ORANGE COUNTY BAR ASSOCIATION

ADR Section Meeting

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What Commercial Neutrals Need to Know: Recent Decisions and Legislation in 2018 Affecting Arbitration and Mediation Practice

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I.
<u>MEDIATION DEVELOPMENTS</u>

1. Mediation Confidentiality – California Law

(a) *Background Statement*

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 <u>not</u> 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.

After the California Supreme Court decided the *Cassel* case in 2011, a firestorm of negative publicity and public opinion erupted. In response, Assemblyman Gorell introduced AB 2025 in 2012, which proposed to create an exception under Evidence Code § 1124 for "evidence of legal malpractice, breach of fiduciary duty or State Bar disciplinary action." As proposed, the bill still barred the attorney from introducing testimony by other participants (such as the adverse party and the mediator) to defend against the malpractice claims. 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. AB 2025 passed the Assembly in 2012, but then stalled in the Senate Rules Committee. When Gorell was unsuccessful in negotiating a compromise bill in the Senate, the matter was referred to the California Law Revision Commission (CLRC) to analyze the issue and make a recommendation.

Over a five-year period, the CLRC conducted a study, commonly referred to as "Study K-402 – Relationship Between Mediation Confidentiality and Attorney Malpractice and Other Conduct," and conducted numerous public hearings where it received extensive comments in favor and against the proposed amendment. Those advocating for no exception to the broad confidentiality protection afforded by Evidence Code Section 1119, argued that the broad, blanket protection promotes candor, encourages the exchange of information and discussion about information, facilitates greater freedom in discussing possible settlement frameworks and terms, encourages parties to speak to each other directly in joint session, promotes finality / closure and discourages "buyer's remorse" and post-settlement litigation. Those advocating for the exception legislation argued that it would encourage better behavior by all during mediation, promote public confidence in the integrity of the mediation process, and encourage greater decision making responsibility on the part of the

client / party. They also argued that mediated settlements should not be "super contracts," immune from attack on grounds of fraud, duress or coercion, and that attorneys should not be able to hide their incompetence or misconduct under the cloak of mediation confidentiality.

In November 2016, the CLRC proposed draft legislation in its "Memorandum 2016-58," providing for new Section 1120.5 to be added to the Evidence Code that would create an exception to mediation confidentiality protection for "alleged misconduct" of lawyers when representing clients in mediation.[1] The CLRC then took additional public comment and held additional hearings on the proposed legislation. Following intense opposition and debate, in December 2017, the CLRC voted 4 to 1 to send proposed Section 1120.5 to the Legislature in the form of a sponsored bill. That action was met with strong opposition and plans by opponents of the bill to introduce their own competing legislation.

(b) New Evidence Code § 1129 - Attorneys to Obtain Informed Consent from Their Clients re the Restrictions Attendant to Participating in a Mediation

With the support of the California Dispute Resolution Council (CDRC) and others, in January 2018, Senator Wieckowski proposed SB 954 to address the perceived "*Cassel* problem." Instead of creating statutory exceptions to mediation confidentiality, this proposed legislation took another tact directed at the attorney-client relationship, which was the context in which the breadth of mediation confidentiality was tested. The proposed new Evidence Code section would require an attorney representing a person participating in a mediation or a mediation consultation to inform his or her client of the confidentiality restrictions related to mediation, and to obtain informed written consent from the client that he or she understands the restrictions and opts to proceed with participating in a mediation or mediation consultation. SB 954 was approved in August 2018 and signed by the Governor in September 2018. It became effective January 1, 2019. And with that, the saga concerning what statutory exceptions to mediation confidentiality are needed after the California Supreme Court's decision in *Cassel* appears to have come to an end.

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[1] As drafted, the CLRC's proposed Section 1120.5 provided for an exception to mediation confidentiality that would allow disclosure / introduction of (1) evidence relevant to prove or disprove an allegation that a lawyer committed malpractice during a mediation, *if* (2) the evidence is sought or proffered in connection with resolving (a) a complaint against the lawyer under the State Bar Act (Business & Professions Code §§ 6000 et seq.) or (b) a claim of malpractice. The proposed new Section 1120.5 included specific language allowing a court to use a variety of tools to limit the publication of what would otherwise be a confidential mediation communication – e.g., sealing order, protective order, redaction, in cameral hearing, etc. It also included a provision requiring that a notice of complaint must be reasonably provided to all mediation participants (regardless of their status as parties to the complaint or action) so as to allow them to protect themselves from disclosures.

Section 1129, as added to the Evidence Code, reads as follows:

1129. Before engaging in a mediation or a mediation consultation, an attorney representing a client participating in the mediation or a mediation consultation shall inform his or her client of the confidentiality restrictions as described in Section 1119, and obtain the client's written consent to the restrictions, in a form acknowledging that the client is informed of the restrictions and understands them.

The new law includes a 700-word exemplar of how the advance disclosure and acknowledgement should read. A copy of that exemplar is included in Attachment 1.

II.
CONTRACT ARBITRATION DEVELOPMENTS

1. Statutory Developments

(a) *California's SB 766* effective January 1, 2019 – Changes to the Code of Civil Procedure allow foreign attorneys and out-of-state attorneys to represent parties in California mediations, arbitrations and other ADR proceedings related to international commercial disputes.

(1) *Background Statement*

International arbitration, while a branch of what is broadly referred to as "commercial arbitration," is in fact a distinct field. First of all, it is governed by an international treaty known as the New York Convention,[2] which provides that the courts of each of its signatory nations will recognize and enforce arbitration awards that conform to the convention, thereby allowing the parties to avoid the problems typically encountered when trying to enforce a court judgment in a country foreign to the issuing court. Second, it involves disputes between private parties and/or governments where the courts that are "home" to one party are "foreign" to one or more of the other parties. International arbitration provides all parties to a dispute with a neutral and impartial forum. According to a recent study by White & Case LLP and the School of International Arbitration at Queen Mary University of London, 92 percent of in-house lawyers surveyed stated that international arbitration is their preferred method for resolving cross-border commercial disputes. That translates into big business for jurisdictions that are favored as host jurisdictions. New York is one such jurisdiction and, according to a 2014 report in *The Economist*, international arbitrations produces over $1 billion a year in economic benefits to New York City, including fees paid to New York law firms and the ancillary revenue flowing to hotels, restaurants and other businesses.

California is the world's fifth-largest economy, ahead of the United Kingdom and just behind Germany. Additionally, California is home to some of the world's largest companies and Los Angeles operates one of the busiest ports in the world. Given its internationally oriented economy and its talented legal infrastructure, California is an ideal venue for international commercial arbitration. However, it has not been viewed as a favorable host jurisdiction for international arbitrations because of the 20-year old decision of the California Supreme Court in *Birbrower, Montalbano, Condon & Frank v. Superior Court*, 17 Cal. 4th 119 (1998), and the ambiguity that decision created with respect to Code of Civil Procedure Section 1297.351, which states that a party to an international arbitration proceeding may be "represented or assisted by any person of their choice" and that such a person or representative "need not be a member of the legal profession or licensed to practice law in California."

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[2] The full name of the treaty is the "Convention on the Recognition and Enforcement of Foreign Arbitral Awards," and is codified in Chapter 2 of the Federal Arbitration Act (9 U.S.C. §§ 201-208.

The *Birbrower* case involved a fee dispute between a California client and a New York law firm. The firm was retained to represent the client in a domestic arbitration, which ultimately settled. Attorneys from the New York law firm made trips to California where they discussed matters related to the legal dispute, provided legal advice and made strategic recommendations. The issue was whether these activities constituted the "practice of law in California" as that term is used in Section 6125 of the Business and Professions Code. This was a case of first impression for the Court. In the context of domestic arbitration, the Court concluded that the "practice of law in California" was not limited to the situation where an attorney was physically present and encompassed activities that entail "sufficient contact with the California client to render the nature of the legal service a clear legal representation." In this regard, the Court held that the "primary inquiry is whether the unlicensed lawyer engaged in sufficient activities in the state, or created a continuing relationship with the California client that included legal duties and obligations." Applying this reasoning and definition, the Court concluded that the New York law firm had practiced law in California in violation of Business and Professions Code Section 6125 and, as a consequence, the firm was not entitled to receive compensation under the fee agreement for any services performed in California.

The restrictions imposed by the California Supreme Court's interpretation of Section 6125 were removed by an amendment to Code of Civil Procedure § 1282.4, but only with respect to (a) domestic arbitrations, and (b) attorneys licensed in other U.S. states or territories. For this circumstance, Section 1282.4 provides a process similar to the "pro hac vice" process utilized by the courts, only it requires the out-of-state attorney to register with the California State Bar after obtaining the arbitrator's permission to appear in the arbitration with California counsel associated into the matter as co-counsel. The "illegal practice of law" restrictions imposed by *Birbrower* with respect to foreign and out-of-state attorneys appearing in international arbitrations remained until the enactment of SB 766. 2019 thus marks the year that California will throw its hat into the ring and start competing to share in the economic benefits that flow from being a host jurisdiction for private, international arbitration proceedings.[3] In this regard, Chris Poole, the president and CEO of JAMS, explained the anticipated impact of SB 766 in a press release as follows:

> "The passing of SB 766 will position California as a leading market for international arbitration proceedings by allowing the participation of out-of-state and non-U.S. lawyers. It will not only bring advantages to California, our businesses, and the statewide economy, but it provides a sophisticated legal market for businesses and attorneys participating in international arbitration proceedings."

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[3] There very much is a competition for international arbitration business. Fifty-three countries and 19 U.S. states authorize attorneys from foreign countries to represent clients in international arbitrations seated in their jurisdictions. Within the last five years, several countries have announced pro-arbitration reforms, including Russia, India, Saudi Arabia, and Japan. Similarly, New York, Florida, Georgia and other states have established international arbitration centers, and have taken steps to welcome foreign attorney representation of parties in international arbitration.

(2) New CCP §§ 1297.185 - 1297.188

SB 766 makes several amendments to the existing provisions contained in the international arbitration section of the California Arbitration Act (CCP §§ 1280, et seq.). Through new Code of Civil Procedure Section 1297.185, out-of-state and non-U.S. lawyers may be "qualified" to act as an attorney in an international arbitration or related conciliation, mediation or alternative dispute resolution proceeding if they are:

> "(a) Admitted to practice law in a state or territory of the United States or District of Columbia or a member of a recognized legal profession in a foreign jurisdiction, the members of which are admitted or otherwise authorized to practice as attorneys or counselors at law or the equivalent.
>
> (b) Subject to effective regulation and discipline by a duly constituted professional body or public authority of that jurisdiction.
>
> (c) In good standing in every jurisdiction in which he or she is admitted or otherwise authorized to practice."

Through new Code of Civil Procedure Section 1297.186, a "qualified attorney" may participate in an international arbitration or related conciliation, mediation or alternative dispute resolution proceeding if any of the following conditions is satisfied:

> "(1) The services are undertaken in association with an attorney who is admitted to practice in this state and who actively participates in the matter.
>
> (2) The services arise out of or are reasonably related to the attorney's practice in a jurisdiction in which the attorney is admitted to practice.
>
> (3) The services are performed for a client who resides in or has an office in the jurisdiction in which the attorney is admitted or otherwise authorized to practice.
>
> (4) The services arise out of or are reasonably related to a matter that has a substantial connection to a jurisdiction in which the attorney is admitted or otherwise authorized to practice.
>
> (5) The services arise out of a dispute governed primarily by international law or the law of a foreign or out-of-state jurisdiction."

New Code of Civil Procedure Section 1297.187 makes it clear that being a "qualified" out-of-state or non-U.S. attorney for purposes of appearing in an international commercial arbitration matter will not authorize that person to appear in court unless he or she applies for and receives permission to appear as counsel pro hac vice pursuant to the California Rules of Court as may be applicable.

New Code of Civil Procedure Section 1297.188 makes it clear that a "qualified" out-of-state or non-U.S. attorney appearing in an international commercial arbitration matter will be subject to the California Rules of Professional conduct and the laws governing attorney conduct to the same extent as a member of the California State Bar.

(b) ***Code of Civil Procedure § 1281.2*** **– effective Jan. 1, 2018 –** Allows courts to deny enforcement of predispute arbitration agreements contained in documents pertaining to legitimate bank accounts as the basis for compelling arbitration of fraud and identity theft claims arising from bogus accounts opened by the bank's employees in the customer's name without the customer's knowledge or consent.

Wells Fargo, like many financial institutions, requires customers to give up their right to sue in court and to sue in a representative or class capacity when they sign up for personal accounts and other services. In 2013, it was revealed that at least 3,500 Wells Fargo employees had opened approximately 1.5 million bank accounts and over 500,000 credit card accounts using existing customers' names and personal identification information, and that they had done so without the account holders' knowledge or consent. Investigations revealed that the targets of this conduct were often young adults opening their first bank account, small businesses, non-English speaking immigrants and the unsophisticated or infirm elderly. When customers attempted to sue over fees and other damages incurred as a result of the bank's conduct concerning these unauthorized accounts, Wells Fargo successfully argued in state and federal courts across the country that the private arbitration agreements contained in the agreements pertaining to the customers' legitimate accounts were applicable to their claims arising from the fraudulently created accounts. Consumer advocates and others believed that by forcing these matters into arbitration, Wells Fargo was able to (a) keep the scandal out of the public view, (b) allow the fraud to be further perpetrated, and (c) enable the bank to continue profiting from the fraudulent accounts.

In response to the disclosure of the bogus account scheme and Wells Fargo's strategic use of arbitration to keep this problem out of public view, Senator Bill Dodd (D-Napa) and California Treasurer John Chiang proposed SB 33 to amend Code of Civil Procedure section 1281.2(d) to preclude forced arbitration in lawsuits against financial institutions for claims arising out of accounts created by fraudulent, illegal or otherwise surreptitious means.

The proposed amendment became law in October 2017 and becomes effective January 1, 2018. As amended, Code of Civil Procedure § 1281.2(d) allows a court to deny enforcement of an arbitration agreement if it determines that the petitioning party is a state or federally chartered depository institution seeking to apply a consensual arbitration agreement to a purported contractual relationship with the respondent consumer that was "created by the petitioner fraudulently without the respondent consumer's consent and by unlawfully using the respondent consumer's personal identifying information…."

Several bank and business trade groups opposed SB 33, arguing that the FAA preempts state laws that single out arbitration agreements for special treatment and that SB 33 is such a law. Given the current popularity in many state and federal courts of appeal to take on various arbitration topics for review, it is anticipated that there will be litigation concerning the amendment to subdivision (d) of Code of Civil Procedure § 1281.2 in the near future. However, it will probably be several years before we receive a definitive statement from the United States Supreme Court, if at all, with regard to whether or not the amendment to subdivision (d) violates the strong federal policy announced by Section 2 of the FAA to recognize the validity and enforceability of arbitration agreements to the same force and effect as any other contract.

(c) ***AB 3080* – vetoed by Governor Brown in September 2018 –** Legislation banned the enforceability of arbitration agreements required as a condition of employment to the extent that such agreements would require employees to waive any right, forum or procedure for complaining about discrimination, harassment retaliation and other Labor Code violations.

For the past several years, there have been several legislative attempts to ban employers from requiring mandatory arbitration agreements as a condition of employment. 2018 was no exception.

In 2015, the State Legislature passed – and Governor Brown vetoed - AB 465, which would have enacted legislation banning / forbidding employers from requiring employees to agree to mandatory arbitration as a condition of employment. Governor Brown's veto message explained that purported employment abuses "should be specified and solved by targeted legislation, and not a blanket prohibition."

Such "targeted legislation" was enacted in 2017 and was the subject of last year's updates program. In 2017, the state Legislature passed SB 1241 and added Section 925 to the Labor Code, prohibiting employers from requiring an employee who primarily resides and works in California to agree, as a condition of employment, to a provision that would either require the employee to litigate or arbitrate employment disputes (1) outside of California, or (2) under the laws of another state. New Section 925 was targeted legislation aimed at attacking contractual provisions that are hostile to California law, whether they appear in an arbitration clause or elsewhere within an employment agreement required as a condition of employment.

In 2018, the crusade against mandatory arbitration clauses in employment contracts got a boost from the #MeToo movement. At the federal level, in February 2018, every attorney general in the United States signed a letter supporting the "Ending Forced Arbitration of Sexual Harassment Act" introduced in both the House (H.R. 4734) and Senate (S. 2203) in December 2017. The proposed legislation prohibits a predispute arbitration agreement from being valid or enforceable if it requires arbitration of a sex discrimination dispute. It is still pending in Congress.

In August 2018, California joined several other states that have been trying to ban companies from forcing employees to agree to arbitration by passing passed AB 3080, which bans arbitration agreements by characterizing them as illegal and unenforceable contracts to the extent that such agreements would require an employee to waive any right, forum or procedure for complaining about discrimination, harassment, retaliation, wage and hour and other FEHA and Labor Code violations. Governor Brown vetoed the bill in September 2018. The bill was labeled as "job killer" legislation by the Cal Chamber.

Notwithstanding the failed enactment of AB 3080, Google issued a press release announcing the amendment of its workplace policies so as to allow employees to pursue workplace sexual harassment claims in court instead of being required to pursue them through private, individual arbitration. Shortly thereafter, Facebook, eBay, and Airbnb followed suit with similar announcements. The new policies apply only to sexual harassment claims – not all wage and hour and other FEHA or Labor Code violations, which were targeted by AB 3080. In this regard, the aforementioned companies have made it clear that mandatory arbitration for discrimination, contract violations, wage and hour disputes and other harassment or workplace issues is still firmly in place.

2. Arbitrability and Who Decides the Issue

(a) *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) ("*Volt*").

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) ("*First Options*"); 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. Under the FAA, the issue of whether the parties

have a valid arbitration agreement is to be decided by the courts, unless the parties' contract contains a clear and unmistakable delegation of such issues to the arbitrator. *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995); *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (2003). 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 arbitration. *BG Group, PLC v. Republic of Argentina*, 572 U.S. 25 (2014). In any event, when a dispute arises about the threshold arbitrability question – i.e., whether the arbitration agreement applies to the particular dispute at hand – is itself a question of contract. The FAA allows parties to agree by contract that an arbitrator – rather than a court – will resolve threshold arbitrability questions, as well as the underlying merits disputes. *Rent-A-Center West, Inc. v. Jackson*, 561 U.S. 63, 68-70 (2010); *First Options*, supra, 514 U.S. at 943-944.

What qualifies as a clear and unmistakable agreement to delegate authority to an arbitrator to determine his or her jurisdiction is still being ferreted out in the courts. Some arbitration provisions state that the contracting parties agree to arbitrate with a particular provider and to do so pursuant to the named provider's rules. Many courts have held that the reference to the provider's rules and the statement of the parties agreement to arbitrate in accordance with those rules is a clear and express delegation of authority if the provider's rules recognize the arbitrator's power to determine the scope of their authority.[4] *See Brennan v. Opus Bank*, 796 F.3d 1125 (9th Cir. 2005); *Awuah v. Coverall N. Am., Inc.*, 544 F. 3d 7, 10-12 (1st Cir. 2009); *Fallo v High-Tech Inst.*, 559 F.3d 874, 878 (8th Cir. 2009); *Petrofac, Inc. v. DynMcDermott Petroleum Operations Co.*, 687 F.3d 675 (5th Cir. 2012); *Schneider v. Kingdom of Thailand*, 688 F.3d 68, 72-74 (2d Cir. 2012); *Oracle Am., Inc. v. Myriad Group A.G.*, 724 F.3d 1069, 1072-1077 (9th Cir. 2013); *but see Chesapeake Appalachia, LLC v. Scout Petroleum, LLC*, 809 F3d 746, 751 (3d Cir. 2016) (finding that an incorporation of the AAA rules is not a clear and unmistakable delegation to the arbitrators).

[4] For example, Rule R-7(a) of the Commercial Arbitration Rules of the American Arbitration Association provides that "[t]he arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope, or validity of the arbitration agreement or to the arbitrability of any claim or counterclaim."

(b) ***Henry Schein, Inc. v. Archer & White Sales, Inc.*, ____ U.S. ____, 139 S. Ct. 524 (Jan. 8, 2019) –** In a unanimous decision, SCOTUS rules that courts cannot ignore a delegation clause that delegates the threshold arbitrability question to an arbitrator even if, under the contract, the argument for arbitration is wholly groundless in the court's eyes.

This is a significant decision for three reasons. First, it is a unanimous decision of the U.S. Supreme Court, of which there are very few! Second, it is the premiere opinion of Justice Brett Kavanaugh following his appointment to the Court late last year. Third, and perhaps most importantly, it provides a nationwide rule with regard to the "wholly groundless" exception to the courts enforcing a clause in the arbitration agreement that delegates arbitrability to the arbitrator.

In the underlying case, dental equipment manufacturer Archer & White Sales, Inc. sued a manufacturer, which was succeeded in interest by the current defendant, Henry Schein, Inc., for alleged antitrust violations. The plaintiff sought damages and injunctive relief. The contract between the two included an arbitration clause, which provided for disputes to be submitted to arbitration with the American Arbitration Association in accordance with its rules. While the clause was "broad" in the sense that it provided for arbitration of disputes "arising under or related to" the underlying agreement, it included a provision that expressly excepted from the agreement to arbitrate "actions seeking injunctive relief and disputes related to trademarks, trade secrets, or other intellectual property," and it did not expressly delegate to the arbitrator any disputes about arbitrability. Instead, the clause incorporated the AAA Commercial Rules into the arbitration clause which, under Rule R-7(a) provides that "the arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope or validity of the arbitration agreement."

