

**RECENT DEVELOPMENTS IN ARBITRATION &
MEDIATION LAW**

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

February 27, 2017

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MEDIATION DEVELOPMENTS

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 not apply to communications had during a mandatory settlement conference convened pursuant to Rule 3.1380 of the California Rules of Court.

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

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

(b) *2016 State Court Decisions – No Reported Cases*

- *Case Financial, Inc. v. Canadian Commercial Workers Industry Pension Plan*, 2016 WL 237775 (2d Dist. Jan. 20, 2016) – What happens to mediation confidentiality if the mediated settlement agreement provides that the agreement is admissible and subject to disclosure? Interesting drafting question.

Fascinating cautionary tale mainly dealing with attempts to disqualify an arbitrator for failure to adequately disclose connections with attorneys for the prevailing parties. The Theodora firm represented the prevailing parties in the subject arbitration. The arbitrator, Judge Katz, disclosed that he had arbitrated several prior cases where the Theodora firm had represented parties. He also disclosed that one of his awards in one of those cases (the *Hirt* case) had been vacated because he had failed to fully disclose his contacts with the Theodora firm. He disclosed that parties in the *Hirt* case were threatening to sue him and the Theodora firm and that everyone involved was contemplating mediating their dispute. Katz offered to recuse himself if any of the parties to the present case requested it, but no one did.

Eventually, Katz ruled in favor of Theodora’s clients in the present case and the disappointed parties petitioned to have the award vacated. The court handling the vacatur petition allowed limited discovery, and one of the parties attempted to obtain details of the *Hirt* negotiations and settlement, including issuing a subpoena for the *Hirt* settlement agreement that had been reached as part of a mediation. The trial court refused to compel production, holding that the settlement agreement was subject to mediation confidentiality. The settlement agreement provided that it could only be disclosed “for the purpose of establishing in court that an agreement has been reached by the parties for the purposes of enforcing and interpreting the agreement.” The appellate court upheld the trial court’s refusal to compel disclosure of the *Hirt* settlement agreement.

Based on a trial court’s considerable discretion to control discovery, one may accept the conclusion reached by the appellate court, that any error in failing to compel disclosure of the settlement agreement was harmless. Not so convincing is the suggestion that the restrictive language contained in the settlement agreement precludes disclosure based on mediation confidentiality. Evidence Code Section 1119(b) protects writings that are “prepared for the purpose of, in

the course of, or pursuant to, a mediation or a mediation consultation . . .” Section 1123(b) removes that protection if the “agreement provides that it is enforceable or binding or words to that effect.” Nothing in Section 1123 gives the parties the power to make a settlement agreement reached in mediation admissible and discoverable for some purposes, but not others. Ordinarily, parties to any agreement may agree to keep it confidential, but they do not have the power to prevent non-parties from discovering the agreement in appropriate circumstances simply by saying it is confidential.

Certainly, the *Hirt* settlement agreement had relevance to the question of Judge Katz’s possible bias or the appearance of bias. What if the *Hirt* settlement had provided that the Theodora firm would indemnify Judge Katz against the claims made by Theodora’s clients in the *Hirt* litigation in return for Judge Katz agreeing to rule in favor of Theodora’s clients in the present case? The better practice would have been for Judge Katz to recuse himself as soon as he learned that he and the Theodora firm were going to be involved in a dispute where they might have claims against one another. However, having disclosed that situation to the parties in the present case, their failure to insist on recusal at that point resulted in a waiver.

[Case Digest Contributed by Chris Blank]

- *Progressive Casualty Insurance Company, Inc. v. Noland*, 2016 WL 335961 (2d Dist. Jan 27, 2016) – Trial court did not err in excluding parol or extrinsic evidence of statements made at mediation, which plaintiff sought to introduce to show unilateral mistake as a grounds to avoid the contract – once again demonstrating the “super contract” nature of mediated settlement agreements.

A mediation was held in a personal injury lawsuit in which a passenger sued the driver of the vehicle in which he was traveling for injuries sustained in an accident that occurred in Arizona. The driver defendant was insured by Progressive Casualty Insurance Company. Attorney Noland represented the plaintiff passenger. The matter was settled at mediation, and a “stipulation for settlement” was signed by the parties and their counsel. Under the terms of the stipulation plaintiff was paid sum of \$200,000, with the proviso that he and his attorney were responsible for “all liens” and would indemnify Progressive and hold it harmless in the event any liens were asserted. After the settlement payment was disbursed to the passenger plaintiff, St. Joseph’s sued Progressive

to enforce its medical lien for services provided to the plaintiff at one of its hospitals in Arizona. Progressive tendered the defense of the hospital's lawsuit to Attorney Noland, who declined the tender. The hospital provider then moved for summary adjudication, citing the indemnification language of the settlement stipulation. Attorney Noland opposed the motion, claiming that the "all liens" indemnification provision in the settlement stipulation was the product of a drafting error and that the settlement stipulation should have specified that he and his client would indemnify Progressive only for "all *California* liens." In support of his opposition, Attorney Noland sought to introduce evidence of communications, negotiations and settlement discussions had during the mediation process, which the trial court determined was inadmissible under Evidence Code section 1119. Accordingly, the trial court granted Progressive's motion. Because Attorney Noland could not offer admissible evidence to support his claim of unilateral mistake, the trial court determined that he failed to raise a triable issue with respect to his duty to indemnify Progressive for "all liens" as stated in the settlement stipulation.

The Court of Appeal affirmed, noting that per the California Supreme Court's decision in *Cassel v. Superior Court*, 51 Cal. 4th 113 (2011), "the mediation confidentiality statutes must be applied in strict accordance with their plain terms" and that judicially crafted exceptions "are permitted only where due process is implicated, or where literal construction would produce absurd results, thus clearly violating the Legislature's presumed intent."

- *Nevarez v. Foster Farms*, 2016 WL 1020758 (5th Dist. Mar 15, 2016) – Counsel disqualified from representing a plaintiff in an employment lawsuit because he had a consulting relationship with an attorney who had recently mediated a "substantially similar" employment case involving the same defendant during which he had received confidentiality information.

Plaintiff's attorney Whelan, in a class action lawsuit against Foster Farms, consulted with Lowe, an attorney, who had previously served as a mediator in a similar case involving Foster Farms. Whelan and Lowe consulted with respect to general issues involving employment class action lawsuits. Whelan did not disclose the names of the parties to Lowe, and Lowe was never retained or paid by Whelan or its client.

When a Whelan attorney inadvertently included one of Foster Farms' attorneys on an internal firm email that suggested further discussions with Lowe, Foster Farms moved to disqualify Whelan. Foster farms contended that Whelan should be automatically vicariously disqualified because of Lowe's receipt of confidential information during this service as mediator for Foster Farms. Whelan contended that disqualification should not be automatic. Rather, it should be allowed to rebut any presumption that Lowe revealed confidential information about Foster Farms to Whelan. The trial court held that disqualification was automatic once Foster Farms established that Lowe had received confidential information in a matter that was substantially similar to the matter on which Lowe was consulted by Whelan. The appellate court affirmed.

Obviously, Lowe could not ethically represent a party against Foster Farms after serving as a mediator in a case involving Foster Farms, at least where the subject of the two cases were related. Harder to accept automatic disqualification when Lowe was not a part of the Whelan firm, and did not even know who the parties were. The weakest part of the appellate court's analysis was how it backed into the un rebuttable presumption that confidential information had passed from Lowe to Whelan. The court cites a California Supreme Court case, *People ex re. Dept. of Corporations v. SpeeDee Oil Change Systems, Inc.*, 20 Cal.4th 1135 (1999) in support of this conclusion.

In *SpeeDee Oil* the Supreme Court held that, for the purpose of conflict analysis, an attorney client relationship is formed if confidential information is passed to the attorney, whether or not the attorney is eventually hired to represent the client. This makes sense when the client who passed the confidential information to an attorney, but didn't hire her, is trying to disqualify her or her firm from representing an adversary. It is hard to see the same policy considerations when the attorney who obtained the confidential information was never hired by the adversary or the firm that represents the adversary. The court mentions that Whelan passed confidential information to Lowe, and at that point an attorney client relationship was formed, but how could Foster Farms possibly be harmed by confidential information being passed from its adversary to someone who had previously served as a mediator. Puzzling to say the least.

The take home lesson here is that an attorney who serves as a mediator is held to have a fiduciary duty to keep all parties' information in strict confidence, and that one should refrain from seeking or giving advice on a blind basis. Better to reveal the identities of the parties and do a conflict check.

[Case Digest Contributed by Chris Blank]

- *Biller v. Faber*, 2016 WL 1725185 (2d Dist. Apr 27, 2016) – Settlement malpractice lawsuit properly dismissed because the attorney defendant is precluded from presenting a defense due to the inadmissibility of confidential communications during the mediation that resulted in the settlement agreement forming the basis for plaintiff's claim. Another “settle and sue” case.

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

In our inaugural Recent Developments program in 2013, we looked at *Filbin v. Fitzgerald*, 211 Cal. App. 4th 154 (1st Dist., Nov. 12, 2012) as an example of this developing trend of settle with your attorney and then sue your attorney for “negligent” or “inadequate” settlement. Following a bench trial, the trial court in

this case entered judgment in plaintiffs' favor on the malpractice claim. The First District Court of Appeal reversed, explaining that in a "settle and sue" malpractice action, the plaintiff must prove that *but for* the malpractice she would *certainly* have received more money. Simply showing that the attorney erred is not enough. The Court noted that the requirement that a malpractice plaintiff prove damages to a "legal certainty" is difficult to meet in "settle and sue" cases because claims of inadequate settlement are often inherently speculative since settlement involves a wide spectrum of considerations and broad discretion. Importantly, however, the Court did not flatly prohibit liability against former counsel for less favorable settlement, and simply concluded that based upon the facts before it, plaintiffs had failed to prove causation or damages as a matter of law.

It is even more difficult for parties to prove settlement malpractice when the settlement is the product of mediation, because there are the additional hurdles of (1) mediation confidentiality protection under Evidence Code section 1119 making inadmissible as evidence any communications, negotiations or discussions had during a mediation, and (2) that fact that there presently is no exception to the broad scope of confidentiality protection provided by Section 1119 for claims of fraud or professional malpractice during a mediation. *Cassel v Superior Court*, 51 Cal. 4th 113 (2011) is the landmark decision from the California Supreme Court and kicked off this issue in 2011, but we have looked at similar cases of alleged each year since the ADR updates program was first presented in 2013. E.g., *Filbin v. Fitzgerald*, 211 Cal. App. 4th 154 (2012); *Roldan v. Callahan & Blaine*, 219 Cal. App. 4th 87 (2013); *Moua v. Pittullo Howington Barker Abernathy LLP*, 228 Cal. App. 4th 107 (2014); *Syers Properties III, Inc. v. Rankin*, 2014 WL 1761923 (2014); *Amis v. Greenberg Taurig LLP*, 235 Cal. App. 4th 331 (2015).

In *Biller v. Faber* case, plaintiff had been employed in an in-house legal position for Toyota and sued Toyota for various employment law claims. The parties agreed to submit the matter to mediation and both sides accepted a "mediator's proposal" that was issued by the mediator after the conclusion of the mediation. The settlement provided for Biller to receive \$4 million from Toyota. Biller's attorney advised him to accept the mediator's proposal and, as part of those discussions, offered to reduce his contingency fee from 40% to 25%. The settlement was then reduced to a further written severance agreement. Both the severance agreement and the mediator's proposal included terms that provided for confidentiality and a liquidated damages clause should the confidentiality clause be breached.

After resigning from Toyota, Biller established a legal consulting business and created a website on which information about Toyota was posted. Upon learning of these and other disclosures, Toyota sued Biller for alleged breaches of the confidentiality provision of the settlement / severance agreement. Biller countersued, and both the claims and counterclaims were submitted to binding arbitration under the terms of the severance agreement. Toyota was the prevailing party in the arbitration and was awarded \$2.5 million in liquidated damages, plus \$100,000 in punitive damages. Toyota had the arbitration award confirmed and judgment was thereafter entered in Toyota's favor. Biller then initiated the current proceeding complaining that his attorney had committed malpractice by advising him to accept the settlement that begot the severance agreement with the confidentiality provisions that led to the later dispute with Toyota and the \$2.5 million arbitration award and resulting judgment.

In an effort to develop evidence to prove up his defense, Biller's attorney requested documents in Biller's possession pertaining to the underlying employment dispute. Toyota – a non-party – filed an ex parte application to stay production of documents containing its confidential information on various grounds, including mediation confidentiality. The trial court sealed various documents and ordered a stay of any production. In light of these developments, Biller's attorney moved for dismissal of the malpractice complaint, arguing that due to Toyota's assertion of mediation confidentiality, he was incapable of obtaining or using evidence he needed to defend himself at trial. A referee was appointed to evaluate the evidentiary problems and make a recommendation with respect to the motion to dismiss. The referee found that neither party could proceed with the action due to the inadmissibility of necessary evidence; that in the referee's view, all of the privileged or confidential information and documents Biller had obtained were inadmissible. The referee recommended dismissal based on the attorney-client privilege and mediation confidentiality statutes. The trial court adopted the referee's recommendation and dismissed Biller's malpractice action. Biller appealed.

On appeal, the Court of Appeal affirmed, citing *Cassel* and noting that an unavoidable consequence of mediation confidentiality is the increased difficulty in proving attorney malpractice in the mediation context. The Court held that a confidential communication made during mediation remains private and confidential unless *all* participants in the communication agree to its disclosure, and even after a mediation ends, communications and writings exchanged during the process remain confidential. In light of Toyota's refusal to waive

confidentiality of its mediation-related communications, both sides would be missing necessary evidence. The Court of Appeal reasoned that in order for Biller's attorney to explain his mediation strategy, he would have to present evidence of confidential communications received during mediation regarding Toyota's views on sensitive topics – such as its evaluation of Biller's performance, his future earning potential, and his right to a disability leave. Because the attorney was precluded by Evidence Code section 1128 from relying on Toyota's confidential mediation communications at trial, and doing so in violation of the confidentiality statutes would provided a basis for a new trial, the Court held that the trial court was correct in granting dismissal,

- *Nazareth v. Malcolm & Cisneros*, 2016 WL 4491452 (1st Dist. Aug 26, 2016) – Mediation confidentiality protection does not extend to the date, location and attendants at a mediation or to correspondence exchanged two months after the mediation was concluded. It is not enough to show that mediation confidentiality was breached. The complaining party must also show prejudice resulting from the improper admission of such evidence.

Ms. Nazareth, a real estate broker, had a contract with Freddie Mac to sell foreclosed real estate. In the course of her duties she had a property on Harvey Avenue in Oakland “trashed-out” without posting the appropriate Personal Property Notice (“PPN”). This led to a lawsuit by the tenants at the property, and a mediation to settle that lawsuit. For a brief period (4 months) Malcolm & Cisneros (“M & C”) represented both Nazareth and Freddie Mac in the litigation. That dual representation ended when M & C advised Freddie Mac of potential conflicts of interest between Nazareth and M & C with respect to the way they might best defend themselves. Nazareth then hired her own counsel to represent her in the litigation.

The case settled at the mediation, but after the mediation had terminated, Freddie Mac terminated its contract with Nazareth. In support of its decision to terminate the contract with Nazareth, Freddie Mac cited her failure to post the PPN, and her statements and conduct at the mediation. Freddie Mac contended that Nazareth's statements and conduct at the mediation were disparaging toward Freddie Mac, and detrimental to their settlement efforts. Nazareth then sued M & C for breach of contract, breach of the covenant of good faith and fair

dealing and breach of fiduciary duty. M & C moved for summary judgment which was granted.

The appellate court affirmed the trial court's grant of summary judgment. The appellate court upheld the trial court's determination that Nazareth was terminated because she failed to post the PPN. It found that Nazareth herself admitted that she failed to post the PPN. Regardless of whether Freddie Mac learned about the failure to post the PPN from M & C, and regardless of whether that information came to Freddie Mac during the mediation conference, Freddie Mac would have eventually learned about the PPN. Therefore, nothing said or done by M & C was the proximate cause of Nazareth's termination.

The case contains additional discussion about whether declarations submitted by Nazareth and Freddie Mac were properly admitted or excluded. Nazareth contended her contract was terminated because Freddie Mac believed she made disparaging statements about Freddie Mac at the mediation. She submitted evidence that M & C told Freddie Mac that she had made those disparaging statements during the mediation. Freddie Mac submitted a declaration from one of its employees testifying that she was at the mediation and heard Nazareth's disparaging statements herself. The trial court overruled objections to statements about when the mediation occurred and who attended. It excluded some testimony about what was said during the mediation, and what wasn't said.

Arguably none of the testimony about what was or wasn't said during mediation should have been admitted. However, because Nazareth had abandoned this line of argument on appeal, there was no need to determine if the trial court's evidentiary rulings were entirely correct.

It seems farfetched to suggest that Evidence Code Section 1119(c) prohibits a lawyer from telling her client what went on at a mediation. Communications between a lawyer and the lawyer's client about what went on at a mediation should not be considered a breach of mediation confidentiality. But can a statement made in mediation give rise to a claim for breach of contract. Obviously, confidentiality will prevent a lawsuit for breach based on the statement, but is self-help precluded, such as terminating the contract, or refusing further performance? That question was not answered by this case.

[Case Digest Contributed by Chris Blank]

(c) **Statutory Exceptions to Mediation Confidentiality Moving Forward – Draft Legislation re Proposed Evidence Code § 1120.5**

In 2011, the California Supreme Court decided *Cassel v. Superior Court*, 51 Cal. 4th 113 (2011), in which it upheld the broad, unconditional scope of the mediation confidentiality protections afforded by Evidence Code § 1119. In an underlying litigation dispute, Cassel was the plaintiff and, during a mediation, agreed to settle his claims. He then sued his attorneys for malpractice and related claims, asserted that they provided bad advice during the mediation and were both deceptive and coercive towards him during the mediation. The Supreme Court held that the trial court properly granted motions in limine precluding Cassel from introducing any evidence which arose during the mediation, leaving Cassel with no evidence to prove his case.

The attorney–client context in which the scope of mediation confidentiality was tested not surprisingly invited a firestorm of negative publicity and public opinion. 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.

The CLRC conducted a study, commonly referred to as “Study K-402 – Relationship Between Mediation Confidentiality and Attorney Malpractice and Other Conduct.” In each of its public meetings held in and after August 2016, the CLRC has recommended that legislation providing for an exception to mediation confidentiality protection be enacted to address attorney misconduct while representing a client in mediation. In November 2016, draft legislation was proposed as set forth in what is commonly referred to as “Memorandum 2016-58,” and provides for new Section 1120.5 to be added to the Evidence Code. As currently drafted, the CLRC’s proposed draft legislation would create 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, *and* (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.

Side Notes: Proposed Section 1120.5 includes 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 camera hearing, etc. Proposed Section 1120.5 also requires 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. Proposed Section 1120.5 does not change or affect Evidence Code Section 703.5, which provides that mediators are incompetent to testify as witness.

Some Discussion Points:

Pros of broad mediation confidentiality protection – no exception legislation:

- 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; exception legislation potentially invites more litigation, including claims against mediators
- Discourages “buyer’s remorse”

Cons of broad mediation confidentiality protection – exception legislation needed:

- Encourages better behavior by all during mediation
- Promotes public confidence in process integrity
- Encourages greater decision making responsibility on the part of the client
- Attorneys should not be able to hide their incompetence or misconduct under the cloak of mediation confidentiality
- Mediated settlements should not be “super contracts” immune from attack on grounds of fraud, duress or coercion

Text of Proposed Evidence Code Section 1120.5

Evid. Code § 1120.5 (added). Alleged misconduct of lawyer when representing client in mediation context

SEC. _____. Section 1120.5 is added to the Evidence Code to read:

1120.5. (a) A communication or a writing that is made or prepared for the purpose of, or in the course of, or pursuant to, a mediation or mediation consultation, is not made inadmissible, or protected from disclosure, by provisions of this chapter if both of the following requirements are satisfied:

(1) The evidence is relevant to prove or disprove an allegation that a lawyer breached a professional requirement when representing a client in the context of a mediation or a mediation consultation.

(2) The evidence is sought or proffered in connection with, and is used solely in resolving, one of the following:

(A) A complaint against the lawyer under the State Bar Act, Chapter 4 (commencing with Section 6000) of the Business and Professions Code, or a rule or regulation promulgated pursuant to the State Bar Act.

(B) A cause of action for damages against the lawyer based upon alleged malpractice.

(b) If a mediation communication or writing satisfies the requirements of subdivision (a), only the portion of it necessary for the application of subdivision (a) may be admitted or disclosed. Admission or disclosure of evidence under subdivision (a) does not render the evidence, or any other mediation communication or writing, admissible or discoverable for any other purpose.

(c) In applying this section, a court may, but is not required to, sue a sealing order, a protective order, a redaction requirement, an in camera hearing, or a similar judicial technique to prevent public disclosure of mediation evidence, consistent with the requirements of the First Amendment to the United States Constitution, Sections 2 and 3 of Article I of the California Constitution, Section 124 of the Code of Civil Procedure, and other provisions of law.

(d) Upon filing a complaint or cross-complaint that includes a cause of action for damages against a lawyer based on alleged malpractice in the context of a mediation or a mediation consultation, the plaintiff or cross-complainant shall serve the complaint or cross-complaint by mail, in compliance with Sections 1013 and 1013a of the Code of Civil Procedure, on all of the mediation participants whose identities and addresses are reasonably ascertainable. This requirement is in addition to, not in lieu of, other requirements relating to service of the complaint or cross-complaint.

(e) Nothing in this section is intended to affect the extent to which a mediator is, or is not, immune from liability under existing law.

2. Mediation Confidentiality – Federal Law

(a) *Background Statement*

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

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

“The common-law principles underlying the recognition of testimonial privileges can be stated simply. ‘For more than three centuries it has now been recognized as a fundamental maxim that the public . . . has a right to every man’s evidence. When we come to examine the various claims of exemption, we start with the primary assumption that there is a general duty to give what testimony one is capable of giving, and that any exemptions which may exist are distinctly exceptional, being so many derogations from a positive general rule.’”

Jaffee v. Redmond, 518 U.S. 1, 9 (1993), citing *United States v. Bryan*, 339 U.S. 323, 331 (1950). So, the starting place for understanding the federal perspective on mediation confidentiality is the common law rule that (a) the public is entitled to every person's evidence, and (b) testimonial privileges are disfavored. Fed. R. Evid. 408(b)(1)–(2).

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

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

¹ Compare *Bottaro v. Hatton Assocs.*, 96 F.R.D. 158, 160 (E.D.N.Y. 1982) (barring discovery of settlement terms), with *Bennett v. La Pere*, 112 F.R.D. 136, 139–40 (D.R.I. 1986) (allowing discovery of settlement discussions), and *NAACP Legal Def. & Educ. Fund, Inc. v. U.S. Dep't of Justice*, 612 F. Supp. 1143, 1146 (D.D.C. 1985) (allowing discovery if information is relevant to other issues in the pending action).

amount in controversy for the purpose of establishing the date on which such information was first made available to the defendant and thus started the thirty-day time period for removing a state court action to federal court. See, *Babasa v. LensCrafters, Inc.*, 498 F.3d 972 (9th Cir. 2007) (holding that a letter sent by plaintiffs estimating the amount alleged put defendant on notice of the amount in controversy); *Cohn v. Petsmart, Inc.*, 281 F.3d 837 (9th Cir. 2002) (“A settlement letter is relevant evidence of the amount in controversy if it appears to reflect a reasonable estimate of the plaintiff’s claim.”). Numerous district court decisions have used the settlement letter to establish the amount in controversy.²

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

The only other source of confidentiality protection in federal cases is Rule 501 of the Federal Rules of Evidence. Rule 501 empowers the holder of a recognized privilege to use the legal process to prevent others from disclosing protected communications. It also vests the holder with the right to refuse to produce otherwise relevant evidence. What qualifies as a “recognized privilege” is *not* detailed in Rule 501. In federal question cases under 28 U.S.C. § 1331, the extent to which a privilege exists is governed by federal common law³ and may not be augmented by local court rules.⁴ In diversity cases under 28 U.S.C.

² See *Munoz v. J.C. Penny Corp.*, No. CV09-0833 ODW (JTLx), 2009 WL 975846 (C.D. Cal. Apr. 9, 2009) (settlement proposal letter was admissible to establish that the jurisdictional amount in controversy had been met for purposes of removing the case to federal court); see also *Ray v. Am. Airlines, Inc.*, No. 08-5025, 2008 WL 3992644, *4 (W.D. Ark. Aug. 22, 2008) (settlement letter used to establish the amount in controversy); *Haydel v. State Farm Mut. Auto. Ins. Co.*, No. CIV07-939-C, 2008 WL 2781472, *8, n.8 (M.D. La. July 10, 2008); *Finnegan v. Wendy’s Int’l, Inc.*, No. 2:08-cv-185, 2008 WL 2078068, *3 (S.D. Ohio May 13, 2008); *Sulit v. Slep-Tone Entm’t*, No. C06-00045 MJJ, 2007 WL 4169762, *3, n.1 (N.D. Cal. Nov. 20, 2007); *Turner v. Baker*, No. 05-3298-CV-S-SWH, 2005 WL 3132325, *3 (W.D. Mo. Nov. 22, 2005); *LaPree v. Prudential Fin.*, 385 F. Supp. 2d 839, 849, n.9 (S.D. Iowa Aug. 17, 2005).

³ *Id.* See also *Religious Tech. Ctr. v. Wollersheim*, 971 F.2d 364, 367, n.10 (9th Cir. 1992).

⁴ See *Facebook, Inc. v. Pac. Nw. Software, Inc.*, 640 F.3d 1034, 1040-41 (9th Cir. 2011) (“A local rule, like any court order, can impose a duty of confidentiality as to any aspect of litigation, including mediation. . . . But privileges are created by federal common law.”) In *Facebook*, the Winklevosses sought to avoid enforcement of the settlement agreement between ConnectU and Facebook which was negotiated and entered into during a private mediation. *Id.* at 1040. The Winklevosses proffered evidence of what was and was not said during the mediation. *Id.* The District Court for the Northern District of California excluded this evidence under its local rule

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

Rule 501 raises a difficult question regarding which law shall apply in federal question cases with pendent state law claims. In the Ninth Circuit, that question has been resolved so that the law of privilege is governed by federal common law.⁵ That being said, the Ninth Circuit has also held that “[i]n determining the federal law of privilege in a federal question case, absent a controlling statute, a federal court may consider state privilege law.” See, *Lewis v. United States*, 517 F.2d 236, 237 (9th Cir. 1975) (citations omitted).

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

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

⁵ Id. at n.10 (court refused to apply California litigation privilege in copyright action with pendent state law claims); *Folb v. Motion Picture Indus. Pension & Health Plans*, 16 F. Supp. 2d 1164, 1169–70 (C.D. Cal. 1998) (stating that the federal common law of privileges governs both federal and pendent state law claims in federal question cases); see also *Hancock v. Hobbs*, 967 F.2d 462, 467 (11th Cir. 1992) (per curiam) (the federal law of privilege is paramount in federal question cases even if the witness testimony is relevant to a pendent state law count which may be controlled by a contrary state law privilege); *Hancock v. Dodson*, 958 F.2d 1367, 1373 (6th Cir. 1992) (holding that the federal law of privilege is paramount to federal question cases).

settlement demands were at mediation because to deem such evidence inadmissible at trial would violate the due process rights of defendant to provide a defense to its alleged liability for bad faith and punitive damages. “To exclude this crucial evidence would have been to deny Travelers of its due process right to present a defense.” *Id.* at 1108. As discussed below, *Milhouse* was affirmed by the Ninth Circuit in an unreported decision filed on February 23, 2016.

(b) *2016 Federal Cases*

- *Milhouse v. Travelers Commercial Ins. Co.*, 641 Fed. Appx. 714 (9th Cir. Feb. 23, 2016) – The Ninth Circuit once again dodges the issue with regard to what protections exist under federal law for statements made and communications had during a mediation – again falling back on plaintiff’s waiver by failing to raise the issue at or before trial.

After they were unable to settle claim on their policy for loss from fire, homeowners filed suit against insurer alleging breach of contract and breach of covenant of good faith and fair dealing, seeking both compensatory and punitive damages. A jury verdict was returned in favor of the plaintiff homeowners awarding them over \$1.9 million in damages, but the jury found that the insurer had not acted in bad faith and declined to award punitive damages. At trial, as part of its defense to the bad faith claim and request for punitive damages, Travelers was allowed to present evidence regarding statements made during the course of an early mediation conducted before the lawsuit was filed. In particular, testimony was presented that at the mediation, the plaintiffs made a \$7 million demand and asked for \$1 million in attorney’s fees even though their attorney had only worked on the case for a few weeks.

