm. Based on the jury's verdict, the trial court entered judgment against the Delucas in the amount of $8,720. The parties then litigated the issue of costs.

With regard to costs, the trial court ruled Dubord was liable for the Delucas' costs because the amount of the judgment she recovered against them was less than the amount of their pretrial settlement offers. The court awarded the Delucas their costs and expert fees in the amount of $54,735. After subtracting the amount of damages the Delucas owed Dubord, the court entered an amended judgment in favor of the Delucas for the difference: $46,115. Dubord appealed.

On appeal, Dubord did not dispute the fact that she had failed to obtain a judgment greater than the amount of either of the Delucas' settlement offers. Instead, Dubord argued that neither pretrial offer complied with the requirements of Section 998. With regard to the first offer, the offer stated that to accept the offer, Dubord needed to notify the Delucas in writing and also specified the means of acceptance that would satisfy the statutory requirements for a valid acceptance (i.e., a writing signed by Dubord or her attorney). Dubord argued that the offer itself needed to include an acceptance provision. The court disagreed. "To be valid, the offer did not also have to include a notice of acceptance provision with a signature line for Dubord or her counsel to indicate acceptance." *9. In this regard, the court noted that the offers in the three recent cases relied on by Dubord were completely silent on the manner of acceptance and were invalidated for that reason. See, e.g., *Boeken v. Philip Morris USA, Inc.*, 217 Cal. App. 4th 992, 1001-1004; *Perez v. Torres*, 206 Cal. App. 4th 418, 422-426 (2012); *Puerta v.*

Torres, 195 Cal. App. 4th 1267, 1270-1273 (2011). Having determined that the Delucas' first settlement offer was valid under Section 998, the could found that it was unnecessary to consider the validity of the second offer, relying on the 2013 Supreme Court decision in *Martinez v. Browncо Construction Co.*, 56 Cal. 4th 1014, 1017 (2013), which held that a subsequent 998 offer does not extinguish the prior off for purposes of cost shifting under the statute. As such, regardless of the validity of the second settlement offer, the trial court could properly award costs to the Delucas, including their expert witness fees, based upon the validity of the first offer.

(c) Plaintiff Must Suffer the Consequences of Rejecting a 998 Offer and Then Obtaining Only a Meager Verdict Against Defendant – *Harmon v. Safeway, Inc.*, 2014 WL 2738665 (1st Dist., Jun. 17, 2014) (Not Reported)

Harmon sued Safeway, alleging that while shopping at Safeway, he suffered a fractured wrist and other damages when a train of shipping carts being pushed by a Safeway employee broke free and hit his wrist. Before trial, Safeway made a 998 offer to settle the matter for $100,000. Plaintiff rejected that offer and then, essentially lost at trial when the jury returned a verdict of only $5,060. Safeway then made a section 998 motion for costs of approximately $40,000, which was granted, and resulted in a net award and judgment in favor of Safeway in the amount of approximately $35,000. At the time Safeway made the offer, it had admitted liability in response to requests for admissions propounded by plaintiff. That admission was later withdrawn with the court's permission. Plaintiff's challenge to the cost award was the he could not properly evaluate the offer because, when it was made, Safeway had admitted liability. The court rejected this argument because the issue at the heart of the case was one of causation and was contentious throughout the litigation: namely, whether plaintiff's pre-existing arthritic condition was made worse by the cart accident. In affirming the trial court's award of costs, the court of appeal noted with approval the trial court's observation that the defendant had done "what 998 was precisely designed to do, namely get a genuinely good offer on the table for plaintiff to consider before taking the gamble of the uncertainty of trial." *11. That the plaintiff had had a chance to settle versus going through a protracted trial with expert testimony by both sides clearly irritated the trial court, quoted by the court of appeal as saying the following:

> "Clearly it was [plaintiff's] right to reject [Safeway's] offers and take this matter to trial, but, having done so, he must suffer the consequences of the meager verdict and the overwhelming of same by the legitimate costs that Safeway incurred…. [T]his was a gamble by plaintiff … and the gamble

did not pay off. He was not 'playing with the house's money' here. And whether defendant Safeway is a multi-million dollar corporation or simply an individual of modest means, the company has the right to expect that a rejection of their good faith offer would trigger the consequences set forth in the statute should the verdict fall short of the mark."

Id.

(d) The Nonmonetary Terms of the 998 Offer were Uncertain and Thus not Sufficiently Capable of Valuation for Purposes of Later Determining Whether the Value Offered was More than the Resulting Judgment, so no Shifting of Costs – *Estate of Katz*, 2014 WL 3050128 (4th Dist., Jul. 7, 2014) (Not Reported)

The executor of the estate of David Katz filed an action seeking to substitute funds in a blocked account in place of a lease guaranty given by decedent to El Paseo Collection Elegante, which leased space to decedent's corporation. El Paseo (the landlord) countered that, under the Probate Code, the decedent's estate was required to deposit the total amount that would be payable if the contingent claim was immediately due and prayed for a "declining cash deposit of the entire amount potentially due under the lease" or some other adequate security for the remaining term of the lease. Thereafter, the executor of the decedent's estate served a 998 offer on El Paseo which offered "to provide adequately for, and fully satisfy, the contingent creditor claim … if any debt becomes absolute, established or due" by 1. depositing $780,000 into an interest-bearing, blocked account requiring a court order for any withdrawal, except that interest earned on the blocked savings would be paid annually to the residuary beneficiaries of the estate and, upon expiration of the lease, any remaining principal and accrued interest would then be paid to them; 2. requiring the landlord to file a motion for release of funds if he claimed any default under the lease; and 3. allowing the executor or any residuary beneficiary to seek to modify the judgment on the offer if the landlord obtained other security, the decedent's corporation was sold or it was otherwise believed to be "appropriate" to reduce the security.

After a multi-day trial, the court entered an order requiring the decedent's estate to deposit $559,000 into an interest-bearing account. Withdrawal was authorized only by court order, and expressly provided for the withdrawal by the executor of decedent's estate (presumably for the benefit of the residuary beneficiaries) of $100,000

at nine months, six months and three months prior to the end of the lease. The judgment provided that the balance of the deposit would be released to the executor as ordered in the final decree of distribution. Believing that he was the prevailing party since he had offered to deposit more into an interest-bearing account and withdraw less for the benefit of the residuary beneficiaries, and since both the 998 offer and the judgment required a court order for any withdrawal in the event of a default under the lease, the executor of decedent's estate filed a motion to be adjudicated the prevailing party and to be awarded post-offer costs, including attorney's fees, under Section 998. The executor's post-offer attorney's fees equaled just over $100,000.