In the court litigation matter, Henry Schein moved to compel arbitration of the dispute. Archer & White opposed the motion on the grounds that the dispute was outside the scope of what the parties had agreed to arbitrate; that it was seeking injunctive relief against Henry Schein and the arbitration agreement expressly excepted such disputes from the agreement to arbitrate. Henry Schein argued that an arbitrator – not the court – should decide the arbitrability of Archer & White's claims because, by the contract's own terms, the Commercial Arbitration Rules of the American Arbitration Association govern any arbitration, and those rules (specifically, Rule R-7(a)) give the arbitrator the power to resolve arbitrability questions. Archer & White countered that Henry Schein's argument for arbitration was "wholly groundless," and so the district court could resolve the threshold arbitrability question. The district court agreed with Archer & White, consistent with the defense recognized by Texas district courts allowing judges to deny motions to compel arbitration where they found that the arbitration claim was "wholly groundless." On

appeal, the Fifth Circuit Court of Appeals affirmed. *Archer & White Sales, Inc. v. Henry Schein, Inc.*, 878 F.3d 488, 495 (5th Cir. 2017).[5]

The United States Supreme Court granted certiorari and reversed. Overturning the Fifth Circuit Court of Appeals, the Court held that where an arbitration agreement clearly and unmistakably delegates to an arbitrator the determination of arbitrability of a claim or dispute, there is no exception allowing the court to ignore that provision of the arbitration agreement just because the court agrees with the opposing party's contention that the moving party's assertion of arbitrability is wholly groundless. The Court held that the "wholly groundless" exception was inconsistent with the Federal Arbitration Act, finding that parties to an arbitration agreement "may agree to have an arbitrator decide not only the merits of a particular dispute, but also 'gateway' questions of 'arbitrability.'" Drawing heavily on late Justice Antonin Scalia's opinion in *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63, 68-70 (2010), the court interpreted the FAA strictly, noting that arbitration is a creature of contract and that the question of who decides arbitrability is itself a question of contract; that the FAA allows the parties to agree by contract that an arbitrator, rather than a court, will resolve threshold arbitrability questions as well as the merits disputes. *2, citing *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943-944 (1995). The Court went on to say that "when the parties' contract delegates the arbitrability question to an arbitrator, a court may not override the contract, even if the court thinks that the arbitrability claim is wholly groundless." In so ruling, the Court eliminated an exception recognized by the Fifth, Fourth, Sixth and Federal Circuits. See e.g., *Simply Wireless, Inc. v. T-Mobile US, Inc.,* 877 F.3d 522 (4th Cir. 2017); *Turi v. Main Street Adoption Services, LLP*, 633 F.3d 496 (6th Cir. 2011); *Qualcomm, Inc. v. Nokia Corp.*, 466 F.3d 1366 (C.A.Fed. 2006).

The Court explained that the conclusion reached in the case followed not only from the text of the Federal Arbitration Act, but also from case precedent. In *AT&T Technologies, Inc. v. Communications Workers*, 475 U.S.C 643, 649-650 (1986), the Court held that a court may not deny a motion to compel arbitration and itself rule on the merits, even if it appears to the court that the claims are frivolous; that in the face of an arbitration clause, the court has "no business weighing the merits of the grievance" because the "agreement is to submit all grievances to arbitration, not merely those which the court will deem meritorious." Id. at 650. The Court went on to hold that the *AT&T Technologies* principle applies with equal force to the threshold issue of arbitrability. "Just as a court may not decide a merits question that the parties have delegated to an arbitrator, a court may not decide an arbitrability question that the parties have delegated to an arbitrator." *4. In summary, the Supreme Court held that it must interpret the Federal Arbitration Act as written, which in turn requires courts to interpret arbitration agreements as written.

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[5] Shortly after the Fifth Circuit's decision, the Tenth Circuit rejected this approach in *Belnap v. Iasis Healthcare*, 844 F.3d 1272 (10th Cir. 2017). While the court in *Belnap* claimed that the Ninth Circuit had joined the First, Second, Fourth, Eighth and D.C. Circuits in this rejection, in fact, district courts in California still recognized the "wholly groundless" exception to enforcement as grounds for denying motions to compel arbitration. See, e.g., *Zenelaj v. Handybook, Inc.*, 82 F.Supp. 3d 968 (N.D.Cal. 20150.

There are (at least) two important takeaways from the *Henry Schein* decision. The first is what the decision decided: namely, that courts can no longer ignore delegation clauses by applying the "wholly groundless" exception. That defense to enforceability, as well as the cases recognizing the exception, have been abrogated. See e.g., *Simply Wireless, Inc. v. T-Mobile US, Inc.,* 877 F.3d 522 (4th Cir. 2017); *Turi v. Main Street Adoption Services, LLP*, 633 F.3d 496 (6th Cir. 2011); *Qualcomm, Inc. v. Nokia Corp.*, 466 F.3d 1366 (C.A.Fed. 2006).

The second takeaway concerns the issue the Court expressly did <u>not</u> decide: namely, whether the reference to an arbitration provider's rules provides a clear and unmistakable expression of the parties' intent / agreement to delegate the arbitrability question to an arbitrator. In this regard, the Court noted that the Fifth Circuit Court of Appeals did not decide that issue. Accordingly, on remand, the Court stated that the Court of Appeals "may address that issue in the first instance."[6] *6.

Note with respect to the California Arbitration Act: California law has long recognized the "wholly groundless" exception to delegation of arbitrability decisions to the arbitrator. See, *Dream Theater, Inc. v. Dream Theater*, 124 Cal. App. 4th 547, 553 (2004), as modified on denial of rehearing (Dec. 28, 2004) ("unless a claim of arbitrability is wholly groundless, the court should stay proceeding spending the arbitrator's determination of his or her own jurisdiction."); *McCarroll v. Los Angeles County District Council of Carpenters*, 49 Cal. 2d 45, 65 (1957) ("court should stay proceedings pending the arbiter's determination of his own jurisdiction unless it is clear that the claim of arbitrability is wholly groundless."). It is unclear whether the "wholly groundless" exception recognized under California arbitration law survives the *Henry Schein* decision. The unanimity of the Supreme Court Justices in *Henry Schein* demonstrates how far in favor of arbitration the law has moved at the federal level. It is probably safe to say that if California courts continue to apply the "wholly groundless" exception that, if challenged, the current Supreme Court would find California law preempted by the FAA.

Note Further: In June 2018, six months before the United States Supreme Court's decision in *Henry Schein* (discussed above), the California Court of Appeal for the First District applied the wholly groundless defense in finding that a delegation provision was

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[6] While the Court did not decide this issue, there is another case pending before the Court that squarely presents the issue, albeit in the context of class arbitrability. In *Spirit Airlines, Inc. v. Maizes*, 899 F.3d 1230, 1233-1236 (11th Cir. 2018), petition for cert filed November 13, 2018 (Case No. 18-617), the Eleventh Circuit examined the question of whether the incorporation of the AAA Rules into an arbitration clause presented clear and unmistakable evidence that an arbitrator should decide whether the agreement permitted class arbitration. The Court of Appeal held that, absent express language to the contrary in the arbitration agreement itself, whether class arbitration is permitted under an arbitration agreement providing for arbitration in accordance with the AAA Rules is an issue for the arbitrator – not the court – to decide. Less than a week later, the Tenth Circuit took up the same issue in *DISH Network LLC v. Ray*, 900 F.3d 1240 (10th Cir. 2018), and reached the same conclusion. These decisions create a circuit split with the Third, Fourth, Sixth and Eighth Circuits, which have held that the incorporation of the AAA Rules alone does not delegate the question of class arbitrability to an arbitrator. See, *Catamaran Corp. v. Towncrest Pharm.*, 864 F.3d 966, 972-973 (8th Cir. 2017); *Chesapeake Appalachia, LLC v. Scout Petroleum, LLC*, 809 F.3d 746, 762-763 (3d Cir. 2016); *Dell Webb Cmtys., Inc. v. Carlson*, 817 F.3d 867,876-877 (4th Cir. 2015); *Reed Elsevier, Inc. ex rel. LexisNexis Div., v. Crockett*, 734 F.3d 594, 599-600 (6th Cir. 2013).

unenforceable and then denying the motion to compel because the plaintiff's claims were outside the scope of the arbitration agreement. See, *Smythe v. Uber Technologies, Inc.*, 24 Cal. App. 5th 327 (2018).[7] Notably, the court decided this matter under the FAA – specifically relying on *Qualcomm, Inc. v. Nokia Corp.*, 466 F.3d 1366 (C.A.Fed. 2006) (discussed above). As such, I believe that it is abrogated and should no longer be cited in support of the application of the "wholly groundless" defense to the enforceability of a delegation provision included in an arbitration agreement governed by the FAA. Apparently my belief is not shared by Westlaw because it does not show a red flag when you pull up this case.

(c) ***New Prime, Inc. v. Oliveira, Inc.*, ___ U.S. ___, 139 S. Ct. 532 (Jan 15, 2019) –** Starting off 2019 with a second unanimous decision involving the FAA, SCOTUS holds that the provisions of the FAA obligating courts to stay litigation and compel arbitration (Sections 3 and 4) apply only if the dispute is one to which the FAA applies, that construction of a statute regarding the court's authority is for the court to decide, and that the broad exemption for transportation workers contained in Section 1 of the FAA covers independent contractors working as interstate truck drivers.

New Prime. Inc. is an interstate trucking company and employed Dominic Oliveira as one of its drivers. Mr. Oliveira worked for New Prime under an agreement that called him an independent contractor. That agreement contained a mandatory arbitration clause. When Mr. Oliveira filed a class action alleging that New Prime denied its drivers lawful wages, New Primer asked the court to invoke its authority under Sections 3 and 4 of the FAA to stay the litigation and order the matter to arbitration. Mr. Oliveira opposed the company's motion arguing that the court lacked authority because Section 1 of the FAA excepts from its coverage disputes involving "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce." As an interstate truck driver working for an interstate trucking company, Mr. Oliveira argued that his contract fell within the Section 1 exemption. New Prime argued that the question regarding the applicability of the Section 1 exemption was for the arbitrator to decide. The district court and First Circuit Court of Appeal agreed with Mr. Oliviera and denied New Primer's motion.

On January 15, 2019, the United States Supreme Court ruled unanimous in favor of Mr. Oliveira and affirmed the courts below. The Court decided that the construction of law issue – the applicability of the Section 1 exemption -was a threshold issue that had to be decided before arbitration could be compelled under Section 4 because that section came later in the FAA (i.e., it followed Section 1).

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[7] In *Smythe*, a driver for both Uber and Lyft claimed that Uber tried to undermine Lyft and its drivers by making phantom requests for Lyft rides, causing Lyft drivers to lose time and money going to collect riders who never showed up. The claim arose solely from plaintiff's role as a Lyft driver, not from his role as an Uber driver.

> "While a court's authority under the Arbitration Act to compel arbitration may be considerable, it isn't unconditional. If two parties agree to arbitrate future disputes between them and one side later seeks to evade the deal, §§ 3 and 4 of the Act often require a court to stay litigation and compel arbitration 'accord[ing to] the terms' of the parties' agreement. But this authority doesn't extend to *all* private contracts, no matter how emphatically they may express a preference for arbitration.
>
> Instead, antecedent statutory provisions limit the scope of the court's powers under §§ 3 and 4. Section 2 provides that the Act applies only when the parties' agreement to arbitrate is set forth as a 'written provision in any maritime transaction or a contract evidencing a transaction involving commerce.' And § 1 helps define § 2's terms. Most relevant for our purposes, 1 warns that 'nothing' in the Act 'shall apply' to 'contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce."…
>
> … The parties' private agreement may be crystal clear and require arbitration of every question under the sun, but that does not necessarily mean the Act authorizes a court to stay litigation and send the parties to an arbitral forum."

The Court rejected New Prime's argument that an arbitrator should decide the dispute concerning Section 1's application because the arbitration provision in question contained a delegation clause, which thus gave an arbitrator authority to decide the initial question of whether the parties' dispute is subject to arbitration. In so ruling, the Court noted that a delegation clause is merely a specialized type of arbitration agreement and that the FAA operates on this additional arbitration agreement just as it does on any other, meaning that a court may use Sections 3 and 4 to enforce a delegation clause only if the clause appears in a "written provision in … a contract evidencing a transaction involving commerce" consistent with Section 2, *and* only if the contract in which the clause appears does not trigger Section 1's "contracts of employment" exception.

Having determined that the scope of the transportation exception was a question for the court to decide, the Court turned to the second question raised by the appeal: namely, whether "contracts of employment" is limited to removing employer-employee contracts from the FAA's coverage or whether the exception it includes contracts involving independent contractors working in foreign or interstate commerce. The Court ruled that the meaning to be given to the phrase "contracts of employment" is that which was in existence at the time the FAA was enacted in 1925, rejecting New Prime's argument that the modern (master-servant) meaning should be applied.

"When Congress enacted the Arbitration Act in 1925, the term 'contracts of employment' referred to agreements to perform work. No less than those who came before him, Mr. Oliveira is entitled to the benefit of that same understanding today."

(d) On the Horizon - *Spirit Airlines, Inc. v. Maizes*, 899 F.3d 1230, 1233-1236 (11th Cir. 2018), petition for cert filed November 13, 2018 (Case No. 18-617) – whether the incorporation of a provider's rules into an arbitration clause alone presents clear and unmistakable evidence of the parties' agreement to submit to an arbitrator the determination of the "gateway" or "threshold" issue of whether class arbitration is permitted under the parties' agreement.

In *Spirit Airlines*, the Eleventh Circuit examined the question of whether the incorporation of the AAA Rules into an arbitration clause alone presented clear and unmistakable evidence of the parties' agreement to submit to an arbitrator – rather than the court – the determination of the "gateway" or "threshold" issue of whether class arbitration was permitted under the parties' agreement. The Court of Appeal held that, absent express language to the contrary in the arbitration agreement itself, whether class arbitration is permitted under an arbitration agreement providing for arbitration in accordance with the AAA Rules is an issue for the arbitrator – not the court – to decide. Less than a week later, the Tenth Circuit took up the same issue in *DISH Network LLC v. Ray*, 900 F.3d 1240 (10th Cir. 2018), and reached the same conclusion. These decisions create a circuit split with the Third, Fourth, Sixth and Eighth Circuits, which have held that the incorporation of the AAA Rules alone does not delegate the question of class arbitrability to an arbitrator. See, *Catamaran Corp. v. Towncrest Pharm.*, 864 F.3d 966, 972-973 (8th Cir. 2017); *Chesapeake Appalachia, LLC v. Scout Petroleum, LLC*, 809 F.3d 746, 762-763 (3d Cir. 2016); *Dell Webb Cmtys., Inc. v. Carlson*, 817 F.3d 867,876-877 (4th Cir. 2015); *Reed Elsevier, Inc. ex rel. LexisNexis Div., v. Crockett*, 734 F.3d 594, 599-600 (6th Cir. 2013). We are waiting to see if the U.S. Supreme Court grants the petition for certiorari filed by Spirit Airlines. According to the Court's online docket, the issues raised by the cert petition are: (1) whether a party must overcome higher burden to show that an arbitration agreement delegates to the arbitrator the power to decide the availability of class arbitration than to show that it delegates the power to decide the availability of bilateral arbitration, and (2) whether an arbitration agreement may be interpreted to delegate to the arbitrator the power to decide the availability of class arbitration if the agreement lacks an express statement making such a delegation, but instead merely requires the arbitration to be conducted under a provider's arbitration rules.

(e) ***ASARCO LLC v. United Steel Etc.***, 893 F.3d 621 (9th Cir. Jun. 19, 2018) –By submitting arguments on the merits to the arbitrator, without objecting to his jurisdiction until long after the fact, employer waived the argument on vacatur that the arbitrator lacked authority to decide the claim.

This decision is more pertinent to the specialized topic of labor arbitration, but as a matter of general arbitration law jurisprudence it is instructive because it details the ways in which a party objecting to the arbitrator's authority to decide an issue must raise that objection in order to preserve the right to challenge an adverse award as one that was outside the scope of the arbitrator's authority to decide. While the general rule is that the arbitrator's authority to hear and decide a matter is based on the parties' contract, where an issue about that authority exists and is not raised, a party may be deemed to have implicitly consented to the arbitrator's authority to determine the issue. This case explains how and why implicit consent works in application.

In this case, a collective bargaining agreement (CBA) called for arbitration of disputes but also provided that the arbitrator could not add to, detract from or alter the CBA. The union sought arbitration to compel payment of a bonus to new hires, whom the CBA, it claims, disentitled that class of employees by reason of a mutual mistake of the contracting parties. At the beginning of the arbitration, the parties stipulated that the matter was properly before the arbitrator and that the arbitrator had jurisdiction to decide the grievance. After hearing six days of evidence, the arbitrator concluded that neither party had anticipated that a 2011 modification to the CBA would impact new hires' eligibility for a bonus. Because the arbitrator found that the parties were mutually mistaken as to the terms of the 2011 amendment, he ordered that the agreement be amended so as to provide that new hires were eligible to participate in the bonus program.

ASARCO filed a petition to vacate the award. In that petition, ASARCO did not challenge the arbitrator's findings of fact or conclusions of law. Instead, ASARCO argued that the no-add provision in the CBA deprived the arbitrator of authority to grant the requested relief, which it argued amounted to an amendment to the CBA. The district court confirmed the award, finding that the arbitrator's ruling did not violate the no-add provision because the reformation corrected a defect in the 2011 amendment, which was the product of a mutual mistake, so as to reflect the terms the parties had agreed upon.

The general rule with regard to an arbitrator's subject matter jurisdiction is that it is defined by the arbitration agreement. However, arbitration agreements are construed broadly and in favor of arbitration, and there is no requirement that the arbitration agreement specifically delineate particular matters or issues that the arbitrator can decide. In fact, the law is to the contrary, that an agreement to submit a particular issue to arbitration "may be implied from the conduct of the parties." *Ficek v. S. Pac. Co.*, 338 F.2d 655, 656 (9th Cir. 1964). By voluntarily submitting an issue to the arbitrator, through that act, the parties may be deemed to have evinced a subsequent agreement to arbitrate. *Id.* The rule is sometimes stated in the alternative in terms of waiver: A party may not submit

to arbitration, await the outcome, and if the decision is unfavorable, then challenge the authority of the arbitrator to decide the submitted issue. *Id.* At 657.

In this case, ASARCO stipulated at the beginning of the arbitration that the matter was properly before the arbitrator and that the arbitrator had authority to decide the grievance. The objection ASARCO raised in the arbitration was with respect to the arbitrator's authority to grant the relief being requested – namely, reformation on the grounds of mutual mistake. However, after making that objection, ASARCO then argued at length why the arbitrator lacked authority and, by so doing, the Ninth Circuit reasoned that it had evinced its agreement to submit that issue to the arbitrator for decision.

This case is instructive because the Ninth Circuit referred back to its 1984 decision in *George Day Const. Co. v. United Blvd. of Carpenters & Joiners of Am., Local 354*, 722 F.2d 1471 (9th Cir. 1984) to remind us how to avoid waiver of the right to object to the scope of the jurisdiction exercised by the arbitrator through a post-award vacatur petition. First, a party may refuse to arbitrator the case, thus forcing the other side to petition the court to compel arbitration. The objecting party might lose and be forced to arbitration, but the issue will have been preserved. Second, a party may object to the arbitrator's authority in the arbitration, but then it should refuse to argue the jurisdictional issue to the arbitrator and simply proceed to the merits of the dispute. Third, the objecting party might initiate a declaratory relief action and seek an injunction to enjoin the arbitration pending the outcome in the declaratory relief action. *Id.* At 1476.

(f) ***Munro v. University of Southern California***, 896 F.3d 1088 (9th Cir. Jul. 24, 2018) –The Ninth Circuit declines to require individual arbitration of ERISA claims brought as a putative class action on behalf of the ERISA plans and their beneficiaries based upon the arbitration clauses contained in the complaining plaintiffs' employment agreements.

This is a follow on to a 2017 Ninth Circuit decision in which the court ruled that while the words "arise out of" and "relate to" define a broad scope of claims subject to arbitration, that scope was not unlimited and did not require arbitration of a former employee's *qui tam* action based upon the arbitration clause contained in his employment agreement. *United States ex rel. Welch v. My Left Foot Children's Therapy, LLC*, 871 F.3d 796 (9th F.3d. 2017). In deciding the matter, the court noted that its holding rested "on a rather unremarkable textual analysis" of the words used in the plaintiff's employment agreement. 871 F.3d at 794. In finding that the terms of the plaintiff's employment agreement did not cover *qui tam* claims brought by the employee on behalf of the United States under the False Claims Act, the court noted that while "arising out of" and "relating to" are words that have been interpreted as defining a broad scope of arbitrability, they do not "stretch to the horizon" when tied to "a boundary by indicating some direct relationship" – in this case that of employer / employee - because to do otherwise would result in a meaningless and empty term because relations would then stop nowhere. Id, citing *New York State Conference, Etc. v. Travelers Ins. Co.*, 514 U.S. 645, 655 (1995). In this regard, the court acknowledged that it has interpreted "relating to" as being broader in scope than "arising

out of" or "arising under," but reasoned that there is a difference between a clause being "broad" versus "unlimited." Id. at 798, citing *N. Cal. Newspaper Guild Local 52 v. Sacramento Union*, 856 F.2d 1381, 1383 (9th Cir. 1988). The court found that the *qui tam* suit had no direct connection with Welch's employment because she would have been eligible to act as a relator in bringing the lawsuit even if she had never been employed by the offending company. Id. at 799. Accordingly, Welch was not required to arbitrate the *qui tam* claims and the employer's motion to compel was denied.