After trial, the plaintiffs moved for new trial on bad faith, arguing that it was error for the Court to have allowed Travelers to present evidence regarding the statements made at mediation and that said error was prejudicial on the issue of bad faith. The Court denied plaintiffs’ motion on two independent grounds. First, the Court found that plaintiffs had waived their right to claim any mediation confidentiality privilege because they failed to raise the issue with the Court at or before trial. Second, the Court found that even if the plaintiffs had timely objected to the admissibility of the parties’ mediation statements “[d]ue process demanded that the Court allow the jury to hear the testimony regarding the parties’ mediation statements.” In this regard, the Court noted that at trial, the

plaintiffs had argued extensively that Travelers had acted unreasonably and without proper cause by refusing to settle their claims.

“For the Milhouses, the case was one about a despicable insurance company that had a policy of not fairly and reasonably cooperating with its insured to settle their claims after tragic loss. They now argue that the Court erred by allowing the jury to hear the parties’ mediation statements. The Milhouses are wrong. Travelers needed to present the parties’ mediation statements to provide a complete defense of its actions and to avoid paying millions of dollars in bad faith and punitive damages for wrongfully refusing to settle the Milhouses’ claim… What the jury could not understand without hearing the parties’ respective mediation statements … was why … the parties could not reach a reasonable settlement of the claim. The parties’ mediation statements provided an answer for the jury. It was not Travelers who acted unreasonably in settling the claim. Sadly, it was the Milhouses. They demanded way too much money to settle their claim.”

In reaching its decision on the mediation confidentiality issue, the Court found that the case presented a “rare, but serious tension between the dictates of Federal Rule of Evidence 408 and Rule 501.” It noted that under Rule 501, in civil cases, where state law provides the rule of decision, state law governs the privilege issue. Because the Court was exercising its diversity jurisdiction in hearing the matter, California substantive law applied and Rule 501 would thus seemingly require the application of California Evidence Code section 1119, which the Court acknowledged bars disclosure of communications made during mediation absent an express statutory exception. Where, as here, a party seeks to introduce mediation statements for a purpose other than proving or disproving the validity of a claim – “for example, to show that its conduct was not taken in bad faith” – the Court found that there was a conflict between Section 1119, applied through Rule 501, and Rule 408, which allows evidence of settlement negotiations to be admitted where offered not to prove liability, but to refute a claim of undue delay or bad faith. On this issue, the Court stated that it did not need to resolve the question given the plaintiffs’ waiver, but nevertheless noted that it harbored a doubt “the that Federal Rules of Evidence intended themselves to be subordinated to the application of state evidence law.” *18, n. 10.

On appeal to the Ninth Circuit, the district court’s ruling was affirmed. The Milhouses argued that the district court erred in applying federal law instead of

California Evidence Code section 1119 in determining whether a mediation privilege barred the admission of evidence related to statements and conduct undertaken during mediation proceedings. The Ninth Circuit declined to address the merits of this issue because it deemed the issue waived due to the fact that Milhouse's counsel failed to object to the proffered evidence on the basis of the mediation privilege, and did not alert the district court that they he believed that California Evidence Code section 1119, not Federal Rule of Evidence 408, controlled the issue concerning the admission of evidence from mediation proceedings. "By failing to object on the basis of the mediation privilege at trial, the Milhouses did not preserve for appeal whether the district court erred when it admitted mediation statements." 641 Fed. Appx. At 717.

- *In re TFT-LCD (Flat Panel) Antitrust Litigation*, 835 F.3d 1155 (9th Cir. Sep. 1, 2016) – Federal privilege law related to mediation confidentiality governs admissibility when there are both federal and state law claims. Dismissal of the federal claims was of no moment because, at the time of the mediation, both federal and state law claims were pending.

In 2010, HannStar Display Corp., a producer of LCD panels, admitted that it had participated in a conspiracy to fix LCD prices. Sony and HannStar entered into a tolling agreement by which Sony would investigate how much money it had lost as a result of the price fixing. The two companies agreed to mediate the dispute. After the mediation, the mediator sent both sides a mediator's proposal by email suggesting a \$4.1 million settlement amount. Both sides accepted the mediator's proposal and sent emails to that effect. When HannStar refused to pay, Sony sued in federal court to enforce the agreement. The district court denied Sony's motion for summary judgment, holding that California Evidence Code section 1123(b) precluded admission of the email exchange (and the resulting settlement contract) because they did not contain an express statement to the effect that the settlement was intended to be enforceable or binding. Judgment was entered for HannStar and Sony appealed.

On appeal to the Ninth Circuit, the judgment was reversed on the grounds that the district court should have applied the federal law of privilege even though Sony had dismissed its federal question claims and was proceeding in district court under the court's diversity jurisdiction to enforce a state law contract claim. The Ninth Circuit acknowledged that the general rule is that federal privilege law applies where there are federal question claims and pendent state law claims present, and that state law governs privilege when state law supplies

the rule of decision, 635 F.3d at 1158, citing *Agster v. Maricopa County*, 422 F.3d 836, 839 (9th Cir. 2005) and Fed. R. Evid. 501. The Court held, however, that the rule was slightly different when the action was one to enforce a settlement of both federal and state claims, as it had clarified in *Wilcox v. Arpaio*, 753 F.3d 872 (9th Cir. 2014). In *Arpaio*, the Court held that although state contract law governed whether the parties had reached a settlement, the underlying action that was allegedly settled contained both federal and state claims. Accordingly, the Court held that federal privilege law applied because “the same evidence relates to both federal and state law claims.”

Applying *Wilcox* to the case at hand, the Court found that the district court erred in applying California privilege law concerning mediation confidentiality because, at the time the parties engaged in mediation, their negotiations concerned (and the mediated settlement settled) both federal and state law claims.⁶ As such, the Court concluded that federal privilege law applies, and remanded the matter for redetermination applying federal privilege law. The district court already found that the emails did not provide that the settlement agreement under discussion was contained terms to the effect that it was “enforceable or binding.” While the district court scrutinized the absence of those words for purposes of determining whether the emails were admissible evidence, on remand the district court will be asked to determine whether the emails suffice to demonstrate a meeting of the minds on the threshold issue of contract formation.

Whatever the outcome at the district court level, if a further appeal to the Ninth Circuit is taken, it will not be the first time the Ninth Circuit has been tasked with determining whether a term sheet from a mediation contains sufficient terms to be enforceable. *Facebook, Inc. v. Pacific Northwest Software, Inc.*, 640 F.3d 1034 (9th Cir. 2011) involved a high-stakes litigation dispute that was settled in mediation with a handwritten agreement less than one-and-a-half pages in length. The settlement fell apart post-mediation when the parties could not agree to the form of the final deal documents drafted by Facebook. At issue was whether the agreement signed at mediation was enforceable.

Facebook attempted to enforce the short “term sheet” agreement, which provided that it would acquire all of the Winklevoss’ ConnectU shares in

⁶ The Honorable Barbara M. G. Lynn, Chief District Judge for the Northern District of Texas, sitting by designation, filed a dissenting opinion in which she stated that the question of whether to apply *Arpaio* should be analyzed against the backdrop of the claims pending when the admission of evidence is sought, and noted that in this case, only state law claims remained at the time Sony sought to admit evidence of the email exchange in support of its motion for summary judgment to enforce the alleged settlement. *Id.* at 1159.

exchange for cash, a percentage of Facebook stock, mutual releases and a waiver of claims. The Winklevosses asserted that the “term sheet” was unenforceable because it lacked material terms and was procured by fraud. The missing “material” terms, according to the Winklevosses, were later presented in lengthy stock purchase and shareholder agreements which they refused to sign. The district court found the short agreement enforceable and ordered the Winklevosses to transfer all ConnectU shares to Facebook.

Upon review, the Ninth Circuit distinguished a “necessary term, without which there can be no contract,” from an “important term that affects the value of the bargain.” Omitting the former renders the contract a nullity. However, an agreement that omits the latter is enforceable if the terms are “sufficiently definite for a court to determine whether a breach has occurred, order specific performance or award damages.” The “term sheet” easily passed this low-threshold test. It remains to be seen whether the email exchange between counsel for Sony and HannStar and the mediator will so qualify.

3. Miscellaneous

- *Gaines v. Fidelity Nat’l Title Ins. Co.*, 62 Cal. 4th 1081 (Feb. 25, 2016) – An agreement entered into by the parties to stay a case pending mediation did not toll the five-year period within which an action must be brought to trial under CCP § 583.340(b).

In this case, the California Supreme Court clarified what constitutes a “complete stay” for purposes of tolling Code of Civil Procedure section 583.310’s five-year limit to bring a case to trial. The Court ruled that a stay of the proceedings to allow the parties to engage in mediation was not a “complete stay” of the action and, therefore, did not toll the Section 583.310’s requirement that an action “be brought to trial within five years after the action is commenced against the defendant.”

The case stemmed from the sale of the plaintiff’s home after she and her husband missed multiple mortgage payments. The plaintiff alleged that the defendants deceived her into selling the home to the defendants. After plaintiff failed to bring the case to trial within five years of filing, the defendants moved to dismiss the case and the trial court granted the motion.

On appeal, the plaintiff argued relied on subdivisions (b) and (c) of Section 583.310, which provide that the five-year statutory timeframe is tolled during periods where “[p]rosecution or trial of the action was stayed or enjoined, or [b]ringing the action to trial, for any other reason, was impossible, impracticable, or futile.” Plaintiff argued that various delays in the course of pretrial proceedings satisfied the foregoing exceptions, including the 120-day period where the trial court stayed the action, vacated the trial date, and ordered mediation pursuant to the parties’ stipulation (which plaintiff agreed to at defendant’s request).

In evaluating plaintiff’s arguments, the Court first analyzed whether the stay was a “complete” stay of the action or merely a “partial” stay. To be a “complete” stay, the Court held that it must “freeze a proceeding for an indefinite period, until the occurrence of an event that is usually extrinsic to the litigation and beyond the plaintiff’s control,” such as waiting for the resolution of a related appeal. The Court found that the stay was not a “complete” stay because limited discovery and mediation were allowed to proceed, both of which were events related to moving the litigation forward.

The Court also considered whether the five-year statute could be tolled on the basis of the exception for periods of time where it is “impossible, impracticable, or futile to bring the action to trial.” The Court found that because the parties chose to attempt mediation, the plaintiff had control over the progress of the case. Thus, no tolling was in order. The dissent took issue with the majority’s reasoning and noted that it rewarded plaintiff “for working cooperatively with an opposing party by depriving her of her day in court.”

As a practice pointer, plaintiffs’ counsel should take note that the majority gave weight to the plaintiff’s failure to secure an express stipulation pursuant to Code of Civil Procedure section 583.330 to toll the five-year limit any time a trial date is vacated or continued by stipulation. It is worth noting that under the facts of this case, the stay stipulation occurred midway through the five-year period and was probably not something the plaintiff then had reason to believe would be necessary.

- *Pinto v. Pantaleoni*, 2016 WL 2908405 (1st Dist. May 16, 2016) – Plaintiffs’ mediation demands on threat of litigation signaled their belief that the architects bore some liability and started the statute of limitations clock running as to those defendants.

This is a statute of limitations/statute of repose case. Plaintiffs attempted to add Defendant architects to construction defect lawsuit as Doe defendants after expiration of 10 year statute of limitations/statute of repose had run. One may only use a Doe amendment to add a party who was unknown to the plaintiff at the time the lawsuit was filed. Doe amendments can be used if plaintiff is ignorant of the defendant’s identity, or if the plaintiff is ignorant of the defendant’s liability. Here, Plaintiffs’ lawyers had sent (1) a notice of potential liability pursuant to CC Section 1375, (2) a settlement demand letter, and (3) a demand for participation in a mediation to the architects. The lawyers filed the lawsuit on time, but did not name the architects as defendants. After the time limit had passed, the attorneys attempted to add the architects as Doe defendants. The architects successfully had the lawsuit dismissed based on the evidence of the notice and demand letters that showed the plaintiffs and attorneys were aware of their identity and asserted that they had potential liability for the claims.

In a footnote the court mentions that the demand letters might be inadmissible under Evidence Code Section 1119 and Civil Code Section 6000, but held that Plaintiffs’ failure to object to the admission of these documents waived the issue.

[Case Digest Contributed by Chris Blank]

CONTRACT ARBITRATION DEVELOPMENTS

1. Statutory Developments

- *Code of Civil Procedure § 1282.5* – Addition to the California Arbitration Act creating a right to have a certified shorthand reporter transcribe any deposition, proceeding or hearing in an arbitration

New Code of Civil Procedure § 1282.5 specifies that a party to arbitration has the right to have a certified shorthand reporter transcribe any deposition, proceeding or hearing. The request for a reporter must be made either in a demand, response, answer, or counterclaim related to the arbitration, or at a pre-hearing scheduling conference. If the arbitration agreement does not provide for a court reporter, the cost of the reporter is borne by the party requesting the reporter (except in the case of an indigent consumer in a consumer arbitration). A party whose request for a reporter is refused may petition the court for an order to compel the arbitrator to grant the party's request. The Court may stay any hearing, deposition or proceeding in the arbitration pending the decision on the petition for a court reporter.

Practice Note:

It is fairly common place for the court reporter issue to be included on the agenda for the initial preliminary hearing. The agenda description looks something like the following as pertains to the evidentiary hearing:

5. Court Reporter

5.1 Does any party want a Court Reporter at the evidentiary hearing?

Requested by Claimant? YES NO
Requested by Respondent? YES NO

[Note: If requested, the Court Reporter must be arranged and paid for by the requesting party or jointly if all parties agree.]

5.2 If yes, will the Reporter's transcript be the official record of the proceeding?

YES NO

[Note: The Reporter's transcript will not be the official record of the proceeding unless all parties so stipulate and the Arbitrator so orders, in which case, the Arbitrator is to be provided with a copy of the transcript in the same manner as provided to the parties (e.g., hard copy, disk, CD). If real time transcripts are provided to the parties at the evidentiary hearing, they shall also be provided to the Arbitrator.]

At the time of the initial preliminary hearing, parties frequently have not made a decision with regard to whether or not to have a court reporter at the evidentiary hearing. It is fairly common place for the court reporter issue to nevertheless be included in the Scheduling Order with a provision along the following lines:

3.8 *Stenographic or Other Official Record.* If any party wishes to utilize a court reporter for the evidentiary hearing or any other proceeding, the responsibility for making arrangements to have the court reporter present rests with that party – and not with the Case Manager, the AAA or the Arbitrator. To avoid having multiple court reporters present for the same proceeding, any party wishing to have a stenographic record must advise all other parties at least seven days prior to the commencement of the evidentiary hearing. The Arbitrator has no preference regarding the use (or non-use) of a court reporter. If a court reporter is present, both sides must be given the opportunity to purchase a transcript according to the same pricing schedule.

- *Labor Code § 925* – Addition to the California Labor Code prohibiting an employer 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.

For companies with headquarters outside of California and with a work force in California, as well as other states, forum-selection and choice-of-law provisions were a common practice. Some would say that the practice was in an effort to have uniformity and consistency in administering litigated disputes with employees. Otherwise would say that the practice was aimed at avoiding California courts and dodging California employment law, such as California’s prohibition of covenants not to compete. Whatever the case, with the passage of SB 1241 and the addition of Section 925 to the California Labor Code, a provision included in an employment contract requiring a California employee, as a condition of employment, to agree to litigate or arbitrate any employment disputes (1) outside of California, or (2) under the laws of another state are now categorically unenforceable, except in the case where the clause has been negotiated with an employee “individually represented by legal counsel.”

The enactment of SB 1241 followed Governor Brown’s veto of AB 465 in 2015. AB 465 attempted to ban mandatory employment arbitration agreements. Governor Brown’s veto message explained that purported employment abuses “should be specified and solved by targeted legislation, and not a blanket prohibition.” New Section 925 is one such piece of targeted legislation, 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.

Significantly, new Section 925 does not affect employment agreements already in effect. By its terms, the new law applies only to contracts entered into, modified, or extended on or after January 1, 2017.

2. Arbitrator Disqualification / Required Disclosures / Evident Partiality

When an arbitrator fails to disclose at the front-end of the arbitration process an interest or relationship that amounts to “evident partiality” under 9 U.S.C. §10(a)(2), the FAA requires vacatur. As demonstrated by the cases discussed below, there is no clear consensus among the federal circuits on what constitutes “evident partiality” for purposes of vacating an arbitration award. Rather, on a fact driven basis, the courts have fashioned similar, yet different, tests for analyzing whether an arbitrator’s existing or prior relationships are sufficient to support vacatur on the grounds of “evident partiality.”

(a) “Evident Partiality” in the Context of Disclosed Conflicts

“Evident partiality” may exist where there is actual bias on the part of the arbitrator, or where an arbitrator’s failure to disclose information gives the impression of bias in favor of one party. See *Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145, 149 (1968); *Schmitz v. Zilveti*, 20 F.3d 1043, 1045 (9th Cir. 1994); *Ventress v. Japan Airlines*, 603 F.3d 676, 679 (9th Cir. 2010).

In actual bias cases, the integrity of the arbitrator’s decision is directly at issue. See *Schmitz v. Zilveti*, 20 F.3d 1043, 1045 (9th Cir. 1994); *Woods v. Saturn Distribution Corp.*, 78 F.3d 424, 427 (9th Cir. 1996); *Ventress v. Japan Airlines*, 603 F.3d 676, 679 (9th Cir. 2010).

“The appearance of impropriety, standing alone, is insufficient” because a reasonable impression of partiality does not necessarily mean that the award was the product of impropriety. See *Sheet Metal Workers Int’l Ass’n Local 420 v. Kinney Air Conditioning Co.*, 756 F.2d 742, 746 (9th Cir. 1985); *Schmitz v. Zilveti*, 20 F.3d 1043, 1047 (9th Cir. 1994); *Woods v. Saturn Distribution Corp.*, 78 F.3d 424, 427 (9th Cir. 1996); *Ventress v. Japan Airlines*, 603 F.3d 676, 679 (9th Cir. 2010).

The party alleging evident partiality in an actual bias (known conflict) case must establish specific facts which indicate improper motive on the part of the arbitrator. *Sheet Metal Workers Int’l Ass’n Local 420 v. Kinney Air Conditioning Co.*, supra, 756 F.2d at 746. An example of such a circumstance is provided by *Morelite Const’n Corp. v. New York City Dist. Council, Etc.*, 748 F.2d 79 (2d Cir. 1984). In this case, the arbitrator was the son of the president of an international labor union, which was a party to the arbitration. The Court noted that

“[e]xactly what constitutes ‘evident partiality’ by an arbitrator is a troublesome question.” *Id.* at 82. Acknowledging that the standard of “appearance of bias” is too low for the invocation of Section 10, and “proof of actual bias” is too high, it settled on a “reasonable person” standard, meaning that “evident partiality” will be found “where a reasonable person would have to conclude that an arbitrator was partial to one party to the arbitration.” *Id.* at 84. While there was no evidence concerning the specifics of the arbitrator’s relationship with his father, the court nevertheless concluded that “sons are more often than not loyal to their fathers, partial to their fathers, and biased on behalf of their fathers,” and thus inferred that the awarded was grounded in “unfairness,” and subject to vacatur. *Id.*

On the flip side, Fourth Circuit took a different tact in *Consolidation Coal Co. v. Local 1643, Etc.*, 48 F.3d 125 (4th Cir. 1995), when presented with the circumstance where the arbitrator’s brother was an employee of an international labor union not directly involved in the matter at hand. The district court granted vacatur based upon the finding that the sibling relationship was “strong evidence of partiality by [the arbitrator]” because it was analogous to the father-son relationship that led to vacatur in the *Morelite* case. *Id.* at 129. On appeal, the Fourth Circuit disagreed and reversed, finding that, without any further evidence, a court should not assume the same degree of loyalty and partiality in a sibling relationship that it can assume in a father-son relationship; that a finding of partiality based solely on the existence of the sibling relationship was “at best remote, uncertain and speculative;” that through his relationship with his brother, the arbitrator had only an indirect relationship to a party in the arbitration and that relationship had no connection with the issues submitted to the arbitrator for decision. *Id.* at 129-130, citing with approval *Hobet Mining, Inc. v. International Union, UMWA*, 877 F.Supp. 1011, 1021 (S.D.W.Va. 1994) (setting forth a four-factor test to assist in determining evident partiality: (1) any personal interest, pecuniary or otherwise, the arbitrator has in the proceeding; (2) the directness of the relationship between the arbitrator and the party he is alleged to favor; (3) the connection of the relationship to the arbitration; and (4) the proximity in time between the relationship and the arbitration proceeding).

A more difficult situation is presented when there are disclosures of a relationship or conflict circumstance, but those disclosures are later discovered to be incomplete or understated. The issue then becomes one of inquiry notice and constructive knowledge. Several courts have held that where a party has only constructive knowledge of an arbitrator’s potential conflicts, the losing

party's failure to object to the arbitrator before an award is issued will not waive that party's right to seek vacatur on the grounds of evident partiality unless it is shown that the facts being argued to support vacatur were known at the time the grievance was submitted. See, e.g., *Apperson v. Fleet Carrier Corp.*, 879 F.2d 1344, 1359 (6th Cir. 1989); *Early v. Eastern Transfer*, 699 F.2d 552, 558 (1st Cir. 1983). Other courts have invoked the waiver principle, finding that the complaining party was put on inquiry notice and 1. should have known of the facts indicating partiality of an arbitrator, and 2. should have raised an objection prior to the arbitration decision being rendered. See, e.g., *JCI Communications, Inc. v. Int'l Brotherhood of Electrical Workers, Etc.*, 324 F.3d 42, 52 (1st Cir. 2003); *Kiernan v. Piper Jaffray Cos., Inc.* 137 F.3d 588, 593 (9th Cir. 1998); *Fidelity Federal Bank v. Durga Ma Corp.*, 386 F.3d 1306, 1313 (9th Cir. 2004). In these cases, the challenging party's failure to object to the arbitrator until after the award is issued, is deemed a waiver of that party's right to challenge the award based on evident partiality. As one court explained, the application of the waiver doctrine is consistent with the court's policies favoring the finality of arbitration awards and the speedy and cost-effective resolution of disputes. See *Fidelity Federal Bank v. Durga Ma Corp.*, supra, 386 F.3d at 1313.

(b) *“Evident Partiality” in the Context of Nondisclosure*

The FAA does not specifically address the matter of what disclosures an arbitrator must make prior to his or her appointment. It is only after an award has been issued, if a party moves to vacate the award on the grounds of alleged bias by the arbitrator, that the court examines whether the arbitrator had existing or pre-existing relationships or other conflicts that should have been disclosed, and whether the award must be set aside due to the taint of bias. See, e.g., *Michael v. Mariforum Shipping, S.A.*, 624 F.2d 411, 414 n. 4 (2d Cir. 1980) (“[I]t is well established that a district court cannot entertain an attack upon the qualifications or partiality of arbitrators until after the conclusion of the arbitration and the rendition of an award.”); accord *Gulf Guaranty Life Ins. Co. v. Connecticut General Life Ins. Co.*, 304 F.3d 476, 490 (5th Cir. 2002).

On its face, “evident partiality” conveys a stern standard. Partiality means bias, while “evident” is defined as “clear to the vision or understanding” and is synonymous with manifest, obvious, and apparent. See *Webster’s Ninth New Collegiate Dictionary* 430 (1985) 9 U.S.C. § 10(a)(2). Although linguistically facile, in application the phrase “evident partiality” has proven problematic for the courts, especially when the question involves an arbitrator’s failure to disclose existing or prior relationships, dealings or conflicting interests. In its

only decision to date interpreting the “evident partiality” standard in the nondisclosure context, the Supreme Court in *Commonwealth Coatings v. Continental Casualty Co.* attempted to provide guidance on this critical issue. However, the result of that decision has invited disagreement among the circuits and anything but clarity with respect to what types of relationships mandate disclosure and disqualification.

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

On further review by the United States Supreme Court, the confirmation of the award was reversed and the award vacated because the arbitrator’s past business relationships created an impression of possible bias. The Justices who decided *Commonwealth* expressed two different views on the ethical standard governing arbitrator disclosures. Those views were – literally – Black and White. Justice Black, writing for the plurality, appeared to impose upon arbitrators the same lofty ethical standards required of Article III judges, suggesting that “we should, if anything, be even more scrupulous to safeguard the impartiality of arbitrators than judges, since the former have completely free rein to decide the law as well as the facts and are not subject to appellate review.” 393 U.S. at 149. Using language that has since been seized upon by unsuccessful parties to arbitration, Justice Black concluded by writing that arbitrators, like judges, must avoid even the “appearance of bias.” *Id.* In Justice Black’s view, “evident partiality” in the FAA meant that an arbitrator must not only be unbiased, but must also avoid the appearance of possible bias. *Id.* at 150.

Justice White, joined by Justice Marshall, stated that he was “glad to join” Justice Black, and wrote additional remarks, emphasizing that the Court was not

deciding that arbitrators are to be held to the same standards as Article III judges. Id. (“The Court does not decide today that arbitrators are to be held to the standards of judicial decorum of Article III judges, or indeed of any judges.”) According to Justice White, because arbitrators are “men of affairs, not apart from, but of, the marketplace,” they should not be “automatically disqualified by a business relationship with the parties before them.” Id. For Justice White, such relationships are acceptable so long as the parties “are informed of the relationship in advance, or if they are unaware of the facts but the relationship is trivial.” Id. Justice White’s concurrence required arbitrators to disclose only those relationships that would lead a “reasonable person [to] … conclude that an arbitrator was partial,” but offered no guidance with respect to what types of relationships that will be deemed significant versus trivial for purposes of defining where an arbitrator’s disclosure obligation begins and where it leaves off. Justice White’s opinion fully envisions upholding awards when arbitrators fail to disclose insubstantial relationships, offering that “where the arbitrator has a substantial interest in a firm which has done more than trivial business with a party, that fact must be disclosed,” but an arbitrator “cannot be expected to provide the parties with his complete and unexpurgated business biography.” Id. at 151–152.

Because there was no majority opinion in *Commonwealth*, some federal circuits have taken the position that the vote of Justice White or Justice Marshall was necessary for the formation of a majority for reversal. Because Justices White and Marshall concurred with reasoning on grounds slightly different from that set forth in the plurality opinion written by Justice Black, the resulting decision is a “plurality” opinion, leaving it to the circuits to pick between the two expressed views. See, e.g., *Merit Ins. Co. v. Leatherby Ins. Co.*, 714 F.2d 673, 681 (7th Cir. 1983) (noting that *Commonwealth* “provides little guidance because of the inability of a majority of the Justices to agree on anything but the result”); *Morelite Const’n Corp. v. New York City Dist. Council, Etc.*, 748 F.2d 79, 83 n. 3 (2d Cir. 1984) (“Because the two opinions are impossible to reconcile, however, we must narrow the holding to that subscribed by both Justices White and Black”); *ANR Coal Co., Inc. v. Cogentrix of North Carolina, Inc.*, 173 F.3d 493, 499–500 (4th Cir. 1999) (noting that courts have given Justice White’s concurrent particular weight); *Nationwide Mutual Ins. Co. v. Home Ins. Co.*, 429 F.3d 640, 644 n.5 (6th Cir. 2005). This has led some commentators and courts to refer to a “split among the circuits,” and to refer to a “majority” view (Justice White) or a “minority” view (Justice Black) when applying *Commonwealth* to determine whether “evident partiality” exists on the part of the arbitrator so as to warrant vacatur of his or her award. See, e.g., *Montez v. Prudential*

Securities, Inc., 260 F.3d 980, 983 (8th Cir. 2001); Howard S. Suskin & Suzanne J. Prysak, “New Developments on the Standard for Finding “Evident Partiality” (2006)

https://jenner.comhttps://jenner.com/system/assets/publications/7677/original/Bloumberg_Law_Reports_Securities_Arbitration.pdf?1323206353; Susan A. Stone

& Jen C. Won, “Arbitrator Impartiality in the Context of a Tripartite Tribunal” (2013)

http://www.americanbar.org/content/dam/aba/administrative/litigation/materials/2013_corporate_counselcseminar/9_2_arbitration_impartiality_in_context.authcheckdam.pdf.