The trial court denied the motion on several grounds, including that 1. neither party clearly prevailed, 2. the petition was not an action on a contract (the lease) for which attorney's fees were recoverable under Civil Code Section 1717, and 3. certain terms of the 998 offer were uncertain and thus not sufficiently capable of valuation to determine whether the offered amount exceeded the value of the resulting judgment. In particular, the trial court noted that although the executor offered to deposit more than the court had ordered, the 998 offer also included a unilateral right for the executor or beneficiaries to later seek modification of the judgment, as well as the right to make early withdrawal of interest earnings on the deposit without a court order. The executor appealed.

On appeal, the Fourth District (Bedsworth, Fybel and Thompson) reviewed the trial court's decision *de novo* and determined that the conditional terms of the offer were too uncertain to be valued and, accordingly, affirmed the judgment. In so holding, the court noted that while a 998 offer may include terms or conditions apart from the termination of the pending action in exchange for monetary consideration, such provisions make it difficult and sometimes impossible to determine the value of what was offered. Relying on *Fassberg Construction Co. v. Housing Authority of City of Los Angeles*, 152 Cal. App. 4th 720, 766 (2007), the court held that the trial court was not required to undertake "extraordinary efforts" in an attempt to determine whether the resulting judgment was more favorable than the 998 offer. Instead, the trial court was correct in concluding that the offer was not sufficiently specific or certain to determine its value and deny cost shifting. *4.

(e) When a 998 Offer is Silent With Respect to the Compromise of Attorney's Fees, the Accepting Party May Seek Them – *Biscoe v. The Painted Nail*, 2014 WL 4095744 (2d Dist., Aug. 20, 2014) (Not Reported)

This matter involved an employment dispute between an employee and her former employer. Included in the plaintiff employee's complaint was a cause of action alleging a violation of Labor Code Section 201 for the employer's delay in sending her a final paycheck and requesting an award of statutory attorney's fees under Labor Code Section 218.5. The defendant employer made a 998 offer to plaintiff offering to compromise for $25,000 and providing that payment of such settlement amount shall include a complete release and dismissal of all claims. Plaintiff accepted defendant's offer to allow judgment to be entered in plaintiff's favor and against defendants for the sum of $25,000. After the acceptance, the defendant's counsel emailed plaintiff's counsel a lengthy general release and dismissal document, which plaintiff refused to sign, claiming that it contained terms and conditions inconsistent with the 998 offer. Defendant then filed a motion to have judgment entered pursuant to Code of Civil Procedure Section 664.6. Plaintiff responded by filing a separate motion for attorney's fees under Civil Code Section 1021.5 and Labor Code Section 218.5.

The trial court declined to enter judgment pursuant to Code of Civil Procedure 664.6 because defendant had failed to present evidence of an agreement personally executed by the litigants. The trial court also declined to vacate the proposed judgment on the 998 offer because defendant failed to establish excusable neglect by its counsel in drafting the 998 offer. The trial court then granted plaintiffs motion for attorney's fees under Labor Code Section 218.5 and entered judgment in favor of plaintiff. Defendant appealed.

The court of appeal affirmed the trial court in all regards. With regard to defendant's challenge to the attorney's fee award, the court agreed with trial court that when a 998 offer is silent on attorney's fees, the prevailing party may seek them. See, *On-Line Power v. Mazur*, 149 Cal. App. 4th 1079, 1084 (2007). "Here, the section 998 offer fails to specifically reference and preclude attorney fees. The trial court did not err by awarding fees to [plaintiff]." *3. To add salt to defendant's wound, the court of appeal remanded to the trial court for a determination / add-on to attorney's fees award for plaintiff's fees on appeal.

(f) Defendant's 998 Offer to Settle for $30,000 a Claim Known to Potentially be Worth $500,000 was Found to be Reasonable and Made in Good Faith for Purposes of Shifting Defendant's Costs in Excess of $85,000, Including Expert Witness Expenses of More Than $41,000 – *Najah v. Scottsdale Ins. Co.*, 230 Cal. App. 4th 125 (2d Dist., Sep. 30, 2014)

Holders of promissory note secured by second trust deed to commercial property, who purchased the promissory note secured by a first deed of trust from the lender, took assignment of that deed of trust, foreclosed on a second deed of trust, and acquired title to the property after a full credit bid. The note holders then brought suit against their CGL insurer for the borrower's pre-foreclosure damage to the property. Prior to trial, the insurer made a statutory offer to settle for $30,000, which the plaintiff note holders did not accept. After a defense judgment was entered, the insurer filed a memorandum of costs seeking over $86,000 in costs, including over $41,000 for expert witness expenses. Plaintiffs filed a motion to tax costs, contending that the insurer's offer was unreasonable and in bad faith given the small dollar amount of the offer as compared to the potential exposure of over $500,000 in repair cost damages. Plaintiffs' motion was denied based on the trial court's finding that the insurer's offer was made in good faith and that plaintiffs had failed to show that the requested expenses were unreasonable or unnecessary to the conduct of the litigation. Plaintiffs appealed.

The Second District Court of Appeal affirmed the trial court and held that the reasonableness of a defendant's 998 offer is evaluated in light of what the offeree knows or does not know at the time the offer is made. "Where the defendant obtains a judgment more favorable than its offer, 'the judgment constitutes prima facie evidence showing the offer was reasonable….'" 230 Cal. App. 4th at 143-144, citing *Bates v. Presbyterian Intercommunity Hospital, Inc.*, 204 Cal. App. 4th 210, 221 (2012), quoting *Santantonio v. Westinghouse Broadcasting Co.*, 25 Cal. App. 4th 102, 117. In this regard, the appellate court found that nothing precluded the trial court from concluding that the $30,000 was reasonable based on the ultimate determination that the insurer had no liability. That fact that the insurer's motion for summary judgment on the liability issue had been denied a few months before the offer was made was deemed to be of no moment. "[A]lthough potential damages were extensive, given the reasonable possibility that liability did not exist, the trial court did not abuse its discretion in determining that [the insurer's] offer was reasonable." Id. at 145. See, *Regency Outdoor Advertising, Inc. v. City of Los Angeles*, 39 Cal. 4th 507, 531 (2006) (where liability is in dispute, the fact that defendant's summary judgment motion is denied does not require the defendant "to issue an offer more generous than the one it extended").