The 2018 *Munro* decision concerns current and former employees of the University of Southern California who brought a putative class action against the university for its alleged breach of fiduciary duty in the administration of two ERISA plans in which the plaintiffs participated. In their putative class action, the employees sought financial and equitable remedies to benefit the ERISA plans and all affected participants and beneficiaries. The university moved to compel arbitration based upon the individual arbitration provisions contained in the plaintiffs' employment contracts. While there were five different iterations of the arbitration agreement, consistent among the various agreements was an agreement to arbitrate all claims either party might have against the other, including claims for violations of federal law. The district court denied the university's motion, determining that the employees had entered into the arbitration agreements in their individual capacities through their employment agreements with the university, and held that those agreements did not bind the ERISA plans, who did not themselves consent to arbitration of the asserted claims. The university appealed.

On appeal, the Ninth Circuit affirmed the district court, finding that the language of the arbitration agreements at issue in this case was not meaningfully distinguishable from that considered in *Welch*. As it saw the matter, the issue was whether claims for breach of fiduciary duty under ERISA should be treated the same as *qui tam* claims brought under the False Claims Acts. The court determined that they should be, finding that "[t]here is not shortage of similarities between *qui tam* suits under the FCA and suits for breach of fiduciary duty under ERISA" because in both the "plaintiffs are not seeking relief for themselves." 896 F.3d at 1092.

In the *Welch* case, the court held that there was a "textual limitation" imposed by the language of the subject arbitration clause because, to be arbitrable, the dispute must arise from, relate to, or be connected with Welch's employment because that is what the agreement stated – namely, that arbitrable disputes were ones that arose out of, related to or had some connection to Welch's employment with the company. Finding that the language used in the Munro employment agreement was of the same ilk as that which was at issue in the Munro case, the arbitration agreement in the Munro contract could not be "stretched" to apply to the ERISA claims, for which any recovery was singularly for the benefit of the ERISA plans and were not among the claims an employee might have against the university. 896 F.3d at 1094

Comment: In *Welch* the Ninth Circuit introduced the drafting notion that if it was really intended to include within the scope of arbitrable dispute "any and all disputes *whatsoever*," including those claims and disputes brought in a representative capacity, the agreement should say exactly that. With its decision in *Munro*, the court seems to be emphasizing exactly that. It also demonstrates how courts (listen up California) can decide not to force representative-type actions to arbitration even in the face of a broadly worded arbitration clause by employing general principles of contract interpretation applicable to all contracts and thus avoiding the making any pronouncements about the arbitrability (or non-arbitrability) of certain types of claims as a matter of law, which approach may run afoul of the FAA.

3. Class Arbitration, Class Action Waivers, Contract Silence and Who Decides

(a) *Background Statement*

Over the past five or six years, we have looked at a string of major case law developments at both the state and federal levels concerning class arbitration and the enforceability of arbitration agreements in the consumer and employment context where those agreements include provisions limiting employees and consumers to individual arbitration of their claims and waivers of class action rights. What we have seen thus far is the U.S. Supreme Court taking a fairly firm stand in favor of enforcing arbitration agreements, even those waiving class action rights or limiting the parties to individual arbitration of claims, and the California Supreme Court issuing what some have called "pro-employee" and "pro-consumer" decisions by limiting the scope of arbitration to exclude PAGA claims[8] and denying enforcement to arbitration agreements whose provisions include waivers of a consumer's right to seek public injunctive relief on the grounds that such provisions are against California public policy and have nothing to do with arbitration at all.[9]

In 2010, the United States Supreme Court 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*, 563 U.S. 333 (2011). 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

[8] See, *Iskanian v. CLS Transp. Los Angeles LLC*, 59 Cal. 4th 348 (20140, cert. den., 131 S.Ct. 1155 (2015).
[9] See, *McGill v. Citibank*, 2 Cal. 5th 945 (2017).

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.[10] 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

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[10] *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.

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).

In 2014, 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 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 <u>not</u> 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*.[11] 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, likewise, have jurisdiction to interpret and apply state law. While federal courts typically defer to state supreme court decisions interpreting state laws, that is not what is going on in these decisions. Both state and federal courts were determining whether PAGA is preempted by the FAA (determined by *Southland* to be substantive law),

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[11] See, e.g., *Lucero v. Sears Holdings Mgmt. Corp.*, No. 14-cv-1620, 2014 WL 6984220 (S.D.Cal., Dec. 2, 2014); *Mill v. Kmart Corp.*, No. 14-cv-02749, 2014 WL 6706017 (N.D.Cal., Nov. 26, 2014); *Langston v. 20/20 Companies, Inc.*, No. 14-cv-1360, 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.*, No. 14-cv-5750, 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.*, 52 F.Supp. 3d 1070 (E.D.Cal. 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*, No. 14-cv-00561, 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).

and both were necessarily interpreting federal law to do so. This has resulted in an unusual split of authority because the California Supreme Court is not required to give deference to the federal court decisions, nor are the federal courts required to give deference to the California Supreme Court decision. It was thus a surprise when, on January 20, 2015, the Supreme Court denied certiorari to decide this issue. It was an even greater surprise when, a few months later, the Ninth Circuit issued a reported decision *following* the rule announced by the California Supreme Court in *Iskanian*: namely, that PAGA waivers included in arbitration clauses contained in employment agreements are unenforceable. See, *Sakkab v. Luxottica Retail North America, Inc.*, 803 F.3d 425 (9th Cir. 2015). Before this decision, the federal district courts were disinclined to follow *Iskanian* and instead were applying *Concepcion*.

(b) ***Epic Systems Corp. v. Lewis***, ___ U.S. ___, 138 S.Ct. 1612 (May 21, 2018) – SCOTUS settles a long-standing split among the federal courts of appeal and approves the use of class action waivers in arbitration agreements included in employment contracts.

In 2012, the National Labor Relations Board ("NLRB") issued its decision in *D.R. Horton, Inc.*, 397 N.L.R.B. 2277 (2012), finding for the first time that individual employment arbitration agreements run afoul of the NLRA, and that class action waivers included in employment arbitration agreements are unlawful and thus the agreement to arbitrate is unenforceable. This became known as the "*D.R. Horton Rule*."

Prior to 2016, four Circuit Courts of Appeal had denied enforcement of the *D.R. Horton Rule*. These decisions rejected the argument that an employee's right to prosecute a collective action under the FSLA is a non-waivable substantive right and that the "savings clause" of Section 2 of the FAA removes the obligation of the courts to enforce arbitration agreements in accordance with their stated terms.[12] See, e.g., *Murphy Oil U.S.A., Inc. v. NLRB*, 808 F.3d 1013 (5th Cir. 2015) ("*Murphy Oil*"); *Walthour v. Chipio Windshield Repair*, 745 F.3d 1326 (11th Cir.), cert denied, 134 S.Ct. 2886 (2014); *D.R. Horton, Inc. v. NLRB,* 737 F.3d 344 (5th Cir. 2013); *Sutherland v. Ernst & Young LLP,* 726 F.3d 290 (2d Cir. 2013); *Owen v. Bristol Care, Inc.*, 702 F.3d 1050 (8th Cir. 2013); *Cellular Sales of Missouri, LLC v. NLRB*, No. 15-1620, 2016 WL 3093363 (8th Cir. June 2, 2016).

In 2016, the Seventh Circuit became the first Court of Appeal to adopt the NLRB's position, striking down class waivers in employment contracts and, based upon the inclusion of class waivers in the arbitration clause, denying enforcement of the arbitration agreement as violative of the NLRA. See, *Lewis v. Epic Systems Corp.*, 823 F.3d 1147 (7th Cir. 2016) ("*Epic*

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[12] 9 U.S.C. § 2 provides as follows:

> "A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." [Emphasis added.]

Systems." The court in *Epic Systems* opined that there is nothing quite so "concerted" as a piece of class action litigation, where employees band together to collectively assert a legal challenge to a workplace practice. A few months later, the Ninth Circuit followed suit and echoed the Seventh Circuit's reasoning in *Morris v. Ernst & Young LLP*, 834 F. 3d 975 (9th Cir. 2016), cert. granted, 137 S.Ct. 809 (2017) ("*Ernst & Young*").

The United States Supreme Court granted certiorari in *Murphy Oil*, *Epic Systems*, and *Ernst & Young*, and consolidated the three cases to resolve the circuit split. The issue before the Court was whether the NLRA barred class relief waivers in employment arbitration agreements. Section 7 of the NLRA guarantees workers "the right … to engage in other concerned activities for the purpose of collective bargaining or other mutual aid or protection." Per the *D.R. Horton Rule*, seeking class certification of a wage and hour suit was "concerted activity." As such, including a class action waiver provision in an employment arbitration program was an unfair labor practice, thus making the arbitration agreement unenforceable.

As with its other arbitration rulings over the past three decades, the Court started with the "liberal federal policy favoring arbitration agreements." 138 S.Ct. at 1621, citing *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1 (1983). "Not only did Congress require courts to respect and enforce agreements to arbitrate; it also specifically directed them to respect and enforce the parties' chosen arbitration procedures." Id. The Court when on to say that it had "often observed that the Arbitration Act requires courts 'rigorously' to 'enforce arbitration agreements according to their terms, including terms that specify *with whom* the parties choose to arbitrate their disputes and *the rules* under which that arbitration will be conducted.'" Id., citing *American Express Co. v. Italian Colors Restaurant*, 570 U.S. 228 (2013).

The Court then rejected each of the arguments raised by the NLRB and the individual employees. First, the Court held that the FAA's "savings clause" contained in Section 2 of the FAA – which provides that arbitration agreements are presumptive enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract" – does not provides "refuge for defenses that apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue." 138 S.Ct. at 1622. In other words, because this argument specifically singled out individual arbitration proceedings as illegal under the NLRA, the "savings clause" was not implicated because it recognizes only defenses that apply to "any" contract. The Court explained that [i]n this way the clauses establishes a sort of 'equal-treatment' rule for arbitration contracts. Id., citing *Kindred Nursing Centers, L.P. v. Clark*, ___ U.S. ___, 137 S.Ct. 1421 (2017) ("*Kindred*"). The Court further explained that the "savings clause" only permits agreements to arbitrate to be invalidated by "'generally applicable contract defenses, such as fraud, duress, or unconscionability.'" Id., citing *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011).

"… [T]he clause 'offers no refuge for 'defenses that apply only to arbitration or that derive their meaning from the fact that an agreement to arbitrate is at issue.' [Citation.] Under our precedent, this means the saving clause does not save defenses that target arbitration either by name or by more subtle methods, such as by 'interfer[ing] with fundamental attributes of arbitration.'"

Id, citing *Kindred*, supra.[13]

Second, the Court rejected the argument that the NLRA and FAA conflict and that, because the NLRA (enacted in 1935) was enacted after the FAA (enacted in 1925), it should control the issue. The NLRB and individual employees argued that the because Section 7 of the NLRA guarantees workers the right to organize and bargain collectively through representatives, and "to engage in other concerted activities," the "other concerted activities" provision constituted a "clear and manifest congressional command to displace the [FAA]." The Court rejected that argument and stated that it was not at "'liberty to pick and choose among congressional enactments' and must instead strive 'to give effect to both.'" 138 S.Ct. at 1624, citing *Morton v. Mancari*, 417 U.S. 535 (1974). It further explained that there is a strong presumption "that repeals by implication are 'disfavored' and that 'Congress will specifically address' preexisting law when it wishes to suspend its normal operations in a later statute." Id., citing *United States v Fausto*, 484 U.S. 439 (1988). The Court noted that Section 7 of the NLRA focuses on the right to organize unions and to bargain collective, and does not hint anywhere that Congress intended to displace the FAA. Id. At 1626. Accordingly, the Court found that "the absence of any specific statutory discussion of arbitration or class actions is an important and telling clue that" Congress did not displace the FAA when it enacted Section 7 of the NLRA. "Congress 'does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions – it does not, one might say, hide elephants in mouseholes.'" Id. at 1627, citing *Whitman v. American Trucking Assns., Inc.*, 531 U.S. 457 (2001).

Finally, the NLRB and employees argued that even if the Court did not see what they saw in Section 7 of the NLRA, the Court owed deference to the administrative agency's interpretation of the law it was charged with administers pursuant to the holding in *Chevon U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). The Court rejected that argument, noting that the NLRB, through its decision in *D.R. Horton* sought not to interpret just the NLRA, which it administers, but to interpret that statute in a way that

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[13] In his concurring opinion, Justice Thomas added that the FAA's "savings clause" means that the only grounds for revoking an arbitration agreement are "those that concern the formation of the arbitration agreement," such as fraud or adhesion; that the employees' argument that the class action waivers in their arbitration agreements are unenforceable because the NLRA makes those waivers illegal is a public-policy defense that goes to enforceability and "does not concern whether the contract was properly made." For these additional reasons, and the reasons in the Court's opinion, Justice Thomas concluded that the "savings clause" does not apply and the arbitration agreements in question must be enforced according to their terms. 138 S.Ct. at 1632-1632.

limits the work of the FAA, which the agency does not administer. 138 S.Ct. at 1629. Further, the Court observed that *D.R. Horton* was an outlier in terms of NLRB precedent because it represented the "first time in the 77 years since the NLRA's adoption" that the NLRB had taken the position that the NLRA effectively nullifies the FAA. Id. at 1621.

The implications of the *Epic Systems* decision are significant:

- On May 21, 2018, the NLRB issued a statement saying that at the time the decision was handed down, it had 55 pending cases with allegations that employers had violated the NLRA because their arbitration agreements contained class action waivers. *Supreme Court Issues Decision in NLRB v. Murphy Oil USA,* NLRB (May 21, 2018), https://www.nlrb.gov/news-outreach/news-story/supreme-court-issues-decision-nlrb-v-murphy-oil-usa. In that statement, the NLRB stated that it respected the Court's decision, "which clearly establishes that arbitration agreements providing for individualized proceedings, and waiving the right to participate in class or collective actions, are lawful and enforceable," and that it would expeditiously resolve the pending cases "in accordance with the Supreme Court's decision."

- Because collective actions under Section 16 of the FLSA are similar to representative actions under California Private Attorneys General Act of 2004 (California Labor Code §§ 2698, et seq.), some have questioned whether the California Supreme Court's 2014 decision in *Iskanian v. CLT Transportation Los Angeles, Inc.*, 59 Cal. 4th 348 (2014) will stand if reviewed by the United States Supreme Court. In *Iskanian*, the California Supreme Court held that waivers of the right to bring representative actions under PAGA were unenforceable. The Court also held that PAGA claims could not be forced to arbitration under the FAA it applies only to purely private contractual disputes and cannot be used to interfere with a state's police power. In this regard, the Court reasoned that PAGA claims do not belong to the employee, but are pursued by an employee as a deputy / agent of the state. The Court held that enforcing an employee's representative action waiver would be akin to forcing the state to arbitrate its enforcement claims. Whether the United States Supreme Court will agree with the California Supreme Court's interpretation remains to be seen. However, given the Court's unanimous decision last year in *Kindred Nursing Centers, L.P. v. Clark*, ___ U.S. ___, 137 S.Ct. 1421 (2017), its reference to that decision in *Epic Systems*, some, and its repeated reference to arbitration agreements being enforced in accordance with their terms, some commentators have offered that *Epic Systems* is currently important for California employers.

  "First, if the employer has a collective action waiver, *Epic Systems* assures that it will shield the employer from future

> multi-state collective actions under the FLSA. Second, because collection actions under the FLSA's W3dtion 16(b) are similar to representative actions under [PAGA], the *Epic Systems* ruling will likely have great influence over where and hose those claims are resolved. Like Section 16(b), PAGA allows an employee who asserts state labor law violations to proceed on his own behalf and that of similar situated employees. [Citation.] As such, the Supreme Court's decision that, under the [FAA], an employee may waive the right to bring such a collective action, could directly impact future interpretations of similar waivers under PAGA."[14]

Edward F. Donohue, *An Epic shadow over PAGA*, Los Angeles Daily Journal, p. 1 (July 13, 2018).

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[14] -An unreported Ninth Circuit decision decided shortly after *Iskanian*, demonstrated just how differently court were approaching some of the PAGA issues left after the *Iskanian* decision. In *Valdez v. Terminix Int'l Co. Ltd. Ptnrshp.***,** 681 Fed. Appx. 592 (9th Cir. 2017), the court ruled that while under *Iskanian* a PAGA waiver is invalid and unenforceable, such a provision can be severed and then the question is whether or not a PAGA claim falls within the scope of the remaining arbitration clause. If it is a covered dispute, it must be submitted to binding arbitration. In contrast to the California courts of appeal, several recent decisions by California courts of appeal have decided the issue concerning the arbitrability of PAGA claims differently. Relying on the rationale of *Iskanian*, they have concluded that an employer cannot compel an employee to arbitrate representative PAGA claims through a predispute arbitration agreement. See, e.g., *Tanguilig v. Bloomingdale's, Inc.*, 5 Cal. App. 5th 665 (2016) (because the state controls PAGA actions, "a PAGA claim, individual or collective, cannot be arbitrated pursuant to a predispute arbitration agreement without the state's consent"); *Betancourt v. Prudential Overall Supply*, 9 Cal. App. 5th 439 (2017) ("[t]he state is not bound by Betancourt's predispute agreement to arbitrate," and that "Betancourt is suing on behalf of the state," so that the employer cannot rely on the predispute agreement with Betancourt to compel arbitration" of the PAGA claims being asserted by Betancourt in his representative capacity); *Montano v. Wet Seal Retail Inc.*, 7 Cal. App. 5th 1248 (2015) (The court acknowledged that several federal district courts within California had found PAGA waivers to be enforceable under the FAA. However, the court went on to state that decision of lower federal courts are not binding on state courts and that, therefore, until the United States Supreme Court resolves the issue, they are bound to follow the California Supreme Court's decision in *Iskanian)*; *Julian v. Glenair, Inc.*, 17 Cal. App. 5th 853 (2017) (Under the principles and public policy considerations set forth in *Iskanian*, the classification of an agreement as "predispute" or "postdispute" must be made by reference to the point in time at which an individual employee acquires the status of the state's agent in relation to the creation of the agreement to arbitrate).

(c) ***Correia v. NB Baker Electric, Inc.***, ___ Cal. App. 5th ___, 2019 WL 910979 (2019) – PAGA claim will not be compelled to arbitration because *Epic* did not overrule the California Supreme Court's holding in *Iskanian* and state courts are thus bound by that decision.

Plaintiffs sued their former employer alleging wage and hour violations and seeking civil penalties under PAGA. The employer responded by petitioning for arbitration under the parties' arbitration agreement. The agreement provided that arbitration all be the exclusive forum for "all employment-related claims" and included a waiver of any right "to maintain any representative action in arbitration or any court." The trial court granted the arbitration petition on all causes of action except for the PAGA claim. On the PAGA claim, the court followed the California Supreme Court's decision in *Iskanian v. CLS Transportation Los Angeles, LLC*, 59 Cal. 4th 348 (2014), and the California Court of Appeal decision in *Tanguilig v. Bloomingdale's, Inc.*, 5 Cal. App. 5th 665 (2016), and ordered the PAGA claim stayed pending the conclusion of the arbitration. NB Baker appealed. Among the arguments it raised was that *Iskanian* was no longer binding because it was inconsistent with the United States Supreme Court decision in *Epic Systems corp. v. Lewis* (discussed in section (b) above).

The Fourth District Court of Appeal affirmed the trial court's order denying NB Baker's petition to compel arbitration of the employees' PAGA claims. The Court of Appeal held that *Iskanian* was still good law because the United States Supreme Court had not overruled it. In this regard, the appellate court noted that because the California Supreme Court had found that a PAGA claim involved a dispute not governed by the FAA, and the waiver would have precluded the PAGA action in *any* forum, it held its PAGA-waiver unenforceability determination was not preempted by the FAA. The appellate court noted that the United States Supreme Court in *Epic* did not reach the issue of whether a governmental claim of the nature of a PAGA claim was governed by the FAA, nor did it consider the implications of a complete ban on *state* law enforcement action. Thus, the court concluded that it – and presumably other state courts – were bound by *Iskanian* with regard to the arbitrability of PAGA claims and the enforceability of PAGA-claim waivers.

(d) On the Horizon – *Lamps Plus, Inc. v. Varela*, 701 Fed. Appx. 670 (2017), cert granted, 138 S.Ct. 1697 (Apr. 30, 2018), argued (Oct. 29, 2018) – The issue to be decided is whether class arbitration can be ordered without an explicit agreement to that effect in the arbitration provision or whether the interpretation of general language commonly used in arbitration agreements will suffice.

Lamps Plus was subjected to a successful phishing attack in 2016 during which one of its employees sent copies of current and former employees' W-2 forms for 2015 to a third party. Shortly thereafter, Frank Varela filed a putative class action in California federal court seeking relief for the release of his and other employees' personal identifying information. Lamps Plus responded by moving to compel Varela to bilateral arbitration. The district court granted the motion to compel arbitration, but authorized class arbitration based on its interpretation of the language used in the arbitration agreement. Lamps Plus appealed. A divided Ninth Circuit panel affirmed.