What has been described as the “majority” view is that which is attributed to Justice White’s concurring opinion. The courts applying this standard have followed Justice White’s reasoning that arbitrators are not subject to the same standards of impartiality as Article III judges. Finding the standard of “appearance of bias” too low and proof of “actual bias” too high, these courts have held that “evident partiality” within the meaning of Section 10 of the FAA will be found where “a reasonable person would have to conclude that an arbitrator was partial to one party to the arbitration.” See *Applied Industrial Materials Corp. v. Ovalar Makin Ticaret Ve Sanayi, A.S.*, 492 F.3d 132, 137 (2d Cir. 2007), quoting *Morelite Const’n Corp. v. New York City Dist. Council, Etc.*, 748 F.2d 79, 84 (2d Cir. 1984). Unlike a judge, who can be disqualified “in any proceeding in which his impartiality *might* reasonably be questioned,” *Apple v. Jewish Hospital & Medical Center*, 829 F.2d 326, 332–333 (2d Cir. 1987), an arbitrator is disqualified only when a reasonable person, considering all of the circumstances, “would *have* to conclude” that an arbitrator was partial to one side. *Morelite Const’n Corp. v. New York City Dist. Council, Etc.*, 748 F.2d 79, 84 (2d Cir. 1984); see also *Gianelli Money Purchase Plan & Trust v. ADM Investor Services, Inc.*, 146 F.3d 1309, 1312 (11th Cir. 1998); *Olson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 51 F.3d 157, 159 (8th Cir. 1995); *ANR Coal Co. v. Cogentrix of North Carolina, Inc.*, 173 F.3d 493, 500 (4th Cir. 1999); *Gianelli Money Purchase Plan & Trust v. ADM Investor Services, Inc.* The courts that apply this standard sometimes talk about the need for evidence of bias or interest that is direct, definite and capable of demonstration, rather than remote, uncertain or speculative. See, e.g., *Ormsbee Development Co. v. Grace*, 668 F.2d 1140, 1147 (10th Cir. 1982); *Consolidation Coal Co. v. Local 1643, Etc.*, 48 F.3d 125, 129 (4th Cir. 1995); *Andersons, Inc. v. Horton Farms, Inc.*, 166 F.3d 308, 329 (6th Cir. 1998).

In contrast, the Ninth Circuit has adopted the “appearance of bias” standard, which has been attributed to Justice Black’s plurality opinion, and has held that “evident partiality” exists when “undisclosed facts show a reasonable impression of partiality.” See, e.g., *Schmitz v. Zilveti*, 20 F.3d 1043, 1046 (9th Cir. 1994); *Middlesex Mutual Ins. Co. v. Levine*, 675 F.2d 1197, 1201 (11th Cir. 1982). In applying this standard, the courts sometimes talk about “evident partiality” being established by the circumstance where an arbitrator fails to disclose relationships or dealings that “might create an impression of possible bias.” See, e.g., *Crow Const’n v. Jeffrey M. Brown Associates, Inc.*, 264 F.Supp. 2d 217, 220 (E.D.Pa. 1003) (“evident partiality” established when an arbitrator failed to disclose “any dealings that might create an impression of possible bias.”). The focus here is on the fact of nondisclosure and the perceived relationship between that which was not disclosed and the particulars of or parties to the arbitration. As demonstrated by the cases discussed in Sections (B) and (C), below, in application, this standard also looks for something of significance about an existing or prior relationship that has not been disclosed before a finding of “evident partiality” will be made.

The difference between what qualifies as “evident partiality” under the “reasonable person” standard, as distinguished from the “reasonable impression of partiality” standard, is difficult to articulate. Indeed, one court has commented that “it is difficult to extract from the cases [applying *Commonwealth*] more than a mood,” and the mood “is one of reluctance to set aside arbitration awards for failure of the arbitrator to disclose a relationship with a party. *Merit Ins. Co. v. Leatherby Ins. Co.*, 714 F.2d 673, 682, cert denied, 464 U.S. 1009, as amended, 728 F.2d 943 (1984). *Commonwealth* reflects the ideal that arbitration functions best when arbitrators do not have an apparent reason to be partial to a given party. There is no clear consensus among the federal circuits on what constitutes “evident partiality” for purposes of vacating an arbitration award, except perhaps with regard to there being greater tolerance for relationships and overlapping engagements for party-appointed, as opposed to neutral, arbitrators.⁷ Rather, on a fact driven basis, the courts have fashioned similar, yet

⁷ “The rationale of *Sphere Drake*, which places an onerous burden of proof on the party alleging evident partiality of a party-appointed arbitrator, is entirely consistent with the *Apperson* standard, which likewise requires proof of circumstances ‘powerfully suggestive of bias.’” *Nationwide Mutual Ins. Co. v. Home Ins. Co.*, 429 F.3d 640, 647 (6th Cir. 2005), quoting, *Apperson v. Fleet Carrier Corp.*, 879 F.2d 1344, 1358 (6th Cir. 1989), cert. denied 495 U.S. 947 (1990); see also *Merit Ins. Co. v. Leatherby Ins. Co.*, 714 F.2d 673, 679–680 (7th Cir. 1983); *Sunkist Soft Drinks, Inc. v. Sunkist Growers, Inc.*, 10 F.3d 753, 759 (11th Cir. 1993); *Delta Mine Holding Co. v. AFC Coal Prop., Inc.*, 280 F.3d 815, 821–822 (8th Cir. 2001); *Sphere Drake Ins. Ltd. v. All-Am. Life Ins. Co.*, 307 F.3d 617, 620–623 (7th Cir. 2002).

different, tests for analyzing whether an arbitrator's relationships or other interests are sufficient to support vacatur on the grounds of "evident partiality."

(c) *Notable Historical Cases Granting Vacatur Based Upon Nondisclosure*

Regardless of which standard is applied, it is the rare case where a challenge to an award based upon "evident partiality" is successful. As demonstrated by the cases discussed in this section, where vacatur is granted, most would agree that either test could have been applied to reach the same result. As a result, there is some guidance at the extreme outer edges with regard to disclosures arbitrators should make so as to give parties an opportunity to object before they render a decision, but there is no clear guidance for arbitrators operating under the FAA with regard to what types of existing or prior relationships constitute "conflicts" requiring disclosure and / or investigation by the arbitrator. The following are a few notable case examples.

Schmitz v. Zilveti, 20 F.3d 1043 (9th Cir. 1994) – This is a nondisclosure case involving an arbitrator who had no actual knowledge of the fact that his law firm had represented the parent company of a party "in at least nineteen cases during a period of 35 years" with the most recent representation ending less than two years before the arbitration was submitted. The Ninth Circuit held that an arbitrator's failure to investigate potential conflicts of interest may result in a "reasonable impression of partiality" under *Commonwealth*. In reaching its holding, the Court rejected the argument that the arbitrator's lack of knowledge precluded a finding of evident partiality. Based on *Commonwealth*, the Ninth Circuit concluded that the legal standard for evident partiality is whether there are "facts showing a 'reasonable impression of partiality.'" *Id.* at 1048. The Court explained that this legal standard can be satisfied even where an arbitrator is unaware of the facts showing a reasonable impression of bias because an arbitrator "may have a duty to investigate independent of [his] ... duty to disclose." *Id.* Under the NASD Code, the arbitrator had a duty to investigate. Because an actual conflict relationship existed due to the arbitrator's firm's representation of the parent company of a party, the court found that the arbitrator had violated his duty to investigate under the NASD Code, and that the resulting nondisclosure created a reasonable impression of partiality to support vacatur for "evident partiality" under Section 10 of the FAA. *Id.*

Olson v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 51 F.3d 157 (8th Cir. 1995) – The Eight Circuit reversed the district court’s order confirming an arbitration award because the arbitrator had failed to disclose his job title and the fact that his employer had ongoing business relationships with one of the parties. The arbitrator disclosed only that he was employed by a securities firm. He did not disclose that his firm did a substantial amount of business with Merrill Lynch in which they were co-underwriters on numerous bond issues. Because his firm had more than a trivial business relationship with a party and because the arbitrator was viewed as having a substantial interest in his firm by virtue of his high ranking officer positions (e.g., chief financial officer, compliance officer and vice president), the court concluded that these were matters that the arbitrator had a duty to disclose. *Id.* at 159. The nondisclosure of what amounted to a significant business relationship with a party to the arbitration thus showed evident partiality warranting vacatur of the award. The Eight Circuit noted that while there is some uncertainty among the circuits as to whether the Justice White opinion in *Commonwealth* provides for a narrow standard than that presented in the majority opinion written by Justice Black, the court said that it did not need to sort out this uncertainty to decide the present case; that evident partiality was established under either view. *Id.*

Applied Industrial Materials Corp. v. Ovalar Makine Ticaret Ve Sanayi, A.S., 492 F.3d 132 (2d Cir. 2007) – The Second Circuit held that an arbitration award should be vacated for evident partiality where one of three arbitrators who was the chairperson, president and CEO of a “multi-billion dollar company with 50 offices in 30 countries” failed to either investigate what he knew to be a potential business relationship between his company and the parent company of a party to the arbitration or to inform the parties that he had erected a Chinese Wall that prevented him from learning more. *Id.* at 134–135. The court began with the proposition that where an arbitrator knows of a material relationship with a party and fails to disclose it, “[a] reasonable person would have to conclude that the arbitrator was evidently partial.” *Id.* at 137. That “material” relationship in this case was a commercial relationship that existed between the arbitrator’s company and the parent of Applied Industrial that had generated approximately \$275,000 in revenue for the arbitrator’s company. *Id.* at 135. Quoting from Justice White’s opinion in which he stated that arbitrators are not automatically disqualified by an undisclosed business relationship if the relationship is “trivial,” the court ruled that where an arbitrator has reason to believe that a nontrivial conflict of interest might exist, the arbitrator must either investigate the circumstance or disclose his or her decision to not investigate. *Id.* at 138. In this case, the arbitrator confirmed that he had been informed that

one a branch of his company was negotiating with one of Applied Industrial's subsidiaries to enter into a business relationship. The court found that at this moment in time, the arbitrator "knew, at a minimum, that a potential conflict existed." *Id.* The court held that the arbitrator's decision to not investigate and his concomitant failure to so inform the parties that he had erected a so-called "Chinese Wall," was sufficient to establish evident partiality for purposes of vacating the arbitrator's award.

HSMV Corp. v. ADI Ltd., 72 F.Supp. 2d 1122 (C.D.Cal. 1999) – The arbitrator's law firm represented the parent company of a party to the arbitration. That attorney-client relationship began prior to the arbitration and continued during the proceeding. The court found that the arbitrator, as a lawyer, had a duty to investigate whether a conflict relationship might exist prior to accepting his engagement as the sole "neutral" arbitrator in this dispute. *Id.* at 1129. Citing the Ninth Circuit's decision in *Schmitz*, the court noted that precedent had been established to the effect that an arbitrator who is also a lawyer may have an independent duty to investigate possible conflicts and, failing to do so, opens the door to vacatur of any award he or she renders if such an undisclosed relationship is later revealed that could have been discovered by a simple conflicts check.⁸ *Id.* at 1129-1130.

New Regency Productions, Inc. v. Nippon Herald Films, Inc., 501 F.3d 1101 (9th Cir. 2007) – The arbitrator made a number of disclosures to the parties who had jointly selected him: e.g., that he had previously arbitrated a where one of the parties' counsel had represented a party; that he had negotiated deal with various executives of New Regency before they became executives at New Regency; and that he expected to be called as a witness in an unrelated litigation matter where an attorney from the firm representing Nippon Herald in the current arbitration was representing a party. What the arbitrator did not disclose was the fact that during the course of the arbitration, he was recruited and accepted a high-level executive position with a film company that "[was doing] more than trivial business closely connected to a party to the arbitration." *Id.* at

⁸ The *Schmitz* court cited *Close v. Motorists Mutual Ins. Co.*, 21 Ohio App. 3d 228, 486 N.E.2d 1275 (1985) as an example of a case where "the parties can expect a lawyer/arbitrator to investigate and disclose conflict." 20 F.3d at 1048. In *Close*, the Ohio Court of Appeals vacated an arbitration award on the ground that evident partiality existed where the lawyer/arbitrator failed to disclose his law firm's ongoing representation of one of the parties. The court was not persuaded that there could be no evident partiality where the arbitrator had no knowledge of the conflict, noting that lawyers routinely conduct conflicts checks as part of the process of taking on new clients. The *Close* court held that "the same duty is owed to the parties to an arbitration." 21 Ohio App. 3d at 230.

1107. As it did in *Schmitz*, the Ninth Circuit again rejected the argument that evident partiality could not be established if the arbitrator does not have actual knowledge of the facts he or she failed to disclose. “[L]ack of knowledge of actual knowledge of the presence of a conflict does not excuse non-disclosure where the arbitrator had a duty to investigate, and thus had constructive knowledge of, the conflict.” *Id.*, citing *Schmitz*, 20 F.3d at 1048. In this case, the court reasoned that the arbitrator had a duty to investigate because “the parties could reasonably have expected [him] to investigate potential conflicts when, during the pendency of the arbitration, he took a job, the duties of which included overseeing the legal department of another film company.” *Id.* at 1109. The court held that the arbitrator’s decision to accept a high-level executive position a company in the same industry as the parties to the arbitration was precisely the type of situation where an arbitrator should have reason to investigate to determine the existence of potential conflicts requiring disclosure to the parties. *Id.* at 1109, citing *Applied Industrial Materials Corp. v. Ovalar Makine Ticaret Ve Sanayi, A.S.*, 492 F.3d 132 (2d Cir. 2007).

Thomas Kincaid Company v. White, 711 F.3d 719 (6th Cir. 2010) – The court was presented with strategic gamesmanship gone awry. Against the backdrop of a tortured set of facts representing the penultimate in gamesmanship aimed at currying the arbitrator’s favor, the serious issue of “evident partiality” was missed by both the arbitrator and the provider organization, and thus had to be corrected by the courts. The case involved a dispute between the Thomas Kinkade Company and one of its dealers. The company claimed that the dealers had not paid for artwork worth hundreds of thousands of dollars, and the dealers counterclaimed that they had been fraudulently induced to enter into the dealer agreements with the company. The entire case is worth a read because, as noted by the Sixth Circuit, it presents “a model of how not to conduct [an arbitration].” *Id.* at 720. After nearly 5 years and 50 days of hearing (with the arbitration still not complete), the dealers and persons associated with the dealers began showering the arbitrator’s law firm with new business directed to various of the arbitrator’s partners on matters where the fees for the engagements were expected to be substantial. The arbitrator disclosed the fact of these engagements to the parties. Not surprisingly, in response, the Thomas Kinkade Company objected to these concurrent engagements in a letter directed to the provider organization (the AAA). The arbitrator was re-confirmed after his partner declined one representation and the partner on the other representation left the firm. The Thomas Kinkade Company renewed its request for disqualification, which both the provider and the arbitrator denied. The arbitrator then proceeded to continue with the arbitration in a manner that

allowed the dealers several opportunities to correct errors and put documents into evidence they had failed to exchange as ordered. At the end of the arbitration, the arbitrator issued a \$1.4 million award in favor the dealers. The Thomas Kinkade Company then petitioned the district court for vacatur under Section 10(a)(2) of the FAA, which the court granted and the Sixth Circuit affirmed.

The Sixth Circuit held that the Thomas Kinkade Company had established “a convergence of undisputed facts that, considered together, show a motive for [the arbitrator] to favor the [dealers] and multiple concrete actions in which he appeared actually to favor them. To begin with the motive: nearly five years into this arbitration, and in the space of eight weeks, the purportedly neutral arbitrator’s law firm – of all the law firms that practice commercial litigation in Michigan – was hired by one party’s arbitrator-advocate . . . and then again by that same party . . . for engagements that by all appearances would be substantial.” *Id.* at 724. On the issue of the arbitrator’s disclosure of the engagements to the parties, the Sixth Circuit noted that “[w]hen the neutral arbitrator engages in or attempts to engage in mid-arbitration business relationships with non-neutral participants, it jeopardizes what is supposed to be a party-structured dispute resolution process.” *Id.* What also appears to have swayed the Sixth Circuit was the “dilemma” the arbitrator’s mid-arbitration disclosures created for the Thomas Kinkade Company because it was forced to raise the issue of arbitrator bias to the arbitrator during the course of evidentiary proceedings. The Sixth Circuit concluded that a party who has paid a neutral arbitrator to prepare for and sit through nearly 50 days of hearings over a five-year period, “deserve[d] better treatment than this.” *Id.* at 724-725.

(d) *Notable Historical Cases Denying Vacatur Despite Missing or Incomplete Disclosures*

When courts deny vacatur, they usually do so after conducting their own case-by-case factual analysis to determine whether an undisclosed relationship rises to the level of a conflict sufficient to create an impression of possible bias. While the cases purport to be applying the Justice White or the Justice Black standard as set forth in the *Commonwealth* decision, it is hard to discern a bright line of demarcation as to what relationships, interests or other conflicts are trivial or unsubstantial and thus do not prompt a duty on the part of the arbitrator to investigate further or make disclosure to the parties. The following are a few notable case examples.

Sanko S.S. Co. v. Cook Industries, 495 F.2d 1260 (2d Cir. 1978) – At the commencement of arbitration, the arbitrator disclosed that he owned a grain company and had had dealings with one of the parties (also a grain company) “of a spot nature.” After the arbitrator ruled against Sanko, it conducted an investigation and found that in fact the business dealings between the two grain companies was extensive; that while the companies were technically competitors, they arranged “swaps” and “sales” between themselves or their affiliates running into the millions of dollars. The trial court stated that it would forego an evidentiary hearing and accept Sanko's version of contested facts regarding the arbitrator's prior dealings with the opposing party. Nevertheless, the trial court made findings at variance with Sanko's position and concluded that the arbitration award should not be vacated. The Second Circuit reversed and remanded, concluding that an evidentiary hearing was necessary to determine the full extent and nature of the relationships at issue so that the district court would be in a better position to follow the dictates of *Commonwealth*. Id. at 1263.

ANR Coal Co. v. Cogentrix of North Carolina, Inc., 173 F.3d 493 (4th Cir. 1999) – The dispute arose from a coal sales contract between ANR Coal and Cogentrix. Cogentrix purchased coal from ANR, which it used to generate electric power in its North Carolina facility that, in turn, was sold to Carolina Power & Light Co. Ten years prior to the arbitration dispute, the arbitrator was a member of a law firm that merged with the firm representing Cogentrix. That merger lasted only one year and during the time of the merged law firm's operations, the arbitrator was ill with leukemia and not actively practicing law or otherwise involved with the law firm. The arbitrator disclosed the fact of his affiliation with the temporary merged law firm and stated that it was through that affiliation that he was acquainted with Cogentrix's counsel in the arbitration. What the arbitrator did not disclose, and what ANR Coal learned after an award was issued in favor of Cogentrix, was that the merged law firm had represented Cogentrix and that certain attorneys at the firm had loaned money to Cogentrix in consideration for stock warrants in the company. Based upon this showing, the district court granted ANR's vacatur petition. On appeal, the Fourth Circuit reversed, finding that ANR had failed to show that the arbitrator had any personal interest in the arbitration or any real connection between the arbitrator and Cogentrix. Applying the Justice White standard in *Commonwealth*, the court found that all of the facts proffered by ANR, alone or taken together, would not permit a reasonable person to assume that the arbitrator was partial to Cogentrix; that the facts demonstrated nothing more than a trivial relationship between the arbitrator and the prevailing party. Id. at 501–502.

Lucent Technologies Inc. v. Tatung Co., 379 F.3d 24 (2d Cir. 2004) – One member of a three-member panel had been a paid patent license expert for Lucent in a matter pending concurrently with the subject arbitration. That same member had shared ownership of an airplane with another arbitrator on the panel from more than a dozen years prior to the arbitration. The first circumstance was disclosed, but Tatung claimed to have not received the disclosure form. The airplane ownership relationship was not disclosed by either arbitrator. After Tatung lost at arbitration, it petitioned for vacatur on the grounds of evident partiality for nondisclosure. With regard to the arbitrator’s engagement as an expert witness for Lucent, the court found that the arbitrator had complied with his obligation to make disclosures by completing the AAA form and returning it to the provider; that Tatung knew of the AAA rules requiring disclosure by arbitrators and had received disclosure forms for the other two arbitrators, so there was no persuasive reason for Tatung to have assumed that the third arbitrator had not submitted a similar form. With regard to the arbitrators’ co-ownership of an airplane from 1974 to 1990, the court rejected the notion that *Commonwealth* established a per se rule requiring vacatur of an award whenever any type of undisclosed relationship is discovered. Rather, the court noted that the Supreme Court in *Commonwealth* had directly observed that some “undisclosed relationships … are too insubstantial to warrant vacating the award.” Id. at 30, citing *Commonwealth*, 393 U.S. at 152. The court specifically did not decide whether an undisclosed relationship between arbitrators could be cause for vacatur under certain circumstances, but it found that the arbitrators’ relationship of co-ownership of a plan more than a decade in the past was simply “too insubstantial to require vacatur.” Id. at 31.

Positive Software Solutions, Inc. v. New Century Mortgage Corp., 476 F.3d 278 (5th Cir. 2007) – After losing in the arbitration, Positive Software conducted a detailed investigation of one of the arbitrator’s background and discovered that several years earlier he and his former law firm had represented the same party as New Century’s counsel in a major patent litigation matter involving Intel and Cyrix. That litigation had involved six different lawsuits in the early 1990’s in which Intel was represented by seven law firms and at least 34 lawyers, including the arbitrator and New Century’s counsel in the arbitration. Positive then moved the district court for an order vacating the award. That motion was granted based upon the district court’s finding that the arbitrator had failed to disclose “a significant prior relationship with New Century’s counsel,” thus

creating an appearance of partiality requiring vacatur.⁹ On appeal, and after rehearing en banc, the Fifth Circuit reversed, holding that awarding vacatur “based on a mere appearance of bias for nondisclosure would hold arbitrators to a higher ethical standard than Article III judges.” The court went on to note that had the same relationship occurred between an Article III judge and an attorney in a case pending before him or her, “neither disclosure nor disqualification would have been forced or even suggested.” Id at 285, citing *Chitimacha Tribe of La. v. Harry L. Laws Co.*, 690 F.2d 1157, 1166 (5th Cir. 1982) (rejecting a finding of judicial bias where the federal judge had represented a party to the case in an unrelated matter at least six years prior). In final analysis, the court concluded that the prior case relationship between the arbitrator and New Century’s counsel was trivial, and noted that it had been unable to find a case vacating an arbitration award “for nondisclosure of such a slender connection between the arbitrator and a party’s counsel.” Id. at 284, citing *Montez v. Prudential Securities, Inc.*, 260 F.3d 980, 982 (8th Cir. 2001); *ANR Coal Co., Inc. v. Cogentrix of N.C., Inc.*, 173 F.3d 493, 495–496 (4th Cir. 1999); *Al-Harbi v. Citibank, N.A.*, 85 F.3d 680, 682 (D.C.Cir. 1996); *Lifecare Int’l, Inc. v. CD Med., Inc.*, 68 F.3d 429, 432–434 (11th Cir. 1995); *Health Services Management Corp. v. Hughes*, 975 F.2d 1253, 1255 (7th Cir. 1992); *Merit Ins. Co. v. Leatherby Ins. Co.*, 714 F.2d 673, 677 and 680 (7th Cir. 1983); *Ormsbee Dev. Co. v. Grace*, 668 F.2d 1140 1149–1150 (10th Cir. 1982). The court reasoned that requiring vacatur on facts such as those presented in the instant case would result in the loss of expert decision makers acting as arbitrators “because the best lawyers and professionals, who normally have the longest lists of potential connections to disclose, have no need to risk blemishes on their reputations from post-arbitration lawsuits attacking them as biased.” Id.

Lagstein v. Certain Underwriters at Lloyds, London, 607 F.3d 634 (9th Cir.), cert. den., 131 S.Ct. 832 (2010) – The Ninth Circuit narrowly construed an arbitrator’s required disclosures to relationships and dealings with the current arbitration participants. In *Lagstein*, a three-arbitrator panel concluded that Lloyds had breached an insurance contract and acted unreasonably with regard to the handling of the insured’s claims, but the panel split on the amount of damages to be awarded. The majority concluded that Lagstein (the insured) should be awarded the full value of his policy (\$900,000), plus \$1.5 Million for emotional distress. The dissenting arbitrator would have awarded Lagstein only \$11,000 and would not have awarded emotional distress damages. Subsequent to the initial award, proceedings were held on the request for punitive damages.

⁹ *Positive Software Solutions, Inc. v. New Century Mortgage Corp.*, 337 F.Supp. 2d 862, 865 (N.D.Tex. 2004).

Again, the majority awarded Lagstein punitive damages in the amount of \$4 Million, whereas the dissenting arbitrator argued that the panel lacked jurisdiction and, even if it had jurisdiction, the award should be limited to \$50,000. Following the panel's awards, Lloyds investigated the backgrounds of the arbitrators and discovered that the arbitrators forming the majority had been involved in an ethics controversy over a decade earlier. Lloyds then filed a motion to vacate the arbitration award on several grounds, including the arbitrators' failure to disclose their involvement in the prior ethics controversy. The district court granted vacatur, but not on the ground of "evident partiality." On appeal, the district court's vacatur was reversed and remanded with instructions. However, with regard to the "evident partiality" challenge, the Ninth Circuit agreed with the district court that Lloyds had not established the existence of "an inappropriate relationship or contact" between the two arbitrators or a failure to disclose "information that would warrant vacating the award." *Id.* at 645. To show "evident partiality" in an arbitrator, the court held that the moving party "must establish specific facts indicating actual bias toward or against a party or show that [the arbitrator] failed to disclose to the parties information that creates '[a] reasonable impression of bias.'" *Id.* at 645-646, citing *Woods v. Saturn*, 78 F.3d at 427. The court held that vacatur of an arbitration award is not required under Section 10(a)(2) of the FAA simply because an arbitrator fails to disclose a matter that might be of some interest to a party. Instead, an arbitrator is required to disclose "only facts indicating that he 'might reasonably be thought biased against one litigant and favorable to another.'" *Id.* at 646, citing *Commonwealth*, 393 U.S. at 150. Here, the Ninth Circuit found that Lloyds had failed to show any connection between the parties to the present arbitration and any of the majority arbitrator's past difficulties that would give rise to a reasonable impression of partiality toward Lagstein. Indeed, the court found that the majority arbitrator's alleged misconduct occurred more than a decade before the subject arbitration and concerned neither of the parties to the current case. *Id.*, citing *Paine-Webber Group, Inc. v. Zinsmeyer Trusts P'ship*, 187 F.3d 988, 995 (9th Cir. 1999) (characterizing a claim of evident partiality as "border[ing] on frivolous" where there was no alleged relationship between the parties and the arbitrators, and "there [was] no evidence the arbitrators had any financial or personal interest in the outcome of the arbitration").

In re Sussex, 76 F.3d 1092 (9th Cir. 2015) – Plaintiffs were purchasers of condominium units in a luxury condominium project seeking rescission of their purchase agreements or money damages arising from a wide range of fraud and other claims. Pursuant to the arbitration clause contained in the purchase and

sale agreement, the dispute was submitted to arbitration in 2011. At about the same time as his appointment, the arbitrator founded a company that “invests in high-value, high-probability legal claims and litigations.” In connection with that business venture, the arbitrator participated as a panelist in a couple of litigation finance and investment seminars and created a website to attract investors to his new firm. The arbitrator did not disclose his litigation finance business venture, but at some point in time the defendants learned of it and asked the AAA to disqualify the arbitrator from further service in the matter. That request was denied. Defendants then petitioned the district court, and that request was granted even though no arbitration award had yet been issued. The district court found that the arbitrator’s founding of a company that intends to profit from funding large, potentially profitable litigations of the kind that he was overseeing was likely to give rise to justifiable doubt regarding his impartiality, particularly since he failed to disclose his new pursuit. In this regard, the Court noted that the arbitrator stood to profit from a business that funds plaintiffs in high-value cases such as the one before him; that the business pursuit he failed to disclose was substantial and his failure to disclose it created a reasonable impression of partiality that would likely lead to vacatur of any award he might eventually make.¹⁰ On appeal, the Ninth Circuit reversed, finding that the undisclosed facts regarding the arbitrator’s “modest efforts” to start a company to attract investors for litigation financing did not give rise to a reasonable impression that the arbitrator would be partial to either party. The court noted the lack of any relationship between the arbitrator and any party to the dispute, and thus reasoned that the arbitrator’s potential ability to profit from a large award in favor of the plaintiffs “can best be described as ‘attenuated and insubstantial.’” *Id.* at 1074, citing *New Regency*, 501 F.3d at 1110.