(g) Vague Language in Offer Made it Invalid for Purposes of Shifting Costs – *MacQuiddy v. Mercedes-Benz USA, LLC*, 233 Cal. App. 4th 1036 (2d Dist., Jan. 2, 2015) *[Digest provided by Chris Blank]*

Automobile owner brought an action against the manufacturer for breach of warranty under the "Lemon Law" statutes following multiple, unsuccessful repair attempts and sought a refund for the car and a civil penalty for the alleged willful violation of the Song-Beverly Act. Prior to trial, defendant made a 998 offer in which it offered to comply with the restitution provision of the Act, but limited its compliance to repurchase of the car, "in an undamaged condition, save normal wear and tear." That offer was not accepted and the matter proceeded to trial. At trial, the parties stipulated that plaintiff was entitled to $68,948 under the Act for repurchase of the car. The only issue presented to the jury was whether to impose a civil penalty against Mercedes-Benz for willfully failing to repurchase or replace the car. After the presentation of evidence and brief deliberations, the jury returned a special verdict finding that Mercedes-Benz did not willfully fail to repurchase or replace the car. It was then left to the judge to determine which party had prevailed and whether that party was entitled to costs and/or attorney's fees. Based on the finding that the 998 offer was valid and that plaintiff had failed to receive a judgment more favorable than the offer, the trial court taxed all of plaintiff's requested costs, except for his filing fee and service of process costs, and then awarded Mercedes-Benz all of its requested costs, excluding attorney's fees (which totaled $68,000).[31] Plaintiff appealed.

The Second District Court of Appeal agreed with the plaintiff and reversed the trial court. The court noted that in order to be valid, a 998 offer must be unconditional, citing *Barella v. Exchange Bank*, 84 Cal. App. 4th 793, 799 (2000). Mercedes-Benz's offer was not. While defendant offered to comply with the restitution provision of the Act, it limited compliance to repurchase of the car "in an undamaged condition," and what qualified as an "undamaged condition" was not defined, nor was it clear from the offer what would happen if the plaintiff accepted the offer, but Mercedes-Benz subsequently concluded that the car was "damaged" beyond "normal wear and tear." Because of the undefined and subjective nature of the term that Mercedes-Benz would repurchase the car in "undamaged" condition, the appellate court concluded that the 998 offer "was at least ambiguous, and therefore was not valid" for purposes of shifting costs to plaintiff.

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[31] While attorney's fees were denied, how would you like to be a contingent fee plaintiff on the other side of a $68,000 attorney's fees request all because you accepted your attorney's advice to reject the defendant's 998 offer?

See, *Chen v. Interinsurance Exchange of Automobile Club*, 164 Cal. App. 4th 117, 122 (2008). Accordingly, due to the invalidity of the 998 offer, plaintiff's right to recover his costs were not cut off and defendant was not entitled to recoup its post-offer costs. The trial court's cost order was reversed and the matter was remanded with instructions to permit plaintiff to file a new memorandum of costs and to recalculate such costs without regard to Mercedes-Benz's 998 offer.

(h) <u>Plaintiff Saddled with Defendant City's Defense Costs and Attorney's Fees in Excess of One Hundred Thousand Dollars for Maintaining Suit Without Reasonable Cause</u> - *Suarez v. City of Corona*, 229 Cal. App 4th 325 (4th Dist., Aug. 29, 2014) ***[Digest provided by Chris Blank]***

Another cautionary tale about refusing a settlement offer.

Suarez was injured by a gas explosion as a passenger in a car owned by the City of Corona. He sued several parties for his injuries, including the City. As to the City his complaint alleged that the filling station maintained by the City constituted a dangerous condition of public property. Several times the City offered to waive costs in return for a dismissal with prejudice. Suarez never accepted these offers. Eventually, the City was granted summary.

Subsequently, the City moved to recover costs of its defense under CCP § 1038. That section provides a way for public entities to recover costs and fees when a suit is maintained against them without reasonable cause. The trial court awarded more than $100,000.00 in fees and costs against the plaintiff and plaintiff's counsel, Robinson, Calcagnie, Robinson, Shapiro and Davis.

On appeal, the court reversed the award against the attorneys, but upheld it as against the plaintiff. I suppose that was good news, but I'd hate to be the one to have to explain to the client that he alone should bear this expense. Hopefully, the potential for this result was discussed with the client prior to each time the City's settlement offers were refused.

(3) Federal Law – FRCP 68

Rule 68 of the Federal Rules of Civil Procedure is the federal counterpart to CCP § 998 with regard to cost-shifting and statutory offers. The primary distinction is that Rule 68 is a one-way provision available to defendants only. The way Rule 68 works is that up to 14 days before trial, a defendant may serve a plaintiff with an offer to allow judgment to be taken against the defendant for a specified amount of dollars or property with costs as then accrued. Where a suit is brought under a statute that provides for an attorney fee award to the prevailing plaintiff, the relevant "costs" include attorney's fees. *Marek v. Chesny*, 473 U.S. 1 (1985).

In *Marek*, the Supreme Court interpreted the cost-shifting provision of Rule 68 to apply equally in cases where a plaintiff is entitled to an award of attorney's fees under 42 U.S.C. § 1988. This means that if a plaintiff rejects a valid Rule 68 offer made by a defendant and subsequently recovers damages in an amount less than the rejected offer or not at all, the plaintiff is not entitled to recover its post-Rule 68 costs and attorney's fees *and* will have to pay the defendant's post-Rule 68 offer costs. Id.

If the offer is accepted in writing within 14 days, either party may file the offer and acceptance with the court. "The clerk must then enter judgment," Fed. R. Civ. P. 68(a), meaning that the court has no discretion to alter or modify the parties' agreement. *Webb v. James*, 174 F.3d 617, 621 (7th Cir. 1998), citing *Mallory v. Eyrich*, 922 F.2d 1273, 1279 (6th Cir. 1991). If the offer is rejected and the "judgment that the offeree finally obtains is not more favorable than the unaccepted offer, the offeree must pay the costs incurred after the offer was made." Fed. R. Civ. Proc. 68(d). The rule's purpose is to encourage settlement and discourage protracted litigation. *Marek*, supra, 473 U.S. at 5.

While Rule 68 does not expressly state that the defendant's offer must be in writing, it does require that the offer be "served" on opposing counsel. Thus, only a written offer will satisfy the service requirements of Rule 68. See *Magnuson v. Video Yesteryear*, 85 F.3d 1424, 1429 (9th Cir. 1996).

To qualify as a valid statutory offer, the offer must specify a definite sum for which judgment may be entered, but need not include an admission of liability by the defendant. See *Mite v. Falstaff Brewing Corp.*, 106 F.R.D. 434, 435 (N.D.Ill. 1985). A monetary offer must specify a definite sum for which judgment may be entered against the offering defendant so as to provide "a clear baseline from which plaintiffs may evaluate the merits of their case relative to the value of the offer." *Thomas v. Nat'l Football League Players Ass'n*, 273 F.3d 1124, 1130 (D.C.Cir. 2001).