Because the agreement in question was susceptible to two reasonable constructions, the Ninth Circuit found that the district court correctly found ambiguity. Because state contract principles require that an ambiguity be construed against the drafter of an adhesion contract, the court found that the district court correctly construed the agreement against Lamps Plus. Finally, by accepting the construction posited by Varela – that the ambiguous terms in the arbitration agreement permitted class arbitration – the court found that the district court properly found the necessary "contractual basis" for an agreement to class arbitration as required by *Stolt-Nielsen S.A. v. AnimalFoods Int'l Corp.*, 559 U.S. 662, 684 (2010).

The contract language in question provided that "arbitration shall be in lieu of any and all lawsuits or other civil legal proceedings relating to my employment," and expressly waived the employee's right to file a lawsuit or other civil action or proceeding, as well as the employee's right to resolve disputes through trial by judge or jury. The Ninth Circuit agreed with the district court that the agreement's language was ambiguous and should be construed against Lamps Plus (the drafter). The court noted that the most reasonable interpretation of the expansive language (quoted above) was that it authorized class arbitration.

> "It requires no act of interpretive acrobatics to include class proceedings as part of a 'lawsuit or other civil legal proceeding[].' Class actions are certainly one of the means to resolve employment disputes in court. The arbitration will be 'in lieu of' a set of actions that includes class actions can be reasonably read to allow for class arbitration."

701 Fed. Appx. At 672.

The Ninth Circuit further reasoned that its construction was supported by the broad language used to describe the claims covered by the arbitration clause. In this regard, the agreement specified that arbitrable claims are those that "would have been available to the parties by law," which the court found was broad enough to include claims brought as a class proceeding. That paragraph also include a non-limiting list of specific types of claims covered, including many types of claims for discrimination or harassment, and noted that these types of claims are frequently brought and resolved through class proceedings. Finally, the paragraph concluded by excluding from arbitrable claims two types of claims, but did not specify claims brought as class or collective proceedings. Finally, the court noted that the broad language of the arbitration provision was not limited to "claims," but required employees to surrender their right to bring all "lawsuit[s] or other civil action[s] or proceeding[s]," and that it authorized the arbitration to "award any remedy allowed by applicable law." The court ruled that such remedies included class-wide relief.

The arbitration agreement in *Lamps Plus* did not contain an explicit waiver prohibiting arbitration of class or collective claim, nor did it contain an explicit agreement to arbitrate only individual, and not class or collective, claims. It also did not explicitly state that class claims were included in what was therein defined as arbitrable claims. The question before the United States Supreme Court is whether an arbitration agreement must expressly provide for class arbitration and, if such express language is missing, whether the court is foreclosed from looking at the language of the arbitration agreement to see if, under general contract interpretation principals, it can reasonably be construed as an agreement to submit class claims to arbitration.

The Supreme Court heard oral argument on October 29, 2018. It was reported that at oral argument, counsel for Lamps Plus argued that the parties must "clearly and unmistakably" agree to class arbitration for such arbitration to be compelled by a court. It was also reported that Justice Kagan questioned Lamps Plus's counsel extensively regarding the language used in the Lamps Plus employment agreement, suggesting that the language (as quoted in the Ninth Circuit decision) was broad enough to support a finding that such an agreement had been made. It was reported that Justice Sotomayor expressed concern that the Supreme Court had previously made clear that state law controls the interpretation of arbitration agreements and, by adopted Lamps Plus's proposed "clear and unmistakable" standard, the Court would be "creating a federal common law … something we're loathe to do in virtually every other context." Finally, it was reported that Justice Kavanaugh expressed concern about whether such a standard had any basis in the text of the FAA.

(e) ***O'Connor v. Uber Techs., Inc.*, 904 F.3d 1098 (9th Cir. 2018) –** District court's denial of Uber's motion to compel individual arbitration reversed; the question of arbitrability was delegated to the arbitrator to decide.

The backdrop of this case / decision is a little tortured (at least for the non-class action / employment law practitioner), but it is important to the "bottom line" significance of the case, discussed below.

The O'Connor plaintiffs are current and former Uber drivers who filed putative class actions against Uber complaining of violations of various federal and state labor and employment statutes. Among the relief the O'Connor plaintiffs sought was an order requiring Uber to provide enhanced notice and opportunities for the putative class to opt out of arbitration. The district court granted that request and Uber provided drivers with updated agreements. Thereafter, the district court certified several classes and subclasses.

In a separate action, plaintiff Mohamed filed a putative class action against Uber asserting various federal and California law claims. The district court denied Uber's motion to compel arbitration, finding, among other things, that the existing arbitration agreements were unconscionable and thus unenforceable. On appeal to the Ninth Circuit, the district court's order was reversed, finding that the question of whether the arbitration agreements were enforceable was not properly before the court, and was a matter to be decided by the arbitration in accordance with the delegation provisions, which were found to be not adhesive pursuant to California law and therefore not procedurally unconscionable. *Mohamed v. Uber Technologies, Inc.*, 848 F.3d 1201 (9th Cir. 2016).

In December 2015, Uber issued new arbitration agreements to all drivers, which prompted the O'Connor, Mohamed and other similar matters to file separate motions to enjoin Uber from distributing and enforcing the new agreements. Initially, the district court granted the plaintiffs' motions. However, after the Ninth Circuit's ruling in the *Mohamed* matter (discussed below), the order was vacated prospectively. The court refused to vacate its order retroactively. This resulted in numerous appeals, which were consolidated in the *O'Connor* decision captioned above.

In *O'Connor*, the Ninth Circuit rejected plaintiffs' argument that the lead plaintiffs' opt out of the arbitration agreements constituted a constructive opt out applicable to the entire class. The panel relied on the Supreme Court decision in *Epic Systems Corp. v. Lewis*, ___ U.S. ___, 132 S.Ct. 1612 (2018), finding that the arbitration agreements did not violate the NLRA, and reversed the district court's order denying Uber's motion to compel arbitration, The Ninth Circuit relied on its decision in *Mohamed v. Uber Technologies, Inc.*, 848 F.3d 1201, 1206 (9th Cir. 2016), in which the same panel ruled that it was for the arbitrator and not the court to decide enforceability of the arbitration agreements because that power was reserved to the arbitrator under the delegation clauses contained in the clauses in question. The Court concluded that the district court's denied of Uber's motions to compel arbitration had to be reversed based upon *Mohamed*. From that flowed the Court's

determination that "[b]ecause the arbitration agreements are enforceable, the district court's class certification orders in *O'Connor* must also be reversed."

Bottom Line Comment: The *O'Connor* decision represents a major victory for the employers involved because the district court's class certification orders and other wins in the consolidated cases were undone.

In light of the Supreme Court's decision in *Epic Systems Corp. v. Lewis,* ___ U.S. ___, 138 S.Ct. 1612 (2018), and *Mohamed*, supra, the Ninth Circuit reversed the district

The O'Connor plaintiffs filed a putative class action against Uber for failure to remit gratuity paid by customers, and for misclassification of the drivers as independent contractors and failing to pay their business expenses. The O'Connor plaintiffs sought an order declaring Uber's 2013 arbitration agreements unconscionable, and thus unenforceable, or, in the alternative, requiring Uber to provide enhanced notice and opportunities to the putative class to opt out of arbitration. The district court granted the O'Connor plaintiffs' alternative request and Uber provided drivers with updated licensing agreements.

In a separate action, Mohamed filed a putative class action against Uber

3. The Award and Challenges to the Arbitration Award

(a) *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).[15] 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

[15] 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.").

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).

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 involving the same parties. *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); *Bucur v. Ahmad*, 244 Cal. App. 4th 175 (2016) (same).

The procedure by which a prevailing party obtains a judgment on its award is a petition to confirm. Under both the FAA and CAA, the prevailing party must petition the court to confirm the award. 9 U.S.C. §§ 9, 13; Cal. Code Civ. Proc. §§ 1285, 1286, 1287.4. Under the FAA, the petition to confirm must be filed within one year of the issuance of the award. 9 U.S.C. § 9. Under the CAA, the deadline for filing the petition to confirm is four years from the date of service of the award. Cal. Code Civ. Proc. §§ 1288, 1288.4. 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. 9 U.S.C. § 13(c); Cal. Code Civ. Proc. § 1287.4; see *Britz, Inc. v. Alfa-Laval Food & Dairy Co.*, 34 Cal. App. 4th 1085, 1106 (1995).

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 and 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 v. Heily & Blase*, 3 Cal. 4th 1, 6 (1992); *City of Palo Alto v. Service Employees Int'l Union*, 77 Cal. App. 4th 327, 333 (1999). 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). Vacatur relief must be sought by petitioning the court to vacate the award and may be filed by any party. *Baldwin Co. v. Rainey Const. Co.*, 229 Cal. App. 3d 1053, 1058 (1991). The time frame for seeking vacatur is quite narrow: three months after the award is "filed or delivered" under the FAA (9 U.S.C. § 12), and 100 days after the date of service of the award under the CAA (Cal. Code Civ. Proc. § 1288)

Vacatur Under the FAA

Grounds for vacatur under the FAA are primarily directed at process errors, as described below:

- The award was procured by corruption, fraud or undue means. 9 U.S.C. § 10(a)(1).

- There was evident partiality or corruption in the arbitrators or either of them. 9 U.S.C. § 10(a)(2).

- The arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy. 9 U.S.C. § 10(a)(3).

- The arbitrators exceeded their powers or so imperfectly executed them that a final and definite award was not made. 9 U.S.C. § 10(a)(4).

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,[16] or where an obvious error of law exists.[17] "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).

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[16] 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).

[17] 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).

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.[18] This common law ground for vacatur under the FAA is not uniformly accepted. Additionally, as demonstrated by the recent Ninth Circuit decision in *Sanchez v. Elizondo*, 878 F.3d 1216 (9th Cir. 2018), discussed below at page 153, the courts sometimes talk about what does and does not qualify as a statutory ground for vacatur using verbiage that sounds like one of the common law grounds. For example, in the *Sanchez* decision, the Ninth Circuit held that vacatur under Section 10(a)(4) of the FAA is a very high standard that requires a showing that the award issued "is completely irrational." 878 F.3d at 1221.

Vacatur Under the CAA

Just like its FAA counterpart, the grounds for vacatur under the CAA are also directed at process errors. Those grounds are similar to Section 10 of the FAA, but have some additional statutory grounds as described below:

- The award was procured by corruption, fraud or undue means. Cal. Code Civ. Proc. § 1286.2(a)(1).[19]

- There was corruption in any of the arbitrators. Cal. Code Civ. Proc. § 1286.2(a)(2).

- The rights of the party were substantially prejudiced by misconduct of a neutral arbitrator. Cal. Code Civ. Proc. § 1286.2(a)(3).

- The arbitrators exceeded their powers and the award cannot be corrected without affecting the merits of the decision upon the controversy submitted. Cal. Code Civ. Proc. § 1286.2(a)(4).[20]

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[18] 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).

[19] 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).

[20] 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. *Moncarsh v. Heily & Blase*, 3 Cal. 4th 1, 8 (1992); *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,

- The rights of the party were substantially prejudiced by the refusal of the arbitrators to postpone the hearing upon sufficient cause being shown therefore or by the refusal of the arbitrators to hear evidence materials to the controversy or by other conduct of the arbitrators contrary to the provisions of this title. Cal. Code Civ. Proc. § 1286.2(a)(5).[21]

- An arbitrator making the award either (a) failed to make a required disclosure, or (B) was subject to disqualification after making a required disclosure and receiving an objection to his/her appointment, but failed upon receipt of a timely demand to disqualify himself or herself as required by California Code of Civil Procedure § 1281.91. Cal. Code Civ. Proc. § 1286.2(a)(6).[22]

Vacatur Because an Award Violates Well-Defined Public Policy

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

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based on the parties' submissions, to reach a certain issue, not whether the arbitrator correctly decided the issue. See, e.g., *DiRussa v. Dean Witter Reynolds, Inc.*, 121 F.3d 818, 824 (2d Cir. 1997).

[21] 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 – and most final awards include language to the effect that all claims, defenses, affirmative defenses, and counterclaims not specifically mentioned in the award were denied. *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 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).

[22] 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). The significance of California's disclosure requirements is that if an affirmative disclosure is made, that triggers the unqualified right of the parties to object to the arbitrator's appointment *and* the unconditional duty of the arbitrator to recuse himself or herself upon receiving an objection to his or her appointment after making disclosures.

labor arbitration award that required the reinstatement of a seaman who was found to be highly intoxicated while on duty); *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 Reynolds, Inc.*, supra, 121 F.3d at 824-825.

Both state and federal common law recognize this "public policy" exception to confirmation of an award, and thus allow vacatur of such an award.

Expanded Review by Party Agreement

While arbitration is a creature of contract, the United States Supreme Court ruled in 2008 that Section 10 of the FAA provides the exclusive grounds for vacatur under the FAA; 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 CAA. 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 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. We have a recent decision out of the Second District Court of Appeal – *Harshad & Nasir Corp. v. Global Sign Systems, Inc.*, 14 Cal. App. 5th 23 (2017), discussed at page 159 - in which the Court held that the language in the parties' arbitration agreement dictates the standard of review when one party seeks vacatur of the award. As discussed below, the language in the parties' arbitration agreement was quite broad and subjected the award to review for both legal and factual errors, which the court found existed, and ordered vacatur.

(b) ***Sheppard Mullin Richter & Hampton LLP v. J-M Manufacturing Co., Inc.***, 6 Cal. 5th 59 (2018) – When the entire agreement containing an arbitration clause is illegal as contrary to statute or public policy, the arbitration clause and any subsequent arbitration award are unenforceable.

We looked at this case in 2017 when it was a 2016 Court of Appeal decision representing an example of vacatur when an arbitrator's decision is found to run far afield of the law and to violate public policy. In this case, the are of the law in question was that of attorney-client relations and the public policy at issue was the all-important area of an attorney's inviolate duty not to concurrently represent clients who have conflicting interests without obtaining their advance consent and waiver of conflicts. The California Supreme Court accepted certiorari and decided the matter last summer. As discussed later, the Court's decision seems to be at odds with the separability doctrine established by *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967) ("*Prima Paint*"); *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440-445 (2006) ("*Buckeye*").

J-M Manufacturing Company ("J-M") retained Sheppard Mulling to represent it in defending against a federal *qui tam* (whistle blower) lawsuit. There were several public entity intervenors in the *qui tam* action, including the South Tahoe Public Utility District ("South Tahoe"). Prior to being retained by J-M, Sheppard Mullin did a conflict check and discovered that it had done a small amount of unrelated work for South Tahoe (employment counseling). As was its standard practice, Sheppard Mullin's retainer agreement with both South Tahoe and J-M contained a blanket waiver of all current and future conflicts. The waivers in both retainer agreements allowed Sheppard Mullin to represent "another client in a matter in which we do not represent [Client], even if the interests of the other client are adverse to [Client]," as long as "the other matter is not substantially related to our representation of [Client]," and provided that the firm had not obtained confidential information from the first client [South Tahoe] relevant to the adverse representation. The firm concluded that it could undertake the representation of J-M in the *qui tam* action and did so without disclosing to either South Tahoe or J-M the known / presently existing conflict. After performing about 10,000 hours of work for J-M in the *qui tam* action, South Tahoe discovered the conflict and successfully moved to disqualify Sheppard Mullin.

After the court disqualified Sheppard Mullin, J-M refused to pay the firm for the balance due on its pre-disqualification services. The firm filed suit in state court to recover approximately $1.2 million in unpaid legal fees. J-M countersued, seeking disgorgement of the nearly $2 million it had paid to the firm prior to its disqualification. Based upon the arbitration clause contained in the firm's retainer agreement, Sheppard Mullin petitioned the state court to compel arbitration of the parties' disputes. J-M opposed arbitration partly on the basis that the entire agreement containing the arbitration provision was illegal and void as a matter of public policy because Shepard Mullin's undisclosed and unwaived conflict of interest violated Rule 3-310(C)(3) of the Rules of Professional Conduct. The trial court granted Sheppard Mullin's motion to compel, reasoning that the gravamen of J-M's

"illegality" claim was fraudulent inducement – that J-M knew what it was signing, but was allegedly induced to give such consent by fraudulent means. The trial court thus determined that this contract defense should be presented to and decided by the arbitrator, which reasoning was entirely consistent with the separability doctrine recognized by the United States Supreme Court.[23]

The matter proceeded to arbitration before a panel of three arbitrators, where the panel ruled in favor of Sheppard Mullin on all claims and counter-claims and awarded the firm$3.8 million in fees, including pre-judgment interest. When Sheppard Mullin petitioned to confirm the award, J-M sought vacatur, arguing that the arbitrators had exceeded their powers by effectively enforcing a contract that was illegal and void. Over J-M's objection, the trial court confirmed the award and specifically held that Professional Rule 3-310 did not render the retainer agreement with the advance waiver provision illegal, void or unenforceable. It reasoned that whether an attorney should be entitled to fees despite the existence of an ethical violation was at the heart of the equitable determination made by the arbitrators, and that the court could not disrupt the legal and factual findings of the arbitrators in this regard.

On appeal by J-M, the Second District reversed and remanded – not with instructions to the trial court to hear and determine J-M's illegality challenge to the enforceability of the retainer agreement and Sheppard Mullin's entitlement to fees on some other ground (e.g., quantum meruit) - but with instructions to determine that Sheppard Mullin "is not entitled to its fees for the work it did for J-M while there was an actual conflict with South Tahoe." The Second District further ordered the trial court to conduct proceedings to determine the amount of fees that Sheppard Mullin "must reimburse to J-M" consistent with the appellate court's stated reasoning and analysis. In a lengthy and strongly worded opinion, the court basically ruled that Sheppard Mullin's engagement agreement with J-M was illegal and thus unenforceable as a matter of law and public policy because of the firm's prior / concurrent representation of the South Tahoe. In this regard, the court found that it "strains credulity" for SMRH's to suggest that the "boilerplate waiver provision" contained in the retainer agreement constituted informed written consent of the firm's actual conflicts to J-M "when, in fact, [Sheppard Mullin] was silent about any conflict."

With regard to its expanded review of the arbitration award confirmed by the trial court, the Second District held that the limited review standard recognized by the California Supreme Court in *Moncarsh v. Heily & Blasé,* 3 Cal. 4th 1 (1992) was not controlling because it addressed judicial review in the context of when a party has alleged that only a portion of

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[23] 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 separated from the remainder of the contract – i.e., the separability doctrine unique to arbitration for purposes of determining subject matter jurisdiction as between the courts and the arbitrator. See also *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 445 (2006).

an otherwise enforceable contract is illegal, rather than the contract as a whole. The appellate court then reached back to a 1949 case in which a trial court was reversed for confirming an arbitration award in favor of unlicensed contractors. *Loving & Evans v. Blick*, 33 Cal. 2d 603 (1949). In that case, the Supreme Court held that "the rules which give finality to the arbitrator's determination of ordinary questions of fact or of law are inapplicable where the issue of illegality of the entire transaction is raised in a proceeding for the enforcement of the arbitrator's award." Relying on its earlier decision *Lindenstadt v. Staff Builders, Inc.,* 55 Cal. App. 4th 882, 892, fn. 2 (1997), the Second District held that on appeal from an order confirming an arbitration award, it reviewed the trial court's order (not the arbitration award) under a de novo review standard and that such review is "the standard of review that governs a trial court's review of an arbitrator's decision where one of the parties claims that the entire contract or transaction underlying the award is illegal."[24]

In April 2017, the California Supreme Court granted review and, in August 2018, affirmed the Court of Appeal, finding that Sheppard Mullin's entire retainer agreement, including the arbitration provision, was illegal and thus unenforceable. The court reaffirmed its 1949 decision in *Loving & Evans v. Blick*, supra, and held that when an agreement containing an arbitration clause is illegal as contrary to statute or public policy, the arbitration clause cannot be enforced and, likewise, any arbitration award issued based upon the arbitration clause cannot be enforced. It also held that the determination of the "illegal contract" issue is for the court – not an arbitrator – to decide. Here, the Court found that Sheppard Mullin's retainer agreement violated Rule 3-310(C)(3) of the Rules of Professional Conduct because the firm had an on-going, if episodic, attorney-client relationship with South Tahoe, who was one of the intervenor plaintiffs in the *qui tam* action, and knew so at the time it contracted with J-M to defend it in that action. Even though the conflicting representation was on an unrelated matter, the Court held that it triggered Shepperd Mullin's duty of loyalty and determined that the firm was not shielded from the ethical violation by the broad advance waiver contained in the J-M retainer agreement because, at the time, the firm knew of an actual conflict and did not disclose it to J-M at the time it solicited the waiver.