(e) *California’s Ethics Standards for Neutral Arbitrators Serving in Commercial Arbitrations*

As is been true with many other aspects of arbitration, California’s approach to arbitrator disclosures and disqualification differs markedly from how those matters are handled under the FAA. Commercial arbitrators serving as neutral arbitrators are required to make a number of advance disclosures and must recuse themselves if any party timely objects after receipt of the arbitrator’s disclosures. Standard 6 of California’s Ethics Standards for Neutral Arbitrators in Contractual Arbitration (the “Ethics Rules”) squarely places the responsibility on the arbitrator to assess his or her ability to be impartial and to decline an appointment if he or she is unable

¹⁰ See *Sussex v. Turnberry/MGM Grand Towers, LLC* 2013 WL 6895845 (C.D.Cal. 2013) (Slip Opinion).

to be so “notwithstanding any contrary request, consent or waiver by the parties.” The Ethics Rules are found at the end of the California Rules of Court and are incorporated by reference into the California Arbitration Act at Sections 1281.85(a) and 1281.9(a)(1) of the California Code of Civil Procedure.

As a matter of common law, California courts historically held that arbitration awards shall be vacated if it is shown that the arbitrator failed to disclose facts creating a reasonable impression of possible bias. See *Britz v. Alfa-Laval Food & Dairy Co.*, 34 Cal. App. 4th 1085 (1995); *Betz v. Pankow*, 31 Cal. App. 4th 1503 (1995). As a matter of statute, neutral arbitrators are required to disclose “all matters that could cause a person aware of the facts to reasonably entertain a doubt that the proposed neutral arbitrator would be able to be impartial.” Cal. Code of Civ. Proc. § 1281.9(a). Included within those disclosure obligations are six specific disclosures concerning relationships the arbitrator or any member of his or her immediate family has or had with any party or lawyer for a party in the current arbitration proceeding.

- Whether the arbitrator has a current arrangement concerning prospective employment or other compensated service as a dispute resolution neutral with any party or attorney to the current matter. Cal. Code of Civ. Proc. § 1281.9(a)(1).
- Whether the arbitrator is, or within the last two years has, participated in discussions regarding prospective employment or other compensated service with any party or attorney to the current matter. Cal. Code of Civ. Proc. § 1281.9(a)(1).
- Whether the arbitrator is serving or has previously served as a party-appointed arbitrator for any party. Cal. Code of Civ. Proc. § 1281.9(a)(3).
- Whether the arbitrator is serving or has previously served as a neutral arbitrator for any party. Cal. Code of Civ. Proc. § 1281.9(a)(4).
- Whether the arbitrator has or had an attorney-client relationship with any party or lawyer for a party in the current matter. Cal. Code of Civ. Proc. § 1281.9(a)(5).

- Whether the arbitrator or any member of his immediate family has or had any professional or significant personal relationship with any party or lawyer for a party in the current matter. Cal. Code of Civ. Proc. § 1281.9(a)(6).

An even more detailed and extensive list of required disclosures is contained in Standard 7 of the Ethics Rules. Among other matters, the Ethics Rules require disclosure generally of 1. any matter that might cause a person aware of the facts to reasonably entertain a doubt that the arbitrator would be able to be impartial and, more specifically, 2. any interest that could be substantially affected by the outcome of the arbitration.” Ethics Rules, Standards 7(d)(14) and (d)(11).

The Ethics Standards provide that arbitrators have an obligation to inform themselves about matters that need to be disclosed, Ethics Rules, Standard 9(a), and that an arbitrator's duty of disclosure is a continuing duty. Ethics Rules, Standard 7(f). Thus, if something arises in the course of an arbitration that triggers a need to make a supplemental disclosure, the arbitrator must disclose the added information within 10 calendar days and parties have 15 calendar days after the disclosure within which to disqualify the arbitrator. Ethics Rules, Standard 10(a)(3).

Disqualification based on disclosures is an absolute right of the parties, and can occur at the outset of the process or at any time during the process if new disclosures are provided by the arbitrator. See, *Azteca Construction, Inc. v. ADR Consulting, Inc.*, 121 Cal. App. 4th 1156, 1163 (2005); *Ovitz v. Schulman*, 133 Cal. App. 4th 830, 840 (2005). In this regard, parties not only have an absolute right to disqualify an arbitrator for failing to serve a disclosure statement as required, but nondisclosure also grants an objecting party the absolute right to have an arbitration award vacated without a showing of actual bias or evident partiality. *Id.* It is the simple fact of the failed disclosure or the failure of the arbitrator to recuse himself or herself after receipt of a timely objection after making disclosures that serves as grounds for vacatur. Cal. Code Civ. Proc. § 1286.2(a)(6). Under Section 1281.9(b) of the California Code of Civil Procedure, disqualification is mandatory; operates as a peremptory challenge; and takes effect when a party timely serves a notice of disqualification.

Under Section 1281.91(b), there is no limit on the number of times a party may challenge a proposed arbitrator. For the recalcitrant party trying to avoid binding arbitration, an obvious tactic would be to serve a notice of disqualification within 15 days of each proposed arbitrator’s disclosures. The only way to limit the number of

peremptory challenges a party may assert is by seeking court intervention via a motion that asks the court to appoint the arbitrator as provided by Code of Civil Procedure section 1281.91. Section 1281.91(a)(2) then provides that a party shall have the right to disqualify one court-appointed arbitrator without cause in any single arbitration and, beyond that, may petition the court to disqualify a subsequent appointee “only upon a showing of cause.”

Code of Civil Procedure section 1286.2 provides the “strong-arm” mechanism for enforcing arbitrator disclosures – namely, vacatur. As amended, Section 1286.2 mandates that a court “shall” vacate an arbitration award if the arbitrator making the award (a) failed to disclose a ground for disqualification of which the arbitrator was aware, or (b) was subject to disqualification upon grounds specified in Section 1281.9 but failed to disqualify himself or herself after receipt of a timely notice of disqualification. At least one court has commented that, on its face, “the statute leaves no room for discretion. If a statutory ground vacating an award exists, the trial court must vacate the award.” See, *Ovitz v. Schulman*, 133 Cal. App. 4th 830, 845; accord, *International Alliance of Theatrical Stage Employees, etc. v. Laughton*, 118 Cal. App. 4th 1380, 1386 (2004).

Despite the breadth and detail of the Ethics Rules, the California Supreme Court has previously made clear that the statutory disclosure requirements are intended to ensure the impartiality of the arbitrator, not mandate disclosure of “all matters that a party might wish to consider in deciding whether to oppose or accept the selection of an arbitrator.” *Haworth v. Superior Court*, 50 Cal. 4th 372, 393 (2010). In this regard, the Supreme Court cautioned against construing the governing standard too broadly. “An impression of possible bias in the arbitration context means that one could reasonably form a belief that an arbitrator was biased *for or against a party for a particular reason*.” *Id.* at 389 (italics in the original). In this regard, one California Court of Appeal has construed the Ethics Rules so that “‘ordinary and insubstantial business’ arising from participation in the business or legal community do not necessarily require disclosure.” *Luce, Forward, Hamilton & Scripps, LLP v. Koch* (2008) 162 Cal. App. 4th 720, 723, quoting *Guseinov v. Burns* (2006) 145 Cal. App. 4th 944, 959. As evidenced by the decision of the California Court of Appeal in *Mt. Holyoke Homes, L.P. v. Jeffer Mangels Butler & Mitchell*, 219 Cal. App. 4th 1299 (2013), the issue of what type of relationships require disclosure on penalty of vacatur is still under discussion and development in the courts, and involve similar, fact-driven decisions versus any clear line of demarcation as to what personal or professional relationships rise to the level of being “substantial” or “meaningful” or otherwise provocative for purposes of mandating a disclosure.

(f) Notable Historical Cases re What Does and Does not Constitute a Required Disclosure Under California's Ethics Standards

Azteca Construction, Inc. v. ADR Consulting, Inc., 121 Cal. App. 4th 1156 (2004) – Disqualification based upon an arbitrator's disclosures is an absolute right of the parties and is "essential to ensuring the integrity of the arbitration process." The provisions in the CAA relating to arbitrator disqualification cannot be waived because they were "enacted primarily for a public purpose." Upon objection of a party based upon the arbitrator's disclosures, disqualification is not subject to review or determination by the provider institution or other higher outside authority.

Ovitz v. Schulman, 133 Cal. App. 4th 830, 840 (2005). Under Code of Civil Procedure section 1281.91(b), disqualification is mandatory; operates as a peremptory challenge; and takes effect when a party timely serves a notice of disqualification. The failure of the arbitrator to recuse himself / herself is vacatur of any award he / she thereafter makes. "[T]he statute leaves no room for discretion. If a statutory ground vacating an award exists, the trial court must vacate the award."

Guseinov v. Burns, 145 Cal. App. 4th 944 (2006) – The arbitrator having acted as an uncompensated mediator in prior matters where lawyer for a party to the arbitration represented a party unrelated to the current arbitration was insufficient to constitute a professional relationship within the meaning of the statute, and was not a required disclosure.

Hayden v. Superior Court, 150 Cal. App. 4th 360 (2007) – No grounds to vacate the arbitration award for conflict of interest where the alleged conflict relation was the mid-arbitration acquisition of a party to the arbitration by an entity that had previously looked to the arbitrator and his provider organization for private dispute resolution services. The acquisition did not make the acquiring entity a party to the dispute for disclosure or conflict disqualification purposes.

Advantage Medical Services, LLC v. Hoffman, 160 Cal. App. 4th 806 (2008) – After claims were referred to arbitration and an interim award for the LLC was issued, the arbitrator was asked to disqualify himself after the founding member of the LLC discovered that the arbitrator was "correspondent counsel" for marine entities who procured reinsurance from the London insurance market association. On petition to the court, the interim award was vacated because the

arbitrator had failed to make a required disclosure when counsel for Lloyds of London entered an appearance in the case as the LLC's insurer in the matter. Affirmed.

Dornbirer v. Kaiser Foundation Health Plan, Inc., 160 Cal. App. 4th 831 (2008) – The statutory scheme does not require an arbitration award to be vacated “when the arbitrator has generally disclosed the grounds for disqualification, i.e., his or her relationships and prior interactions with the parties to the arbitration and/or their attorneys, but has not provided all of the specific details required … and despite the omissions, the parties agreed to go forward with the arbitration.”

Casden Park La Brea Retail LLC v. Ross Dress for Less, Inc., 162 Cal. App. 4th 468 (2008) – Only significant or substantial business relationships between a neutral arbitrator and a party or its representative must be disclosed to avoid the appearance of impropriety, but ordinary and insubstantial business dealings do not necessarily require disclosure. Arbitrator had no duty to disclose a \$500 contribution to the mayoral campaign of one party's arbitrator more than five years before the arbitration. The campaign contribution was ordinary and insubstantial. Arbitrators are not expected to be entirely without business contacts.

Luce, Forward, Hamilton & Scripps, LLP v. Koch, 162 Cal. App. 4th 720 (2008) – “[O]rdinary and insubstantial business’ arising from participation in the business or legal community do not necessarily require disclosure.”

Haworth v. Superior Court, 50 Cal. 4th 372 (2010) – Despite the breadth and detail of the Ethics Rules, the California Supreme Court has made clear that the disclosure requirements are intended to ensure the impartiality of the arbitrator, not mandate disclosure of “all matters that a party might wish to consider in deciding whether to oppose or accept the selection of an arbitrator.” (In this case, the fact that the arbitrator, a retired judge, had disclosed the fact of judicial discipline many years in the past.) In this case, the Supreme Court cautioned against construing the governing standard too broadly. “A impression of possible bias in the arbitration context means that one could reasonably form a belief that an arbitrator was biased *for or against a party for a particular reason.*”

Rebmann v. Rohde, 196 Cal. App. 4th 1283 (2011) – A judge or arbitrator's impartiality should never be questioned simply because of who they are. Jewish arbitrator did not have a duty to disclose his family background and associations just because one party (the losing party) was of German decent. There was nothing

in the arbitrator's professional record that indicated bias toward German's. The arbitrator's background was entirely irrelevant to the commercial dispute before him and the losing party's family background was unknown to the arbitrator at the time of the arbitration.

Gay v. Chiu, 212 Cal. App. 4th 1355 (2013) – Vacatur granted where the arbitrator failed to disclose that one of the attorneys for one of the parties had become associated as a neutral on the arbitrator's provider panel.

Mt. Holyoke Homes, L.P. v. Jeffer Mangels Butler & Mitchell, 219 Cal. App. 4th 1299 (2013) – The Arbitrator's failure to disclose that managing partner in defendant law firm had been listed as a reference on his resume required vacatur of the award. The connection between the undisclosed fact of the arbitrator's naming an attorney as a reference on his resume and the subject matter of the arbitration, a legal malpractice action against the law firm in which the same attorney is a party, was sufficiently close that a person reasonably could entertain a doubt that the arbitrator could be impartial. An objective observer reasonably could conclude that an arbitrator listing a prominent litigator as a reference on his resume would be reluctant to rule against the law firm in which that attorney is a party as a defendant in a legal malpractice action. "To entertain a doubt as to whether the arbitrator's interest in maintaining the attorney's high opinion of him could color his judgment in these circumstances is reasonable, is by no means hypersensitive, and requires no reliance on speculation."

United Health Centers v. Superior Court, 229 Cal. App. 4th 63 (2014) – Not every omission of information that is required to be disclosed pursuant to CCP §1281.9 and the Ethics Rules constitutes a ground for disqualification. A party may forfeit his / her ability to vacate an arbitration award if the party had knowledge of the omitted or incomplete disclosures and took no action. In this case, plaintiff – the petitioning party – was charged with knowledge that the arbitrator previously had conducted an arbitration in which plaintiff's attorneys were involved, and yet took no action to either disqualify the arbitrator or request more information. The forfeiture principle set forth in *Dornbirer v. Kaiser Foundation Health Plan, Inc.* (2008) 106 Cal. App. 4th 831 remains viable.

(g) *2016 Cases*

- *Ruhe v. Masimo Corp.*, 640 Fed. Appx. 685 (9th Cir. Feb. 19, 2016) – Trial court vacatur decision reversed. The facts and circumstances concerning the associations and litigation activities of the arbitrator’s attorney brother were not enough to satisfy the “reasonable impression of bias” standard followed in the Ninth Circuit in determining evident partiality as a grounds for vacatur.

This is an employment case in which the plaintiffs complained of wrongful termination from defendant Masimo. In September 2011, the Court ordered the parties to arbitration. That matter proceeded to arbitration and to evidentiary hearing before a JAMS arbitrator, Richard C. Neal (a former Court of Appeal Justice). Thirty-six hours before the final hearing, Masimo made a for-cause challenge to the continued service of the arbitrator. The challenge was based upon Masimo’s recent discovery that the Arbitrator’s brother (Stephen C. Neal) had represented its chief competitor in two highly contentious litigation losses to Masimo with liability verdicts totaling over half a billion dollars. One of the verdicts obtained against the Arbitrator’s brother was reported as one of the largest jury verdicts handed down in 2005.

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

Five days after the hearing, the Arbitrator issued the final award and found in favor of plaintiffs on their wrongful termination claim, awarding the full amount of compensatory damages they had requested – approximately \$310,000. The Arbitrator then assessed Masimo with \$5 million in punitive damages. The

Arbitrator acknowledged that this award was more than 16 times the total compensatory damages awarded, but reasoned that it was “in no sense disproportionate [because] it is only a fraction of [Masimo’s] annual net income.”

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

In an unpublished opinion, the Ninth Circuit reversed the trial court based on its finding that Masimo did not establish that the arbitrator had failed to disclose information that created a reasonable impression of bias; that Masimo had failed to show how the litigation practice of the arbitrator’s brother would cause a reasonable person to doubt the arbitrator’s impartiality; and that Masimo had failed to establish facts showing actual bias.

- *Baxter v. Bock*, 247 Cal. App. 4th 775 (1st Dist. May 24, 2016) – Arbitrator appointed under the Mandatory Fee Arbitration Act (MFAA) was not required to disclose to the parties that his consulting practice included auditing attorney bills and that he had written extensively above attorney overbilling. The arbitrator’s consulting practice did not create an appearance of impartiality where the arbitrator’s consulting practice was not devoted exclusively to one side of fee disputes and a significant percentage of his clients were attorneys looking for expert support for their bills or fee applications.

After an adverse decision in an arbitration under the MFAA, attorney Joseph Baxter challenged the decision based on: (1) the arbitrator’s failure to disclose facts relating to his consulting practice, in which he audited legal bills, and (2) the arbitrator’s perceived bias against attorneys based on various articles and promotional materials.

This case presents the opportunity to absorb many lessons regarding the interplay between the Mandatory Fee Arbitration Act, (“MFAA”), (Business & Professions Code Sections 6200 et. seq.), and the California Arbitration, (“CAA”), (CCP §§ 1280 et. seq.). MFAA provides a speedy and inexpensive way to resolve disputes between attorneys and clients regarding fees and costs. CAA governs private contractual arbitration. MFAA arbitration awards can be advisory or binding. The MFAA specifies that binding awards under the act may be enforced like contractual arbitration awards pursuant to Chapter 4 of the CAA commencing with Code of Civil Procedure section 1285. The MFAA does not incorporate or make reference to the first three chapters of the CAA. Specifically, the disclosure and disqualification provisions of the CAA are not referenced in the MFAA. Rather, the MFAA, in B&P Code section 6204.5, provides that the “State Bar shall provide by rule for an appropriate procedure to disqualify an arbitrator or mediator upon request of either party.”

Unfortunately, the State Bar has failed to do so. State Bar MFAA Rule 3.537(B) states: “An arbitrator who believe he or she cannot render a fair and impartial decision or who believes there is an appearance the he or she cannot render a fair and impartial decision must disqualify himself or herself or accede to a party’s challenge for cause.” Rule 3.537 also allows for a party to “disqualify one arbitrator without cause”, and it provides that a “party is entitled to

unlimited challenges of an arbitrator for cause.” However, the Rule says nothing about how parties are supposed to learn about facts that might lead to a challenge for cause. There is no disclosure required of arbitrators under the State Bar Rules, and California Rule of Court, Ethics Standards for Neutral Arbitrators in Contractual Arbitration, Standard 3(b)(2)(C) provides that the stricter contractual arbitration standards in Code of Civil Procedure sections 1281.9 and 170.1 do not apply to “an attorney–client fee arbitration proceeding [under the MFAA].”

The Mandatory Fee Arbitration Committee of the State Bar has published “Arbitration Advisory 2015–1 Disclosure Guidelines” for MFAA arbitrators suggesting that disclosures are not required. Rather, disqualification should be self-executing, or left up to the arbitrator. If the arbitrator believes he or she cannot render a fair decision, then the arbitrator should step down, but there is no requirement for the arbitrator to disclose information that might cause a party to question the arbitrator’s impartiality and disqualify the arbitrator with or without cause.

The Court of Appeal in *Baxter* does its best to make sense of this muddle. In *Baxter* the arbitrator, Mr. Schratz, clearly erred in his decision. He found that “Baxter had billed the Bocks \$99,373; the services were worth only \$68,148; and the Bocks had paid Baxter \$68,148.” 247 Cal. App. 4th at 780. He therefore awarded \$0 to Baxter. The trouble was that the Bocks admitted that they only paid \$29,225 to Baxter. The factual error was caused in part by Baxter himself because he had submitted evidence with the mistaken figures in it. However, neither side disputed that the findings were erroneous. When Baxter requested that Schratz correct the award, Schratz refused. This led to litigation to vacate, correct or confirm the award. The trial court confirmed the award, and both sides appealed. Baxter appealed the refusal to correct or vacate the award. The Bocks appealed the trial court’s award of only a fraction of the attorney fees they incurred in getting the award confirmed.

In one of the unpublished portions of the appellate opinion, the Court explains why the award could not be vacated or corrected by the court, even in the face of an admitted factual error. **Lesson one:** Opt for an advisory MFAA award, rather than a binding award. If everyone is satisfied with the award and no one asks for trial de novo within 30 days after the award is served, it becomes binding, but if the arbitrator makes an obvious error and refuses to fix it, at least you’ll have another shot in the trial de novo.

The meat of the *Baxter* decision concerns the disclosures that were made by Schratz, and those that were not made. The appellate court held that Code of Civil Procedure section 1286.2 applies to MFAA arbitrations. That section specifies the grounds for vacating an award under the CAA. Subsection (A) provides for an award to be vacated if an arbitrator fails to disclose a ground for disqualification. Subsection (B) provides for an award to be vacated if the arbitrator was subject to disqualification but refused a timely demand for disqualification.

The appellate court then discusses the lack of a disclosure requirement in the MFAA, and the lack of a disclosure requirement in the State Bar MFAA Rules. The court then references the 2005 version of the State Bar's Fee Arbitration Handbook which advises that arbitrators should "disclose any prior or present relationship to any party or participant in the proceeding and any other fact that may bear upon his or her disqualification as an arbitrator." That advice has subsequently been removed from the State Bar's Fee Arbitration Handbook, but the appellate court in *Baxter* nonetheless held that this advice means that "the general disclosure requirements of the MFAA and CAA are, for practical purposes, the same . . ." *Id.* at 786. Incidentally, the Cal Bar MFAA committee was so troubled by this conclusion that it petitioned the State Supreme Court to either depublish the decision or accept Mr. Baxter's petition for review. The State Supreme Court declined both requests.

Turning back to the facts of the case, Mr. Baxter contended that Schratz should have disclosed that he had worked most of his career scrutinizing and chopping attorney fee bills. Schratz had worked for an insurance company for 2 decades as a fee auditor and gatekeeper with respect to paying attorney bills. He had written extensively criticizing block billing, and other billing practices he considered abusive. Since leaving the insurance company, he and his firm were advertised as experts with respect to attorney billing disputes. None of this was disclosed prior to the arbitration.

Neither the trial court, nor the appellate court, were convinced that the award should be overturned for Schratz's failure to disclose these facts. Both courts concluded that the only information that needed to be disclosed was information that would demonstrate, or at least raise a question about, whether the arbitrator's own financial interest would be enhanced or harmed based on how this particular case might be decided. Schratz and his firm usually served as consultants and experts on behalf of litigants challenging a request for attorney fees. However, Schratz occasionally testified as an expert in favor of a law firm

seeking to recover fees. Therefore, the court held that one could not conclude that Schratz would necessarily have a financial incentive to rule against attorneys, since he performed auditing services for both sides – i.e., parties challenging legal bills and parties justifying legal bills.

While Baxter claimed that the arbitrator’s various writings showed his bias against “block billings,” the Court of Appeal noted that criticism of block billing is common and, that there was otherwise no evidence that the arbitrator had prejudged the issue by applying a per se rule of exclusion. The Court went on to hold that if Baxter had wished to exclude an arbitrator with particular beliefs, “he was required to perform his own investigation” – quite a departure from the Ethics Rules governing commercial arbitrators, where the burden is on the arbitrator to make a broad range of disclosures, including anything that might cause a reasonable person to doubt the arbitrator’s impartiality.

Lesson two: Do your homework. Schratz’s writings on the topic of billing disputes were readily available on the internet. His philosophical hostility to certain billing practices, and perhaps to attorney bills in general, was on public display. In hindsight Baxter certainly would have been well advised to ding Mr. Schratz immediately after he was assigned.

The court also dealt with an interesting side issue. The Bock’s were awarded only a fraction of the attorney fees they incurred in getting their award confirmed. The firm they hired assigned two partners to their case. One of the partners was female, one was male. Both partners billed at the rate of \$375 per hour, but sought an award from the court at the rate of \$425 per hour. The court drastically cut the hours that were billed by the Bock’s attorneys, and also reduced the rate of compensation for the female attorney to \$300 per hour, while reducing the rate of the male attorney to \$350 per hour. The appellate court could find no justification in the record for the disparate rates applied to the two attorneys and remanded for further proceedings. However, the appellate court left the reduction in hours undisturbed.

[Case Digest Contributed by Chris Blank]

3. Class Arbitration and the Status of Waivers and Contract Silence

(a) *Background Statement*

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

In 2011, the Supreme Court expanded on the *Stolt–Nielsen* decision and held that the FAA’s overarching purpose is to “ensure the enforcement of arbitration agreements according to their terms.” *AT & T Mobility LLC v. Concepcion*, 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 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.¹¹ That being said, the *Brown* majority did not reach the issue regarding the invalidity of the class action waiver because it found that the plaintiff had failed to satisfy *Gentry*’s four-factor test. On the flip side, several California federal courts have held that *Concepcion* overruled *Gentry*. See, *Steele v. American Mortg. Management Servs.*, 2012 WL 5349511 (E.D.Cal. Oct. 26, 2012); *Sanders v. Swift Transp. Co. of Ariz., LLC*, 834 F.2d 1033 (N.D.Cal. 2012); *Lewis v. UBS Fin. Servs*, 818 F.2d 1161 (N.D.Cal. 2011); *Valle v. Lowe’s HIW, Inc.*, 2011 WL 3667441 (N.D.Cal. Aug. 22, 2011); *Murphy v. DIRETV, Inc.*, 2011 WL 3319574 (C.D.Cal. Aug. 2, 2011). And at least two California federal courts have questioned the *Brown* court’s holding that the right to bring a PAGA claim cannot be waived in an arbitration agreement. See, *Quevedo v. Macy’s, Inc.*, 798 F.Supp. 2d 1122 (C.D.Cal. 2011); *Grabowski v. C.H. Robinson Co.*, 817 F.Supp. 2d 1159 (S.D.Cal. 2011).

¹¹ *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.

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 not enforceable. While one would think that forbidding the enforcement of PAGA claim waivers would, like prohibiting class action waivers, run up against FAA preemption, the California Supreme Court said otherwise:

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

59 Cal. 4th at 386–387.

CLS Transportation petitioned for review by the United States Supreme Court with respect to the determination that PAGA claim waivers remained enforceable in light of the FAA and the holding in *Concepcion*. The legal community expected that certiorari would be granted because, in the months after *Iskanian*, several federal district courts in California issued decisions rejecting *Iskanian*.¹² In essence, these decisions found that while California is entitled to interpret

¹² See, e.g., *Lucero v. Sears Holdings Mgmt. Corp.*, 2014 WL 6984220 (S.D.Cal., Dec. 2, 2014); *Mill v. Kmart Corp.*, 2014 WL 6706017 (N.D.Cal., Nov. 26, 2014); *Langston v. 20/20 Companies, Inc.*, 2014 WL 5335734 (C.D.Cal., Oct 17, 2014) (concluding that the FAA preempts California’s rule against arbitration agreements that waive an employee’s right to bring representative PAGA claims and that the reasoning in *Iskanian* is inconsistent); *Chico v. Hilton Worldwide, Inc.*, 2014 WL 5088240 (C.D.Cal., Oct 7, 2014) (noting that “numerous federal courts have determined that the FAA preempts California’s rule prohibiting waiver of representative PAGA claims” and “agree[ing] and adopt[ing] the reasoning of these cases”); *Ortiz v. Hobby Lobby Stores, Inc.*, 2014 WL 4691126 (E.D.Cal., Oct 1, 2014) (“It is clear that the majority of federal district courts find that PAGA action waivers are enforceable because a rule stating otherwise is preempted by the FAA and *Concepcion*.”); *Fardig v. Hobby Lobby Stores*, 2014 WL 4782618 (C.D.Cal., Aug. 11, 2014) (“Even in light of *Iskanian*, the Court continues to hold that the ruling making PAGA waivers unenforceable is preempted by the FAA).

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), 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.

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

(b) *Notable Historical Cases*

Discover Bank v. Superior Court, 36 Cal. 4th 148 (2005) – Some class action waivers are unconscionable and thus unenforceable. The “Discover Bank Rule” was rejected by the U.S. Supreme Court in 2011 in *Conception*.

Gentry v. Superior Court, 42 Cal. 443 (2007) – Some class action waivers found in adhesion employment agreements are unenforceable. The “Gentry Rule” was disapproved by the California Supreme Court in 2014 in *Iskanian*.

Stolt-Nielsen v. Animal Feeds Int’l Corp., 559 U.S. 662 (2010) – 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). 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.