When an offer of judgment is made in a multi-party case, the offer should specify how much each defendant is offering to each plaintiff. Otherwise, if the offer is rejected, it may be impossible to tell whether the judgment obtained by a particular plaintiff against a particular defendant is "more favorable" than the offer. See *Gavoni v. Dobbs House, Inc.*, 164 F.3d 1071, 1076 (7th Cir. 1999). However, where several defendants make a package offer to a single plaintiff, several courts have held that no apportionment is necessary. See *King v. Rivas*, 555 F.3d 14, 19 (1st Cir. 2009); *Le v. University of Pennsylvania*, 321 F.3d 403, 408 (3rd Cir. 2003).

To be valid, a Rule 68 offer must include an agreement to pay plaintiff's costs incurred as of the date of the offer. See *Cruz v. Pacific American Ins. Co.*, 337 F.2d 746, 750 (9th Cir. 1964). Thus, an offer to pay reasonable attorney fees and costs prior to the date of the offer does not permit an award for work done thereafter (e.g., preparing the cost bill and motion for fees). See *Guerrero v. Cummings*, 70 F.3d 1111, 1113 (9th Cir. 1995).

No equivalent procedure exists under federal law for plaintiffs to put cost-shifting pressure on defendants. *Delta Air Lines, Inc. v. August*, 450 U.S. 346, 350 (1981). However, in diversity jurisdiction cases, Rule 68 does not preclude plaintiffs from making settlement demands under the state statutory offer rules. See *MRO Communications, Inc. v. AT&T Corp.*, 197 F.3d 1276, 1281 (9th Cir. 1999). Rule 68 does not apply if the defendant obtains a judgment. *MRO Communications, Inc. v. American Tel. & Tel. Co.*, 197 F.3d 1276, 1280 (9th Cir. 1999), citing *Delta Air Lines, Inc. v. August*, 450 U.S. 346, 351 (1981) ("It is clear that [Fed. R. Civ. P. 68] applies only to offers made by the defendant and only to judgments obtained by the plaintiff. It therefore is simply inapplicable to this case because it was the defendant that obtained the judgment.")

(4) <u>Cases</u>

(a) Ninth Circuit Follows Precedent and Rejects Mootness Arguments Arising from an Unaccepted Rule 68 Offer that Would Fully Satisfy Plaintiff's Claim – *Gomez v. Campbell-Ewald Company*, 768 F.3d 871 (9th Cir., Sep. 19, 2014) ***[Digest provided by Gail Killefer]***

Consumer plaintiff brought putative class action against advertiser alleging violations of the Telephone Consumer Protection Act (TCPA), 47 U.S.C. § 227(b)(1)(A)(iii)(2012). The plaintiff alleged that the advertiser instructed or allowed a third-party vendor to send unsolicited text messages to consumer's cell phone on behalf of the United States Navy, with whom the advertiser had a marketing contract.

The Defendant advertiser offered plaintiff $1,503.00 per violation, plus reasonable costs, but plaintiff rejected the offer by allowing it to lapse. Defendant then moved for summary judgment, arguing that plaintiff's rejection of the offer mooted his individual and class claims.

The Ninth Circuit followed recent precedent in holding that the unaccepted offer alone was not sufficient to moot Plaintiff's individual claim. See *Diaz v. First American Home Buyers Prot. Corp.*, 732 F.3d 948, 950 (9th Cir. 2013)("A]n unaccepted Rule 68 offer that would fully satisfy a plaintiff's claim is insufficient to render the claim moot.")

As Plaintiff rejected the offer before he moved for class certification, his rejection did not affect any class claims. See *Pitts v. Terrible Herbst, Inc.*, 653 F.3d 1081, 1091-92 (9th Cir. 2011)("[A]n unaccepted Rule 68 offer of judgment – for the full amount of the named plaintiff's individual claim and made before the named plaintiff files a motion for class certification – does not moot a class action.")

(b) Court Applies Usual Rules of Contract Construction to Rule 68 Offer of Judgment – *Dowd v. City of Los Angeles*, 28 F.Supp. 3d 1019 (C.D.Cal., May 23, 2014)
[Digest provided by Gail Killefer]

The City made a valid Rule 68 offer of judgment to plaintiff performers in their § 1983 action against the City alleging that certain ordinances regulating vending and expressive activity on beach boardwalk, and City Council's rules of decorum, violated the First Amendment. The Rule 68 offer made specific monetary offers to eight of the ten plaintiffs, and required acceptance by "all plaintiffs." Plaintiffs rejected the offer and obtained a jury verdict for less than the amounts in the Rule 68 offer.

The district court noted that the requirements of a valid Rule 68 offer are simple. "A Rule 68 offer of judgment must (1) specify a definite sum for which judgment may be entered, (2) be unconditional, and (3) include costs then accrued." 28 F. Supp.3d at 1038 (citation omitted).

To determine whether Defendant's offer of judgment met these requirements, the Court applied the usual rules of contract construction. The Court construed ambiguities against the offeror as the drafting party and, where there were ambiguities, the Court examined extrinsic evidence of the parties' intentions to construe the meaning of the offer's material terms.

Plaintiffs argued that the Rule 68 offer was defective for several reasons, including because the Offer was contingent on acceptance by "all plaintiffs" but did not offer money to all plaintiffs and was not served on all plaintiffs, and because the Offer was unreasonable because it required acceptance by "all plaintiffs" despite failing to offer two plaintiffs any incentive to accept.

The district court found that Defendant was justified in not offering money to one plaintiff who had lost interest in the litigation. In granting his counsel's motion to withdraw before the Rule 68 offer, the Court noted that no one had heard from the plaintiff for several months and there was no current address available for him. The defendant had filed a motion to dismiss the plaintiff, which was unopposed. The Court found this plaintiff was not a "plaintiff" in any meaningful sense of the word when Defendant served its Rule 68 offer.

With respect to the second plaintiff who had not been offered money in the Rule 68 offer, the Court noted that this plaintiff had previously entered into a stipulation with Defendant which provided that he had no remaining claims to pursue at trial, but reserved his right to appeal the Court's judgments. The Court found the Defendant's unwillingness to offer this plaintiff a monetary sum was logical, and that the Plaintiff was incentivized to accept the offer. The offer was properly served on his counsel, who also represented the other plaintiffs.

The Court found that where a Rule 68 offer is silent on the right to appeal, the offer's impact on a party's appellate rights is a question "distinct from and irrelevant to the validity of the offer of judgment." *Id.* at 1043.