On the question of whether the arbitration provision was enforceable notwithstanding the attack on the validity of the advance conflict waiver as being against public policy as reflected in the California Rules of Professional Conduct, the Court held that the conflict of interest charge went to the entirety of the engagement agreement between J-M and Sheppard Mullin. As such, in the Court's view, this was sufficient to distinguish the case before it and partial illegality situations in which the arbitration provision would be upheld (and presumably, the dispute concerning the validity and enforceability of the agreement would be sent to arbitration). Examples of situations given by the Court where arbitration

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[24] *Note: This part of the decision is a bit confusing, since the opening part of the decision made it sound like the basis for reversal was that the court – not the arbitrator – should have decided the illegality / enforceability issue and, thus, the arbitrators exceeded their power by deciding the issue. Such a holding presumably would have resulted in remand back to the trial court to hear and decide the matter, but as discussed above, the Second District wanted to decide the illegality / enforceability issue.*

would be upheld included disputes over engagement agreements that allegedly contained impermissible fee-splitting provisions and engagement agreements that call for services to be provided by non-California lawyers outside of California (for which the firm can collect), and within California (for which the firm cannot collect).

It remains to be seen how future cases and courts will draw the line between partial versus full illegality for purposes of determining the validity and enforceability of an arbitration provision contained in a contract whose other terms are challenged as illegal as a matter of statute or public policy. For this author, the Court's decision seems to fly in the face federal law dictated by the United States Supreme Court, which has held that when parties commit to arbitrate their 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 clause itself, are to be resolved by the arbitrator in the first instance, and not by a federal or state court. In *Prima Paint*. the Supreme Court reasoned that an arbitration agreement is a separate contract from the contract in which it is imbedded for purposes of all contract defenses. Thus, an attack on the contract as a whole is not an attack on or defense to the validity or enforceability of the arbitration agreement, so the defense to the contract must be decided by the arbitrator and not the court. 388 U.S. at 403-404. As the Supreme Court later explained in *Buckeye*:

> "Challenges to the validity of arbitration agreement upon such grounds as exist at law or in equity for the revocation of any contract can be divided into two types. One type challenges specifically the validity of the agreement to arbitrate. The other challenges the contract as a whole, either on a ground that directly affects the entire agreement … or on the ground that the illegality of one of the contract's provisions renders the whole contract invalid … Regardless of whether the challenge is brought in state or federal court, a challenge to the validity of the contract as a whole, and not specifically to the arbitration clause, must go to the arbitrator."

546 U.S. at 444.

This author thinks the trial court got it right and that the decisions of both the Court of Appeal and California Supreme Court reflect California's continuing resistance to arbitration and its persistence in creating judicially crafted exceptions to the enforcement of pre-dispute arbitration agreements, especially when it knows the arbitration outcome and disagrees with it!

(c) ***Monster Energy Company v. City Beverages dba Olympic Eagle Distributing*****, Case No. 5:17-cv-00295-RGK-KK, on appeal to the Ninth Circuit as Case No. 17-56082 –** This case raises several vacatur issues, including what level of specificity will suffice to trigger a party's obligation to object, on penalty of being deemed to have waived the right to later complain and seek vacatur on the grounds of evident partiality for failure to disclose a significant relationship with a party or its counsel. Here, the significant relationship involved a "repeat player" and the arbitrator's ownership interest in the provider who provided one party with "repeat" services.

Olympic is a beverage distribution company located in the State of Washington, and is the exclusive distributor of Anheuser-Busch ("AB"). Monster is an energy drink company. In 2006, Monster entered into an agreement with AB regarding the distribution of Monster products. Under the terms of the AB-Monster agreement, all of AB's existing distributors could elect to also distribute Monster products. Pursuant to this setup, Olympic became a Monster distributor and began distributing Monster branded products in the State of Washington under the terms of two separate Monster-Olympic distribution agreements.

The Monster-Olympic distribution agreements provided that the distribution relationship would last for 20 years, but Monster had the right to terminate the agreements without cause if Monster: (1) repurchased Olympic's unsold Monster inventory, advertising material and equipment, and (2) paid Olympic an amount equal to Olympic's twelve-month trailing gross profit earned from its sale of Monster products.

In 2014, Monster decided to seek a broader distribution agreement with Coca-Cola that would require Monster to terminate its existing distribution agreements, including the ones with Olympic. As such, Monster sent Olympic written notice terminating their agreements, repurchased the excess inventory, advertising material, and equipment, and sent Olympic a check for $2,523,923, representing Olympic's twelve-month training gross profits from Monster sales.

In March 2015, Olympic notified Monster that it was challenging the termination based on Washington franchise law, which Olympic contended profits Monster from terminating their agreement without cause. In response, Monster filed a lawsuit in the federal district court of the Central District of California seeking declaratory relief and asking the Court to enforce the arbitration provisions contained in the Monster-Olympic distribution agreements by order the matter to arbitration. The district court found that the parties' dispute over Monster's right to terminate the distributions agreements fell within the terms of the arbitration provisions and ordered the matter to arbitration. In accordance with the terms of the arbitration provisions, the arbitration was conducted using JAMS and the JAMS.

In November 2016, following extensive briefing and a two-week evidentiary hearing, the JAMS arbitrator found that Olympic was not a "franchisee" and that Monster was not a "franchisor" under Washington law. The arbitrator determined that Washington's franchise law did not apply and that the early termination provisions of the Monster-Olympic distribution agreements were valid and enforceable. The arbitrator also found that the arbitration provisions of the distribution agreements allowed the arbitrator to award reasonable attorney's fees and costs to the prevailing party. Accordingly, the arbitrator awarded Monster its attorney's fees and costs of $3,000,000.

In response to Monster's petition to confirm the arbitration award, Olympic petitioned to vacate the award. Among the grounds stated was vacatur for evident partiality.

At the time of his appointment, the Arbitrator made the following disclosure / statement:

> "I practice in association with JAMS. Each JAMS neutral, including myself, has an economic interest in the overall financial success of JAMS. In addition, because of the nature and size of JAMS, the parties should assume that one or more of the other [sic] [neutrals] who practice with JAMS has participated in an arbitration, mediation or other dispute resolution proceeding with the parties, counsel or insurers in this case and may do so in the future."

Post-award, Olympic discovered that Monster had been a "repeat" user of JAMS services over the years and that the arbitrator was not just interested in the general financial well-being and success of JAMS, but was actually a part owner of JAMS. Olympic complained to the district court that the arbitrator's disclosures were insufficient and that the non-disclosure of Olympic's "repeat player" status and the arbitrator's ownership interest in JAMS (and thus indirect financial interest in those other matters) was sufficient to create an impression of evidentiary partiality warranting vacatur of the arbitrator's award.

In addressing the issue, the district court noted that under *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145, 147 (1968), the party seeking to vacate an arbitration award need no show that the arbitrator was actually guilty of fraud or bias in deciding the case, but need only establish that the arbitrator failed to disclose any significant dealings "that might create an impression of possible bias." *New Regency Products v. Nippon Herald Films*, 501 F.3d 1101, 1105 (9th Cir. 2007). However, in deciding the matter, the court held that as a threshold matter, Olympic had waiver its right to seek vacatur on the grounds of evident partiality because it had failed to timely object when if first learned of the potential for "repeat player" bias due to the arbitrator's economic interest in JAMS. The district court relief on its earlier decision in *Fidelity Federal Bank, FSB v. Durga Ma Corp.*, 386 F.3d 1306, 1313 (9th Cir. 2004), where it held that "the waiver doctrine applies where a party to an arbitration has constructive knowledge of a potential conflict but fails to timely object" so as to be in harmony with the federal policy "favoring finality of arbitration awards." The court noted that Olympic was a sophisticated commercial entity and should have been aware of the potential for a "repeat player" bias after the arbitrator disclosed that he had an "economic interest" in JAMS at the outset of the arbitration. Based upon the arbitrator's "economic interest" disclosure, the court held that

“[t]he proper time for Olympic to further investigate or object to the Arbitrator’s potential conflict of interest … was *before* the arbitration award was issued.”

Assuming for the sake or argument that Olympic had not been found to have waived its right to seek vacatur for evident partiality, the court, in dicta, stated that it could see nothing in the evidence provided that would suggest partiality on the part of the arbitrator. The court noted that the arbitrator had disclosed from the outset that he had an economic interest in JAMS, and stated that “[a]n ownership interest … is merely a type of economic interest.” In this regard, the court stated that it saw no reason to require the arbitrator to make disclosures beyond this “granular level” unless the parties inquired further. The court also noted that Olympic had offered to “*particularized* evidence” that would establish partiality or bias resulting from his economic interest in JAMS.

As mentioned above, Olympic has appealed to the Ninth Circuit to review the district court’s decision denying vacatur and confirming the arbitration award. As of January 2019, the matter had been fully briefed and was awaiting scheduling for oral argument. A decision is expected later this year.

(d) ***ASPIC Engineering & Construction Co. v. ECC Centcom Constructors LLC*, 913 F.3d 1162 (9th Cir. 2019)** - Arbitrator’s award vacated on the grounds that the arbitrator exceeded his powers under 9 U.S.C. § 10(a)(4) because his award ignored the plain text of the controlling contracts and resulted in an “irrational” award based upon the arbitrator’s notion of fairness in order to prevent what the arbitrator deemed to be an unfair result under the subject contracts.

This matter involved a dispute between the prime government contractor (ECC) and one of its subcontractors (ASPIC), who was awarded two subcontracts for the construction of various buildings and facilities in Afghanistan. The government terminated ECC’s prime contract for convenience and, in turn, ECC terminated ASPIC’s two subcontracts for convenience, which the triggered application of the Federal Acquisition Regulation (FAR) and its provisions governing termination for convenience and settlement procedure as incorporated into the contracts in question by reference. ASPIC submitted a termination settlement proposal to ECC and ECC in turn submitted a termination settlement proposal to the government that included the monies ASPIC claimed to be owed. The Defense Contract Audit Agency conducted and audit and informed ECC that it had overpaid ASPIC for its performance under one of the subcontracts and would not pay any part of ASPIC’s claim included in ECC’s settlement proposal. A dispute then arose between ECC and ASPIC because ASPIC believed it was owed more money for its efforts under the subcontracts, irrespective of the government’s audit determinations. The parties’ private settlement efforts were unsuccessful and the matter proceeded to arbitration in accordance with provisions in the subcontracts requiring arbitration for disputes arising from the contracts in accordance with California law.

The matter proceeded to arbitration and resulted in an award in favor of ASPIC for essentially all that it claimed to be due for its efforts under the two subcontracts. In making this determination, the arbitrator rejected ECC's argument that ASPIC was subject to the same FAR precision and adherence requirements as ECC through the pass through provisions in the subcontracts, and found that it was not reasonable under the circumstances (i.e., Aspic was a local Afghanistan-based company) for ECC to expect that Aspic would be capable of modifying its local business practices to strictly conform to U.S. governmental contracting practices that were normal to ECC. As such, the arbitrator determined that "[t]here was not a true meeting of the minds when the subcontract agreements were entered. Hence, ASPIC was not held to the strict provisions of the subcontract agreements that ECC had to the USACE." The arbitrator further determined that ASPIC had conducted its business practices in a manner normal to Afghanistan, and was thus entitled to be paid for its efforts.

ASPIC petitioned the state court to confirm the award, but to reverse the arbitrator's determination that it was not entitled to recover its attorney's fees. The state court affirmed the award and modified it to include an award of attorney's fees to ASPIC in the amount of $435,840. ECC then removed the case to the Northern District of California, where it renewed its effort to vacate the award. The district court granted vacatur, holding that the arbitrator had exceeded the scope of his authority because the award conflicted with the contract because the arbitrator had effectively "voided and reconstructed parts of the Subcontracts based on a belief that the Subcontracts did not reflect a 'true meetings [sic] of the minds.'" ASPIC then appealed to the Ninth Circuit, which affirmed.

The Ninth Circuit held that by concluding that ASPIC did not need to comply with the FAR requirements, the arbitrator had exceeded his authority and failed to draw the essence of the award from the subcontracts; that because the arbitrator's award disregarded specific provisions of the plain text of the subcontracts in order to prevent what the arbitrator deemed to be an unfair result, the arbitrator's award was "irrational" and thus subject to vacatur under 9 U.S.C. § 10(a)(4). In support of its ruling, the Ninth Circuit referred to its earlier ruling in *Kyocera Corp. v. Prudential-Bache Trade Servs., Inc.*, 341 F.3d 987, 997 (9th Cir. 2003), where it held that arbitrators "exceed their powers" when the award they issue is "completely irrational" or exhibits a "manifest disregard of the law." That was found to be the case here.

(e) ***Honeycutt v. JP Morgan Chase Bank, N.A.*, 25 Cal. App. 5th 909 (2018) –** "Repeat player" case resulting in vacatur based upon a finding that the arbitrator failed to make disclosures about the arbitrator's offers he had received of neutral work, as well as his acceptance of those offers in cases involving the attorney for Chase in the pending arbitration.

Background

Courts have long struggled with the problem of ensuring not only the neutrality but also the perception of neutrality of arbitrators, who wield tremendous power to decide cases and whose decisions are subject to limited judicial review. Because arbitrators wield such power, we have seen the California Legislature take an increasingly more active role in protecting the fairness of the process, especially in the area of imposing disclosure obligations on the part of arbitrators and providers. See, e.g., *Mahnke v. Superior Court*, 180 Cal. App. 4th 565, 574 (2009); *Gray v. Chiu*, 212 Cal. App. 4th 1355, 1362 (2013); *Royal Alliance Associates, Inc. v. Liebhaber*, 2 Cal. App. 5th 1092, 1105 (2016). Indeed, the California Legislature has gone out of its way, particularly in recent years, to regulate arbitrator neutrality by revising the procedures relating to the disqualification of private arbitrators and by adding vacatur as a penalty for noncompliance with the prescribed affirmative arbitrator disclosure obligations. See, *Azteca Construction, Inc. v. ADR Consulting, Inc.*, 121 Cal. App. 4th 1156, 1167 (2004).

In California, arbitrators who are appointed to serve in contract arbitration matters are required to make a number of disclosures as a matter of law, as codified in the California Arbitration Act. Code of Civil Procedure § 1281.85 provides that:

> "a person serving as a neutral arbitrator pursuant to an arbitration agreement shall comply with the ethics standards for arbitrators as adopted by the Judicial Council pursuant to this section."

Code of Civil Procedure § 1281.9(a) provides that a proposed neutral arbitrator:

> "shall 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 …"

According to Code of Civil Procedure § 1281.9(a)(2), among the specific disclosures a proposed neutral arbitrator is required to make are:

> "[a]ny matters required to be disclosed by the ethics standards for neutral arbitrators adopted by the Judicial Council pursuant to this chapter."

Standard 7(f) provides that arbitrators have a continuing duty to make disclosures about the matters covered by Standard 7(d) and (e). Those standards basically deal with various types of business, professional and personal relationships between the arbitrator and/or his family, on the one hand, and any party or attorney in the dispute, on the other (Standard 7(d)(1)-(8)), other professional relationships (Standard 7(d)(9)), financial interest in a party or the subject matter of the arbitration (Standard 7(d)(10)-(11)), an interest that might be affected by the outcome of the arbitration (Standard 7(d)(12)), knowledge about the disputed facts of the arbitration (Standard 7(d)(13)), membership in any organizations practicing discrimination (Standard 7(d)(14)), any other matter that might cause a person aware of the facts to reasonably entertain a doubt that the arbitrator would be able to be impartial (Standard 7(d)(15)), professional discipline (Standard 7(e)(1), and circumstances that will create constraints on the arbitrator's time and availability to conduct the arbitration (Standard 7(e)(2).

If the proposed arbitrator fails to comply with his or her disclosure obligations, that too is grounds for automatic disqualification, provided that such notice is given within 15 calendar days of the proposed arbitrator's failure to comply - e.g., 10 days from notice of appointment. CCP § 1281.9(b). Upon receipt of a timely notice of disqualification, the proposed arbitrator has no choice but to withdraw or recuse himself or herself. CCP § 1281.91(a). The failure to do so sets the matter up for automatic vacatur. CCP § 1286.2(a)(6)(A).

If a party entitled to receive disclosures from the proposed arbitrator fails to timely serve a notice of disqualification, that party shall be deemed to have waived the right to disqualify the proposed arbitrator unless it is shown that the proposed arbitrator made a material omission or material misrepresentation in his or her disclosures. CCP § 1281.91(c). Except where grounds for disqualification exist under CCP § 170.1, a notice of disqualification may not be given after a hearing of any contested issue of fact relating to the merits of the claim or after any ruling by the arbitrator regarding any contested matter. Id.

Honeycutt Case

Plaintiff (Honeycutt) sued her employer (Chase) alleging employment law violations. The trial court ordered the matter to arbitration. The arbitrator filled out a standard disclosure worksheet, but the Case Manager omitted one page of that worksheet when it was transmitted on to the parties' counsel. The missing page included a "yes" or "no" disclosure as to whether the proposed arbitrator intended to accept other employment offers from the parties or their counsel during the pendency of the current matter (Question No. 28). While the arbitrator had answered "no" to most of the questions on the worksheet, he answered "yes" to Question No. 28. The completed worksheet that the parties' counsel did receive included a page which included space for the proposed arbitrator to explain any "yes" answer to any question and to make such additional disclosures as he believed were

appropriate. On this page, the arbitrator wrote: "#28. I will entertain offers to serve as a dispute resolution [sic] in other cases. I will evaluate any potential conflict at that time prior to accepting [sic] offer."

No objections or challenges were made to the arbitrator's proposed appointment based upon the disclosure worksheet. The matter proceeded to a six-day arbitration, at the end of which, the arbitrator issued an interim award in favor of Chase and against Honeycutt on all of her claims. Counsel for Honeycutt was surprised that her client lost because she thought the evidence presented in the arbitration was overwhelmingly in favor of her client. Suspicious, Honeycutt's attorney asked the AAA to provide her with a list of every other case the arbitrator had accepted involving Chase or its attorney. She also complained for the first time that the disclosure worksheet that had been sent to her was missing a page, and omitted questions 21 through 28.

During the pendency of the arbitration, the AAA case manager had provided the parties' counsel with notice that the arbitrator had accepted an arbitration appointment in four new matters involving Chase's attorney in the current matter. In response to Honeycutt's attorney's post-award inquiry, the AAA case manager advised her that there were four additional matters in which the arbitration had accepted an arbitration appointment involving Chase's attorney in the Honeycutt matter. Honeycutt's attorney immediately served an objection to the arbitrator continuing to serve and requested his immediate disqualification. That request was denied, and the arbitrator proceeded to issue a final award, in which he ordered that Honeycutt "take nothing on her claims" and ruled that the arbitration costs and fees "be borne as incurred."

Chase filed a petition to confirm the award and Honeycutt filed a petition to vacate it. The trial court confirmed the award, finding that the arbitrator had sufficiently made the required disclosures and that no prejudice had been shown to support any other ground for vacatur. Honeycutt appealed, and the Second District Court of Appeal reversed.

With regard to the page missing from the disclosure worksheet, the Court of Appeal noted that the handwritten answer regarding Question No. 28 implicitly informed the parties that the arbitrator intended to entertain future offers of employment as a dispute resolution neutral, but it was deficient in terms of the type of further disclosure required by Standard 12(d). If an arbitrator in a consumer arbitration like the Honeycutt employment arbitration make a disclosure about entertaining offers of appointment in future arbitration matters, the arbitrator must also state that he or she "will inform the parties as required … if he or she subsequently receive an offer while the arbitration is pending," even if the offer is not accepted. The arbitrator's further disclosure did not comport with Standard 12(d). He did not state that he would inform the parties if he received an offer, only that he would "evaluate any potential conflict" before accepting the offer. The Court of Appeal found that the rule requires disclosure of subsequent offers regardless of the arbitrator's personal evaluation or whether there is a conflict, and even if the arbitrator does not accept the offer. The significance here is that the Court of Appeal held that Honeycutt had waived her right to seek vacatur based on the arbitrator's failure to comply with Standard 12(d) because she knew (or should have known) that the arbitrator's disclosures did not comply

with the Ethics Standards and that triggered the 15-day time frame within which she could object. Citing *Dornbirer v. Kaiser Foundation Health Plan, Inc.*, 166 Cal. App. 4th 831, 846 (2008), the court found that Honeycutt had waived her right to disqualify the arbitrator and to seek vacatur for a failed disclosure.

The Court of Appeal's reversal of the trial court's confirmation of the award was based upon the undisputed fact that the arbitrator had accepted four arbitration appointments in which Chase's attorney was involved and that no disclosure had been made to Honeycutt about the offer or acceptance of the appointments. Even as to the four matters where Honeycutt was given notice that the arbitrator had accepted appointment in matters involving Chase's attorney, the problem was that no disclosure was given about the offer of appointment. The reversal was also based upon the arbitrator's violation of his continuing disclosure duties under Standard 7(f). In this regard, the court noted that the arbitrator disclosure rules

> "are strict and unforgiving. And for good reason. Although dispute resolution provider organizations may be in the business of justice, they are still in business. The public deserves and needs to know that the system of private justice that has taken over large portions of California law produces fair and just results from neutral decisionmakers."

25 Cal. App. 5th at 270, citing *Gray v. Chiu*, supra, 212 Cal. App. 4th at 1366 (2013) (while the rule under section 1286.2 requiring the court to vacate the award "seems harsh, it is necessary to preserve the integrity of the arbitration process"); see also, *Advantage Medical Services, LL v. Hoffman*, 160 Cal. App. 4th 806, 822 (2008) ("'neutrality of the arbitrator [was of] … crucial importance'" to the Legislature); *Azteca Construction, Inc. v. ADR Consulting, Inc.*, supra, 121 Cal. App. 4th at 1168. While the disclosure rules the arbitrator in Honeycutt violated might seem technical, the Court of Appeal noted that are important and must be followed because "they are part of the Legislature's effort to ensure that private arbitrations are not only fair, but appear fair." 25 Cal. App. 5th at 271.