AT & T Mobility LLC v. Concepcion, 563 U.S. 333 (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.” The arbitration agreement in that case included a class-action waiver in a consumer contract that required the parties to arbitrate only in their “individual capacity, and not as a plaintiff or class member in any purported class or representative proceeding.” The arbitration agreement also prohibited the arbitrator from consolidating the claims of more than one person, or from presiding over any form of representative class proceeding. 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* (2005) 36 Cal. 4th 148. The Supreme Court reversed the Ninth Circuit, finding that because it California’s *Discover Bank* rule “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,” it is preempted by the FAA. (5-4 decision)

Oxford Health Plans v Sutter, ___ U.S. ___, 133 S.Ct. 2064 (2013) – In the arbitration, the parties agreed to submit to the arbitrator the issue of whether the parties’ contract authorized class arbitration. The arbitrator concluded that it did. Noting that the question turned on “construction of the parties’ arbitration agreement,” the arbitrator reasoned that the clause sent to arbitration “the same universal class of disputes” that it barred the parties from bringing as civil actions in court; that the intent of the clause was “to vest in the arbitration process everything that is prohibited from the court process.” The arbitrator further reasoned that a class action “is plainly one of the possible forms of civil action that could be brought in a court” absent the agreement. Accordingly, the arbitrator concluded that the arbitration clause expressed the parties’ agreement to class arbitration. The Supreme Court granted certiorari and affirmed. In an opinion by Justice Kagan, the Court reasoned that FAA section 10(a)(4) limits a court’s ability to overturn an arbitrator’s decision where it is arguably based on

an interpretation of the parties' agreement. While the Court conceded that the parties' agreement did not contain any language authorizing class arbitration, it noted that the arbitrator found the arbitration clause "unambiguously evinced an intention to allow class arbitration" based on construing "the arbitration clause in the ordinary way to glean the parties' intent." Tacitly acknowledging the arbitrator's potentially erroneous interpretation, the Court again made clear that section 10(a)(4) provides that the "arbitrator's construction holds, however good, bad, or ugly." Citing *Green Tree Financial Corp. v. Bazzle* (2003) 539 U.S. 444, the Court stated that the issue would have been different had Oxford Health challenged the availability of class arbitration as a "question of arbitrability." Such questions include preliminary matters such as whether the parties have a valid agreement and are presumptively decided by the courts. Instead, Oxford Health challenged the decision as a matter within the arbitrator's discretion to decide. Consequently, the Court did not inquire into whether class arbitration is a question of arbitrability.

American Express Co. v. Italian Colors Restaurant, ___ U.S. ___, 133 S.Ct. 2304 (2013)– Class action waiver clause held to be enforceable even though it would be uneconomical for plaintiff to pursue federal statutory claim on an individual basis. The FAA does not permit courts to invalidate a contractual waiver of class arbitration on the ground that the plaintiff's cost of individually arbitrating a federal statutory claim exceeds the potential recovery. Even claims alleging the violation of a federal statute are subject to binding arbitration unless the FAA's mandate has been "overridden by a contrary congressional command," citing *CompuCredit Corp. v. Greenwood* (2012) ___ U.S. ___, 132 S.Ct. 665.

Ferguson v. Corinthian Colleges, 733 F.3d 928 (9th Cir. 2013) – *Concepcion* preempts the *Broughton-Cruz* rule that arbitration may not be compelled when a plaintiff, acting as a private attorney general, seeks a "public injunction" to enjoin future deceptive practices for the benefit of the general public. The Ninth Circuit the argument that because an injunction is technically a remedy rather than a cause of action, the *Broughton-Cruz* rule is insulated from the FAA. As stated by the Supreme Court in *Concepcion* in 2011 and reiterated in 2012 in *Marmet Health Care Center, Inc. v. Brown* (2012) ___ U.S. ___, 132 S.Ct. 1201 "[w]hen state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA." Recognizing that its decision overruled an important aspect of consumer protection in California, the Ninth Circuit offered some hints about how plaintiffs might proceed in the future, but withheld judgment about the success of those possible procedures. "We decline to resolve in advance the question of what, if

any, court remedy Plaintiffs might be entitled to should the arbitrator determine that it lacks the authority to issue the requested injunction. That is beyond the scope of this appeal. If the arbitrator comes to that conclusion, Plaintiffs may return to the district court to seek their public injunctive relief. We express no opinion on any question that might arise at that time. Similarly, we decline to resolve now questions that could arise or a motion is brought in court to confirm an arbitration award that includes injunctive relief, or whether it might be necessary for a court to enforce a public injunction awarded by an arbitrator. Those questions can be better addressed in the context of an actual case, with arguments directed more specifically to the questions raised in that case.”

Iskanian v. CLS Transp. Los Angeles LLC, 59 Cal. 4th 348 (2014), cert. den., 131 S.Ct. 1155 (2015) – The California Supreme Court held that after the U.S. Supreme Court’s ruling in *Concepcion*, class action waivers are generally valid and enforceable – even in employment contracts. However, with regard to PAGA claim waivers, the Court held that such waivers are not enforceable because a PAGA claim lies outside the FAA’s coverage. The Court explained that a PAGA claim is not a dispute between an employer and employee arising out of their contractual relationship but, rather, is a dispute between an employer and the State concerning alleged violations of the Labor Code. The employer filed a petition for writ of certiorari with the U.S. Supreme Court. That petition was denied on January 20, 2015, thereby leaving intact the California high court’s decision requiring that representative actions brought under PAGA proceed on a representative basis in some forum – whether it be in court or an arbitration. On remand from the California Supreme Court, Judge Robert L. Hess ruled on November 25, 2015 (L.A. Superior Court Case No. BC35621) that the individual claims subject to arbitration must be resolved before the trial court would address the PAGA claims.

DirecTV v. Imburgia, ___ U.S. ___, 136 S.Ct. 463 (2015) – Justices of the U.S. Supreme Court had scorching criticism for a California court’s refusal to enforce an arbitration agreement. In this case, two customers who objected to the company’s early termination fees sought to represent a class of people in the same situation by filing a class action lawsuit in 2008. After *Concepcion*, DirecTV asked a state court judge to dismiss the lawsuit and require arbitration. The case turned on an odd provision in the company’s contract that forbid class arbitration, but made the entire arbitration provision unenforceable if “the law of your state” barred class arbitration waivers. Applying to the law as it existed at the time the lawsuit was filed, the request for arbitration was denied and the matter was allowed to proceed in court as a class action. Justice Breyer, writing

for the majority, said that the state court failed to take into account the Court's 2011 decision in *Concepcion*, which allowed companies to avoid class actions by insisting on individual arbitrations. He went on to say that the right way to read the contract was to assume that it referred to *valid* California laws and not to ones displaced by the 2011 decision.

Sakkab v. Luxottica Retail North America, Inc., (9th Cir. 2015) 803 F.3d 425 (9th Cir. 2015) – PAGA claims cannot be waived in employment arbitration agreements, following the rule announced by the California Supreme Court in *Iskanian*. With this 2-1 ruling, the Ninth Circuit majority found that the *Iskanian* rule barring PAGA waivers is not preempted by the FAA. The majority rejected the preemption argument, holding that “[f]ollowing the logic of *Concepcion* ... the *Iskanian* rule is a ‘generally applicable’ contract defense that may be preserved by [the FAA’s] savings clause” because “the *Iskanian* Rule does not conflict with the FAA’s purposes.” The court found here that the waived PAGA claims did not mandate procedures that interfere with arbitration, as the class action claims in *Concepcion* did.

Sanchez v. Valencia Holding Co., LLC, 61 Cal. 4th 899 (2015) – Car buyer brought class action against dealer alleging violations of the CLRA and other consumer protection laws. The CLRA provides for a right to file a class action and also provides that such right is unwaivable. The Court held that the anti-waiver provision was unenforceable under the U.S. Supreme Court’s decision in *Concepcion* and thus the class waiver provision was enforceable. The Court also held that that conclusion did not limit the unconscionability rules applicable to other provisions of the arbitration agreement, and affirmed the lower court’s denial of arbitration on that grounds.

Securitas Security Services USA, Inc. v. Superior Court, 234 Cal. App. 4th 1109 (2015) – The trial court ruled that a PAGA claim waiver was unenforceable, but issued an order compelling arbitration of all claims – including the PAGA claim. The Court of Appeal reversed, holding that the PAGA waiver rendered the entire arbitration agreement unenforceable due to the existence of a non-severability provision that immediately followed the class action and representative action waiver provisions. The court stated that “Notwithstanding any other clause in this Agreement, the proceeding sentence shall not be severable from this Agreement in any case in which the dispute to be arbitrated is brought as a class, collective or representative action.” The court held that the non-severability provision essentially turned the arbitration agreement into an all-or-nothing proposition: If the class or representative action waivers are not

enforceable, the entire agreement to arbitrate is unenforceable, and all dispute must be resolved in court.

(c) *2016 Cases*

- *Morris v. Ernst & Young, LLP*, 834 F.3d 975 (9th Cir. Aug. 22, 2016) – Arbitration agreement that required employees to bring claims in “separate proceedings,” thereby prohibiting class and collective actions, is illegal under the NLRA and thus unenforceable.

This is a significant case because it further deepens the split among the Circuits concerning the intersection of the FAA and the long line of cases promoting the enforcement of arbitration agreements by their terms, including class action waivers, on the one hand, and a developing trend of cases flowing from administrative decisions of the National Labor Relations Board (NLRB) that deny enforcement of arbitration clauses that include class action waivers when included in employment contracts because they impair the collective action rights of employees under the National Labor Relations Act (NLRA) to prosecute collective action complaints against employers for violations of the Fair Labor Standards Act (FLSA), on the other. The holding in this case concerning the unenforceability of class action waivers is context specific – mandatory class action waivers included in employment contracts where the employee seeks to assert a collective action for alleged workplace violations under the FLSA. With the Ninth Circuit joining the Seventh Circuit in favor of non-enforcement (versus the Second, Fifth, Eighth and Eleventh Circuits favoring enforcement), there is now a clear split among the circuits, increasing the odds that the issue will be taken up by the Supreme Court in the near future. On September 8, 2016, Ernst & Young filed its petition for certiorari with the Supreme Court, where it is awaiting consideration as Case No. 16-300. This case will continue to be on our “watch list.”

Prior to 2016, four Circuit Courts of Appeal had denied enforcement of NLRB rulings declining to enforce arbitration agreements that contained class action waivers, thereby rejecting the argument that an employee’s right to prosecute a collective action under the FLSA is a non-waivable substantive right. See, e.g., *Murphy Oil U.S.A., Inc. v. NLRB*, 808 F.3d 1013 (5th Cir. 2015); *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*, 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 and strike down class waivers in employment contracts. See, *Lewis v. Epic Systems Corp.*, 823 F.3d 1147 (7th Cir. 2016). 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*.

In this case, the plaintiff worked for the accounting firm, Ernst & Young, and like all new hires, he was required to sign an arbitration agreement at the outset of his employment as a condition to employment. The arbitration agreement contained a class action waiver and expressly required “covered disputes” to be heard in “separate proceedings.” Despite the existence of this provision, plaintiff brought a class and collective action against his employer in federal court, alleging that he and others had been misclassified as exempt from overtime under the FLSA. Ernst & Young moved to compel individual arbitration. Plaintiff opposed, challenging the “concerted action waiver” and arguing that it violated the NLRA by interfering with the right of employees to pursue work-related legal claims together. The trial court granted Ernst & Young's motion and ordered the plaintiff and all others who felt aggrieved to pursue individual arbitration claims, and dismissed the case. Plaintiffs appealed.

Dismissing contrary holdings by the Second, Fifth and Eighth Circuits, as well as the California Supreme Court, the Ninth Circuit joined the Seventh Circuit and held that the “concerted action waiver” violated the NLRA. The Ninth Circuit reversed the decision and struck down the class waiver provisions. Just as the Seventh Circuit ruled in *Epic Systems*, the Ninth Circuit held that employers interfere with the right of all employees – not just those unionized – to engage in concerted activity under the NLRA by requiring them to pursue claims in separate proceedings. The Court noted that Section 7 of the NLRA provides a statutory right to employees to engage in concerted activities for their mutual aid or protection, and determined that this included class action litigation.

Although the employer defended its position by pointing out that the Federal Arbitration Act (FAA) mandates a liberal policy in favor of upholding arbitration agreements, the Ninth Circuit was not persuaded. “The problem with the contract at issue is not that it requires arbitration, it is that the contract term

defeats a substantive federal right to pursue concerted work-related legal claims.” By concluding that the rights established under the NLRA are substantive in nature and not just procedural, the Court ruled that these rights could never be waived via a standard, mandatory arbitration agreement, thus adopting the view of the currently constituted NLRB.

Ernst & Young filed a petition for certiorari with the United States Supreme Court, which was granted. No. 16-30 2017 WL 125665 (Jan. 13, 2017). This will be a case to watch, and will be among the first batch of cases to be decided by the newly constitute Supreme Court once Justice Scalia’s seat is filled.

- *Perez v. U-Haul Company of California*, 3 Cal. App. 5th 408 (2d Dist. Sep. 16, 2016) – Employer may not compel arbitration to determine if plaintiff employee is an “aggrieved employee” for purposes of being qualified to bring a PAGA claim.

As a condition of their employment with U-Haul, plaintiffs were required to sign a mandatory arbitration agreement that contained an arbitration clause, as well as an agreement by the employees to “forego any right to bring claims as a representative or as a member of a class or in a private attorney general capacity.” After leaving their employment with U-Haul, plaintiffs filed a representative action under PAGA, alleging that U-Haul had violated several provisions of the Labor Code, including overtime and meal break requirements. U-Haul filed a motion to compel plaintiffs to individually arbitrate the issue of whether they qualified as “aggrieved employees” for purposes of having standing to pursue a PAGA claim. The trial court denied the motion, concluding that California law – per the California Supreme Court’s decision in *Iskanian* – prohibits an employer from compelling an employee to split the litigation of a PAGA claim between multiple forums and individual versus representative claims.¹³

On appeal, the parties briefed the issue of what was within the scope of the arbitration clause – i.e., what was arbitrable – given the fact that while there was “broad” language in the arbitration clause, there was also an additional clause stating that the parties would not seek arbitration (or litigation) of an “claims as

¹³ The trial court reasoned that the California Supreme Court in *Iskanian v. CLS Transportation Los Angeles, LLC*, 59 Cal. 4th 348 (2014) was “unequivocal” in its finding that a PAGA claim is not subject to the FAA and that the dispute is between the State and the employer. 3 Cal. App. 5th at 414, 417-184.

a representative ... or in a private attorney general capacity.” U-Haul conceded that under *Iskanian*, the PAGA waiver in its arbitration clause was unenforceable and that plaintiffs were therefore permitted to proceed with their PAGA claims in court. However, U-Haul contended that the plaintiffs could nevertheless be compelled to individually arbitrate the “predicate issue” of whether they are “aggrieved employees” within the meaning of PAGA – i.e., whether they have standing to bring such representative claims. This argument was rejected by the Court of Appeal.

“Given that the parties did not agree to arbitrate representative claims, and that a PAGA action is by definition a form of representative claim, we conclude that PAGA claims are categorically excluded from the arbitration agreement. Moreover, the agreement contains no language suggesting that despite this exclusion of representative claims, the parties did agree to arbitrate whether the complaining party had standing to initiate a representative claim in court. We fail to see how an agreement that excludes representative claims can nonetheless be reasonably interpreted to require plaintiffs to arbitrate their standing to bring a representative claim.”

The Court of Appeal went on to hold that even if the agreement could be interpreted as requiring plaintiffs to arbitrate whether they have standing to bring a PAGA claim, it agreed with the Court of Appeal decision in *Williams v. Superior Court*, 237 Cal. App. 4th 642 (2015) that California law prohibits the enforcement of an employment agreement provision that requires an employee to individually arbitrate whether he or she qualifies as an “aggrieved employee” under PAGA, and then (if successful) to litigate the remainder of the representative action in the courts. Citing *Iskanian*, the Court noted that every PAGA action is a representative action brought on behalf of the state, whether seeking penalties for Labor Code violations with respect to only one or a group of employees, and that the Supreme Court held that requiring an employee to bring a PAGA claim in his or her “individual” capacity, rather than in a “representative” capacity, would undermine the purposes of the statute. 59 Cal. 4th at 383–384, 387. Given these conclusions by the Supreme court, the Court of Appeal held that it did “not believe an employer may force an employee to split a PAGA claim into ‘individual’ and ‘representative’ components, with each being litigated in a different forum.” 3 Cal. App. 5th at 421.

- *Nguyen v. Applied Medical Resources Corporation*, 4 Cal. App. 5th 232 (4th Dist. Oct. 4, 2016) and *Tanguilig v. Bloomingdale's, Inc.*, 5 Cal. App. 5th 665 (1st Dist. Nov. 16, 2016) – Plaintiffs asserting both class and PAGA claims may be forced to make difficult decisions because, under *Tanguilig*, PAGA claims are not arbitrable and, under *Nguyen*, the dismissal of class claims is not immediately appealable as long as the PAGA claim remains.

These two cases should be read and discussed together because they show how the court of appeal may treat labor claims subject to arbitration where the plaintiff asserts both class and PAGA claims.

In *Nguyen*, a former employee brought a putative class action against his former employer, alleging individual, class and PAGA claims. Defendant moved to compel arbitration of the individual claims, strike the class allegations, and stay the PAGA cause of action. The trial court granted defendant's motion in all regards. Ordinarily, an order compelling arbitration is not an appealable, final judgment. Such orders may be appealed under the "death knell" doctrine only when the order also eliminates any non-arbitrable class action claims, leaving the plaintiff with a *de minimis* individual claim and ringing the proverbial death knell for the claims of the absent class members. In *Nguyen*, the trial court dismissed the class claims and referred the individual claims to arbitration, but retained jurisdiction over the plaintiff's PAGA claim. The Court of Appeal declined to disturb the trial court's order compelling arbitration of the non-PAGA wage and hour claims. Held that the remaining PAGA claim provided plaintiff with adequate incentive to continue pursuing the absent class members' claims, and prevented application of the death knell doctrine.

In *Tanguilig*, an employee at Bloomingdale's filed PAGA claims on behalf of herself and fellow employees, alleging several Labor Code violations by the company. Bloomingdale's filed a motion to compel arbitration of Tanguilig's individual PAGA claim and to stay or dismiss the remainder of the complaint. The trial court denied the motion and the Court of Appeal affirmed. The Court held that PAGA claims, whether or not cognizable as an action on behalf of an individual plaintiff, may not be ordered to arbitration without the consent of the state. Applying *Iskanian*, the Court held the pre-dispute waiver of the employee's right to bring a PAGA claim was unenforceable as a matter of state law. Citing the Ninth Circuit's decision in *Luxottica*, the Court held that

California's representative action nonwaivability rule is not preempted by the FAA.

Since under *Tanguilig*, PAGA claims are not arbitrable, and under *Nguyen*, the dismissal of class claims is not immediately appealable as long as a PAGA claim remains, plaintiffs asserting both class and PAGA claims may be forced to make the difficult decision of whether to await resolution of individual claims in arbitration to obtain review of the dismissal of class allegations or dismiss their PAGA claims in order to obtain immediate appellate review.

4. 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). 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. Warrior & Gulf Nav. Co.*, 363 U.S. 574, 582 (1960). Accordingly, as a preliminary matter, before parties are ordered to arbitration, a valid agreement to arbitrate must exist and the particular dispute must fall within the scope of the agreement. *Volt*, supra, 489 U.S. at 479; *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995); see also *Trippe Mfg Co. v. Niles Audio Corp.*, 401 F.3d 529, 532 (3d Cir. 2005).

In construing the parties' agreement to determine arbitrability, the law requires that questions of arbitrability “be addressed with a healthy regard for the federal policy favoring arbitration,” and that “any doubts concerning . . . scope . . . be resolved in favor of arbitration.” *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 631 (1985); *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1, 24–25 (1983); *Moses H. Cone*, supra, 460 U.S. at 24–25. 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*, ___ U.S. ___, 134 S.Ct. 1198 (2014). At least one court has held that the reference to the AAA Rules in the arbitration provision was sufficient to constitute clear and unmistakable evidence that the parties intended to delegate to the arbitrator the determination of arbitrability of the dispute. See *Brennan v. Opus Bank*, 796 F.3d 1125 (9th Cir. 2005).

(b) *Separability Doctrine*

Section 2 of the FAA specifically provides that arbitration provisions in written agreements “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract. 9 U.S.C. § 2. Because arbitration provisions are treated like other contracts, they can be invalidated and held to be unenforceable under “generally applicable contract defenses, such as fraud, duress, or unconscionability.” *Doctor’s Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996). In reliance on this exception, some parties have tried to avoid arbitration by attacking the existence or validity of the contract containing the arbitration clause. The reasoning behind these attacks is that because arbitration is purely a creature of contract, there can be no obligation to arbitrate if the contract containing the arbitration clause was induced by fraud, has been repudiated or is otherwise unenforceable. This line of attack is directly contrary to the separability doctrine established by the Supreme Court in *Prima Paint*.¹⁴

In *Prima Paint*, the Supreme Court 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

¹⁴ 388 U.S. 395 (1967). The doctrine of separability is different from the general rule of contracts that, if a court finds that a provision in a contract is unconscionable or illegal, the court may refuse to enforce the entire contract *or* it may sever the offending provision(s) and enforce the remainder of the contract. See, e.g., California Civil Code § 1670.5; *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal. 4th 83 (2000); *Marathon Entertainment, Inc. v. Blasi*, 42 Cal. 4th 974 (2008).

a federal or state court. The 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; *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440-445 (2006).

The Court later explained in *Buckeye Check Cashing*,

“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.”

Id. at 444.

(c) *2016 Cases*

- *Sandquist v. Lebo Automotive, Inc.*, 228 Cal. App. 4th 65 (2014), *affirmed* 1 Cal. 5th 233 (Jul. 28, 2016) – As a matter of state contract law, the question of whether class arbitration is available is for the arbitrator, not the court, to decide. The trial court’s error in deciding the issue was not reviewable for harmless error, but rather was reversible per se.

This case has quite a history with lots of judges weighing in with their thoughts and opinions on whether classwide arbitrability is a procedural or contract interpretation – meaning, whether the arbitrator or the court is to decide the issue.

This case involved a dispute between a plaintiff employee and his employer. Plaintiff sued asserting class and individual claims for racial discrimination. The trial court compelled arbitration based on the broad arbitration provisions contained in the documents plaintiff was required to sign as a condition of employment, which contained multiple arbitration agreements. The trial court also dismissed plaintiff's class claims on the grounds that the agreements did not permit class arbitration. Plaintiff took an appeal.

The Second District Court of Appeal reversed, finding that the trial court erred in deciding the arbitrability of the class action issue. The trial court was ordered to vacate its order dismissing the class claims and to enter a new order submitting to the arbitrator the issue of whether the parties had agreed to class arbitration. In making its decision, the appellate court looked at a number of recent lower court decisions that have decided the "who decides" question of class arbitrability and found that those courts "have reached conflicting conclusions," with most concluding that the question of class arbitration is for the arbitrator. The court was particularly impressed with the reasoning of two district court cases, one out of the Central District of California – *Lee v. JP Morgan Chase & Co.* (C.D.Cal. 2013) 982 F.Supp. 2d 1109 – and one out of the Eastern District of New York – *Guida v. Home Savings of America, Inc.*, (E.D.N.Y. 2011) 793 F.Supp. 2d 611. In the *Guida* case, the court stated that in light of the Supreme Court's decisions in *Stolt-Nielsen* and *Bazzele*, "the ability of a class to arbitrate a dispute where the parties contest whether the agreement to arbitrate is silent or ambiguous on the issue is a procedural question that is for the arbitrator to decide." The California Supreme Court granted review and, on July 28, 2016, a divided court affirmed the Court of Appeal's decision.

Justice Werdegar, writing for the majority, was joined by Chief Justice Cantil-Sakauye and Justices Liu and Cuellar. The Court first held that there is no hard and fast rule to determine whether the issue of class arbitrability is decided by the arbitrator or the court, but that the matter must be resolved under state law based on the language of the parties' arbitration agreement. Here, the arbitration agreement language was extremely broad, which the Court held suggested, but did not conclusively establish, that the arbitrability of class claims must be resolved by the arbitrator. Because the arbitration agreement at issue in this case applied to all claims related to employment, the Court held that its silence about who should decide the issue meant that the presumption in favor of arbitration meant that the arbitrator – not the court – should decide the issue. In reaching this holding, the Court examined two other principals of state contract

law: (1) where there is a close question of whether an arbitration agreement allocates a particular dispute to the arbitrator or the court, the doubt is resolved in favor of arbitration, and (2) where there is ambiguity in a contract, it is resolved against the drafter. Since the defendant employer was the drafter, both of these principles of state law weighed in favor of referring the permissibility of class arbitration to the arbitrator. Accordingly, the Court affirmed the Court of Appeal's order reversing the trial court's order dismissing the class action claims.

Justice Kruger dissented, reasoning that in recent years, the U.S. Supreme Court has disavowed any notion that the *Bazzle* decision had decided that the classwide arbitrability question was a procedural matter and, instead, given every indication short of an outright holding that classwide arbitrability is a gateway question rather than a subsidiary one, citing *Reed Elsevier, Inc. v. Crockett* (6th Cir. 2013) 734 F.3d 594, 598, cert. denied 134 S.Ct. 2991 (2014). Justice Kruger also noted that "every federal court of appeals to consider the issue on the merits has concluded – in contrast to the majority's holding today – that whether an arbitration agreement permits class arbitration is presumptively a question for the court, rather than the arbitrator."

- *Martin v. Yasuda*, 829 F.3d 1118 (9th Cir. Jul. 21, 2016)
 - Waiver by litigation conduct is a gateway issue for the court – not the arbitrator – to decide.

In October 2013, cosmetology school students sought to bring a collective action under the Fair Labor Standards Act (FLSA) against defendant school and its owner and president, alleging violation of overtime and minimum wage requirements. Between October 2013 and March 2014, over 70 individuals opted to join the action. The complaint was served on defendants in February 2014, and counsel for defendants filed a notice of appearance in March 2014. Thereafter, the parties stipulated that there should be discovery and an opportunity for the court to resolve the question whether the plaintiffs were employees of defendant under wage laws before any effort to certify the class because the lawsuit presented "unique legal claims." The court granted the parties' joint stipulation motion. Over the course of the next six months, plaintiffs amended their complaint twice, the parties filed a joint Rule 26(f) report and the district court conducted a scheduling conference. At the scheduling conference, the district court asked defendants' counsel whether defendants intended to file a motion to compel arbitration, and counsel responded that a decision had not yet been made. A scheduling order was issued

and the parties commenced discovery, including a protective order issued by the court per the parties' stipulation. It was not until 17 months after the start of the case that defendants moved to compel individual arbitration. Plaintiffs opposed the motion, arguing that the defendants had waived their right to compel through their litigation conduct. The district court denied defendants' motion, finding that (1) it was indisputable that the defendants had knowledge of their existing right to compel arbitration, (2) the defendants had engaged in conduct inconsistent with the right to compel arbitration by delaying their motion to compel and by actively participating in the litigation for 17 months, and (3) granting the motion to compel would result in prejudice to the plaintiffs.

Defendants appealed arguing that (1) an arbitrator, rather than the court, should decide whether the defendants had waived their right to arbitration through litigation conduct, and (2) even if the district court was correct to decide the issue, it had erred by finding waiver. The Ninth Circuit affirmed.

On the first issue, the Ninth Circuit held that it had previously made clear in *Cox v. Ocean View Hotel Corp.*, 533 F.3d 1114, 1120–1121 (9th Cir. 2008), that waiver by litigation conduct is a gateway issue for the court – not the arbitrator to decide. The Court noted that “[e]very circuit that has addressed this issue – whether a district court or an arbitrator should decide if a party waived its right to arbitrate through litigation conducted before the district court – has reached the same conclusion.” *Id.* at 1123, citing *Marie v. Allied Home Mortg. Corp.*, 402 F.3d 1, 14 (1st Cir. 2005); *Ehleiter v. Grapetree Shores, Inc.*, 482 F.3d 207, 217–218 (3^d Cir. 2007); *JPD, Inc. v. Chronimed Holdings, Inc.*, 539 F.3d 388, 394 (6th Cir. 2008); *Grigsby & Associates, Inc. v. M Sec Inv.*, 664 F.3d 1350, 1353 (11th Cir. 2011); see also *Hong et al v. CJ CGV Am. Holdings, Inc.*, 222 Cal. App. 4th 240, 256–258 (2013) (finding that the First, Third, Sixth and Eleventh Circuits, as well as the Supreme Courts of Colorado, Nebraska, Texas and Alabama allow courts to decide the waiver by litigation conduct issue).

On the second issue, the Ninth Circuit noted that because waiver of the right to arbitration is disfavored, the party arguing waiving bears a heavy burden of proof. *Id.* at 1124, citing *Belke v. Merrill Lynch, Pierce, Fenner & Smith*, 693 F.3d 1023, 125 (11th Cir. 1982). As such, the party seeking to provide waiver of a right to arbitration must demonstrate: (1) knowledge of an existing right to compel arbitration, (2) acts inconsistent with that existing right, and (3) prejudice to the party opposing arbitration resulting from such inconsistent acts. The Court found that all three requirements were satisfied. Defendants conceded that they had knowledge of the right to compel arbitration. The

records showed that defendants had spent 17 months litigating the case and, 14 months into the litigation, had told the district court that they were likely “better off” in federal court versus seeking to compel arbitration. With regard to prejudice, that element is established when a party has expended considerable time, effort and money on the federal court litigation, including conferring with opposing counsel regarding how to conduct the case on the merits, analyzing how to approach discovery and class certification, and contesting the defendant’s motion to dismiss on the merits.