Finally, the Court found that the City was entitled to costs after plaintiffs' rejection of the Rule 68 offer, and plaintiffs were barred from recovering attorney fees incurred after they rejected the offer – including attorney fees for post-offer time spent on preparing a fee application or litigating the attorney fee issue.

(c) Second Circuit Joins Other Circuits in Reaching the Conclusion that Rule 68 Reverses FRCP 54(d) and Requires a Prevailing Plaintiff to Pay a Defendant's Post-Offer Costs if Plaintiff's Judgment is Less Favorable than the Unaccepted Offer – *Stanczyk v. City of New York*, 752 F.3d 273 (2d Cir., Jun. 3, 2014)

[Digest provided by Gail Killefer]

In a § 1983 action, defendants City and police officers made a Rule 68 Offer to plaintiff, who alleged the officers used excessive force while arresting her. Plaintiff rejected the Offer and proceeded to trial, where she obtained a jury verdict for a sum less than the Offer. The district court limited plaintiff's costs and attorney's fees to those incurred before the Offer, and ruled that the Offer entitled Defendants to costs, excluding attorney's fees, that they incurred after making the Offer. Plaintiff appealed, arguing that Rule 68 cuts off a prevailing plaintiff's right to costs but does not require the prevailing plaintiff to pay defendant's post-offer costs.

The Second Circuit joined other circuits – the First, Fourth, Seventh, and Ninth Circuits – in finding that Rule 68 not only cancels the operation of FRCP 54(d), which entitles a prevailing party to costs, but reverses Rule 54(d) and requires a prevailing plaintiff to pay a defendant's post-offer costs if the plaintiff's judgment is less favorable than the unaccepted Rule 68 offer.

(d) Sixth Circuit Joins Other Circuits in Holding that When Rule 68 Applies, Post-Offer Costs Exclude an Award of Attorney Fees to Defendants – *Hescott v. City of Saginaw*, 757 F.3d 518 (6th Cir., Jul. 2, 2014)

[Digest provided by Gail Killefer]

In a § 1983 action alleging unconstitutional seizure and destruction of personal effects after demolition of rental property, plaintiff property owners rejected City's offer of judgment. After a jury verdict that awarded less than the Rule 68 offer, both the plaintiffs and the City moved for attorney fees.

The district court awarded costs to the plaintiffs, but found that "special circumstances" warranted a denial of attorneys' fees under 42 U.S.C. § 1988(b). The court explained that fees were denied because of "the degree of success obtained" which was "modest," and because the constitutional violation "was of little effect."

The district court granted the City costs and attorneys' fees because plaintiffs' jury award fell below the Rule 68 offer. In response to plaintiffs' motion for reconsideration, the court then reversed itself and denied the City attorneys' fees.

The Sixth Circuit reversed the denial of attorneys' fee to plaintiffs, finding that prevailing civil rights plaintiffs are presumptively entitled to attorney fees under § 1988 and no special circumstances existed to reverse this presumption.

The Sixth Circuit joined the First, Third, Fifth, Seventh, Eighth, and Ninth Circuits in holding that post-offer "costs," to which defendants are entitled when Rule 68 applies, exclude an award to defendants of attorneys' fees under § 1988. Under § 1988, a civil rights defendant may recover attorneys' fees only if the defendant is a "prevailing party" and proves that the plaintiff's action was "frivolous, unreasonable, or without foundation." *Hughes v. Rowe*, 449 U.S. 5, 14 (1980)(citation omitted). As plaintiffs prevailed on their § 1983 claim, the Court properly denied the City's request for attorneys' fees under § 1988.

(e) Prejudgment Interest is not a "Cost" Item Under Rule 68 – *Miller v. Dugan*, 764 F.3d 826 (8th Cir., Aug. 21, 2014) ***[Digest provided by Gail Killefer]***

Plaintiff accepted a Rule 68 offer of judgment in a § 1983 action against the City and police officers, in which he alleged violations of his constitutional rights under the First and Fourth Amendment and several state tort law claims. After the district court entered judgment in favor of plaintiff and against the City and officers jointly, plaintiff moved for attorneys' fees and expenses, and prejudgment interest.

The district court awarded plaintiff attorneys' fees and costs, but declined to award prejudgment interest. Plaintiff appealed on several issues, including his claim for prejudgment interest which, he argued, should have been awarded, at least as to his state law claims.

The Eighth Circuit held that "[p]rejudgment interest is not a 'cost' in th[e] narrow sense" that Rule 68 uses the terms, citing *United States v. Am. Commercial Barge Line Co.*, 988 F2d 860, 864 (8th Cir. 1993). A Rule 68 offer of judgment for a sum certain "must, absent indication otherwise, be deemed to include prejudgment interest. To hold otherwise would undermine the purpose of Rule 68." (Citation omitted).

C. MISCELLANEOUS

(1) Settle with Your Adversary and Sue Your Attorney for Settlement Malpractice – A Possible Trend

Settle and sue cases are generally disfavored, because the "problem with allowing the proposed post-settlement litigation is that it would deprive the settling parties of a major advantage of settlement. Establishing the insured's actual liability after settlement would involve litigation of the very issue that the insured and the insurer attempted to avoid litigating. Whether the claimant wins or loses on the liability issue, he has succeeded in forcing the insurer and insured to litigate the claim they had previously concluded by settling. Allowing such a post-settlement trial on the insured's liability would diminish any advantage to be gained by either the insured or the insurer in settling the underlying claim. Indeed, it would *penalize* the insurer for choosing to settle a claim rather than pursuing it to a final judgment, by subjecting the insurer to subsequent litigation on the liability issue it has already settled." *Moradi-Shalal v. Fireman's Fund Ins. Companies*, 46 Cal.3d 287, 312 (1988); but see *Earth Elements, Inc. v. National American Ins. Co*., 41 Cal. App. 4th 110 (1995) [remedy against insurer available where damages directly result from breach of duty to indemnify]. Thus, courts have not granted post-settlement remedies, for example, in attorney malpractice actions where there is no causal connection between the attorney's negligent acts and omissions and the amount the clients received when they settled. *Barnard v. Langer*, 109 Cal. App. 4th 1453 (2003).