(f) ***Benaroya v. Willis*, 23 Cal. App. 5th 462 (2018)** – It is for the court to decide whether a non-signatory is bound by an arbitration agreement, even when the agreement delegates arbitrability issues to the arbitrator.

In September 2014, Benaroya Pictures entered into a contract with Westside Corporation to pay Bruce Willis to perform in a movie to be produced by Benaroya. Producer and Lender entered into an escrow agreement with Creative Artists Agency to hold $8 million in trust for the services of Willis. Willis signed the agreement as president of Westside – described as the "Lender" under the contract, and Michael Benaroya signed the agreement on behalf of Benaroya, described in the "Producer" in the contract. The agreement contained an arbitration clause which provided in relevant part as follows:

> "If there is any dispute between Producer and Lender with respect to the disposition of funds deposited in the Escrow Account, the parties agree that such dispute shall be resolved exclusively through arbitration … pursuant to the rules and regulations of JAMS before a single arbitrator. If the parties are unable to agree upon an arbitrator, the arbitrator will be selected according to the Commercial Arbitration Rules of JAMS."

When Benaroya failed to pay Willis, Willis and Westside filed a demand for arbitration naming Benaroya (the entity). Benaroya (the entity) appeared in the arbitration by filing an answer and counterclaim. Thereafter, Willis and Westside filed a motion before the arbitrator to amend the demand to name Michael Benaroya, individually, as an additional party respondent. Michael opposed the motion, arguing that he was not a party to the arbitration agreement, and that the question whether a non-signatory can be compelled to arbitrate is a question for the trial court, not the arbitrator. The arbitrator heard the motion over Michael's objection and then granted the motion allowing claimants to amend their demand to add Michael Benaroya to the arbitration matter as a party respondent. The matter then proceeded to evidentiary hearing, with Michael continuing to object to the arbitrator's exercise of jurisdiction over him. Ultimately, the arbitrator ruled in favor of Willis and Westside, awarding them over $5 million in damages against both Benaroya and Michael, finding that Michael was Benaroya's alter ego. The trial court confirmed the award and Michael appealed.

On appeal, the Fourth District Court of Appeal reversed, finding that the trial court erred. The court noted that although there are circumstances where a nonsignatory can be compelled to arbitrate, California case law is clear that "an arbitrator has no power to determine the rights and obligations of one who is not a party to the arbitration agreement. [Citation.] The question of whether a nonsignatory is a party to an arbitration agreement is one for the trial court in the first instance." 23 Cal. App. 5th at 469, citing, *American Builder's Assn. v. Au-Yang*, 226 Cal. App. 3d 170, n179 (1990). While arbitration is a favored method of resolving disputes, "the policy favoring arbitration does not eliminate the need for an agreement to arbitrate and does not extend to person who are not parties to an agreement to arbitrate." Id., citing *Matthau v. Superior Court*, 151 Cal. App. 4th 593, 598 (2007).

With regard to Willis and Westside's argument that the terms of the arbitration agreement in question clearly and unmistakenly delegated arbitrability issues to the arbitrator, the appellate court found that they were mistaken in their position that that provision operated to give the arbitrator jurisdiction over Michael with respect to the determination of the alter ego issue for purposes of binding him to the arbitration agreement (versus the ultimate liability).

The appellate court also found unpersuasive the argument Willis and Westside made to the effect that the evidence was "overwhelming" that Michael was in fact the alter ego of Benaroya so that confirmation of the award against him amounted to harmless error. The court responded that :[t]he wrong decision-maker decided the issue." As such, the arbitrator exceeded his authority by purporting to compel Michael to arbitrate, and by making him liable for the award against Benaroya as Benaroya's alter ego. Accordingly, the court concluded that the award must be set aside insofar as it bound Michael.

(g) ***Maplebear, Inc. v. Busick*, 26 Cal. App. 5th 394 (2018) –** Vacatur petition denied because a partial final award that decided a preliminary issue, but left unanswered almost every question raised in the arbitration demand, was not an "award" on which the superior court had jurisdiction to act.

Maplebear, Inc. (referred to as Instacart in the decision) is a grocery deliver service whose workers shop and deliver goods to customers. Busick was an Instacart employee and filed a class action arbitration demand pursuant to the terms of an agreement between her and Instacart. In her demand, Busick complained that Instacart had violated California law by classifying its workers as independent contractors rather than employees. The parties submitted a threshold issue to the arbitrator: namely, whether the agreement permitted Busick to seek class certification within the arbitration. The arbitrator issued a "partial final award" on that issue and ruled that Busick could make such a motion in the arbitration, without addressing whether certification would be appropriate. Instacart petitioned the superior court to vacate the partial final award. The trial court concluded that it lacked jurisdiction and dismissed the petition because the "partial final award" that was the subject of the petition did not constitute an "award" as defined by Code of Civil Procedure § 1283.4. Instacart appealed.

On appeal, the First District Court of Appeal affirmed, finding that the trial court correctly determined that it had no jurisdiction to reach the merits of Instacart's vacatur petition because the award at issue left undecided almost every question raised by Busick in her arbitration demand. It also rejected Instacart's argument that *Cable Connection, Inc. v. DIRECTV*, 44 Cal. 4th 1334 (2008) required the trial court to reach the merits of the petition to vacate the arbitrator's partial final award because Busick and Instacart had agreed to expanded review of an arbitrator's award for legal error i.e., that where parties have agreed to expanded review for legal error, they have also agreed (and thus vested the court with jurisdiction) to judicial review of interim awards. The appellate court held that the California Arbitration Act does not support Instacart's position and, moreover, does not

offer a workable distinction between interim awards where immediate review is reasonably necessary to ensure an effective remedy and interim awards where such review is not necessary. The appellate court concluded that in the face of section 1283.4, which defines an "award" as "a determination of all the questions submitted to the arbitrators the decision of which is necessary in order to determine the controversy," parties to an arbitration agreement cannot confer jurisdiction on courts to review interim rulings by private agreement. While parties are generally free to structure their arbitration as they see fit, a request for superior court review of an arbitration award is subject to statutory constraints that cannot be altered by contract. The appellate court pointed out that Justice Baxter, in his concurring opinion in *Cable Connection*, had said that "it is questionable whether parties to an arbitration agreement may contract to obtain premature judicial merit review of arbitral decisions that are labeled 'awards,' but which in substance merely resolve one or more legal or factual issues pertaining to only a portion of the controversy submitted to the arbitrators for their determination. *Out court has not addressed this issue, and it had not been raised or litigated in the instant case."* 44 Cal. 4th. at 1367 (italics added).

5. Challenges to Enforceability

(a) ***Saheli v. White Memorial Medical Center*, 21 Cal. App. 5th 308 (2019)**

– Defendants entitled to invoke an arbitration clause in defending against plaintiff's Bane and Ralph Act discrimination claims since the portions of those acts which seek to discourage arbitration by specifying special contracting requirements target arbitration agreements and are preempted by the FAA.

Saheli enrolled in a medical residency program at White Memorial Hospital Center. As part of her enrollment, Dr. Saheli signed an arbitration agreement wherein she agreed to submit "all issues" to final and binding arbitration, except those "not arbitrable under applicable state law." When she was terminate, Dr. Saheli filed a complaint alleging harassment and discrimination, among other causes of action. Defendants moved to compel arbitration of the entire action. The trial court granted the motion in part, compelling arbitration of all claims except those asserted under the Bane and Ralph Acts, which make unenforceable the waiver "of any forum or procedure …. unless expressly not made as a condition of entering into a contract for services." Defendants appealed.

On appeal, the Second District Court of Appeal reversed. Following *DirecTV v. Imburgia*, 136 S.Ct. 463 (2015), the court noted that the United States Supreme Court had been presented with language very similar to that before it and had held that such language unambiguously excluded state law preempted by the FAA; that a contrary interpretation would itself be preempted by the FAA. Accordingly, the appellate court held that by providing in their arbitration agreement that it was governed by the FAA and "applicable state law," the parties did not thereby incorporate portions of California state law that are preempted by the FAA, but only valid applicable state law. That there is no judicial opinion declaring that the FAA preempts the Bane and Ralph Acts' provision requiring a party seeking to enforce any waiver of a party's right to sue in court to prove the waiver was knowing and voluntary

and not made as a condition of providing or receiving goods or services was of no moment. The United States Supreme Court has made clear on numerous occasions – most recently its decision in *Kindred Nursing Centers, L.P. v. Clark*, ___ U.S. ___, 137 S.Ct. 1421 (2017) – that arbitration agreements must be placed on an equal footing with general contracts as a whole, and special contracting requirements related to waiving or foregoing a jury or the right to submit dispute to court for decision – both a defining feature of arbitration – are ill-disguised attempts to target and disfavor arbitration agreements.

Comment: There is an interesting concurring opinion by Justice Rubin. While he agreed with the majority that, under United States Court precedent, the reference in an arbitration agreement that excludes "any claim that is non-arbitrable under applicable state or federal law" must be read to refer to state law that is not otherwise preempted by the FAA, he lamented the fact that the court's decision "continues the recent march of our nation's jurisprudence toward eliminating the right to a jury trial (or any trial) in a large number of civil cases by its ever-extending embrace of arbitration." Id. at 333. In this regard, he noted that in the six years following the United States Supreme Court's decision in *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011), the Court issued 12 opinions "either upholding arbitration agreements in the face of various challenges to their enforceability or directing lower courts to reconsider their previous decisions in light of *AT&T Mobility*."

(b) *Cohen v. TNP 2008 Participating Notes Program, LLC*, 31 Cal. App. 5th 840 (2019) – (1) Non-signatory parent company of a signatory subsidiary can be compelled to arbitration on an agency theory when the parent company wielded significant control over the subsidiary, and the claims against the parent company arose out of the agency relationship, and (2) attorney lacked standing to enforce arbitration agreements as the agent of his clients because agents ordinarily do no have a claim based upon some third party's violation of its principal's rights.

This is a factually convoluted case – but a nevertheless an interesting one – so hold on to your hats! The value of this case is not so much in its ruling per se, but in its application of general arbitration law principles as pertains to non-signatories in arbitration for purposes of (a) being compelled to arbitration as the controlling agent of a signatory, and (b) having standing to enforce an agreement to arbitrate. The "rules" are simple and make sense. The facts of this case are not!

Thompson National Properties LLC (TNP) created two subsidiary limited liability companies to raise funds from accredited investors for various real estate investments - TNP 2008 Participating Notes Program, LLC (2008 Program) and TNP 12% Notes Program, LLC (12% Program) (collectively, Programs). The Programs issued private placement memoranda offering investments through the sale of promissory notes, guaranteed by TNP. Mark Cohen (Cohen), an attorney and investment advisor, recommended that his clients and his law firm's retirement plan invest in both Programs. When the Programs defaulted on their promissory notes, Cohen initiated arbitration in his name as claimant for the

behalf of his clients with respect to their claims against the Programs, TNP and Thompson (sued as TNP's alter ego). Only Cohen's clients, his firm's retirement plan and the Programs signed the operative arbitration agreements – meaning that he, TNP and Thompson were all non-signatories. He on the offensive end. TNP and Thompson on the defensive end.

The Programs agreed to arbitration, but TNP and Thompson did not. Cohen and his firm's retirement plan petitioned the court to compel arbitration against TNP and Thompson and did so based on the allegation that they were parties to the Programs, even though Cohen did not invest in either Program and the retirement plan invested only in the 12% Program. TNP and Thompson opposed the motion to compel on the grounds that they were not signatories to any arbitration agreement with Cohen or the retirement plan. They also challenged Cohen's standing to assert claims on behalf of his clients. Cohen and the retirement plan responded that TNP and Thompson were agents and alter egos of the Programs and could be compelled to arbitration, and that because he had acted as an agent for his clients for many years, he had the authority to bring action on their behalf. The trial court decided both issues in favor of Cohen and ordered TNP and Thompson to arbitration.

In arbitration, the parties stipulated to the amounts owed to each investor / noteholder. The primary issues for the arbitrator to determine were whether Thompson was an alter ego of TNP and the Programs (and thus liable on the notes), and whether Cohen had standing to bring claims on behalf of his clients. After the arbitration hearing, but before the award was issued, Cohen moved to amend the caption to add as claimants all of Cohen's clients for whom he had been acting. Over the objection of the Programs, TNP and Thompson, the arbitrator granted the relief and then issued an award in favor of Cohen's individual clients only (denying any relief to Cohen, his law firm or his law firm's retirement plan)[25] for the amounts owed under their respective notes. The arbitrator also ruled that TNP was liable for those amounts because it guaranteed the notes, and that Thompson was personally liable as an alter ego of the Programs and TNP.

Not surprisingly, the Programs, TNP and Thompson petitioned for vacatur. They argued that the arbitrator had exceeded his authority by issuing an award against non-signatories TNP and Thompson and that Cohen lacked standing to litigate claims on behalf of his clients. The trial court denied the petition and confirmed the award. The Programs, TNP and Thompson appealed.

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[25] The arbitrator had some choice words for Cohen. In limiting the basis for the award to "breach of contract and no other cause of action," the arbitrator went on to note that "[i]f any fraudulent representations did occur, Cohen probably made them to his clients, assuring them that the investments were safe based solely on Thompson's record, rather than on the [private placement memoranda], which contained all the information upon which the investors were entitled to rely. The [private placement memoranda] clearly show that the Programs involved Notes issued by new limited liability companies with no assets, and that the Notes were guaranteed by TNP, a new entity with insufficient assets to meet its obligations under the guaranty once all the Notes were issued." The arbitrator suggested that Cohen "promised to advance his clients' attorneys' fees and costs" to avoid legal action against himself for recommending "unsuitable investments to his clients," most of whom were over 70 years old and retired. The arbitrator concluded that "[a]warding attorneys' fees and costs to the law firm whose founding partner is a culpable party, who profited from his mistaken advice, would be a gross injustice and violate the equitable principle of unclean hands." 31 Cal. App. 5th at 854.

On appeal, the Second District Court of Appeal affirmed in part, reversed in part and remanded with instructions. With regard to the arbitration issues, the court ruled as follows:

1. Affirmed: TNP, the non-signatory parent company of the Programs, was properly compelled to arbitration based upon agency theory. In so ruling, the court adopted the standard promulgated in *E.I. DuPont de Nemours v. Rhone Poulene Fiber*, 269 F.3d 187 (3d Cir. 2001), a case where a non-signatory parent was compelled to arbitrate based upon an arbitration agreement signed by its subsidiary because the subsidiary acted as an agent for the parent and the dispute arose out of that relationship. As applied to this case, the appellate court concluded that "an arbitration agreement signed by a subsidiary may bind the parent company only where the party seeking to compel arbitration can show the parent had sufficient control over the subsidiary's activities such that the subsidiary was a mere agent or instrumentality of the parent *and* the causes of action or claims against the parent arise out of this relationship." 31 Cal. App. 5th at 864-865 (emphasis in original). In this case, the court found that the claims against TNP arose directly from its agency relationship with the Programs, and that TNP had taken several actions that "blurred the lines between the two entities." Id. at 865. In so ruling, this decision confirms that distinct corporate entities, although legally separate, may through their conduct subject a non-signatory parent and/or subsidiary entities to binding arbitration agreements.

2. Reversed: The trial court erred in compelling Thompson to arbitrate because he was not a party to any agreement containing an arbitration clause and no evidence was provided that would support a finding that Thompson was an agent who accepted the benefits of the notes or was a third-party beneficiary of the notes. Id. at 866-867.

3. Reversed: The trial court erred in its determination that Cohen had standing to enforce the arbitration agreements as an agent of his clients. The appellate court found that even if Cohen had acted as attorney-in-fact or investment manager to his clients, neither of those posts gave him standing to enforce his clients agreements or to bring a "representative" action on their behalf to compel arbitration. Id. at 857, citing, *JSM Tuscany, LLC v. Superior Court*, 193 Cal. App. 4th 1222 (2011) ("when a nonsignatory of a contract is attempting to seek relief for breach of the contract itself, that nonsignatory *must* be doing so by means of either a third-party beneficiary argument, or a legal theory which entitles that nonsignatory to 'stand in the shoes' of a party to the agreement – either by virtue of a preexisting relationship, or as an assignee or successor in interest."). The court noted that Cohen did not claim to be a third party benefits, his clients did not assign him the notes or any of their rights thereunder, and he did not identify any statute giving him standing to enforce agreements on behalf of his clients by virtue of that attorney-client relationship. As such, the court ruled that the trial court erred in compelling TNP and Thompson to arbitrate Cohen's claims against them.

Comment: This is a 30-page decision that addresses the pitfalls and pratfalls of this unhappy set of events surrounding a failed investment scheme. In terms of the final disposition, which undid most of what had transpired in the trial court and arbitration, you leave the case shaking your head and wondering how such an exercise in futility could have gone on for so long. The only explanation I have come up with is that there is confusion and misunderstanding about what arbitration is. Very simply, while the courts speak of private arbitration as a "favored" dispute resolution process and one that is to be supported and facilitated by the courts, it is a creature of contract and consent. Start with the contract – who are the parties? who are the signatories? what does it say about agents, affiliates, successors and assigns? what does it say about the type of claims and disputes to be submitted to arbitration? Etc. Here, the trial court started with the dispute and appears to have gotten confused when it saw the prospect of hundreds of retiree investors facing the prospect of pursuing claims in both an arbitral and judicial forum. *That* prospect was entirely of Cohen's making because he started there (in arbitration) instead of in the court. And he started with a petition to compel arbitration instead of a complaint. If the court had been presented with a complaint in the first instance, it no doubt would have recognized Cohen's standing problem. The questions remain (for me at least) – why didn't the arbitrator see the standing problem and deal with it at the outset? Why didn't the arbitrator see the jurisdiction / authority issues and return to the arbitration agreements in question to confirm who he had jurisdiction over and what matters he had the power to hear and decide?

(c) ***Fuentes v. TMCSF, Inc.*, 26 Cal. App. 5th 541 (2018)** – Trial court properly denied a motion to compel arbitration where the moving party was not a signatory to the agreement which contained the arbitration provision.

Fuentes bought a Harley-Davidson motorcycle. He executed a purchase agreement with Riverside Harley-Davidson, which did not contain an arbitration clause. At the same time, he entered into a separate agreement with a bank to finance his purchase of the motorcycle. That agreement did not contain an arbitration clause. Thereafter, Fuentes sued Riverside in a putative class action, claiming that Riverside had made several misrepresentations in violation of several statutes in connection with the sale of the motorcycle, among them, that the motorcycles were marketed as new, but there were in fact used. Riverside moved to compel arbitration based upon the arbitration clause contained in the finance agreement. The trial court denied the motion because the arbitration provision applied solely to Fuentes' agreement with the bank. Riverside was not a party. Riverside appealed.

On appeal to the Fourth District Court of Appeal, the court affirmed, rejecting Riverside's argument that the purchase agreement and finance contract constituted a single contract and, thus, it was a party to the arbitration agreement contained in the bank's finance contract. In this regard, the appellate court noted that under Civil Code § 1642, "[s]everal contracts relating to the same matters, between the same parties, and made as parts of substantially one transaction, are to be taken together." However, in this case, the purchase agreement and the finance contract, by their own terms, were not between the same

parties. Accordingly, Section 1642 did not apply so as to allow Riverside to inure to the rights / benefits of the arbitration clause contained in the finance contract. The appellate court agreed with the trial court that the arbitration provision in the finance contract applied solely to disputes that might arise between Fuenstes and the bank. The appellate court also agreed with the trial court that the dealership could not seek to enforce the arbitration clause under agency, third-party beneficiary or equitable estoppel theories.

(d) *Williams v. Atria Las Posas*, 24 Cal. App. 5th 1048 (2018) – Denial of motion to compel arbitration based on an integration clause contained in a residential care facility's contract was in error because the arbitration agreement was signed later in time.

After suffering a traumatic brain injury and other injuries, Williams signed a residency agreement to live in Atria Los Posas, a residential care facility for elder and dependent adults. The agreement contained an integration clause which stated that it constituted the entire agreement between Williams and the facility and superseded all prior agreements. This agreement did not contain an arbitration clause. Immediately after signing the residency agreement, Williams signed a separate arbitration agreement. The arbitration agreement stated that "[i]t is understood that any and all legal claims or civil actions arising out of relating to care or services provided to you at Atria … or relating to the validity or enforceability of the Residency Agreement … will be determined by submission to arbitration…"Williams wife did not sign any of the agreements.

Shortly after his admission to Atria, Williams walked away from the facility, fell into a ditch and sustained further brain injury and other damages. Williams and his wife sued Atria and Williams' treating physician. Atria petitioned the court to order the matter to arbitration. Williams and his wife opposed the request on several grounds, including the argument that the court could not consider the arbitration agreement because it was not included in the residency agreement, which had an integration clause. The trial court denied Atria's motion and reasoned that the integration clause in the residence agreement barred the subsequent arbitration agreement because the residence agreement represented the parties' complete agreement. Atria appealed.

On appeal, the Second District Court of Appeal affirmed in part and reversed in part. With regard to the reversal, the appellate court found that the trial court erred in concluding that the integration clause in the residence agreement precluded the later signed arbitration agreement. While the residence agreement superseded any "prior" agreements, it did not foreclose or invalidate agreements signed later – such as the arbitration agreement in question. Additionally, the arbitration agreement expressly provided that it applied to claims regarding "the validity or enforceability of the residence agreement."