- *Nguyen v. Applied Medical Resources Corporation*, 4 Cal. App. 5th 232 (4th Dist. Oct. 4, 2016) – Based on broadly worded arbitration provision, it is the arbitrator, not the court, who must decide whether class claims may be asserted in arbitration.

Former employee brought a putative class action against former employer, alleging causes of action under the Labor Code, the Unlawful Competition Law, and the Private Attorney General Act (PAGA). That action sought unpaid overtime, meal and rest period compensation, penalties, and other equitable relief. Defendant moved to compel arbitration of the individual claims, strike the class allegations, and stay the PAGA cause of action. The trial court granted defendant’s motion in all regards.

On appeal, the Court of Appeal vacated the portion of the trial court’s order dismissing the class claims to allow the arbitrator to decide whether the arbitration clause permits arbitration on a class-wide basis. The Court of Appeal applied the holding in *Sandquist v. Lebo Automotive, Inc.*, 1 Cal. 5th 233 (2016) (above), to a similarly broadly worded arbitration provision, which called for arbitration of “all disputes and claims arising out of or relating to the submission of [Plaintiff’s employment] application” and “all disputes which might arise out of or relate to [Plaintiff’s] employment with the [Defendant].” Like the Court in *Sandquist*, the Court of Appeal held that under this sort of broad language, the question of whether or not class claims may be arbitrated is, itself, a question for the arbitrator.

- *Mohamed v. Uber Technologies, Inc.*, ___ F.3d ___, 2016 WL 7470557 (9th Cir. Dec. 21, 2016) – The Ninth Circuit adds to the list of decisions severing PAGA claims from claims sent to arbitration.

The Ninth Circuit delivered a significant victory to Uber by reversing a district court’s denials of Uber’s motions to compel arbitration in companion class action lawsuits brought by former drivers in Massachusetts and California.

In one case, *Mohamed v. Uber Technologies, Inc.*, a Massachusetts driver sued Uber for violations of the Fair Credit Reporting Act and related state laws. He claimed that Uber’s involuntary termination of his business relationship with the company based on consumer credit background information it obtained about him, violated various federal and state laws.

In a related case, *Gillette v. Uber Technologies, Inc.*, other drivers made similar claims related to alleged improper background checks. In this case, the class action lawsuit also pursued PAGA claims, alleging that drivers were improperly classified as independent contractors rather than employees.

In both the Mohamed and Gillette cases, Uber moved to compel arbitration based upon a 2013 agreement signed by Gillette and a 2014 agreement signed by Mohamed. The 2013 and 2014 agreements were similar in that they both required arbitration of all claims and also both provided that all disputes as to arbitrability (i.e., whether the arbitration agreement was enforceable) were to be decided by the arbitrator and not the court. Both agreements also provided that the drivers waived their rights to bring any claim on a class or collective basis, meaning that they cases could only proceed on an individual basis in arbitration. Finally, both agreements included an opt-out provision. The 2013 agreement required drivers to opt-out in person at Uber’s San Francisco office or by overnight mail. The 2014 agreement added options for drivers to opt-out by email or regular mail. The district court denied Uber’s motion to compel based on a finding that the delegation clauses in both agreements were (1) ineffective because they were not clear and unmistakable, and (2) even if clear and unmistakable, were unenforceable because they were unconscionable. With regard to unconscionability, the district court ruled that the agreements were procedurally unconscionable because there was no meaningful opportunity for the driver to reject the 2013 agreement and because the 2014 agreement failed

to notify drivers that a drawback of the delegation clause was that drivers might be required to pay considerable forum fees to arbitrate arbitrability.

The Ninth Circuit rejected the district court's reasoning. The Court relied on *Nagrampa v. MailCoups, Inc.*, 469 F.3d 1257, 1281 (9th Cir. 2006) (en banc) for the proposition that the threshold inquiry in California unconscionability analysis is whether the agreement is adhesive." The Court ruled that both arbitration clauses include a "meaningful right to opt out" and the existence of the opt-out provisions "renders the arbitration clause ... procedurally conscionable as a matter of law." *6, citing *Circuit City Stores, Inc. v. Ahmed*, 283 F.3d 1198, 1199 (9th Cir. 2002); *Kilgore v. KeyBank, N.A.*, 718 F.3d 1052, 1059 (9th Cir. 2013) (en banc). Because the Court found that the agreements were not procedurally unconscionable, and because both procedural and substantive unconscionability must be present in order for an agreement to be unenforceable on unconscionability grounds under *Armendariz*, the Court held that it "need not reach the question whether the agreements here were substantively unconscionable," and that the district court should have ordered the parties to arbitrate their dispute over arbitrability and remanded with instructions for the district court to do so.

The Ninth Circuit also addressed the PAGA waivers contained in the two agreements. The 2013 agreement expressly required the court, not the arbitrator, to decide all challenges to the enforceability of the PAGA waiver. Relying on *Iskanian v. CLS Transportation L.A., Inc.*, 59 Cal. 4th 348 (2014), the Court ruled that the PAGA waiver was invalid but severable because the contract contained a severance provision. With respect to the 2014 agreement, the court relied on the broad scope of arbitration provision and left the determination of that issue to the arbitrator.

Finally, the Ninth Circuit addressed an issue that has been controversial in California courts recently: namely, the question of whether a co-defendant in the same lawsuit, who was not a party to the arbitration agreement at issue, can join in compelling arbitration. In this regard, the subsidiary company that performed the consumer credit background checks for Uber (Hirease LLC) argued that it should be covered by the arbitration agreement because (1) it was alleged to have an agency relationship with Uber, see, e.g., *Murphy v. DirecTV, Inc.*, 724 F.3d 1218 (9th Cir. 2013); (2) it shared an "identity of interest" with Uber, see, e.g., *Jones v. Jacobson*, 195 Cal. App. 4th 1 (2011); and (3) the cause of action alleged against it was "intimately founded in and intertwined with" the underlying contract obligations, see e.g., *Kramer v. Toyota Motor Corp.*, 705

F.3d 1122 (9th Cir. 2013). The Court rejected Hirease’s argument, but in doing so noted that Hirease was only sued on one of many causes of action and based on its own alleged failure to act. The Court distinguished this fact circumstance from other cases where plaintiffs who have signed arbitration agreements with one defendant but not others, bring cases against multiple defendants “that are based on the same facts and are inherently inseparable from the arbitral claims.”

5. Enforceability and Challenges to Enforcement

(a) *Background Statement*

While defenses directed to the underlying contract as a whole will not defeat arbitral jurisdiction, other “end-run strategies” are available to the party wishing to avoid arbitration.¹⁵ Because the right to compel arbitration is a matter of contract, arbitration agreements are subject to the same defenses to formation and enforcement as other contracts.

The most common end-run strategy is to attack the enforceability of the arbitration clause on the grounds that it is unconscionable. While parties are generally free to structure their contracts how they please and to practice the “art of advantage,” there is a limit as to how much advantage-taking will be tolerated when there is 1. significant disparity in the parties’ respective bargaining power or 2. the contract is one of adhesion (meaning non-negotiable), frequently seen in the consumer and employment context. For this attack to be successful, it must be demonstrated that the arbitration clause in question is both procedurally and substantively unconscionable.¹⁶ Under California law, the unconscionability defense has both a procedural and substantive element, the former focusing on oppression or surprise due to unequal bargaining power, the latter focusing on overly harsh, one-sided or unilateral results. *Sanchez v. Valencia Holding Co., LLC*, 61 Cal. 4th 899, 910–911 (2015); see also *Harper v. Ultimo*, 113 Cal. App. 4th 1402 (2003). Both procedural and substantive unconscionability must be present in order for an arbitration agreement to be deemed unconscionable and unenforceable, but they need not be present to the same degree. *Armendariz v. Found. Health Psychcare*

¹⁵ This is the phrase coined by Ben H. Sheppard, Jr., Distinguished Lecturer at University of Houston Law Center and retired partner from Vinson & Elkins LLP, in his work on Pre-Arbitration, set forth in Chapter 17 of the course materials for the 27th Advanced Annual Civil Trial Course presented by the State Bar of Texas in 2004.

¹⁶ Substantive unconscionability focuses on the one-sidedness or overly harsh effect of the contract term or clause. Procedural unconscionability focuses on the factors of surprise and oppression. See, e.g., *Harper v. Ultimo*, 113 Cal. App. 4th 1402 (2003).

Services, Inc., 24 Cal. 4th 83, 114 (2000). The central idea behind the unconscionability doctrine is that the terms of the agreement are “unreasonably favorable to the more powerful party.” *Sonic-Calabasas A. Inc., v. Moreno*, 57 Cal. 4th 1109, 1145 (2013).

Other defenses frequently raised are lack of assent, waiver by conduct, and preemption of certain types of statutory claims making them non-arbitrable. Another tactic to circumvent an arbitration agreement is to file suit on behalf of or against a non-signatory party that the other side will want or need to have included in the global resolution of the dispute. That circumstance might lead the party who would otherwise prefer to be in arbitration to forego that right so as to avoid piecemeal litigation and the expense of litigating in two forums, keeping in mind that only parties who have agreed to arbitrate can be ordered to arbitration.¹⁷

(b) *2016 Cases re Unconscionability Defense*

- *Baltazar v. Forever 21, Inc.*, 62 Cal. 4th 1237 (Mar. 28, 2016) – Mutual injunctive relief carve-out in an adhesion contract was not unfairly one-sided and thus did not amount to a substantively unconscionable term warranting denial of enforcement of the arbitration agreement.

In connection with her employment by Forever 21, plaintiff initially refused to sign an arbitration agreement. Defendant employer told her that she was required to sign the arbitration agreement or she would not get the job. Plaintiff signed. Later, plaintiff sued for wrongful termination and for discrimination based upon her race and gender. Defendant moved to compel arbitration, and the trial court denied the motion on the basis that the agreement was unconscionable and thus unenforceable. Defendant appealed. The Court of Appeal for the Second District reversed, and the California Supreme Court affirmed.

¹⁷ It is a cardinal principle that arbitration “is a matter of consent, not coercion.” *Volt Info. Sciences v. Leland Stanford Jr. University*, supra, 489 U.S. at 479. Thus, “a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.” *AT&T Technologies v. Communications Workers*, supra, 475 U.S. at 648; *Cromus Investments, Inc. v. Concierge Services*, 35 Cal. 4th 376, 384–385 (2005).

While the Supreme Court acknowledged that contracts of adhesion contain a degree of procedural unconscionability even without any notable surprises, and invite the possibility of oppression and overreaching, the prevailing view is that procedural and substantive unconscionability must *both* be present in order for a court to exercise its discretion to refuse to enforce a contract or clause under the doctrine of unconscionability. 62 Cal. 4th at 1243–1244, citing *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal. 4th 83, 114 (2000). The Court went on to note that “the unconscionability doctrine is concerned not with a ‘simple old-fashioned bad bargain’ ... but with terms that are ‘unreasonable favorable to the more powerful party’.” Id. at 1244, citing *Sonic-Calabasas A, Inc. v. Moreno*, 57 Cal. 4th 1109, 1145 (2013).

In affirming the Court of Appeal’s reversal of the trial court’s ruling denying arbitration, the Supreme Court rejected a panoply of arguments attacking the subject arbitration agreement, including findings that: (1) the failure to attach the arbitration provider’s rules to the agreement did not in and of itself create procedural unconscionability unless the employee was challenging some element of the rules themselves; (2) that carve-out allowing the parties to seek temporary restraining orders and injunctive relief in the courts was not substantively unconscionable because it applied mutually to both parties; (3) listing employee claims as examples of claims subject to the agreement did not make the agreement one-sided or unfair; and (4) including a provision providing for protection of the employer’s confidential information (but not the employee’s) was not unfairly one-sided because the employee did not dispute the legitimate commercial need for the agreement to address the employer’s valuable trade secrets and proprietary information.

- *Merkin v. Vonage America, Inc.*, 639 Fed. Appx. 481 (9th Cir. May 4, 2016) – Trial court reversed in denying motion to compel arbitration. While plaintiffs identified several provisions in the arbitration agreement as being substantively unconscionable in the district court proceedings, they only identified a single provision in the appeal, and that one provision was easily severable without affecting the remainder of the arbitration agreement.

The district court refused to compel arbitration by applying *Armendariz* to hold that the arbitration agreement was too one-sided because it excluded from arbitration those types of disputes more likely to be brought by the stronger

party. The Ninth Circuit reversed with directions to grant the motion. The Court rejected defendant's argument that the district court should have referred to the arbitrator the plaintiff's contention that the arbitration provision was unconscionable, reciting the general rule that when a challenge is made to the enforceability of a contract as a whole, the arbitrator decides the validity of the contract, but when a challenge is made to the enforceability of the arbitration agreement, that is a question for the courts to decide. *Id.* at *1, citing *Bridge Fund Capital Corp. v. Fastbucks Franchise Corp.* (9th Cir. 2010). In this case, the Court found that plaintiff's challenge was clearly directed at the arbitration provision. The Ninth Circuit agreed with the district court that the arbitration agreement was procedurally unconscionable because it was a contract of adhesion. *Id.* However, with regard to substantive unconscionability, the Court noted that while plaintiffs had identified several provisions in the arbitration agreement as being substantively unconscionable in the district court proceedings, they had only identified a single provision in the appeal. As to that one provision, the Court found that it could be easily severed without affecting the remainder of the arbitration agreement and held that that was the proper course in this case. *Id.*, citing *Dotson v. Amgen, Inc.* (2010) 181 Cal. App. 4th 975.

- *Rice v. Downs*, 247 Cal. App. 4th 1213 (2d Dist. Jun. 1, 2016) – “But for” test does not apply to determine whether or not a claim “arises out of” contract with narrow arbitration clause.

In this case, attorney Gary Downs formed a limited liability company with some of his clients. The clients sued Downs for breach of the LLC's operating agreement, and also asserted various tort claims based on the attorney's undisclosed and unwaived conflicts of interest in entering into business transactions with his clients. The trial court ordered the entire case to arbitration under the operating agreement's narrow arbitration clause, which applied to disputes “arising out of this Agreement.” After arbitration, both sides appealed, raising various contentions, including the defendant attorney's argument that the tort claims would not exist “but for” the existence of the operating agreement.

The Court of Appeal rejected defendant's “but for” test as an overly-simplistic, sweeping standard. While the parties consented to jurisdiction in the state and federal courts sitting in California “for any action on a claim arising out of, under or in connection with this Agreement or the transactions contemplated by this Agreement,” they agreed to arbitrate only “any controversy between the parties

arising out of this Agreement” – typically construed as a “narrow” clause. Viewing these adjacent provisions together, the Court of appeal ruled that the parties intended to arbitrate only a limited range of claims – i.e., those arising out of the agreement – but agreed to litigate a much broader range of claims – i.e., any claim arising out of, under, or in connection with the agreement or transactions contemplated by the agreement. The Court held that a narrow arbitration clause *could* encompass tort claims, if those claims have their “roots” in the relationship created by the contract, or if the dispute has its “origin or genesis in the contract.” However, the Court held that the three tort claims before it: (a) had their roots in the attorney–client relationship, which predated the operating agreement, and (b) were based on violations of duties independent of the operating agreement. Because the tort claims did not arise out of the operating agreement, the Court of Appeal reversed the trial court’s judgment confirming the arbitration award, finding that the trial court had erred by compelling arbitration of plaintiffs’ tort claims.

- *Magno v. The College Network, Inc.*, 1 Cal. App. 5th 277 (4th Dist. Jul. 8, 2016) – Indiana venue clause and one–sided arbitrator selection clause rendered arbitration agreement unconscionable and thus unenforceable.

Defendant The College Network, Inc. (TCN) is an Indiana–based company with customers nationwide. Plaintiffs were Licensed Vocational Nurses (LVNs) who were sold a program by TCN. The program allowed plaintiffs to take Registered Nurse classes online through Indiana State University (ISU) and clinical program through California State University (CSU). The contract plaintiffs were required to sign was a two–sided, preprinted purchase agreement that included an arbitration clause the required binding arbitration in Marion County, Indiana, before a neutral arbitrator selected by TCN.

After signing the purchase agreement and enrolling in the Registered Nurse B.S. program, plaintiffs discovered that ISU had suspended enrollment into its LVN to B.S. nursing program. Plaintiffs filed suit against TCN for fraud and breach of contract, alleging that TCN had wrongfully concealed this information and misrepresented that by enrolling in the program plaintiffs would qualify for entrance into ISU’s nursing degree program. TCN moved to compel arbitration. The trial court denied TCN’s motion, and the Court of Appeal affirmed, holding that there was procedural and substantive unconscionability that invalidated the arbitration clause. The Court of Appeal held that there was procedural unconscionability due to the rush nature of the negotiation, the unequal

bargaining power and the use of a pre-printed form contract drafted by TCN. The Court found that substantive unconscionability existed because arbitration in Indiana would not have been within the young, college-age students' reasonable expectations, and would put them at a disadvantage in any arbitration. Additionally, the agreement had unilateral provisions beneficial only to TCN, such as providing for TCN to select the neutral arbitrator and for a shortened statute of limitations period applicable only to plaintiffs' claims.

- *Penilla v. Westmont Corp.*, 3 Cal. App. 5th 205 (2d Dist. Sep. 9, 2016) – A mobile home park's arbitration provision was unconscionable and unenforceable because it was given to Spanish-speaking residents in an English-only adhesion contract and required residents to advance half of the cost of a three-person JAMS arbitration, restricted the remedies the arbitrators could award, and imposed a shortened one-year limitations period for asserting claims.

Westmont rents land to low-income mobile home owners. Forty-six mobile home owners who entered into rental agreements with Westmont sued the company on various contract, tort, and statutory claims. Westmont, citing the arbitration provision within its rental agreements, moved to compel arbitration. The mobile home owners opposed the motion, arguing that the arbitration provision was both procedurally and substantively unconscionable.

The mobile home owners said the arbitration provision was procedurally unconscionable because it (1) was a contract of adhesion, (2) was not provided or explained in Spanish for the one-third of the mobile home owners who spoke little English, and (3) was signed under severe economic pressure.

The mobile home owners said the arbitration agreement was also substantively unconscionable, because the agreement (1) required a three-arbitrator panel at JAMS, and required claimants to advance half of the costs associated with the arbitration (which could easily amount to more than the park residents could afford and even exceed the amount of the dispute), (2) contained a shortened on-year limitations period for asserting claims, and (3) limited the recovery of punitive damages.

Although the trial court found that a valid rental contract existed between Westmont and the mobile home owners, it did not compel arbitration, because the arbitration provision was both procedurally and substantively unconscionable. The trial court found that the mobile home owners were under economic pressure to enter the rental agreements since they already were paying for mobile homes and could not afford other housing, and were not informed that the expense of a JAMS arbitrator ranged from \$500 to \$800 per hour and \$5,000 to \$10,000 per day. Westmont appealed this ruling.

The Court of Appeal affirmed the trial court's ruling and reasons for denying the petition to compel arbitration. It also articulated additional grounds for finding the subject arbitration provision to be unconscionable and thus unenforceable. Although an arbitration agreement is not rendered unenforceable merely it is contained in a contract of adhesion, the Court of Appeal noted that the California Supreme Court has specifically opined that the "immobility of the mobile home, the investment of the mobile home owner, and restriction on mobile home spaces" heightens "an economic imbalance of power in favor of mobile home park owners." As applied to Westmont's arbitration provision, the Court of Appeal concluded that the evidence showed that the mobile home owner plaintiffs had no real practical choice but to agree to the rental agreements containing the arbitration provision.

The Court of Appeal also faulted Westmont's managers who explained in Spanish that the rental agreement was required, but did not explain the arbitration provision's terms to the one-third of mobile home owners who were not proficient in English. More importantly, the Court of Appeal explained that, even for the English-proficient mobile home owners, the arbitration provision was "confusing and sometimes contradictory," reflected a "tenuous grasp of grammar and syntax," and would be incomprehensible, deceptive, or surprising to a layperson—in English or Spanish.

The Court of Appeal then found that the failure to explain to mobile home owners that arbitration fees could be up to \$5,000 per day was significant. In addition to the deterrent effect noted by the trial court, the Court of Appeal emphasized the failure in light of the arbitration provision's imposition of a default judgment on parties who failed to advance their arbitration fees and the provision's failure to either limit the amount of arbitration fees, or provide any means of reducing fees (e.g., permitting claims in small claims court or consolidation of claims to permit splitting arbitration fees with others).

Finally, the Court of Appeal noted that the arbitration provision's shortened arbitral limitations period, and limitations on available remedies, also raised concerns of substantive unconscionability. Specifically, the rental agreement created a limitations period for claims of one year—although the claims asserted in the plaintiffs' lawsuit generally were subject to a limitations period of three or four years—and also limited awards of punitive damages to two percent of the owner's equity.

- *Tompkins v. 23andMe, Inc.*, 840 F.3d 1016 (9th Cir. Oct. 13, 2016) – Prevailing party clause, forum selection clause, and the exclusion of intellectual property disputes did not render the arbitration provision in an on-line consumer contract substantively unconscionable.

Plaintiffs were customers of personal genetics company 23andMe who purchased DNA test kits on-line. The company filed a motion to compel arbitration based upon the arbitration provisions contained in the terms of use posted on its website. Plaintiffs challenged the enforceability of the arbitration provisions on the grounds that it contained several substantively unconscionable terms. The district court concluded that although the arbitration provision was procedurally unconscionable, it was not substantively unconscionable and therefore was enforceable under California law. Plaintiffs appealed.

The Ninth Circuit affirmed the district court decision. The Court began its opinion by recognizing that Section 2 of the FAA “is a congressional declaration of a liberal federal policy favoring arbitration agreements.” Any doubts about the scope of arbitrable issues, including applicable contract defenses, are to be resolved in favor of arbitration. *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983). The Court noted that the “savings clause” of Section 2 authorizes a court to strike or limit an arbitration provision only in instances involving generally applicable contract defenses, such as fraud, duress, or unconscionability. It held that a federal court must look to relevant state law in deciding whether an arbitration provision is unconscionable. For this reason, the Ninth Circuit examined California authorities to decide whether provisions of the arbitration clause in the instant case were unconscionable.

The Ninth Circuit first examined the provision in the arbitration clause stating “arbitration costs and reasonable documented attorneys' costs of both parties will be borne by the party that ultimately loses.” Plaintiffs contended that if they

lost, the arbitrators' charge of \$1,500 per day and 23andMe's "top tier" lawyers' fees would be unreasonable, overly burdensome, and unfair. The Ninth Circuit panel reviewed relevant California authorities and found that a number of courts had enforced prevailing party clauses in the non-arbitration context. While several California appellate courts had held cost-shifting clauses to be unconscionable in the context of arbitration agreement, those cases all involved unilateral, rather than bilateral, fee-shifting provisions. where they were unilateral, and thus available to only one side. But plaintiffs were unable to produce any case where a bilateral clause awarding attorney fees and costs to the prevailing party was held to be unconscionable. Indeed, the Court noted that California Civil Code section 1717 appears to approve bilateral prevailing party clauses, since it requires courts to treat all unilateral prevailing party clauses as if they were bilateral clauses. The Court noted that in the present case, the prevailing party clause was expressly bilateral, providing that either party could request binding arbitration, and the arbitration costs and reasonable documented attorney fees of both parties were to be borne by the party that ultimately loses. Because the standard of unconscionability must be the same for arbitration and nonarbitration agreements, coupled with the general rule that parties may validly agree to a bilateral prevailing party clause, the Ninth Circuit concluded that the prevailing party clause at issue in this case was not unconscionable. 840 F.3d at 1026, citing *Sanchez v. Valencia Holding Co., LLC*, 61 Cal. 4th 899, 911 (2015); *Santisas v. Goodin*, 17 Cal. 4th 599, 608 (1998).

Next, the Ninth Circuit addressed plaintiffs' claim that the designation of San Francisco as the forum for arbitration was unconscionable as a matter of California law. The Ninth Court noted that in its 2015 decision in *Sanchez*, the California Supreme Court had indicated that its decision in *Valentino & Smith, Inc. v. Superior Court*, 17 Cal. 3d 491 (1976) (In Bank) exemplified California's unconscionability doctrine with respect to forum selection clauses; that the "modern trend" favors enforceability of forum selection clauses, and that forum selection clauses "are valid and may be given effect, in the court's discretion and in the absence of a showing that enforcement ... would be unreasonable." 17 Cal. 3d at 495-496. The Ninth Circuit looked at cases following *Smith*, *Valentino*, and found that California courts have generally expressed a policy approving forum selection clauses because they "play an important role in both national and international commerce ... and provide a degree of certainty both for businesses and their customers, that contractual disputes will be resolved in a particular forum." 840 F.3d at 1028, citing *Lu v. Dryclean-U.S.A. of California, Inc.*, 11 Cal. App. 4th 1490, 1493 (1992); *Net2Phone, Inc. v. Superior Court*, 109 Cal. App. 4th 583, 588 (2003). Ultimately, the Ninth Circuit concluded that the

designation of San Francisco as the choice of forum was not an unreasonable choice because San Francisco is 23andMe’s principal place of business and thus has sufficient nexus to the contracts in issue; there was adequate notice to consumers about the forum selection clause; seven of the plaintiffs reside in California; and six of the nine actions were filed in California. Additionally, plaintiffs failed to submit affidavits explaining why the expense of traveling to the San Francisco venue would be too burdensome.

The final arbitration clause provision discussed by the Ninth Circuit was the one excluding from mandatory arbitration “any disputes relating to intellectual property rights, obligations, or any infringement claims.” Plaintiffs argued that this clause was substantively unconscionable because 23andMe was more likely to bring intellectual property claims against its customers than vice versa, and therefore 23andMe had reserved for itself the advantages of a judicial forum, while forcing its customers to use an arbitral forum. The Ninth Circuit rejected plaintiffs’ argument, noting that under the terms of service, customers retained certain intellectual property rights including rights in user-generated content and genetic information. As such, customers would be able to bring these claims in court. Conversely, the Court found that plaintiffs had not identified any intellectual property rights claims that 23andMe might be likely to bring against its customers. The Court concluded that the intellectual property claims carve-out had more than a “modicum of bilaterality” and that plaintiffs therefore had not carried their burden of demonstrating that the clause was unconscionable. *Id.* at 1031.

- *Poublon v. C. H. Robinson*, ___ F.3d ___, 2017 WL 461099 (9th Cir. Feb. 3, 2017) – Despite the finding that two aspects of an arbitration clause were unconscionable / unenforceable, those provisions could be severed, allowing the rest of the arbitration clause to be enforced.

A former employee brought a putative class action against her former employer alleging that the employer had misclassified the class of employees as exempt from overtime pay and asserted a PAGA claim. While employed by C. H. Robinson, plaintiff signed an agreement titled “Incentive Bonus Agreement” in order to be eligible to receive a financial bonus. That agreement included an arbitration provision which provided that “neither You nor the Company may bring any Claim combined with or on behalf of any other person or entity, whether on a collective, representative, or class action basis.” It included a

severability clause, providing that if any part of the arbitration agreement was invalid, the rest of it would be enforced. The employer moved to compel arbitration and dismiss the class or representative claims. The district court found that the arbitration clause was procedurally and substantially unconscionable and denied the employer's motion.

The Ninth Circuit reversed, finding that only two aspects of the arbitration clause were unconscionable / unenforceable, and that those could be severed so that the rest of the arbitration agreement could be enforced. The two provisions the Ninth Circuit found were unconscionable were the PAGA waiver and a unilateral provision allowing only the employer to go to court for injunctive or equitable relief.

The Ninth Circuit reversed the district court's determination that a venue provision,¹⁸ a confidentiality provision, a sanctions provision, a unilateral modification provision, and a provision imposing limitations on discovery were substantively unconscionable.

The Court also reversed the district court's determination that the Incentive Bonus Agreement was procedurally unconscionable to a high degree, noting that the adhesive nature of a contract, without more, only gives rise to a low degree of procedural unconscionability and that there was no evidence of any other indications of oppression or surprise to support a conclusion that the degree of procedural unconscionability was high.

¹⁸ The venue provision provided for Hennepin County, Minnesota to be the place of the arbitration hear. Citing its recent decision in *Tompkins* (discussed above), the Ninth Circuit restated its position that courts must enforce a forum selection clause unless there is evidence that "the forum selected would be unavailable or unable to accomplish substantial justice;" that inconvenience and expense associated with the forum alone are not sufficient grounds to deny enforcement. Moreover, the Ninth Circuit noted that the venue provision allowed the parties to agree on a different venue, and allows the arbitrator to select a different venue for "good reason." The Court reasoned that an arbitrator would have good reason to change the venue if plaintiff could demonstrate that Minnesota would be "so gravely difficult and inconvenient" that she would be deprived of her day in court for all practical purposes.