In our inaugural Recent Developments program in 2013, we looked at *Filbin v. Fitzgerald*, 211 Cal. App. 4th 154 (1st Dist., Nov. 12, 2012) as an example of this developing trend of settle with your attorney and then sue your attorney for "negligent" or "inadequate" settlement. Following a bench trial, the trial court in this case entered judgment in plaintiffs' favor on the malpractice claim. The First District Court of Appeal reversed, explaining that in a "settle and sue" malpractice action, the plaintiff must prove that *but for* the malpractice she would *certainly* have received more money. Simply showing that the attorney erred is not enough. The Court noted that the requirement that a malpractice plaintiff prove damages to a "legal certainty" is difficult to meet in "settle and sue" cases because claims of inadequate settlement are often inherently speculative since settlement involves a wide spectrum of considerations and broad discretion. Importantly, however, the Court did not flatly prohibit liability against former counsel for less favorable settlement, and simply concluded that based upon the facts before it, plaintiffs had failed to prove causation or damages as a matter of law.

Last year, we had *Roldan v. Callahan & Blaine*, 219 Cal. App. 4th 87 (4th Dist., Sep. 18, 2013) as a further example of clients suing their attorneys after agreeing to a settlement of the case in which that attorney represented them. Plaintiffs were among a group of elderly, low-income apartment residents who sued the building owner for damages resulting from toxic mold contamination. Callahan & Blaine associated in as counsel, representing the plaintiffs on a contingent fee basis, which also obligated them to advance the substantial costs associated with preparation for trial. Plaintiffs settled the underlying case reluctantly and only after Callahan & Blaine attempted – unsuccessfully – to have them declared legally incompetent so that a guardian ad litem could be appointed to cooperate with the attorneys' settlement efforts. Plaintiffs then brought suit against Callahan & Blaine alleging financial elder abuse, conversion and breach of fiduciary duty, among other claims. The parties stipulated to arbitration pursuant to a stipulation that provided for the law firm to pay all fees and costs associated with the arbitration proceedings, and expressly released the plaintiffs from any potential liability for the costs or fees incurred by the law firm before, during or after the arbitration. Due to the arbitration, the outcome on the merits may not become a matter of public record unless and until the prevailing party seeks confirmation and/or the losing party seeks vacatur of the arbitration award.

This year, we have *Syers Properties III, Inc. v. Rankin*, decided by the First District Court of Appeal in May 2014 (discussed in Section II(A)(3)(b)(iii)) and *Amis v. Greenberg Taurig LLP*, decided by the Second District in March 2015) (discussed in Section II(A)(3)(b)(vi). We also have *Moua v. Pittullo Howington Barker Abernathy LLP*, 228 Cal. App. 4th 107 (2014) decided by the Second District Court of Appeal in June 2014, which offers a new twist – refuse to settle, lose and then blame your attorney..

The backdrop of the *Moua* case was a dissolution action. In 2000, Lilas Moua and Alex Ng participated in a traditional Hmong marriage ceremony. Although they had two children and lived together as husband and wife, they never obtained a marriage license. In 2009, Moua hired the law firm of Pittullo Howington Barker Abernathy LLP (the "Pittullo Firm") to obtain a property settlement and child support from Ng. The Pittullo Firm filed a petition for dissolution of marriage under a putative spouse theory. Ng offered to settle for $550,000. Moua's attorneys strongly recommended that she accept the offer because of the significant risks involved in trying the putative spouse theory which, if she lost, would leave her with nothing. Instead of settling, she fired the Pittullo Firm and hired Stolar & Associates. Ng once again offered to settle. Despite Stolar's recommendation, Moua declined Ng's offer and countered with a demand that he pay her $750,000, which Ng rejected. Later, the family court dismissed Moua's case, finding that Moua was not a putative spouse. Moua received nothing from Ng. She then

sued the Pittullo Firm for legal malpractice. Pittullo moved for summary judgment, arguing that there was no triable issue of material fact as to proximate causation. The trial court agreed and granted the motion. Moua appealed.

On appeal, the Second District affirmed the trial court and held that in order to prevail in a legal malpractice action arising from a civil proceeding, the plaintiff must show, among other things, a proximate causal connection between the attorney's alleged negligence and the resulting injury she suffered. Therefore, where the allegedly negligent conduct does not cause damage to the plaintiff client, it does not give rise to a cause of action against her attorney in tort. Under the facts of this case, Pittullo strongly urged Moua to accept Ng's settlement offer, but she refused. Next, Stolar also encouraged her to accept Ng's settlement, but she refused once again. The court concluded that any damage resulting from the dismissal of her family law case was attributable to her decision to decline the settlement offers. Thus, the trial court properly granted Pittullo's motion for summary judgment because, as a matter of law, there was no causal connection between any alleged malpractice and Moua's loss.

(2) <u>Email Signature is not the Same as an Electronic Signature Under the UETA for Purposes of Enforcing a Settlement Accomplished Via an Exchange of Emails</u> - *J.B.B. Inv. Partners, Ltd. v. Fair*, 232 Cal. App. 4th 974, *as modified* (1st Dist., Dec. 30, 2014), *review filed* (Feb. 9, 2015) ***[Digest provided by Chris Blank]***

This case involves the interplay of California's Uniform Electronic Transactions Act ("UETA") and CCP § 664.6. Section 664.6 provides an expedited procedure for enforcing a settlement agreement by motion. To qualify for the expedited procedure, the settlement agreement must be in writing and signed by all of the parties, or it must have been read into the court record in the presence of the parties and affirmed by them on the record. Section 664.6 is more stringent than the statute of frauds, which merely requires a writing signed by the party to be charged. It is also more stringent than common law which allows for enforcement of oral agreements, and for certain agreements to be executed by an agent of a party, such as the party's attorney.

In *J.B.B. Investment Partners*, plaintiffs' lawyers and the defendant (a former lawyer) emailed back and forth regarding the terms of their proposed settlement. The email stream contemplated a formal agreement to be executed by all parties. After receiving the formal written settlement agreement, defendant changed his mind and decided not to sign it, and not to settle on the terms proposed in the email stream. The trial court granted plaintiffs' motion to enforce it under Section 664.6, finding it more

probably than not that the defendant had agreed to the settlement terms contained in the email stream. The appellate court reversed.

Both decisions focused on whether the defendant's name typed on the bottom of his emails constituted an electronic signature. The trial court focused on just Civil Code § 1633.7(d) which provides "[i]f a law requires a signature, an electronic record satisfies the law." The trial court ignored other provisions of UETA. The appellate court held that for one's name at the bottom of an email to be considered an "electronic signature" (a) the parties must have agreed to proceed under UETA, and (b) the person whose name is typed at the bottom of the email must have intended that act to be an electronic signature. The appellate court found no evidence to support either element under UETA. Because Section 664.6 requires all of the parties to sign the settlement agreement, failure to qualify the typed name as an electronic signature precluded use of the expedited procedure. Therefore, the decision was reversed and the case was remanded.