(e) *Vasquez v. San Miguel Produce, Inc.*, 31 Cal. App. 5th 810 (2019), not citable, rehearing granted Feb 28, 2019 – An employer can enforce an arbitration agreement between a staffing agency (joint employer) and its employees, even if it was not a party to the staffing employment agreement and had no separate agreement to arbitrate with the employee.

San Miguel Product (SMP) leased employees through a staffing agency – Employer's Depot, Inc. (EDI). EDI had arbitration agreements with its staffing employees. SMP did not have such agreements with workers leased through EDI.

Two packing workers that SMP leased through EDI sued SMP for various wage and hour claims. SMP cross-complained against EDI and brought it into the suit. SMP and EDI then joined in filing a motion to compel arbitration based upon the arbitration agreement signed between EDI and the complaining workers.

The arbitration agreement in question provided as follows: "my Temporary Employment Agency … and (my 'Worksite Employer') and I will utilize binding arbitration to resolve all dispute that may arise within the employment context," whether based on tort, contract or statute." It further provided that the employee agreed that "any claim, dispute, and/or controversy that either I may have against my Worksite Employer, my Temporary Employment Agency … having any relationship or connection whatsoever with my seeking employment with, or any other association with my Worksite Employer [or] Temporary Employment Agency … shall be submitted to and determined exclusively by binding arbitration under the Federal Arbitration Act … in conformity with the procedures of the California Arbitration Act."

The trial court denied the motion, accepting the plaintiff employees' arguments that (a) EDI cannot compel arbitration because it was not named as a defendant in their complaint, and (b) SMP cannot compel arbitration because it was not a signatory to the arbitration agreement. SMP and EDI appealed.

On appeal, the Second District Court of Appeal reversed. With regard to EDI's standing to compel arbitration, the appellate court found that EDI would be denied the benefit of the arbitration agreement it had with the plaintiffs if it was obligated to litigate SMP's indemnification claim, which arose directly from plaintiffs' employment. It held that plaintiffs could not avoid arbitration by suing non-signatory defendants for claims that are based upon the same facts and inherently inseparable from the arbitrable claims against signatory defendants. Looking at "'the relationships of persons, wrongs and issues,'"[26] the appellate court concluded that signatory / cross-defendant EDI could compel arbitration of inseparable cross-claims which were based on the same facts alleged against SMP. Id. at

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[26] Citing, *Metalclad Corp. v. Ventana Environmental Organizational Partnership*, 109 Cal. App. 4th 1705 (2003).

With regard to the right of EDI and SMP to jointly enforce the arbitration agreement, the court noted that the general rule is that only a party to an arbitration agreement can invoke it, but that an exception exists when there is an agency or similar relationship between the nonsignatory and one of the parties to the arbitration agreement. In that circumstance, the arbitration agreement may be enforced by the nonsignatory. Citing, *Westra v. Marcus & Millichap Real Estate Investment Brokerage Co., Inc.*, 129 Cal. App. 4th 759, 766 (2005). The appellate court held that the co-employer relationship between EDI and SMP and their identity of interest with regard to their mutual employees allowed them to join in compelling arbitration of the employment dispute. In this regard, the court noted that California's Wage Orders have been construed such that the definition of an employer "reaches situation in which multiple entities control different aspects of the employment relationship," including when one entity hires and pays a worker, and another entity supervises the work,[27] and that the courts have found that co-employers have equal obligations to comply with laws governing wages, meal and rest breaks, etc. [28]

6. Miscellaneous

(a) ***Heimlich v. Shivji***, 12 Cal. App. 5th 152 (2017), cert granted, 400 P.3d 442 (2017) – When a party to an arbitration proceeding makes an offer of compromise pursuant to Code of Civil Procedure section 998 and obtains a result in the arbitration more favorable to it than that offer, how, when, and from whom does that party request costs? Still waiting for a decision from the California Supreme Court.

This is a very interesting case because the court attempted to harmonize – procedurally – the arbitration doctrine of functus oficio with the procedural requirements of CCP § 998(b)(2) and the powers vested in an arbitrator under Rules R-8 and R-47(d)(ii) of the AAA Commercial Rules (the provider rules at issue in the case). However, it has no precedential value because the California Supreme Court has accepted cert to decide the issue of "[w]hen a party to an arbitration proceeding makes an offer of compromise pursuant to CCP § 998 and obtains a result in the arbitration more favorable to it than that offer, how, when and from whom does that party request costs?"

In *Heimlich*, attorney Alan Heimlich (Attorney) sued his client Shiraz Shivji (Client) for unpaid invoices despite a provision in the retainer agreement providing for arbitration. After filing an answer, Client made an offer of settlement under CCP § 998. Later, when the time had passed for Attorney to accept the offer, Client moved to compel arbitration and that request was granted. The arbitration resulted in zero recovery for either side pursuant to an award issued by the arbitrator. Six days after the award was issued, Client asked the arbitrator to award him costs under CCP § 998 because Attorney's non-recovery was less favorable than the 998 offer Client had made two months before demanding arbitration.

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[27] Citing *Martinez v. Combs*, 49 Cal. 4th 35, 76 (2010).

[28] Citing *Benton v. Telecom Network Specialists, Inc.*, 220 Cal. App. 4th 701, 728-730 (2013); *Lubin v. The Wacknhut Corp.*, 5 Cal. App. 5th 926, 931-932 (2016).

Having issued a "final award," the arbitrator determined that he lacked jurisdiction to act on Client's request for a cost award. Client then petitioned the court to confirm the award and grant his request for costs under CCP § 998. The trial court confirmed the arbitration award, but denied costs on the grounds that Client had failed to timely submit a 998 claim to the arbitrator, finding that Client should have presented his 998 request for costs to the arbitrator before the award was rendered. Client appealed.

On appeal, the Sixth District Court of Appeal reversed the trial court and ordered that the trial court partially vacate the award and order the matter back to the arbitrator for a hearing and determination of Client's 998 request. The court held that under the express provisions of CCP § 998(b)(2), the parties in an arbitration can say nothing about the existence of a 998 offer until *after* the award is rendered. CCP § 998(b)(2) provides as follows:

> "If the offer is not accepted prior to trial or arbitration or within 30 days after it is made, whichever occurs first, it shall be deemed withdrawn, and *cannot be given in evidence upon the trial or arbitration.*" (Emphasis added.)

According to the court in *Heimlich*, under the terms of the statute, an arbitrator cannot compare the favorability of an arbitration award to a rejected statutory offer until after the award has been made. The court rejected the argument that it is incumbent on a party to ask the arbitrator to make an interim award (versus a final award) without explaining the reasons why. It also rejected the argument that arbitrators should be burdened with the obligation in every case of making inquiry into whether a 998 offer has been made and rejected because that would require the parties to violate CCP § 998(b)(2) (quoted above) by prematurely disclosing the existence of a rejected statutory offer. The court concluded that "[t]he best practice … would be to present evidence of a rejected section 998 offer after an arbitration award resolves the underlying dispute." 12 Cal. App. 5th at 169. In this regard, the court noted that the AAA rules (which were the provider rules in question) authorize an arbitrator to "assess and apportion the fees, expenses, and compensation" related to an award. While the AAA Rules have no specific provision for awarding costs authorized by CCP § 998, the court stated that "arbitral authority to award costs is presumably subsumed in the authority to award expenses," citing AAA Rule R-47. Id. at 173. Given, the broad discretion vested in arbitrators under the AAA Rule R-8 to "interpret and apply these rules insofar as they relate to the arbitrator's powers and duties," the court reasoned that if and when a party makes a section 998 post-award request, "an AAA arbitrator is empowered to recharacterize the existing award as interim, interlocutory, or partial and proceed to resolve the section 998 request by a subsequent award." Id. at 173-174.

One commentator has noted that being aware of the *Heimlich* decision and its broad interpretation of CCP § 998(b)(2) as applied in an arbitral setting may be a "big deal" going forward because it seems to be at odds with (a) the Second District's decision in *Maaso v. Singer*, 203 Cal. App. 4th 362 (2012), where the court noted without comment that counsel had raised the 998 issue in general terms *prior* to an award being made (but then failed to

obtain a ruling in time thereafter), and (b) two unpublished decisions, one by the First District and one by the Fourth District, that have interpreted CCP § 998(b)(2) narrowly and so as to permit a party to alert the arbitrator to a 998 offer *prior* to an award being made. See, *Barany v. Andron*, 2012 WL 1187934 at *4 (1st Dist. 2012); *Wells Fargo Advisors, LLC v. Fernandez*, 2013 WL 527381 at *4 (4th Dist. 2013).[29]

As noted in the caption above, the California Supreme Court has accepted cert to decide the issue of "[w]hen a party to an arbitration proceeding makes an offer of compromise pursuant to CCP § 998 and obtains a result in the arbitration more favorable to it than that offer, how, when and from whom does that party request costs?" In all likelihood, we will not hear from the Supreme Court on these issues until sometime in 2019. When it decides the issue, the Court has an opportunity to resolve the existing apparent split in authorities regarding the issue of awarding 998 costs in an arbitral setting. Given the increasing use of contractual arbitration as a dispute resolution mechanisms, coupled with the pervasive use of 998 offers in California litigation, litigators and arbitrators alike hoe that the Supreme Court will provide guidance on how such offers should be treated in the arbitral setting.

Comment: Before an award is formally rendered and served on the parties, the final draft is typically provided to the case manager for proofing and "administrative review." My suggestion is a party who has made a 998 offer alert the case manager about the 998 offer and the potential need for further proceedings once the award has been issued. While the record will have been closed on the submitted issues, the issue of 998 costs is something that arises post-hearing and is a product of the award. Once the case manager receives the arbitrator's draft award, he or she can alert the arbitrator of the need for further proceedings and provide the arbitrator with the opportunity to change the title of the award and any "finality" wording. Of course, this all assumes that the California Supreme Court decides that cost awards under 998 are for the arbitrator, and not the court, to decide. Stay tuned!

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[29] Gary A. Watt, "998 Offers & Arbitration," https://www.appellateinsight.com/2017/06/16/998-offers-arbitration.

(b) *Castro v. Tri-Marine Fish Company LLC*, ___ F.3d ___, 2019 WL 942967 (9th Cir. Feb. 27, 2019) – A settlement agreement, confirmed by an "order" of an arbitrator, is not an arbitral award under the New York Convention section of the FAA simply because it is signed in the presence of an arbitrator without an arbitration pending at the time.

Employee (Castro) was a deck hand who sustained a severe injury while working on a vessel during a voyage. The employer (Tri-Marine) had Castro transported to the Philippines for treatment and paid all of his medical and other expenses. In order to get money needed for other purposes, Castro negotiated a settlement with Tri-Marine in return of a cash payment. Castor signed the settlement papers presented to him and was they told that he needed to go to another office in order to pick up his settlement check. That "other place" the lobby of the National Conciliation and Mediation Board, where Castro was introduced to a volunteer arbitrator. This meeting was Castro's first and only interaction with the arbitrator. The volunteer arbitrator then signed a one page document titled "order," which purported to recognize the settlement, finding that it was "not contrary to law, morals, good customs and public policy." The "order" also dismissed the "case" with prejudice even though no arbitration case had been filed by either Castro or Tri-Marine. Tri-Marine then "filed" a purported joint motion to dismiss in a "case" which had no case number.

Castro learned later than his surgery in the Philippines was not successful and that he needed additional surgery to repair the mistakes in the prior surgery and repair his torn meniscus. Castro sued Tri-Marine in Washington state court to recover the additional expenses. Invoking the New York Convention, Tri-Marine removed the case to federal court and moved to compel the "order" obtained in the Philippines as a foreign arbitral award. The district court confirmed the order and dismissed the case. On appeal, the Ninth Circuit reversed, finding that several of the "unique aspects" aspects leading to the order in question led the court to conclude that the order did not meet the requirements of what is an arbitral award within the meaning of the New York Convention. Of importance to the Court was the fact that Castro and Tri-Marine had agreed to settle their dispute, and to the terms for doing so, before they ever visited the arbitrator. Having settled their dispute, the Court reasoned, they had nothing to arbitrate. Additionally, the purported arbitration conducted in the Philippines (as described) did not comport with the arbitration agreement contained in Castro's employment agreement, which provided for arbitration in and subject to the procedural rules of American Samoa. In this regard, the Court noted that "[t]he lobby meeting … was a far cry – in venue and law – from the agreed procedure." Ultimately, the Court concluded that "the parties' free floating settlement agreement and order did not transform into an arbitral award simply because the parties convened with an arbitrator." Tri-Marine was entitled to seek enforcement of the settlement release as a matter of contract, but was not entitled to confirming the settlement as an arbitral award under the New York Convention.

(c) ***Zhang v. Jenevein*, 31 Cal. App. 5th 585 (2019) –** Opinion affirms the trial court's denial of an anti-SLAPP motion brought by defendant in an invasion of privacy suit brought in response to his secret recordings of conversations with a business associate because gathering evidence for use in private arbitration is not protected litigation activity.

Tang Energy Group, Ltd. (Tang) and Aviation Industry of China (AIC), through its subsidiary AVIC International USA, LLC (AVIC) formed Soaring wind Energy LLC (Soaring Wind) to develop wind farms and promote wind power equipment sales. The parties executed a contract which included an exclusivity provision stating that "during the term of this Agreement, each [party] shall only conduct activities constituting the Business in and through the Company and its Controlled subsidiaries." The agreement include an arbitration provision to resolve any disputes that might later arise between or among the parties. In 2013, Patrick Jenevein (Jenevein), president of Tang, learned that AIC had created a number of subsidiaries which he thought were competing with Soaring Wind. In anticipation of arbitration, Jenevein gathered evidence to support Tang's claim against AIC and AVIC by secretly recording at least two conversations with Sherman Zhang, the president of AVIC, relating to the corporate relationships within AVIC. Jenevein later introduce the recordings as evidence in an arbitration that Tang commenced against AIC and AVIC. In December 2015, the arbitration ended with an award of over $65 million in favor of Tang. That award was later affirmed by the United States District Court for the Northern District of Texas and is currently on appeal before the Fifth Circuit.

In January 2016, Zhang sued Jenevein in the Los Angeles Superior Court for eavesdropping, citing Penal Code § 632(a), which proscribes the secret electronic recording of conversations. Jenevein filed a special motion to strike under Code of Civil Procedure § 425.16, contending that his gathering of evidence for use in arbitration was an act in furtherance of his free speech rights in a judicial or official proceeding. The trial court denied the motion because the recorded conversations were gathered in anticipation of, and used in, an arbitration proceeding, which the court held was not a "judicial proceeding" within the meaning of Section 426.16. Jenevein appealed.

On appeal, the Second District Court of Appeal affirmed. The court held that a moving defendant's initial burden is to show that the plaintiff's cause of action arises from protected activity. The court acknowledged that protected conduct includes "any written or oral statement or writing made before a legislative, executive, or judicial proceeding, or any other official proceeding authorized by law. 31 Cal. App. 5th at 805, citing *Park v. Board of Trustees of California State University*, 2 Cal. 5th1057, 1061 (2017). However, it rejected Jenevein's argument that arbitration is a "judicial proceeding" or an "official proceeding authorized by law," and noted that a number of courts have reached the same conclusion. Id. at 806. See, e.g., *Century 21 Chamberlain & Associates v. Haberman*, 173 Cal. App. 4th 1 (2009) (private contractual arbitration is not a judicial proceeding under § 425.16); *Mission Beverage Co. v. Pabst Brewing Co., LLC*, 15 Cal. App. 5th 686, 703 (2017) (arbitration is not a judicial proceeding); *Moss Bros. Toy, Inc. v. Ruiz*, 27 Cal. App. 5th 424, 437 (2018) (demanding private arbitration is an unprotected act). In this case, the appellate court

reasoned that arbitration is not a judicial proceeding because it is an alternative dispute resolution process that operates outside the courts and is predicated upon party agreement evidencing the parties' intent to bypass the judicial system. The court also reasoned that arbitration is not an official proceeding authorized by law because it is not required / imposed on disputing parties by statute. Again, it is a matter of consensual, private contracting between the parties.

Comment: I agree with the court's reasoning because the fact that parties may enter into a pre-dispute arbitration agreement does not foreclose either party from seeking relief in the court system. But if they do, and if the other party wants arbitration and the scope of the arbitration clause includes the dispute, then the courts may order arbitration. If the other party does not move to compel arbitration, the courts can and do properly take jurisdiction over deciding the dispute. The bottom line is that while arbitration looks and feels a lot like litigation, it is a different animal on a lot of fronts!

(d) ***Weller v. Marcus & Millichap Real Estate Investment Services*, 219 Cal. App. 4th 87 (2018) –** The court has the power to reclaim jurisdiction over the merits of a dispute previously ordered to arbitration when the arbitration is suspended due to one party's failure to fund arbitrations fees and expenses and the non-funding party can demonstrate its inability to afford the costs associated with the arbitration proceeding.

"Litigization of arbitration" is a phrase that has been coined to describe litigation over process, which results in litigation over procedural issues being preferred to a hearing and decision on the merits of the dispute. But what happens when all that procedural litigation causes one party to be unable to fund its share of the arbitrator's fees?

When one or more parties is unable to unwilling to fund their share of the arbitrator's fee deposit, as invoiced by the provider, the matter can be put in abeyance and then suspended/terminated, meaning that the matter will not reach a hearing on the merits. There are now three cases – one by the Ninth Circuit in 2016 and two by the California Fourth District Court of Appeal in 2013 and 2018 – in which the courts have reclaimed jurisdiction over the merits of a dispute previously ordered to arbitration. Interestingly, all three cases involved disputes between law firms and their former clients, with the matters being ordered to arbitration pursuant to an arbitration clause contained in the legal services engagement agreement.

Looking at the *Weller* case, twelve years ago, while in her 70's, Rae Weller made an investment in commercial real estate that resulted in a $2.6 million loss that significantly depleted her wealth and retirement savings. She claims that she had no experience in commercial real estate and was persuaded to make the investment by defendant Marcus & Millichap, a law firm specializing in real estate investment, and that the firm misrepresented the value of the property and the income-producing capacity of the property.

After several years of trying make the property work, Weller sold the property at a loss and sued Marcus & Millichap for breach of fiduciary duty, negligence, negligent misrepresentation and elder abuse. Based upon the arbitration clause contained in the firm's engagement agreement, Marcus & Millichap moved to compel arbitration, which the court granted. The matter then proceeded to arbitration. This all happened in about 2012.

For two years, the arbitration moved forward very slowly, with the parties disagreeing not only about the substance of plaintiffs' claims, but about how the arbitration should proceed. For starters, the arbitration clause provided that the arbitration would be administered in accordance with the AAA's Commercial Rules. Due to the amount of the plaintiffs' claim - $2.6 million – the AAA Rules require a three-arbitrator panel, and Marcus & Millichap insisted that the AAA Rules "dictated" that a three-arbitrator panel be appointed. Weller disagreed and asked for a single arbitrator because the expense for arbitrator time would be approximately $1,500 per hour with a three-arbitrator panel versus about $500 per hour with a single arbitrator. An arbitrator was appointed to decide the issue and concluded that a three-arbitrator panel was required. Once the panel was selected, a scheduling order was issued that set discovery, and that is what the parties did until 2015 when Weller could no longer afford the cost of the arbitration.

In 2015, Weller made a motion to the three-arbitrator panel asking them to give the defendant two options: (1) continue with the arbitration and pay the entire cost of it (since it had required the arbitration clause in its engagement agreement), or (2) have the matter referred back to court for trial. This request was based upon an earlier Fourth District decision in *Roldan v. Callahan & Blaine*, 219 Cal. App. 4th 87 (2013), where such a choice was given to a law firm under similar circumstances, holding that where a party to an arbitration agreement is financially incapable of sharing the costs of the arbitration, the Court has discretion to retain jurisdiction over the action and deny arbitration because to do otherwise would deprive the indigent party of a forum for resolution of the dispute. The arbitrators concluded that "*Roldan* relief" was beyond the scope of their jurisdiction. So they ordered Weller back to the superior court to determine the issue.

Weller then filed a separate declaratory relief action seeking a declaration and order that:
(1) defendants bear the full financial responsibility of the costs of the arbitration, or
(2) defendants have waived their right to arbitration and the matter shall be remanded to the superior court. Marcus & Millichap moved for summary judgment, arguing that the *Roldan* decision was based on the unconscionability defense and that unconscionability must be determined as of the time the arbitration agreement is entered into, not years later, and that Weller's *Roldan* claim was untimely. The trial court determined there was no triable issue of fact and granted summary judgment in favor of Marcus & Millichap. This appeal followed.

In May 2018, with Weller now in her 80's and her breach of fiduciary duty / negligence claims firmly ensconced on the back burner, the Fourth District reversed the trial court's summary judgment order and remanded with instructions to the trial court to conduct an evidentiary hearing with regard to Weller's declaratory relief claim because there was a fact dispute concerning Weller's current financial condition and her alleged inability to pay the costs associated with arbitration.