(c) *2016 Cases re Waiver Defense*

- *Martin v. Yasuda*, 829 F.3d 1118 (9th Cir. Jul. 24, 2016)
 - Defendants engaged in acts inconsistent with the right to arbitrate by choosing to delay his right to compel arbitration by actively litigating the dispute and taking advantage of being in federal court.

This is an employment dispute in which cosmetology students, required to complete 1600 hours of technical instruction and practical training by performing services to the college's paying customers, sued the school for its failure to pay minimum hourly wages and overtime and to provide meal and rest breaks. Despite the fact that the Enrollment Agreement the students signed contained an arbitration clause, defendants delayed almost 17 months after the start of the case to move to compel arbitration. The district court denied defendants' motion to compel arbitration, and defendants appealed.

The Ninth Circuit affirmed, and started its analysis by noting that the right to arbitration, like other contractual rights, can be waived. 829 F.3d at 1124, citing *United States v. Park Place Assocs., Ltd.*, 563 F.3d 907, 921 (9th Cir. 2009). While the party arguing waiver bears a heavy burden of proof, where it is shown that a party has engaged in acts that are inconsistent with its right to arbitrate – including such things as actively litigating its case and taking advantage of procedures available in a court setting – that burden will be deemed satisfied. *Id.* at 1125, citing *Van Ness Townhouses v. Mar Indus. Corp.*, 862 F.2d 754, 759 (9th Cir. 1988) (finding waiver when party answered complaints, moved to dismiss the action, and did not claim a right to arbitrate in any of its pleadings); *Kelly v. Pub. Util. Dist., No. 2*, 552 Fed. Appx. 663, 664 (9th Cir. 2014) (finding this element satisfied when the parties conducted discovery and litigated motions, including a preliminary injunction and motion to dismiss); *Plows v. Rockwell Collins, Inc.*, 812 F.Supp. 2d 1063, 1067 (C.D.Cal. 2011) (finding this element satisfied when the defendant actively litigated the case by removing it to federal court, seeking a venue transfer, participating in meetings and scheduling conferences, negotiating and entering into a protective order, and participating in discovery that would not have been available under the arbitration agreement).

In this case, the Ninth Circuit found that the defendants had participated in the preparation of a joint stipulation that dealt with the most resourceful and efficient manner in which to approach discovery and class certification motions,

had filed a motion to dismiss on key merits issues, had entered into a protective order, and answered discovery, and had participated in depositions. While the defendants raised the issue of their right to arbitration at a scheduling conference, they did not do so until a year into the litigation, and then waited another year before filing their motion to compel arbitration.

Another factor motivating the Court's decision was the fact that defendants had raised issues going to the merits of the case in a motion to dismiss, which they had lost. The Court found that plaintiffs would be prejudiced if the case were ordered to arbitration because they would be forced to relitigate a key legal issue on which the district court had ruled in their favor, essentially giving the defendants "a mulligan on a legal issue it chose to litigate in court and lost." *Id.* at 1128., citing

- *Freeney v. Bank of America*, 2:15-cv-2376 (C.D.Cal. Aug. 8, 2016) – Despite the fact that defendant stated in its multiple motions to dismiss that it intended to move to compel arbitration, when it finally made such a motion, the court concluded – following *Yasuda* – that defendant's repeated attacks on the merits of plaintiff's claim were acts inconsistent with the right to compel arbitration. Motion to compel arbitration denied.

This dispute involves Colts and Chargers defensive end and seven-time Pro Bowler Dwight Freeney and Bank of America. In a highly publicized lawsuit, Freeney sued Bank of America Corporation (BAC), Bank of America, N.A. (BANA), Merrill Lynch Pierce Fenner & Smith, Inc. (MLPFS), and Michael Bock, a former employee and financial advisor at MLPFS who handled Freeney's account, Freeney's claim is that he was the victim of an elaborate fraud scheme after entrusting the bank's wealth management division with his assets and seeks to recover over \$20 million in alleged damages. While there is no disputing the fact that Freeney was defrauded – the two primary culprits (Eva Weinberg and Michael Stern) having been criminally indicted¹⁹ – this action raises the question of who should be held legally accountable to Freeney for the damages caused by the fraud.

¹⁹ Stern and Weinberg were charged in 2012 by federal prosecutors in Los Angeles with fraud and other offenses. After reaching plea agreements, Stern was sentenced to five years in prison, while Weinberg got six months.

As originally filed, Freeney alleged that Bank of America “participated in and aided and abetted” in an elaborate, malicious scheme and that truthful disclosure would have dissuaded him from agreeing to become a “BofA client or to entrust the management of his assets, investments and income to BofA.” Bank of America, on the other hand, said that Stern, the primary wrongdoer, never worked for the bank or any of its affiliates, and that Weinberg committed her criminal conduct after leaving Merrill Lynch (a subsidiary of BofA). In July and November 2015, U.S. District Judge Margaret Morrow granted defendants’ motions to dismiss the racketeering and aiding and abetting claims, but allowed Freeney leave to amend. Defendants then filed a motion to compel arbitration and, after Freeney filed his third amended complaint, they then filed a further motion to dismiss. On August 4, 2016, U.S. District Judge Jesus Bernal granted dismissal with prejudice of the racketeering and aiding and abetting charges with prejudice, but denied arbitration finding that through its aggressive litigation in the federal court case, defendants had acted inconsistently with asserting their right to compel arbitration and had thus waived that right.

With regard to the prejudice visited upon plaintiff as a result of defendants’ delay in filing their motion to compel arbitration, the Court took issue with defendants’ filing “two voluminous rounds of motions to dismiss, and a motion to relitigate one of the motions to dismiss, forcing Plaintiff to incur significant legal expenses that would be wasted if this case were now sent to arbitration.” Citing, *Kelly v. Pub. Util. Dist. No. 2, Etc.*, 552 Fed. Appx. 663, 664 (9th Cir. 2014); *Hoffman Const. Co. of Oregon v. Active Erectors & Installers, Inc.*, 969 F.2d 796, 799 (9th Cir. 1992); *Morgan Stanley & Co., LLC v. Couch*, 134 F.Supp. 3d 1215, 1231–1232 (E.D. Cal. 2015); *Plows v. Rockwell Collins, Inc.*, 812 F.Supp. 2d 1063, 1068 (C.D.Cal. 2011); *Steiner v. Horizon Moving Sys., Inc.*, No. EDCV 08–682–VAP (CTx), 2008 WL 4822774 (C.D.Cal. Oct. 30, 2008); *In re Toyota Motor Corp. Hybrid Brake Mktg., Sales, Practices & Products Liab. Litig.*, 828 F.Supp. 2d 1150, 1165 (C.D.Cal. 2011), *aff’d sub nom. Kramer v. Toyota Motor Corp.*, 705 F.3d 1122 (9th Cir. 2013).

(d) 2016 Cases re No Consent to Arbitration Defense

- *Monschke v. Timber Ridge Assisted Living, LLC*, 244 Cal. App. 4th 583 (1st Dist. Jan. 29, 2016) – Motion to compel arbitration denied because plaintiff’s wrongful death claim against nursing home belonged to her – not her mother or her estate – and was thus not subject to the arbitration clause contained in the nursing home contract that plaintiff signed as her mother’s agent under a power of attorney.

Decedent had three daughters, one of whom is the plaintiff. When decedent began suffering from dementia, plaintiff enrolled decedent in one of defendant’s assisted living facilities because it had a memory care unit. Acting as power of attorney for decedent, plaintiff executed a residency agreement allowing defendant to provide core living services for decedent. The residency agreement contained an arbitration clause providing for “any and all claims and disputes arising from or related to this Agreement or to your residency, care or services” to be resolved by binding arbitration and stated that it was binding on all parties to the agreement and their “heirs, representatives, executors, administrators, successor, and assigns.”

While in defendant’s care, decedent suffered a fall while left unattended and eventually dies of her injuries. Plaintiff brought an action against the operator of the assisted living facility for wrongful death and elder abuse. Defendant petitioned the court to compel binding arbitration as to all of plaintiff’s claims. The court denied the petition, and defendant appealed. The Court of Appeal affirmed. As personal representative, plaintiff sued on behalf of decedent’s heirs – not the decedent. Although the arbitration clause in the agreement purported to bind “all parties” and “heirs, representatives, administrators, successors and assigns,” only a party to an arbitration agreement may be bound by it. Since plaintiff signed the residency agreement in her capacity as decedent’s attorney in fact, under a general power of attorney, and not in her personal capacity, the only parties to the residency agreement were the decedent and the defendant. The successors and assigns clause did not bind plaintiff or decedent’s heirs with respect to their personal claims.

- *Casa del Caffè Vergnano S.P.A. v. Italflavors, LLC*, 816 F.3d 1208 (9th Cir. Mar. 15, 2016) – Arbitration denied where parties concurrently executed two agreements, a “Commercial Contract” with an arbitration clause and a “Hold Harmless Agreement” with a provision stating that the Commercial Contract was not legally binding or effective.

If two companies sign a document purporting to be a contract, and later during the very same day sign a separate contract that recites that the previously executed document “does not have any validity or effectiveness between the parties,” then is the first document a “contract” at all? Did the first document ever constitute an enforceable contract? To put it differently, could one of the parties enforce any of the provisions of the first document against its counterparty? These were the questions presented to the Ninth Circuit in this case.

This case involved two documents related to an alleged franchise for an Italian-style coffee shop located in San Diego, executed by the purported franchisor (Caffè Vergnano) and the purported franchisee (ItalFlavors). Both documents were signed in Italy on the same day. The first document signed (referred to in the opinion as the “Commercial Contract”) set forth the commercial terms surrounding the franchise relationship. The second document signed (referred to as the “Hold Harmless Agreement”) recited that the Commercial Contract was entered into for the purpose of allowing one of the principals of ItalFlavors to submit a copy of it to the relevant authorities in order for him to gain an entry visa to work in the United States. The Hold Harmless Agreement stated that the Commercial Contract did “not produce any effect between the parties, who as agreed will sign a future contract which will regulate their commercial relationship as soon as it is prepared in accordance with the federal and national laws of the United States of America.”

The parties offered varying explanations to the Court for the rationale behind the Hold Harmless Agreement. Caffè Vergnano took the view that the Hold Harmless Agreement was not meant to render the Commercial Contract void, but instead was meant to protect Caffè Vergnano in the event of any liability arising from ItalFlavors’ use of the Commercial Contract in connection with U.S. immigration laws. Thus, Caffè Vergnano argued that an arbitration provision in the Commercial Contract should be enforced. ItalFlavors, on the other hand, submitted that the Hold Harmless Agreement was executed because Caffè

Vergnano had concerns over whether the Commercial Contract conformed with U.S. franchise laws.

ItalFlavors subsequently went ahead and established the franchise location in San Diego, but the coffee shop closed within a year. The “future contract” governing the commercial relationship of the parties contemplated by the Hold Harmless Agreement apparently was never executed. ItalFlavors then brought a lawsuit against Caffè Vergnano alleging violations of California’s Franchise Investment Law and Business and Professions Code blaming the failure of the venture on Caffè Vergnano’s alleged failure to provide promised support. Caffè Vergnano sought to enforce the clause in the Commercial Contract which provided for arbitration of disputes. The district court granted Caffè Vergnano’s petition and ordered the matter to arbitration. ItalFlavors appealed.

Applying general principles of federal common law, the Ninth Circuit noted that “the formation of a contract requires a bargain in which there is a manifestation of mutual assent…” and that “where all the parties to what would otherwise be a bargain manifest an intention that the transaction is not to be taken seriously, there is no such manifestation of assent…” (quoting the Restatement (Second) of Contracts). The Court then looked to the “external expressions of intent” of the parties, most notably the statements in the Hold Harmless Agreement that the Commercial Contract did not have any “effectiveness” and that the parties expressly contemplated executing a future contract governing their commercial relationship. Relying on those statements, the Court concluded that the Commercial Contract was nothing more than a “sham” designed as a ploy to aid with the visa application, and thus the Commercial Contract, including the arbitration provision contained therein, was not enforceable.

As shown by this case, mutual intention to be bound by an agreement is a *sine qua non* of a legally enforceable contract, and a court may look to external expressions of intent, such as other contemporaneous agreements entered into by the parties, when determining whether a binding and enforceable contract has been created.

- *Long v. Provide Commerce, Inc.*, 245 Cal. App. 4th 855 (2d Dist. Mar. 17, 2016) – Inconspicuous link to “terms of use” does not create a binding agreement to arbitrate.

A consumer brought a class action against an internet flower retailer, claiming violations of the California Consumer Legal Remedies Act and Unfair Competition Law. Defendant moved to compel arbitration based on a provision contained in the company’s “Terms of Use,” which were viewable via a hyperlink displayed at the bottom of each page on the ProFlowers.com website – commonly referred to as a “browsewrap” agreement. Unlike the other common form of Internet contract – known as a “clickwrap” agreement – browsewrap agreements do not require users to affirmatively click a button to confirm their assent to the agreement’s terms. Instead, a user’s assent is inferred from his or her use of the website. Because assent must be inferred, the determination of whether a binding agreement has been formed depends on whether the user had actual or constructive knowledge of the website’s terms and conditions. Plaintiff opposed the motion to compel arbitration on the ground that he was never prompted to assent to the “Terms of Use,” nor did he actually read them prior to placing his order using the ProFlowers.com website. The trial court denied defendant’s motion, concluding that the “Terms of Use” hyperlinks were too inconspicuous to impose constructive knowledge on plaintiff. Defendant appealed.

On appeal, the Court of Appeal examined the “placement, color, size and other qualities” of the “Terms of Use” hyperlink, and decided that the overall design of the ProFlowers.com website would not have put a reasonably prudent Internet user on notice of defendant’s “Terms of Use.” Therefore, plaintiff could not be deemed to have unambiguously assented to the subject arbitration provision simply by placing an order using the ProFlowers.com website. In reaching this conclusion, the Court noted that under both federal and state law, the threshold question by a petition to compel arbitration is whether there is an agreement to arbitrate; that this threshold inquiry stems from the basic premise that arbitration is consensual in nature and may be invoked as an alternative to the judicial process – “solely by reason of an exercise of choice by [all] parties.” 245 Cal. App. 4th at 861, citing *Wheeler v. St. Joseph Hospital*, 63 Cal. App. 3d 345, 355 (1976). The Court of Appeal went on to note that while Internet commerce has exposed courts to many new situations, it has not fundamentally changed the requirement that “[m]utual manifestation of assent, whether by written or spoken word or by conduct, is the touchstone of contract.” *Id.* at 862,

While Court of Appeal held that the inconspicuous placement of the “Terms of Use” on the website was sufficient alone to negate the enforceability of the arbitration provisions contained therein based on general contract principles, it stated that its analysis was largely guided by two federal cases from the Second and Ninth Circuits, each of which considered the enforceability of a browsewrap agreement applying the objective manifestation of assent analysis dictated by California law, and declined enforcement. *Id.* at 863–864, citing *Nguyen*, *supra*, and *Specht v. Netscape Communs. Corp.*, 306 F.3d 17 (2d Cir. 2002).

- *Espejo v. Southern California Permanente Medical Group*, 246 Cal. App. 4th 1047 (2d Dist. Apr. 22, 2016) – Party seeking to compel arbitration need not submit evidence with its moving papers with respect to authentication of the other party’s signature unless or until challenged.

This case is a follow-on to a 2014 case we looked at as part of the 2015 recent developments program – *Ruiz v. Moss Bros. Auto Group, Inc.*, 232 Cal. App. 4th 836 (2014) – in which an employee successfully challenged the enforceability of an arbitration agreement contained in his employment agreement due to insufficient evidence (a conclusory declaration regarding an electronic signature). After the *Ruiz* decision was reported, the defendant employer submitted a supplemental declaration containing more detailed facts about the electronic intake process used bring a new doctor on board. The trial court found that the supplemental declaration was untimely and denied the motion to compel arbitration based on the lack of proof that both parties had consent to arbitrate their disputes. On appeal, the Court of Appeal reverse, holding that in the unique context of a petition to compel arbitration, the authentication was not required to be submitted with the moving papers; that the party seeking to compel arbitration need only submit authentication evidence if the party opposing arbitration challenges the alleged agreement’s authenticity.

- *Harris v. Tap Worldwide, LLC*, 248 Cal. App. 4th 373 (2d Dist. Jun. 22, 2016) – Arbitration agreement attached to employee handbook is impliedly consented to by the employee’s continuing employment.

The plaintiff employee sued his former employer, alleging wrongful termination and other causes of action. The defendant employer moved to compel arbitration on the basis that the plaintiff had agreed to the arbitration agreement that was attached as Appendix A to the Employee Handbook. The plaintiff argued that the arbitration was unenforceable because he did not read or sign the agreement, but merely acknowledged having received it. The trial court denied defendant employer’s motion.

On appeal, the Court of Appeal reversed the trial court. While plaintiff never signed the arbitration agreement, he did acknowledge in a signed writing before he started working that he had received both the Employee Handbook and the attached arbitration agreement. The arbitration agreement stated in paragraph 10, “If Employee voluntarily continues his / her employment … after the effective date of this Policy, Employee will be deemed to have knowingly and voluntarily consented to and accepted all of the terms and conditions set forth herein without exception.” The Employee Handbook provided, “If for any reason, an applicant fails to execute the Agreement to Arbitrate yet begins employment, that employee will be deemed to have consented to the Agreement to Arbitrate by virtue of receipt of this Handbook.” Based on the uncontroverted language in the Employee Handbook and the arbitration agreement, and plaintiff’s admitted receipt of both, plaintiff employee was held to have consented to arbitration by commencing employment. The Court of Appeal further held that it was legally irrelevant whether or not he chose to actually read the handbook and arbitration agreement.

- *Esparza v. Sand & Sea, Inc.*, 2 Cal. App. 5th 781 (2d Dist. Aug. 22, 2016) – Arbitration provision in employee handbook is *not* enforceable, despite signed acknowledgment of receipt.

The Court of Appeal for the Second District was faced with a situation similar to that presented in *Harris v. TAP Worldwide, LLC* (above), but reached the opposite conclusion – thus illustrating the fact-intensive nature of the cases decided in this area. *Note: Harris* was decided by Division 5 of the Second District. *Esparza* was decided by Division 4 of the Second District. In *Esparza*, the trial court’s denial of the employer’s motion to compel arbitration was denied for lack of a mutual agreement to arbitration. That decision was affirmed on appeal.

There were several key factual differences between the cases. First, unlike the arbitration agreement in *Harris*, neither the employee handbook nor the arbitration agreement in *Esparza* expressly stated that the employee would be deemed to agree to arbitration by voluntarily continuing her employment after the acknowledged receipt. Second, in *Esparza*, the introduction to the employee handbook expressly stated that the handbook was not intended to create any legally enforceable obligations between the company and any employee. Third, while the plaintiff in *Esparza* signed a statement acknowledging that she had received a copy of the handbook, that acknowledgment contained no statement indicating that she agreed to be bound by its terms. Under these facts and circumstances, the Court of Appeal refused to create a binding legal agreement where the parties had not, and affirmed the trial court’s decision to not compel arbitration.

(e) 2016 Cases re Statutory Claims Not Being Subject to Binding Arbitration

- *EPD Investment Co. v. Rund (In re EPD Investment Co.)*, 821 F.3d 1146 (9th Cir. May 9, 2016) – With regard to core bankruptcy claims, the bankruptcy court has discretion to decline to enforce an otherwise applicable arbitration provision if the arbitration would conflict with the underlying purposes of the Bankruptcy Code.

In our inaugural recent updates program in 2013, we looked at two cases decided by the Ninth Circuit involving the intersection of the Bankruptcy Code with the FAA: *Continental Ins. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.)*, 671 F.3d 1011 (9th Cir. 2012) and *Ackerman v. Eber (In re Eber)*, 687 F.3d 1123 (9th Cir. 2012). Before looking at the *EPD Investment* case, let's first review *Thorpe* and *Eber*.

The Thorpe Decision. This case involved an issue of *first impression* in the Ninth Circuit concerning the enforceability of an arbitration agreement when the claims to be arbitrated arise under the Bankruptcy Code or otherwise involve or affect the administration of a bankruptcy case pursuant to the Bankruptcy Code. To understand the Ninth Circuit's holding, it is necessary to first review the background facts of the dispute that were presented to the bankruptcy court in the proceedings below.

Thorpe distributed and installed asbestos-containing products from 1948 to 1972. About 12,000 claims for asbestos-related injuries or deaths have been brought against Thorpe. Thorpe's insurers, including Continental, have paid more than \$180 million defending and indemnifying Thorpe with respect to these claims. In 1985, Thorpe and its insurers entered into an omnibus insurance coverage and claims handling agreement. That agreement included an arbitration agreement for any coverage disputes. In 1998, Continental told Thorpe that it had exhausted its coverage under the Continental policies and ceased indemnifying Thorpe. Thorpe asserted a claim for "non-products" coverage, which Continental disputed and initiated arbitration under the omnibus agreement. The arbitrator rejected Thorpe's claim and found that Thorpe had no remaining coverage rights under the Continental policies. Thorpe appealed and in 2003, the parties entered in a settlement agreement. The settlement agreement released only Thorpe's claims against Continental. It did not refer to the direct action rights of individual asbestos claimants or to the contribution,

indemnity or subrogation rights of other insurers. Those claims were not released. The settlement agreement included an arbitration agreement for any disputes regarding the settlement agreement and its terms.

In 2007, Thorpe filed a voluntary petition under Chapter 11 of the Bankruptcy Code. The primary purpose for the bankruptcy filing was to propose and confirm a plan of reorganization pursuant to Section 524(g) of the Bankruptcy Code, a unique provision in the Bankruptcy Code that provides a mechanism by which the asbestos-related assets and liabilities of a debtor are consolidated into a single trust for the benefit of present and future asbestos claimants. In this regard, Section 524(g) authorizes the bankruptcy court to enter a “channeling injunction” that channels all asbestos claims to a trust for administration and handling, and allows the debtor to continue operating without the continued disruption, expense and exposure of asbestos-claim litigation because, under the terms of such plans, asbestos claimants are enjoined from suing the debtor. The injunction may also be extended to bar actions against third parties, such as the debtor’s insurers, if those third parties contribute to the trust in amounts that are commensurate with their likely liability. In any event, in preparation for its bankruptcy, Thorpe negotiated with insurers other than Continental who agreed to fund the trust in consideration of Thorpe’s filing for bankruptcy and seeking to confirm a “524 plan” that would result in a 524(g) injunction that would protect the insurers against asbestos-related claims arising out of policies issued to Thorpe. Additionally, these participating insurers agreed to assign their contribution, indemnification and subrogation rights against Thorpe’s other insurers, including Continental, to the trust. As is not uncommon in a restructuring bankruptcy, before filing for bankruptcy, Thorpe collaborated with asbestos claimants to begin structuring a 524 plan. When Continental learned of Thorpe’s pre-filing efforts to negotiate a 524 plan and prepare for bankruptcy, it claimed that such actions violated the 2003 settlement agreement. Continental also claimed that Thorpe had encouraged asbestos claimants to file direct actions against it and that that was also a violation of the 2003 settlement agreement. Pursuant to the arbitration clause contained in the 2003 settlement agreement, Continental made a demand for arbitration of this dispute. That arbitration was stayed when Thorpe filed bankruptcy in October 2007.

In the Thorpe bankruptcy case, Continental filed a claim for damages resulting from Thorpe’s alleged violation of the 2003 settlement agreement (as discussed above). Thorpe objected to the claim, thereby commencing a “contested matter” proceeding in the bankruptcy court. Continental filed a motion in the bankruptcy court asking it to compel arbitration of the dispute. The bankruptcy court denied

Continental's motion, and essential held that the claims were not arbitral because (a) the resolution of Continental's claim had to be coordinated with the plan confirmation process because Continental's claim and its objection to plan confirmation overlapped factually, and (b) the remaining claims concerning Thorpe's alleged encouragement of direct actions against Continental involved Thorpe's exercise of its rights in bankruptcy and thus were within the "core" jurisdiction of the bankruptcy court and represented matters that should be decided only by a bankruptcy judge and not in a nonbankruptcy forum that might "end up adjudicating things that [it] has no business adjudicating" and result in violations of bankruptcy law and policy. 671 F.3d at 1019. Continental appealed to the district court, which affirmed, noting that Continental's claim regarding Thorpe's alleged encouragement of direct actions could have been separated out as a standalone claim for purposes of determining arbitrability, but Continental refused to separate that claim from the claims directed at Thorpe with respect to its invocation of its rights under the Bankruptcy Code to file and prepare for filing of a 524 plan. Continental appealed to the Ninth Circuit, which likewise affirmed.

In deciding the issue of whether the bankruptcy court erred in denying the motion to compel arbitration, the Ninth Circuit held that the threshold issue to determining arbitrability in the bankruptcy context is whether the dispute is a "core" or "non-core" proceeding.²⁰ *Id.* at 2010. In non-core proceedings, "the bankruptcy court generally does not have discretion to deny enforcement of a valid prepetition arbitration agreement,"²¹ meaning that such claims are arbitral. *Id.* at 1021. However, in core proceedings, the Ninth Circuit held that the bankruptcy court "has discretion to deny enforcement of an arbitration agreement" if such enforcement would conflict with bankruptcy law.²² The court explained that "[t]he rationale for the core/non-core distinction, . . . is that non-core proceedings 'are unlikely to present a conflict sufficient to override by implication the presumption in favor of arbitration,' whereas core proceedings

²⁰ In so ruling, the Ninth Circuit referred to the earlier decisions on this issue made by several other circuits. See, *Whiting-Turner Contracting Co. v. Elec. Mach. Enters., Inc. (In re Elec. Mach. Enters., Inc.)*, 479 F.3d 791, 796 (11th Cir. 2007); *U.S. Lines, Inc. v. Am. S.S. Owners Mut. Prot. & Indem. Ass'n (In re U.S. Lines)*, 197 F.3d 631, 640 (2d Cir. 1999); *Ins. Co. v. N. Am. V. NGC Settlement Trust & Asbestos Claims Mgmt. Corp. (In re Nat'l Gypsum Co.)*, 118 F.3d 1056, 1066-69 (5th Cir. 1997).

²¹ Again, in so ruling, the Ninth Circuit referred to the earlier decisions on this issue made by several other circuits. See, *In re Elec. Mach. Enters., Inc.*, *supra*, 479 F.3d at 796; *Cyrsen/Montenay Energy Co. v. Shell Oil Co. (In re Crysen/Montenay Energy Co.)*, 226 F.3d 160, 166 (2d Cir. 2000).

²² See, *Phillips v. Congelton, LLC (In re White Mountain Mining Co.)*, 403 F.3d 164, 169 (4th Cir. 2005); *In re U.S. Lines*, *supra*, 197 F.3d at 640; *In re Nat'l Gypsum*, *supra*, 118 F.3d at 1067-68.

‘implicate more pressing bankruptcy concerns.’” Id. Importantly, in terms of leaving the door open for arbitration of “core” bankruptcy disputes, the Ninth Circuit held that “not all core bankruptcy proceedings are premised on provisions of the Code that inherently conflict with the Federal Arbitration Act; nor would arbitration of such proceedings necessarily jeopardize the objectives of the Bankruptcy Act.” Id.

In affirming the bankruptcy court’s decision to deny Continental’s motion to compel arbitration of the claim objection dispute, the Ninth Circuit held that Continental’s claim was a “core” matter in bankruptcy and that the bankruptcy court had discretion to deny Continental’s motion to compel arbitration if it found that arbitration of the claim would conflict with the purposes and policies of the Bankruptcy Code. Because Continental’s claim included a challenge to Thorpe’s right to seek relief under Section 524(g) of the Bankruptcy Code by taking issue with Thorpe’s activities in negotiating, proposing and confirming a plan under that section, the Ninth Circuit held that “[t]here was no error in the bankruptcy court concluding that such a claim must be resolved by a bankruptcy court and not an arbitrator.” Id. at 1023. In so ruling, the Ninth Circuit noted that Continental’s dispute in the case had heightened importance because the Continental’s claim would need to be determined before payments could flow to Thorpe’s creditors under the plan and as part of the plan confirmation process. Id. at 1023–24.

The Eber Decision. This case also concerns the arbitrability of bankruptcy claims and was decided six months after the decision in *Thorpe* (discussed above). To appreciate the Ninth Circuit’s holding, it is necessary to first review the background facts of the dispute that was presented to the bankruptcy court in the proceedings below.