Although the terms of the email stream were not enforceable under section 664.6, that does not mean those terms are a nullity. Although the appellate decision did not address it, other cases have held that an oral settlement agreement may still be enforced under other procedures, such as by separate lawsuit, or summary judgment in the lawsuit that was orally settled.

The case also raises but does not decide whether the prevailing party might be entitled to an award of attorneys' fees under the operative agreement between the parties. The plaintiff originally asked for an award of fees, but the trial court denied it holding that the operative agreement provided for fees if the parties arbitrated, but because they did not arbitrate, no fees were awardable. The appellate court held no fees were awardable because the plaintiffs were not the prevailing parties at this stage of the proceedings.

Practice tips: If you want to use Section 664.6 to enforce your back of the napkin deal point memorandum, make sure everyone signs it. Better yet, go straight to the final settlement documents and get everyone to sign that, either in ink, or electronically. If you're going to accept electronic signatures, be sure you've complied with UETA. And if you are drafting or have an agreement with an ADR provision and an attorney's fee clause in it, make sure you've adequately expressed or understood the conditions to imposing fees on the other side.

(3) <u>Personal Injury Plaintiff's Motion to Tax Prevailing Defendant's Costs Denied. Costs Incurred by Defendant in Photocopying Plaintiff's Extensive Medical Records Allowed as Prevailing Party Costs</u> - *Naser v. Lakeridge Athletic Club*, 227 Cal. App. 4th 571 (1st Dist., Jun. 27, 2014) ***[Digest provided by Chris Blank]***

When evaluating any settlement proposal, the parties should compare the proposal to the Worst Alternative to Negotiated Agreement (WATNA) and Best Alternative to Negotiated Agreement (BATNA) for each party. This case raises the stakes slightly by holding that the prevailing defendant in a slip and fall personal injury action was entitled to recover the cost of photocopying documents it obtained from the plaintiff's medical service providers by way of records only subpoenas.

Recovery of costs is governed by CCP § 1033.5. That section mentions the costs of taking depositions and the cost of photocopying exhibits for trial as recoverable. It does not specifically mention the cost of copying exhibits obtained by use of a records only subpoena. The trial court found that prevailing party photocopying costs related to obtaining medical records were recoverable because they were cost effective, reasonable and necessary (undisputed by either party) to the litigation.

The appellate court affirmed, holding that a records only subpoena was the equivalent of a custodian of records deposition. The court observed that it would be anomalous to deny costs where defendant used a more economical procedure.

(4) <u>Employee was Entitled to Mandatory Costs in Dispute with Employer that Ended in Partial Dismissal Because She Received a "Net Monetary Recovery" Via the Settlement Payment</u> - *DeSaulles v. Community Hospital*, 225 Cal. App. 4th 1427 (6th Dist., May 2, 2014) review granted and opinion superseded, 174 Cal. Rptr. 3d 296 (Jul. 23, 2014) ***[Digest provided by Chris Blank]***

Employee was entitled to mandatory costs in dispute with employer after settlement had been reached (and a partial dismissal filed) because she received a net monetary recovery as her settlement payment. Mandatory costs are governed by CCP § 1032, and allows "the party with the net monetary recovery" to recover costs as a matter of right. Employee argued that the settlement payment was a net monetary recovery, while employer argued that the settlement payments had to be disregarded under *Chinn v KMR*, 166 Cal. App. 4th 175 (2008). Employer contended that it was a defendant in whose favor a dismissal was entered and as the judgment provides that

the employee shall "recover nothing," the plaintiff thus recovered no relief. The court rejected the employer's argument and held that since the settlement agreement was silent regarding costs, the payment by the employer to the employee triggered the mandatory costs as a "net monetary recovery" under CCP §1032.

(5) <u>Plaintiff Saddled with Defendant's Costs Where Action was Dismissed Pursuant to Settlement that did not Include the Petitioning Defendant</u> – *Sheldon v. Strong*, 2014 WL 4694069 (4th Dist., Sep. 22, 2014) (Not Reported) ***[Digest provided by Chris Blank]***

Be careful when your settlement involves dismissal against several defendants if fewer than all of them are signing releases. The ones who don't sign releases are entitled to an award of costs.

The history of this case is fascinating, but much too long to express in detail in these materials. The underlying case was for breach of contract, among other claims, involving the purchase of intellectual property from four individuals by Novell, Inc. The initial trial took place in 2006 and at trial Novell produced 17,000 pages of documents in electronic form that it neglected to produce during discovery. As a sanction, the trial court severely limited Novell's defenses, essentially entering a directed verdict on liability. The jury then awarded the plaintiffs $20 million. On appeal, the court reversed the judgment holding that a monetary sanction would have been sufficient to vindicate the plaintiff's discovery rights and remanded for a determination of the amount of sanctions.

On remand, the trial court entered several sanction orders because several attorneys had been involved in the trial of the case. One such order was in favor of attorney Bill Suojanen in the amount of approximately $1 million. Several other attorneys who had previously been involved in the case demanded a share of the $1 million award. Kathleen Strong was among them. To resolve the competing claims, the plaintiffs filed a declaratory relief action against all of the claimants. In their complaint they disclaimed any interest in the sanction award and alleged that the whole thing should belong to Suojanen. Several of the defendants cross-complained against everyone else, including the plaintiffs.

One of the plaintiffs, Sheldon, tired of the litigation and assigned his rights (whatever those might be in light of the plaintiffs' disclaimer in their complaint) to one of the other plaintiffs. He entered into a settlement with Reed, agreeing to dismiss his complaint in return for Reed dismissing his cross-complaint against Sheldon. Immediately after the dismissal of the complaint was entered, Strong filed a

memorandum of costs as prevailing party as against Sheldon. The trial court awarded costs to Strong over Sheldon's objection.

Sheldon appealed, arguing that Strong was not the "prevailing party" because the claims continued against her. He also argued that electronic filing fees she incurred were not recoverable as costs. The appellate court affirmed. It pointed out that even a dismissal without prejudice gives rise to a mandatory award of costs. The purported assignment of Sheldon's claims to one of the other plaintiffs was of no moment. Because electronic filing is now mandatory in the OCSC, the fees associated with it are awardable as costs even though they are not specifically mentioned in CCP §§ 1032 or 1033.5. They are reasonable and necessary and within the discretion of the court to award.

Practice tip: If you're going to dismiss a complaint against several defendants, try to get releases from all of them before the dismissal is filed.