Side Note: The predicate for “*Roldan* relief” – i.e., allowing the court to reclaim jurisdiction over the merits of a dispute that has been ordered to arbitration – is found in the Ninth Circuit’s 2016 decision in *Tillman v. Tillman*, 825 F.3d 1069 (9th Cir. 2016). In that case, the plaintiff sued a law firm that had represented her in a wrongful death action for malpractice. On motion by the law firm, the matter was ordered to arbitration pursuant to an arbitration clause contained in the retainer agreement. As the case progressed, plaintiff objected to several aspects of the arbitration on the grounds that they unnecessarily increased the cost of the arbitration.[30] The arbitrators nevertheless moved forward with these aspects and required a deposit of approximately $18,500 from both parties. Plaintiff did not pay because she did not have the money to fund the deposit, and the defendant refused to pay it for her. In accordance with the AAA rules, the arbitration was terminated without a hearing or decision on the merits due to the unpaid deposit.

The defendant then filed a motion in district court asking it to lift its stay order and dismiss plaintiff’s complaint due to what the defendant described as the plaintiff’s violation of the court’s order to arbitrate. The district court found that plaintiff could not afford to pay the deposit, but nevertheless dismissed because it believed it lacked authority to hear the arbitrable claims despite plaintiff’s financial condition. The Ninth Circuit reversed, finding that all the relevant AAA rules had been followed concerning suspension and termination of the arbitration due to nonpayment of the full deposit for the arbitrators’ fees. Accordingly, the Court determined that an arbitration had “been had” pursuant to the parties’ agreement and in conformance with Section 3 of the FAA, and it was thus proper to lift the stay of the court proceedings. Additionally, because the arbitration had terminated before the merits were reached or an award issued, the court concluded that plaintiff must be allowed to pursue her claims in the district court because that was the only way her claims would ever be adjudicated. 825 F.3d at 1074, citing, *Pre-Paid Legal Services, Inc. v. Cahill*, 786 F.3d 1287, 1293-1294 (10th Cir. 2015), cert. denied, ___ U.S. ___, 136 S.Ct. 373 (2015).

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[30] In particular, plaintiff objected to the arbitrators’ decision to adjudicate the matter as a “case-within-a-case” adjudication in which the arbitrators would rehear witnesses and evidence presented in the underlying wrongful death action.

(e) ***Sanchez v. Elizondo***, 878 F.3d 1216 (9th Cir. Jan. 5, 2018) – Vacatur under Section 10(a)(4) of the FAA for an arbitrator exceeding his / her power is a very high standard that requires more than merely interpreting or applying the governing law incorrectly. The award must be "completely irrational" to meet this standard.

Customer (Elizondo) sued his securities broker (Sanchez) for the alleged mismanagement of his investment portfolio. The dispute was submitted to FINRA arbitration where FINRA Rule 12401 provides that claims for $100,000 or less will be decided by a single arbitrator. In his demand, Elizondo claimed compensatory damages of $100,000, so his case was assigned to a single arbitrator. Shortly before the evidentiary hearing, Elizondo filed a pre-hearing brief in which he claimed to be entitled to damages in the amount of $125,000. Based upon this assertion, Sanchez objected to the matter proceeding with the single arbitrator. The arbitrator asked the parties for briefing on the applicability of FINRA Rule 12401. Interpreting the language in Rule 12401, the arbitrator found that "the amount of the claim" referred to the amount pleaded in the operative demand rather than any amount later sought in the arbitration. Since Elizondo did not amend his demand, and the arbitrator determined that it was appropriate for him to hear the matter as a sole arbitrator. The arbitrator then issued an award in favor of Elizondo in the amount of $75,000. Sanchez petitioned for vacatur on the grounds that the arbitrator had exceeded his powers when he proceeded as a single arbitrator over Sanchez's objection. The district court granted vacatur on two grounds: (1) exceeding the scope of his authority pursuant to Section 10(a)(4) of the FAA, and (2) the common law ground of manifest disregard of the law. The Ninth Circuit disagreed with the district court and reversed the vacatur order.

With regard to the challenge made under Section 10(a)(4) of the FAA, the court found that this is a very high standard to meet and is not met when a petitioner shows that an arbitration panel committed an error or even a serious error. "'It is only when [an] arbitrator strays from interpretation and application of the agreement and effectively "dispense[s] his own brand of industrial justice" that his decision may be unenforceable.'" 878 F.3d at 1221. The court went on to state that it has found arbitrators to exceed their powers only where "the award is completely irrational." Here, the arbitrator's interpretation of FINRA Rule 12401 – finding that Customer's case could be decided by a single arbitrator because he had not amended his demand to enlarge his original damages claim over the $100,000 limit – was plausible, notwithstanding Customer's pre-hearing assertion that he was owed damages totaling $125,000. Thus, the trial court erred in vacating the award. Reversed and remanded for further proceedings.

III.
MANDATORY FEE ARBITRATION

1. ***Baker Marquart LLP v. Kantor,* 22 Cal. App. 5th 729 (2018)** - Arbitration award struck down because it was procured by "undue means."

This case involves a dispute between attorney (Baker Marquart) and client (Kantor) regarding the proper percentage to apply to a contingency fee contract. The contract provided that if the attorney accomplished 9 specific tasks within a specific time, the fee would be based on 35% of the amount recovered. If not, the fee would be 30% of the amount recovered. Approximately $1.6 million was recovered and the attorneys took 35% of this amount. Kantor initiated arbitration to take back a portion of the fee, arguing that the bonus was not earned, and the fee should have been 30%, rather than 35% of the amount recovered. The demand for arbitration identified only 2 of the 9 tasks that were allegedly not performed.

The fee agreement provided that fee disputes would be handled by the Beverly Hills Bar Association under their Mandatory Fee Arbitration Rules. Although the fee agreement also provided that all arbitration awards would be final and non-appealable, the BHBA MFA rules only allow the parties to agree to binding arbitration after a dispute has arisen. After the dispute arose and before the arbitration hearing, the parties did agree that the award should be binding and neither party could request trial *de novo*. However, under the BHBA MFA rules and the MFA statute, even binding awards are still subject to limited judicial review under California's general arbitration statute. CCP Sections 1284 and 1285.

Prior to the arbitration hearing the parties exchanged many of their exhibits. However, at the apparent invitation of the presiding arbitrator, Kantor submitted a "confidential brief" that alleged that Baker Marquart failed to accomplish any of the 9 specific tasks, not just the two that were identified in the demand for arbitration. At the arbitration hearing, for the first time, Baker Marquart learned that they were accused of failing to accomplish any of the 9 tasks. They requested the opportunity to review Kantor's confidential brief and were denied. They requested a continuance to allow them to meet the new allegations and were denied.

In a split decision, the majority of the arbitration panel determined that Baker Marquart had failed to accomplish 3 of the 9 tasks, and therefore, had failed to earn the 35% fee. The panel made no finding as to the 2 tasks that were identified in the demand for arbitration. The panel awarded Kantor a refund of over $100,000.00.

Baker Marquart petition to have the award vacated. Kantor petitioned to have it confirmed and entered as a judgment. The trial court confirmed the award. On appeal, the Court of Appeal for the Second District reversed. First, it dismissed Kantor's argument that the award was unappealable under the parties' fee agreement. Next, it determined that the confidential brief constituted an improper *ex parte* contact that infected the fairness of the proceedings. Because the award was based on allegations and arguments made in the

confidential brief, the unfairness was significant. The Court of Appeal reversed the trial court and vacated the award under CCP § 1286.2(a)(1) as having been procured by “undue means.” The Court of Appeal referenced heavily s 2012 decision in *Maaso v. Signer*, 203 Cal. App. 4th 362, where it addressed the significance of a party having an ex parte communication with the arbitrator while the arbitrator was presiding over the matter, and concluded that such a circumstance constituted an award issued by “undue means” for purposes of vacatur. “[E]x parte communication between a party’s representative … and a neutral arbitrator is not part and parcel of the business of litigation.” Id. At 373.

In this case, while Baker Marquart had advance notice of Kantor’s proposed evidence in advance of the evidentiary hearing, which included evidence in support of the firm’s alleged failure to complete other tasks, the court found it significant that Baker Marquart was denied an adequate opportunity to present argument with respect to the additional claims being presented for the first time at the hearing and without prior notice to the firm. The Court of Appeal concluded that Kantor’s submission of, and the panel’s reliance on, an ex parte confidential brief that raised issues not known to Baker Marquart “was fundamentally unfair such that the award was procured by ‘undue means.’” Id. At 742.

Comment: This decision addresses a key principle of arbitration that is often overlooked. Just because arbitration operates outside the court system, it is nevertheless a process that seeks to afford “due process” to the parties in terms of fairness of the process and making sure that decisions are based upon evidence and argument presented in everyone’s presence. To me this result is not surprising. What was surprising is that the arbitrators thought that allowing a party to submit a confidential brief was a good idea, and that the trial court was not troubled by the unfairness that resulted.

By: Chris Blank

IV.
<u>SETTLEMENT DEVELOPMENTS</u>

1. Statutory Developments

(a) ***California's SB 1431*** **- effective January 1, 2019 –** Amends Section 1541 of the Civil Code to clarify that the terms "creditor" and "debtor" are interchangeable with the terms "releasing party" and "released party," respectively.

Under existing law an obligation is extinguished by a release therefrom given to the debtor by the creditor, upon a new consideration, or in writing, with or without new consideration. In this regard, Section 1541 of the Civil Code provides:

> "An obligation is extinguished by a release therefrom given to the debtor by the creditor, upon a new consideration, or in writing, with or without new consideration."

However, Section 1542 of the Civil Code provides an automatic preservation of claims that a releasing party may not know exist at the time of executing a general release. Prior to amendment via SB 2431, that section provided as follows:

> "A general release does not extend to claims which the creditor does not know or suspect to exist in his or her favor at the time of executing the release, which if known by him or her must have materially affected his or her settlement with the debtor."

In practice, a waiver of this statute is included in most settlement agreements to ensure that it functions as a true settlement to any and all then-existing claims. a general release does not extend to claims which the creditor does not know or suspect to exist in his or her favor at the time of executing the release, which if known by him or her must have materially affected his or her settlement with the debtor.

SB 1431 provides that an obligation is extinguished by a release therefrom given to the debtor or the released party by the creditor or releasing party, and clarifies that the terms "creditor" and "debtor," as used in these sections, are interchangeable with the terms "releasing party" and "released party," respectively. This change seeks to make clear that the claims protected by Section 1542, and those lost by waiving it, extend to all claims of the "releasing party" at the point of release. This is declaratory of existing law. A general release does not extend to claims that the creditor or releasing party does not know or suspect to exist in his or her favor at the time of executing the release and that, if known by him or her, would have materially affected his or her settlement with the debtor or released party.

To the extent that you include broad general release language in your settlement agreements with a "1542 waiver" that quotes Section 1542, you need to revise your settlement agreement template to quote the new language. That language is as follows, with the new language underlined:

> "A general release does not extend to claims that the creditor or releasing party does not know or suspect to exist in his or her favor at the time of executing the release and that, if known by him or her, would have materially affected his or her settlement with the debtor or released party.
>
> Cal. Civ. Code § 1542 (West)

A sample template is included in Attachment 2.

2. 2018 / 2019 Cases

(a) ***Rescap Liquidating Tr. v. First California Mortg. Co.*, No. 18-CV-03283-WHO, 2018 WL 5310795 (N.D. Cal. Oct. 25, 2018)** - Release provision in settlement agreement was not broad enough to protect pre-agreement fraudulent transfers

First Capital Mortgage Company ("FCMC") was a mortgage loan originator. Rescap is successor in interest to Residential Funding Company ("RFC"). RFC purchased approximately 300 loans from FCMC with a face value of about $125,000,000.00. RFC repackaged the loans and sold them to securitization trusts. When the real estate mortgage market crashed RFC sued FCMC for breach of their loan purchase and sale agreements.

The parties settled with FCMC agreeing to pay about $6.0 million over time. FCMC defaulted and the parties entered into an amended settlement agreement allowing FCMC more time to pay but requiring a lump sum payment. Both settlement agreements included fairly broad release language. Basically, everyone under the sun that was associated with FCMC was released from every conceivable claim, etc. "relating to the Subject Loans."

When the lump sum came due FCMC failed to pay and told Rescap that it had no assets with which to pay. Rescap then sued the principals of FCMC and related entities alleging that they fraudulently transferred FCMC's assets over the four years between the filing of RFC's initial lawsuit and the date the settlement payment was due. The principals argued that the broad release in the settlement agreements protected all transactions that took place before they entered into the settlement agreements. The court disagreed. It found the specific qualifying language "relating to the Subject Loans" to govern over the broader language used in the release provisions. Based on that language, the court concluded that the parties did not intend to absolve the principals from any pre-agreement fraudulent transfers.

Not a very surprising result, at least on a motion to dismiss.

Practice tip: Be careful of exceedingly broad release provisions. Especially when they are coupled with Civil Code Section 1542 waivers. Section 1542 only applies to general releases, not specific releases. The court in this case essentially held that the release was a specific, not a general release. The opinion does not indicate if a Section 1542 waiver was included. If it had been, might the decision have come out a different way?

By: Chris Blank

(b) ***Golden v. California Emergency Physicians Medical Group,* 896 F.3d 1018 (9th Cir. 2018) –** Ninth Circuit reverses order enforcing settlement agreement that imposed restraint of trade.

Golden, an emergency room physician, was fired by his employer - CEP. He sued claiming that the firing was motivated by race. Shortly before trial was set to begin, Golden and CEP settled and placed their settlement on the record. Apparently the attorneys had reduced the agreement to written deal points that provided for CEP to pay Golden a large sum of money, and for Golden to agree that he would not be employed by CEP or in businesses in which CEP had an interest in the future.

After a formal settlement agreement was drafted, Golden refused to sign it. Golden objected to the scope of the provision that specified that he would be prohibited from working for any hospital that contracted with CEP in the future. The agreement even provided that if he was working for a non-CEP hospital and CEP began providing services at that hospital, he would be immediately fired with no compensation or recourse.

Golden argued that these provisions were a void restraint of trade in violation of California Business and Professions Code Section 16600. The trial court disagreed, holding that because the provision only restrained Golden from *working for* CEP, as opposed to *competing with* CEP, Section 16600 was not violated. On appeal in 2015, the 9th Circuit reversed holding that substantial restraints of any type, even if they do not restrain competition, are prohibited. The case was remanded for further factual development to determine if the restraint in the settlement agreement was "substantial."

On remand, the trial court found the restraint to be speculative and insubstantial. The court ordered Golden to sign the settlement agreement and dismissed his lawsuit. In the present appeal, the 9th Circuit reversed again, this time holding that the restraint was substantial and immediate, not speculative. The 9th Circuit also held that the restraint provision was a material term of the settlement. They held that the settlement agreement was void because it contained the illegal restraint, reversed the dismissal and remanded for trial on the merits.

The case is notable not just because of the jurisprudence surrounding restraints of trade, but also because of a few of the quirky facts that are described in the opinions. In the 2015 appeal, CEP argued that the case was not ripe because there was no way to tell if Golden would ever violate the clause regarding future employment by hospitals that already, or subsequently, had contracts with CEP. Dissents in both the 2015 and 2018 opinions championed this argument. However, the majorities found the likelihood of future

problems substantial enough that it amounted to an illegal restraint. No one discussed in detail that Golden's lawsuit was dismissed. Certainly, if the settlement agreement was void in its entirety it should not have been enforced at all. Therefore, the dismissal should not have been entered and required immediate intervention.

The case is unusual also because one of the chief proponents of enforcing the settlement was Golden's own attorney. When Golden refused to sign the settlement agreement, his attorney moved to withdraw as his counsel. The record was unclear about whether the trial court granted that motion. However, his attorney was allowed to intervene in the lawsuit to push for enforcement since he was on a contingent fee and wanted to collect it.

The case also points up the perils of reading an incomplete settlement into the record. The dissenting judge in the 2018 opinion called Golden an "humbug" for reneging on an agreement with which he indicated assent when it was read into the record. The dissenter explained that the agreement had been reduced to writing before it was read into the record. The majority in the 2015 appeal indicated that the formal agreement was only drafted later. The majority in the 2018 appeal could have held that there was no meeting of the minds because the details of the restraint clause were material and the parties did not actually agree to them. But that was not what the majority held. The majority was satisfied that the parties reached an agreement on all of the material terms, but the restraint term was illegal, rendering the entire agreement void. One might ask if the agreement would have been saved by an excision clause.

By: Chris Blank

(c) ***Timed Out, LLC v. 13359 Corp.,*** **21 Cal. App. 5th 933 (2018)** – CCP Section 998 offer for a "total sum, exclusive of costs and fees" is unambiguous.

Defendant made a CCP Section 998 offer in which it offered to pay "the total sum of Twelve Thousand Five Hundred and 00/00 Dollars, ($12,500) exclusive of reasonable costs and attorney[] fees, if any." The offer expired when not timely accepted. At trial, Plaintiff was awarded $4,483.30 "exclusive of any cots [or] attorneys' fees that may be set by noticed [m]otion." The trial court awarded pre-offer costs and fees to plaintiff, and post-offer fees and costs to defendant. The appellate court affirmed.

Plaintiff argued that the 998 offer was ambiguous because the phrases "total sum" "exclusive of" and "if any" rendered the 998 offer invalid for ambiguity. The court disagreed, holding that the plain meaning of these phrases in context left no doubt that Plaintiff could accept the $12,500.00 and still seek costs and fees by motion. Therefore, because the award was less than was offered and rejected, post-offer fees and costs were properly awarded to Defendant.

The case involved a claim by an assignee of a professional model, Eva Pepaj, that her image had been misappropriated for use in promoting a St. Patrick's Day event at a bar. The Plaintiff was described as a "trolling enterprise" in Defendant's papers filed with the Court. Here's a link to the image in case anyone is interested:

https://www.bellazon.com/images/image.php?id=1679467&tid=45271.

ATTACHMENT 1

[Note: Under the circumstances specified in Calif. Evidence Code § 1129, an attorney must make a written disclosure to the client BEFORE the client agrees to participate in a mediation. The written disclosure must: [1] be printed in the preferred language of the client and in at least 12-point font; [2] be printed on a single page that is not attached to any other document provided to the client; [3] include the names of the attorney and the client; and [4] be signed and dated by the attorney and the client. Section 1129(d) approves use of the following language in the written disclosure.**]**

<u>MEDIATION DISCLOSURE AND ACKNOWLEDGMENT STATEMENT</u>

To promote communication in mediation, California law generally makes mediation a confidential process. California's mediation confidentiality laws are laid out in Sections 703.5 and 1115 to 1129 inclusive, of the Evidence Code. Those laws establish the confidentiality of mediation and limit the disclosure, admissibility, and a court's consideration of communications, writings, and conduct in connection with a mediation. In general, those laws mean the following:

- All communications, negotiations, or settlement offers in the course of a mediation must remain confidential.
- Statements made and writings prepared in connection a mediation are not admissible or subject to discovery or compelled disclosure in noncriminal proceedings.
- A mediator's report, opinion, recommendation, or finding about what occurred in a mediation may not be submitted to or considered by a court or another adjudicative body.
- A mediator cannot testify in any subsequent civil proceeding about any communication or conduct occurring at, or in connection with, a mediation.

This means that all communications between you and your attorney made in preparation for a mediation, or during a mediation, are confidential and cannot be disclosed or used (except in extremely limited circumstances), even if you later decide to sue your attorney for malpractice because of something that happens during the mediation.

I, ___________________________ [**Name of Client**], understand that, unless all participants agree otherwise, no oral or written communication made during a mediation, or in preparation for a mediation, including communications between me and my attorney, can be used as evidence in any subsequent noncriminal legal action against my attorney for malpractice or an ethical violation.

NOTE: This disclosure and signed acknowledgment does not limit your attorney's potential liability to you for professional malpractice, or prevent you from (1) reporting any professional misconduct by your attorney to the State Bar of California or (2) cooperating with any disciplinary investigation or criminal prosecution of your attorney.

Name of Client: ______________________________ **Date signed:**________________

Name of Attorney: ___________________________ **Date signed:** _________________

[END OF THIS SINGLE-PAGE DISCLOSURE & ACKNOWLEDGMENT]

ATTACHMENT 2

Appendix 2

1542 Waiver

The parties hereto acknowledge that they may hereafter discover facts different from or in addition to those now known or believed to be true regarding the subject matter of the above-referenced legal proceedings and agree that this agreement shall remain in full force and effect, notwithstanding the existence of any such different or additional facts. The parties intend that this agreement shall be effective as a full and final accord and satisfactory release of each and every matter specifically or generally referred to herein. In furtherance of this intention, the parties acknowledge that they are familiar with Section 1542 of the California Civil Code, which provides as follows:

> "A general release does not extend to claims that the creditor or releasing party does not know or suspect to exist in his or her favor at the time of executing the release and that, if known by him or her, would have materially affected his or her settlement with the debtor released party.

Notwithstanding the provisions of Section 1542 of the California Civil Code, the parties agree, individually and on behalf of their respective heirs, assigns, agents, successors, executors, administrators and beneficiaries, that the releases provided for herein include all claims, causes of action, obligations, debts, liabilities, accounts, liens, damages, losses and expenses, of every kind and nature whatsoever, whether known or unknown, foreseen or unforeseen, patent or latent, suspected or unsuspected, which they had, currently have, or may have had at any time in the past up until the date of this agreement. In this regard, *the parties acknowledge that they have been informed of the provisions of Section 1542 of the California Civil Code and have had an opportunity to consult with independent legal counsel of their own choosing, and do hereby expressly waive and relinquish all rights and benefits that they have or may have had under said section.*