IV.
PANEL BIOS

Christopher Blank has a solo practice in Newport Beach, CA, concentrating in business litigation, real estate finance and business bankruptcy. Previously, he was a partner with an international firm in its Newport Beach office. Chris serves on the Mediation Panel of the United States Bankruptcy Court for the Central District of California. Chris also serves as a fee arbitrator and mediator for the OCBA, and from 2007 through 2013 he served as Co-Chairperson of the OCBA Mandatory Fee Arbitration Committee. He was appointed to the California State Bar Mandatory Fee Arbitration Committee in 2013. He has two adult sons who he is proud to say are self-supporting. For fun, Chris is a bread baker and a licensed pilot with an instrument rating. Contact Info: clblank@pacbell.net 949-250-4600.

Rebecca Callahan is a 30-year, AV-rated attorney who acts a mediator, arbitrator and court referee. She is a full-time neutral with ADR Services, Inc., and is also on the arbitration and mediation panels of the American Arbitration Association. Rebecca has been in the ADR trenches for 15+ years and knows how to put theory into practice. Her experience covers a broad spectrum – including real property, employment, wills and trusts, financial elder abuse and general business/commercial disputes – and is dedicated to helping parties resolve their disputes in a way that is efficient, economical and effective. Rebecca received her JD from the University of California at Berkeley and her undergraduate degree from the University of Southern California. In 2007, she earned an LLM in Dispute Resolution from Pepperdine University School of Law. She is the Immediate Past Chair of the ADR Section of the OCBA and a current member of the OCBA Board of Directors. Rebecca teaches ADR courses as a faculty member of the American Arbitration Association University and as an adjunct professor at Pepperdine University School of Law.

Peter D. Collisson has more than 30 years experience as a commercial litigation attorney in state and federal court. He has been actively involved in the entire range of ADR for almost his entire career. Peter has been a neutral arbitrator with the American Arbitration Association for more than 25 years, arbitrating substantially more than 250 cases to completion. He has been a member of the AAA's national Board of Directors since 1992. In the majority of his arbitration cases, Peter has served as a single, neutral arbitrator, but has also served in many cases as a party-appointed or neutral arbitrator on a three-member panel. In 1983, Peter received the AAA Distinguished Service Award. Peter received his JD from Vanderbilt University and earned a Bachelor's Degree in economics from the University of North Carolina at Chapel Hill.

Rex S. Heinke is co-head of the Supreme Court and Appellate practice at Akin Gump Strauss Hauer & Feld LLP. He has argued over a hundred appeals in federal and state courts throughout the country. Several of his current appeals involve the enforceability of arbitration clauses. Mr. Heinke also has served as lead trial and appellate counsel on behalf of the media in First Amendment, intellectual property, entertainment, and Internet disputes. He has lectured on media, entertainment, Internet, intellectual property, advertising, constitutional, and appellate law for programs presented by many professional and educational organizations. He has also written numerous articles on these issues and is the author of *Media Law* (BNA). Mr. Heinke is a former president of numerous organizations including the Los Angeles County Bar Association and Public Counsel. He is a member of the American and California Academies of Appellate Law. This year, the Southern California Super Lawyers ranked him as one of its Top Ten Lawyers.

Lisa Jaye has been a Circuit Mediator with the U.S. Court of Appeals for the Ninth Circuit since 1998. She conducts global settlement negotiations in federal civil appellate disputes and related federal, state, bankruptcy, workers' compensation and administrative proceedings. Ms. Jaye successfully has mediated to resolution hundreds of appeals including but not limited to constitutional, civil rights, bankruptcy, employment, ERISA, intellectual property, commercial, tax, personal injury, insurance, environmental, tribal, agency and administrative disputes and immigration matters. Since 2001, Lisa has served on special assignment with the Honorable Edward Leavy, Senior Circuit Judge, and mediators from the Federal Energy Regulatory Commission mediating hundreds of petitions seeking refunds arising from the California Energy Crisis with total settlements of in excess of $8 billion. Before joining the court, Ms. Jaye was an equity partner at Hancock, Rothert & Bunshoft in San Francisco, where she litigated insurance and business cases. She is a graduate of Georgetown University Law School and Georgetown University.

Gail Killefer serves as the ADR Program Director for the U.S. District Court, Central District of California. In her work at the district court, Ms. Killefer oversees the administration of the Court's ADR Program and serves as a mediator herself. Before joining the Court in August 2010, Ms. Killefer had a private mediation and law practice in San Francisco and taught mediation at U.C. Hastings College of Law. She served as an Assistant United States Attorney in San Francisco from 1989 to 2001, as Deputy Chief of the Civil Division from 1994 to 1998, and as Chief, Civil Division, from 1998 to 2001. Before joining the U.S. Attorney's Office, she served as a Trial Attorney with the U.S. Department of Justice, Torts Branch, in Washington, D.C., and as a law clerk to the Honorable Barrington D. Parker (D.D.C.).

Lance A. LaBelle is an AV-rated attorney with over 30 years of experience. He is a principal in the law firm of Berger Kahn and leads the firm's third-party Insurance Coverage Practice Group. Lance is a co-founder of IDR Mediation Services, and also serves as a neutral on the Commercial and Complex Coverage panels of the American Arbitration Association. Lance is the current Chair of the ADR Section of the Orange County Bar Association. As a practicing attorney, and as a member of both the California and Minnesota State Bars, Lance has been instrumental in helping to settle thousands of disputed claims and litigated matters. Lance received his mediation training and certification through UC Irvine's Conflict Management and the Use of Alternate Dispute Resolution program. Lance is often retained as an expert. He frequently makes presentations to businesses, insurance professionals, Bar associations and other community groups. He also has authored and contributed articles to consumer and trade publications. Lance has been named to the list of Southern California Super Lawyers in the area of Insurance Coverage from 2009-2015, including the "Top 100" Southern California Super Lawyers in 2013 and the "Top 50" Orange County Southern California Super Lawyers from 2013 – 2015.

Barbara A. Reeves, Esq. has been a full-time neutral with JAMS since 2006, following a career as a litigator and corporate counsel. She has served as an arbitrator, mediator, court appointed master, provisional director, and discovery referee in many areas of commercial law in hundreds of matters. Her practice focuses on commercial disputes, employment, insurance and health care. She has also built upon her involvement in the equestrian world to develop a specialty in equestrian law. She is a certified Electronic Discovery Specialist through ACEDS. She has an exceptionally broad legal background that qualifies her in a wide range of subject areas, using her legal, analytical, and conciliation skills to craft the best possible resolution for each case. She is adept at handling large, complex cases, as well as disputes in which the parties have significant emotional involvement. She received her JD from Harvard Law School, cum laude, and clerked for the Honorable Alfred T. Goodwin of the United States Court of Appeals for the Ninth Circuit. Ms. Reeves also is an adjunct professor at USC School of Law.

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