Creditors commenced an arbitration proceeding against contract debtor seeking \$3.3 million in damages for breach of contract related to the construction and operation of a hair salon in Las Vegas. Later, the contract debtor filed a voluntary bankruptcy petition under Chapter 7 of the Bankruptcy Code, which resulted in the automatic stay of the arbitration proceeding. In the bankruptcy case, creditors filed a complaint under Section 523 of the Bankruptcy Code seeking a determination that the debtor’s liability to them was nondischargeable. Creditors filed a motion for relief from the automatic stay to allow them to proceed to determine the debtor’s liability and to liquidate the amount of their claim in the pre-petition arbitration proceeding. That motion was denied. Creditors then filed a motion to vacate the bankruptcy court’s decision denying

relief from stay and, concurrently, filed a motion to seeking to compel arbitration of the statutory claims they had asserted under Section 523 of the Bankruptcy Code. Both motions were denied and creditors appealed. The first level of appeal was to the district court, which affirmed the bankruptcy court. The district court agreed with the bankruptcy court that because creditors' claims "go to the issue of dischargeability," arbitration of such claims "inherently conflicts with the goals of centralized resolution of bankruptcy issues . . . and the power of the bankruptcy court to enforce its own orders." Creditors then appealed to the Ninth Circuit, where the bankruptcy court's decision was affirmed.

The Ninth Circuit recognized that the claims the creditors proposed be submitted to arbitration were claims that arose under the Bankruptcy Code – specifically, Section 523(a)(2) (the fraud exception), (a)(4) (the breach of fiduciary duty exception) and (a)(6) (the intentional tort exception) – and were thus "core matter[s] which bankruptcy courts have special expertise to decide." The Ninth Circuit viewed the issue on appeal as one of reconciling the Federal Arbitration Act with the Bankruptcy Code, "and, more specifically, the bankruptcy court's jurisdiction to determine dischargeability." *Id.* at 1128. In this decision, the Ninth Circuit looked to the Supreme Court's 1987 decision in *Shearson/Am. Express, Inc. v. McMahan*, *supra*, 482 U.S. 220 for guidance. "While the FAA establishes a federal policy of favoring arbitration,'[l]ike any other statutory directive, the Arbitration Act's mandate may be overridden by a contrary congressional command'" if the party opposing arbitration demonstrates that Congress intended to preclude a waiver of judicial remedies for the particular statutory claim at issue. *Id.* at 1129, citing *McMahan*, *supra*, 482 U.S. at 226-27.

In deciding the issue concerning the arbitrability of 523 claims, the Ninth Circuit applied the "*McMahan* factors"²³ and noted that both the Ninth Circuit and its sister circuits have previously found "no evidence in the text of the Bankruptcy Code or in the legislative history suggesting that Congress intended to create an exception to the FAA in the Bankruptcy Code." *Id.* at 1129, citing *Thorpe*, *supra*, 671 F.3d at 1020. Applying the "*McMahan* facts" and Circuit precedent established by *Thorpe*, the Ninth Circuit held that the district court did not err

²³ In *McMahan*, the Supreme Court constructed a framework under which courts can analyze how the FAA and a particular statute interact for purposes of determining whether Congress intended to override the FAA's policy favoring arbitration with respect to claims brought under a particular statute. Under this framework, courts must examine: (1) the text of the statutes; (2) its legislative history; and (3) whether an inherent conflict between arbitration and the underlying purposes of the statute exist. 482 U.S. at 227.

when it affirmed the bankruptcy court's denial of the creditors' motion seeking to compel arbitration of their 523 claims. While the creditors attempted to characterize their claims as based on state law concerning breach of contract, fraud and breach of fiduciary duty, and thus non-core, arbitrable claims, the Ninth Circuit concluded that the object of the creditors' motion was to arbitrate dischargeability, "a core bankruptcy issue," meaning that the decision to would be left to the discretion of the bankruptcy court. Here, the Ninth Circuit found that the bankruptcy court had not abused its discretion and agreed with the district court that allowing an arbitrator to decide dischargeability issues would conflict with the underlying purposes of the Bankruptcy Code. "When a bankruptcy court considers conflicting policies as the bankruptcy court did here, we acknowledge its exercise of discretion and defer to its determination that arbitration will jeopardize a core bankruptcy proceeding." *Id.* at 1131.

The EPD Decision. In this case, the Chapter 7 Trustee for the bankruptcy estate filed an adversary proceeding seeking to subordinate or disallow a creditor's claim against the estate (as presented through the filing of as proof of claim) and seeking to avoid (and recover) pre-petition payments that had been made to the defendant pursuant to the avoidance "strong arm" powers under the Bankruptcy Code. The defendant/creditor moved to compel arbitration of the claims asserted in the Trustee's adversary proceeding based upon broad arbitration clauses contained in numerous investment and loan agreements executed with the debtor pre-petition. The bankruptcy court denied the motion, and defendant took an appeal to the district court.

The district court affirmed the bankruptcy court. First, the district court determined that the Trustee was not bound by the pre-petition arbitration agreements between the defendant/creditor and the debtor because the claims the Trustee was asserted either belonged to the estate's creditors or were for their benefit, and neither the Trustee nor any creditor was a party to any of the subject agreements. Second, the district court determined that arbitration of the subordination and disallowance of the defendant's claims and recovery or pre-petition transfers were matters submitted to the core jurisdiction of the bankruptcy court and would conflict with the underlying purposes of the Bankruptcy Code because resolution of those causes of action would require factual findings closely linked to the overall administration of the estate. Defendant then took a further appeal to the Ninth Circuit. [*Note: Because bankruptcy courts are Article I – not Article III – courts, the first level of appeal is to the District Court or the Bankruptcy Appellate Panel of the Ninth Circuit.*]

The Ninth Circuit affirmed, holding that the bankruptcy court had properly applied *Thorpe* to determine that the arbitration provisions at issue conflicted with the Bankruptcy Code purposes of having bankruptcy law issued decided by bankruptcy courts, of centralizing resolution of bankruptcy disputes with the bankruptcy court, and of protecting parties from piecemeal litigation. 821 F.3d at 1150, citing *Thorpe*, 671 F.3d at 1022–1023. In this regard, the Court noted that the bankruptcy court’s analysis was supported by the record at the time of the ruling because the bankruptcy court had supervised the debtor’s case for nearly three years, during which the Chapter 7 Trustee had filed more than 100 other adversary proceedings affecting the administration of the estate.

- *Ziober v. BLB Resources, Inc.*, 839 F.3d 814 (9th Cir. Oct. 15, 2016) – Claims brought under the Uniformed Services Employment and Reemployment Rights Act (USERRA) were arbitrable pursuant to arbitration agreement included within plaintiff’s employment contract.

The plaintiff signed an agreement with his employer requiring the arbitration of any legal disputes that might arise between them. Ziober later sued his employer for violation of the USERRA, claiming that he was fired from his job after providing notice of his deployment to Afghanistan in the United States Navy Reserve. The employer moved to compel arbitration and dismiss plaintiff’s complaint based upon the arbitration clause contained in the employment contract. The district court granted the motion, and plaintiff appealed.

Despite the liberal federal policy favoring arbitration agreements, an exception to the FAA mandate exists when it is shown that Congress, in enacting a statutory scheme creating a civil right of action, intended to preclude a waiver of the judicial forum for claims falling within the statutory scheme. *CompuCredit Corp. v. Greenwood*, ___ U.S. ___, 132 S.Ct. 665, 669 (2012). In this case, plaintiff argued that the plain text and legislative history of the USERRA revealed that Congress intended to preclude the compelled arbitration of claims arising under its provisions. The Ninth Circuit rejected plaintiff’s argument, and joined its “sister circuits to have considered the question” in concluding that neither the text nor legislative history of the USERRA evinced such an intent. 839 F.3d at 817, citing *Landis v. Pinnacle Eye Care, LLC*, 537 F.3d 559 (6th Cir. 2008); *Garrett v. Circuit City Stores, Inc.*, 449 F.3d 672 (5th Cir. 2006); *Bodine v. Cook’s Pest Control Inc.*, 830 F.3d 1320 (11th Cir. 2016). The court reasoned that by agreeing to arbitrate a statutory claim, a party does not forgo the

substantive rights created by that statute; it only submits to their resolution in an arbitral, rather than judicial, forum. *Id.* at 818, citing *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985); *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 123 (2001).

- *McGill v. Citibank, N.A.*, 232 Cal. App. 4th 753 (4th Dist. Dec. 18, 2014), review granted and opinion superseded, 345 P.3d 61 (Apr. 1, 2015), argued (Dec. 7, 2016) – This digest is included as a placeholder for 2018, anticipating a decision from the California Supreme Court in 2017 on the issue of whether the FAA, as construed in *Concepcion*, preempts the *Broughton-Cruz* rule that statutory claims for public injunctive relief are not subject to compulsory binding arbitration.

In this case, a credit card holder filed a class action against the issuing bank for unfair competition and false advertising in offering credit insurance plan that plaintiff purchased to protect her credit card account. The bank filed a motion to compel arbitration pursuant to the arbitration clause contained in the customer agreement. The trial court severed and stayed the claims for injunctive relief under California’s unfair competition law, false advertising law and Consumer Legal Remedies Act. Despite finding that the arbitration agreement applied to all of plaintiff’s claims, the trial court refused to order arbitration of the injunctive relief claims based upon the California Supreme Court’s *Broughton-Cruz* rule prohibiting arbitration of injunctive relief claims brought under public-interest statutes. Citibank appealed and the Fourth District Court of Appeal reversed and remanded for the trial court to order all claims to arbitration. The appellate court rejected plaintiff’s argument that *Iskanian* had “reaffirmed” the *Broughton-Cruz* rule established in 1999 and 2003 respectively,²⁴ finding that the FAA’s displacement of state laws that interfere with its purpose is well-established and has been repeatedly affirmed, citing *Preston v. Ferrer* (2008) 552 U.S. 346. In this regard, the court noted that the purpose underlying a state statute or rule is

²⁴ See, e.g., *Broughton v. Cigna Healthplans*, 21 Cal. 4th 1066 (1999) and *Cruz v. PacifiCare Health Systems, Inc.*, 30 Cal. 4th 303 (2003). Under the state-law rule created by these two case precedents, arbitrations provisions were unenforceable as against public policy if they required arbitration of injunctive relief claims brought for the public’s benefit under California’s unfair competition law, false advertising law and/or consumer legal remedies law. The central premise of the *Broughton-Cruz* rule is that “the judicial forum has significant institutional advantages over arbitration in administering a public injunctive remedy, which as a consequence will likely lead to the diminution or frustration of the public benefit if the remedy is entrusted to arbitrators.”

irrelevant; that according to the United States Supreme Court’s decision in *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011), if the state law interferes with the FAA’s purpose of enforcing arbitration agreements according to their terms, the state law is preempted “no matter how laudable its objective.” On April 1, 2015, the California Supreme Court granted view, and described the issue under review as whether the FAA, as interpreted in *Concepcion*, preempts the *Broughton-Cruz* rule that statutory claims for public injunction are not subject to compulsory private arbitration.

The case was argued to the California Supreme Court on December 7, 2016 and, according to an article that appeared in the Daily Journal on December 8, 2016, Justice Liu asked a number of tough questions and at one point in the hearing, flatly said, “This is very different from *Concepcion*,” and “isn’t about arbitration at all.” According to the article, Justice Liu “hammered home his point … that even the Federal Arbitration Act, citing *Concepcion*, does not allow Citibank to take away the statutory rights of credit card holders just because the language is found in an arbitration agreement.” Stay tuned – opinion expected any time!

8. Vacatur / 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).²⁵ However, some provider organizations require that

²⁵ 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.”).

the arbitrator issue an award that includes a statement of the reasons for the award, unless the parties agree otherwise. See, e.g., JAMS Rules, Rule 24. Other provider organizations give the parties the option of requesting a “reasoned award” as part of the process. See, e.g., American Arbitration Association Commercial Rules, Rule R-42. Beyond what is stated in the arbitrator’s award, parties may not depose the arbitrator to establish and then challenge his or her reasoning. *Hoelt 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).

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

An award reached by an arbitrator pursuant to a contractual agreement to arbitrate is not subject to judicial review, except on statutory grounds, and in California on the non-statutory grounds of violation of a substantive statute involving a matter of public policy (*Moncharsh*) or by agreement of the parties (*Cable Connection*). See, 9 U.S.C. § 10(a)(1)–(4); Cal. Civ. Proc. Code § 1286.2(a)(1)–(6); *Moncharsh*, supra, 3 Cal. 4th at 33. Courts may not act *sua sponte*. Cal. Civ. Proc. Code §§ 1286.4, 1286.8; *Valsan Partners Ltd. P’ship v. Calco Space Facility, Inc.*, 25 Cal. App. 4th 809, 818 (1994). Such relief is sought by petitioning to vacate the award and may be filed by any party. *Baldwin v. Rainey Const. Co.*, supra, 229 Cal. App. 3d at 1058. The scope of judicial review of arbitration awards is extremely narrow and is limited to the specific grounds defined by statute, which are directed at the process, not the substance of the award or the merits of the dispute. Generally speaking, an arbitrator’s decision is not reviewable for errors of fact or law. *Moncharsh*, supra, 3 Cal. 4th at 6; *City of Palo Alto v. Service Employees Int’l Union*, 77 Cal. App. 4th 327, 333 (1999). Code of Civil Procedure section 1286.2 provides the limited grounds upon which an award may be reviewed for vacatur, and those grounds are generally directed at process fairness: e.g., the arbitrator exceeded his powers and the award cannot be corrected without affecting the merits of the decision;²⁶ the award was procured by corruption, fraud or other undue means or corruption in any of the arbitrators;²⁷ the award was issued by an arbitrator required to disqualify himself or herself;²⁸ the rights of the party challenging the award were

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

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

²⁸ 9 U.S.C. § 10(a)(2); Cal. Civ. Proc. Code § 1286.2(a)(6). Arbitrators conducting arbitrations in California must comply with the Judicial Council ethics standards which require that an arbitrator make extensive conflict disclosures to the parties before accepting the appointment and hearing the dispute. Cal. Civ. Proc. Code §§ 1281.85, 1281.9 and 1281.91. An arbitrator’s failure to comply with the disclosure requirements may be ground for disqualification of the arbitrator and

substantially prejudiced by the arbitrator's refusal to postpone the hearing despite sufficient cause shown for a postponement, his or her refusal to hear evidence material to the controversy or other misconduct.²⁹ Additionally, both state and federal common law recognize a "public policy" exception to confirmation of an award, which allows courts to refuse to enforce an arbitration award that violates well-defined public policy.³⁰

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

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).

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

³⁰ In 1987, the United States Supreme Court held that courts can decline to enforce an arbitrator's award where enforcement "would violate 'some explicit public policy' that is 'well defined and dominant, and is to be ascertained by reference to the laws and legal precedents and not from general considerations of supposed public interests.'" *United Paperworkers' Int'l Union, AFL-CIO v. Misco, Inc.*, 484 U.S. 29, 43 (1987); see also *Exxon Shipping Co. v. Exxon Seamen's Union*, 11 F.3d 1189, 1191-1192 (3d Cir. 1994) (vacating labor arbitration award that required the reinstatement of a seaman who was found to be highly intoxicated while on duty), or a party's statutory rights. *Board of Education, Etc. v. Round Valley Teachers Ass'n*, 13 Cal. 4th 269, 277 (1996) (vacating arbitration award that required school district to comply with collective bargaining agreement procedure for termination a probationary teacher which was preempted by conflicting Education Code provisions). This exception arises out of the contract defense to enforcement where a contract is found to violate public policy. *Vimar Sequeros y Reasegueros 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.

where the arbitrator knew applicable law but ignored or refused to apply it,³¹ or where an obvious error of law exists.³² “For an arbitrator’s award to be in manifest disregard of the law, it must be clear from the record that the arbitrator recognized the applicable law and then ignored it ….” *Matthews v. Nat’l Football League Mgmt. Council*, 688 F.3d 1107, 1115 (9th Cir. 2012). The second additional common law ground is the “arbitrary and capricious” exception, which allows the award to be vacated where no ground for the decision can be inferred from the facts, which is not yet uniformly accepted.³³

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

³¹ 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).

³² 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).

³³ 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 Cir. 2003) (same).

The rule is different for arbitrations governed by the California Arbitration Act. In 2008, the California Supreme Court relied on the United States Supreme Court's statement in *Hall Street* that “[t]he FAA is not the only way into court for parties wanting review of arbitration awards: they may contemplate enforcement under state statutory or common law, for example, where judicial review of different scope is arguable,” 552 U.S. at 552, to conclude that *Hall Street* did not foreclose a more searching merits review of arbitral awards when done so under authority other than the FAA. See, *Cable Connection, Inc. v. DirecTV, Inc.*, 44 Cal. 4th 1334, 1354–1355 (2008). The California Supreme Court went on to hold that “the CAA established the statutory grounds for judicial review with the expectation that arbitration awards are ordinarily final and subject to a restricted scope of review, but that parties may . . . provid[e] for review of the merits in the arbitration agreement.” 44 Cal. 4th at 1364.

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

(b) Award Procured by Fraud or Undue Means

- *Move, Inc. v. Citigroup Global Markets, Inc.*, 840 F.3d 1152 (9th Cir. Nov. 4, 2016) – The FAA is subject to the established doctrine of equitable tolling. Vacatur granted four years after confirmation of an arbitration award.

The old saw is “bad facts make bad law.” This case represents a departure where bad facts prompted the Ninth Circuit to make good law, finally establishing case precedent in this circuit allowing for equitable tolling of the short time period for seeking vacatur to promote and enhance the integrity of the process and the fairness of arbitral outcomes.

Online real estate company Move Inc. sued Citigroup Global Markets, Inc. for mismanagement of \$131 million of its funds that were invested in speculative auction rate securities. While there was a “Client Agreement” between Move Inc. and Citigroup that contained an arbitration clause covering “all claims or controversies,” before initiating the FINRA arbitration proceedings, FINRA required Move Inc. and Citigroup to sign a submission agreement. The matter then proceeded to arbitration, and FINRA provided the parties with a list of 30 proposed arbitrators and their employment histories, including ten proposed arbitrators from FINRA’s chairperson roster.

Because the dispute involved a complex securities issue, it was important to Move Inc. that the chairperson be an experienced attorney. Move, Inc. ranked “James H. Frank” first who, according to the FINRA arbitrator disclosure report, was a licensed attorney in California, New York and Florida. Mr. Frank was appointed to serve as the chairperson of the panel. The arbitration proceedings commenced in September 2008 and concluded in December 2009 with a unanimous award denying Move Inc’s claims.

Arbitrator Frank sat on nearly 50 panels during the course of his 15 years as a FINRA arbitrator, but was quietly removed from the panel in 2013 when FINRA learned that he had lied about being a lawyer. Move Inc. learned of Frank’s deception in March 2014 as the result of a news story and shortly thereafter filed a motion to vacate the 2009 decision. Citigroup countered with a motion to dismiss the case, arguing that the three-month deadline for seeking vacatur under Section 12 of the FAA had long passed and that, even if the limitations period were tolled, vacatur was unjustified on the merits because the decision

was unanimous and it only took two arbitrators to rule in favor of Citigroup for it to prevail. While the district court noted that whether equitable tolling was available under the FAA presented an “unsettled question of law” in the Ninth Circuit, it agreed with Move Inc. that equitable tolling was available. The district court denied vacatur, however, finding that Move Inc. had failed to demonstrate that Frank’s misbehavior had prejudiced its rights to a fair hearing for purposes of vacatur under Section 10(a)(3). Move, Inc. appealed.

With regard to the equitable tolling issue, the Ninth Circuit agreed with the district court that the case law from other circuits was conflicting and that most circuits had thus far declined to rule on the issue. 840 F.3d at 1156, citing *Garrett v Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 7 F.3d 882, 883 (9th Cir. 1993); *Fradella v. Petricca*, 183 F.3d 17, 21 (1st Cir. 1999); *Taylor v. Nelson*, 788 F.2d 220, 225–226 (4th Cir. 1986); *Piccolo v. Dain, Kalman & Quail, Inc.*, 641 F.2d 598, 601 (8th Cir. 1981); *Pfannenstiel v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 477 F.3d 1155, 1158 (10th Cir. 2007). The Ninth Circuit squarely decided the issue, affirming the district court and holding that the FAA is subject to the established doctrine of equitable tolling. In this regard, the Ninth Circuit reasoned that “[i]t is hornbook law that limitations periods are customarily subject to equitable tolling … unless tolling would be inconsistent with the text of the relevant statute,” and that “Congress must be presumed to draft limitations periods in light of this background principle.” *Id.*, citing *Young v. United States*, 535 U.S. 43, 49–50 (2002). The Court held that that equitable tolling would not undermine the basic purpose of the FAA, which is to make arbitration agreements valid and enforceable. *Id.* at 1158. It also held that in balancing the needs for both finality and due process, “the arbitral process will not be disrupted if parties are permitted to satisfy the high bar of equitable tolling in limited circumstances,” and that permitting equitable tolling would enhance the integrity of the process and the fairness of arbitral outcomes. *Id.*

With regard to the vacatur issue, the Ninth Circuit held that the question to be answered for vacatur under Section 10(a)(3) was “whether the parties received a fundamentally fair hearing.” *Id.* at 1158. The Court noted that the fact circumstances presented in the case were unique and that neither the Ninth Circuit nor its sister circuits had previously addressed the issue of whether vacatur is proper where an arbitrator’s purposeful and material deception resulted in his selection as chairperson of a panel. While there was no evidence that Frank influenced the other members of the panel or that the outcome of the arbitration was affected by his participation, the Ninth Circuit stated that it simply conclude that Move Inc. had received a fundamentally fair hearing under

the facts that existed in this case. In this regard, the Court found that Frank's participation in the hearing process was fundamentally prejudicial to Move Inc. because, under FINRA's rules and regulations, Frank's deceit would have permanently disqualified him from serving as a FINRA arbitrator. In this regard, the Court noted that once Frank's lies were revealed, FINRA immediately removed him from its roster. Accordingly, the Ninth Circuit held that Move Inc. was entitled to vacatur under Section 10(a)(4) and reversed the district court's ruling to the contrary.

(c) Evident Partiality or Corruption in the Arbitrator

See, cases discussed in Section 2, above.

(d) Arbitrator Misconduct / Refusal to Hear Evidence

- *Royal Alliance Associates, Inc. v. Liebhaber*, 2 Cal. App. 5th 1092 (2d Dist. Aug. 30, 2016) – Award vacated for refusal to hear evidence where the arbitration panel only allowed one side to present oral evidence and did not allow the other side to present such evidence or cross-examine the other side,

Liebhaber was an investment customer of Royal Alliance and worked with a broker named Kathleen Tarr. Liebhaber brought a claim against Tarr, alleging that Tarr had improperly placed her retirement funds in risky, illiquid investments. Liebhaber demanded a FINRA arbitration, but settled before the arbitration began. Royal Alliance asked that the arbitration be kept open so that it could move to expunge Liebhaber's allegations against Tarr from FINRA's Central Registration Depository on the ground that the allegations were false. During a telephonic hearing on Royal Alliance's expungement request, Tarr was allowed to speak, but did so without being sworn by the panel. Liebhaber requested that she be allowed to present her own testimony and to cross-examine Tarr. The panel denied Liebhaber's requests, and issued an award recommending expungement. Royal Alliance then moved to confirm the award under the California Arbitration Act, and Liebhaber objected and sought vacatur of the award. The trial court denied confirmation and vacated the award on the ground that Liebhaber's rights were substantially prejudiced by the refusal of the arbitrators to hear evidence material to the controversy. Royal Alliance appealed.

On appeal, Royal Alliance argued that the award should be confirmed because the arbitrators had allowed and considered written submissions from both side in compliance with the applicable FINRA rules. The Court of Appeal rejected that argument, holding that the pertinent question under Code of Civil Procedure section 1286.2(a)(5) was whether or not the arbitrators had prevented a party from fairly presenting its case and prejudiced the party’s rights as a result. While the California Arbitration Act allows parties to be limited to written submission rather than live testimony, if an opportunity to be heard is extended to one side, it must be extended to all parties equally. Because the panel had allowed Tarr to speak during the hearing, but did not allow Liebhaber to speak or to cross-examine Tarr, the Court of Appeal held that Liebhaber had been deprived of a fair opportunity to present her case. The Court of Appeal held that this was prejudicial because the arbitrators could not fully weigh the credibility of the Tarr’s statements without Liebhaber being given the opportunity to cross-examine her.

(e) Arbitrator Exceeded His / Her Powers

No 2016 cases – but a few recent notable cases for review:

Oxford Health Plans LLC v. Sutter, __ U.S. ___, 133 S.Ct. 2064 (2013) – Serious errors of law or fact will not subject an arbitrator’s award to vacatur under Section 10(a)(4) so long as the arbitrator made a good faith attempt to interpret the contract. “Because the parties bargained for the arbitrator’s construction of their agreement, an arbitral decision even arguably construing or applying the contract must stand, regardless of the court’s view of its (de)merits,” citing *Eastern Associated Oil Corp. v. Mine Workers, Etc.* (2000) 531 U.S. 57. The Court concluded that the sole question before it was whether the arbitrator had interpreted the parties’ contract, not whether he had got its meaning right or wrong. In this regard, the Court noted that it would have faced a different issue if Oxford Health had argued below that the availability of class arbitration was a “question of arbitrability,” which is presumptively for the court to decide. That is not what happened. Both parties submitted the contract construction issue to the arbitrator. The Court also noted that it “has not yet decided whether the availability of class arbitration is a question of arbitrability.”

Safari Associates v. Superior Court, 231 Cal. App. 4th 1400 (2014) – Trial court erred in correcting the arbitrator’s award of attorney’s fees and costs because it did not have authority to review the award for legal error. The parties both briefed the issue of how “prevailing party” should be defined. The losing party

could not thereafter complain that the arbitrator had exceeded his powers by deciding the issue, even if the arbitrator may have decided the legal issue incorrectly.

Singerlewak LLP v. Gantman, 241 Cal. App. 4th 610 (2015) – Arbitrator did not exceed his powers by enforcing the non-compete provisions of the partnership agreement even though such provisions are generally unenforceable as a matter of California law because it contained no geographic limitations.

(f) Award Violates a Well-Defined Public Policy

- *Sheppard Mullin Richter & Hampton LLP v. J-M Manufacturing Co., Inc.*, 244 Cal. App. 4th 590 (2d Dist. 2016), review granted, 368 P.3d 922 (Apr. 27, 2016) – Award vacated where the arbitrator’s decision ran far afield of the law in the all-important area of an attorney’s inviolate duty not to concurrently represent clients who have adverse interests without obtaining their advance consent and waiver of, and the companion restriction on charging and recovering fees for services rendered where advance consent and waiver has not been obtained.)

The “Reader’s Digest” summary of this case is that where a contract relationship is governed by the laws of California and a party to that contract challenges the entire contract as illegal or in violation of public policy, the question of enforceability is for the court – not the arbitrators – to decide because (1) the FAA and the contrary U.S. Supreme Court precedent do not apply, and (2) the trial court’s error in not deciding the matter opens the door to de novo review and decision on the merits by the appellate court. Stated alternatively, when appellate courts do not like an outcome, they will find a way to undo it, and that is exactly what the Second District did in this case.

J-M Manufacturing Co. (J-M) was a litigation client of Sheppard Mullin (SMRH) until SMRH was disqualified because, without obtaining informed consent from either client, SMRH represented J-M in defending litigation in which the South Tahoe Public Utility District (Utility District) was a plaintiff and concurrently represented the Utility District in other matters. After the disqualification, SMRH sued J-M for \$1.3 million for services rendered and J-M cross-complained for fraudulent inducement, breach of fiduciary duty and breach of contract. SMRH

then moved to compel arbitration pursuant to the arbitration provision contained in the litigation engagement agreement. 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 SMRH's undisclosed and unwaived conflict of interest violated Rule 3-310(C)(3) of the Rules of Professional Conduct. The trial court granted SMRH'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 such consent by fraudulent means. The trial court thus determined that this contract defense should be presented to and decided by the arbitrator.³⁴

The matter proceeded to arbitration before a panel of three arbitrators, where the panel ruled in favor of SMRH and awarded the firm approximately \$1.3 million in unpaid fees plus interest. When SMRH 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 found that a violation of Rule 3-310 did not render the entire retainer agreement illegal, void or unenforceable. It reasoned that whether an attorney should be entitled to attorney 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 SMRH's entitlement to fees on some other ground (e.g., quantum meruit) – but with instructions to determine that SMRH "is not entitled to its fees for the work it did for J-M while there was an actual conflict with South Tahoe" per the appellate court's reasoning and analysis *16. The Second District further ordered the trial court to conduct proceedings to determine the amount of fees that SMRH "must reimburse to J-

³⁴ Under the FAA, the trial court's ruling was absolutely correct, and the Second District so noted the same thing. *6. The FAA provides that covered arbitration agreements shall be enforced except "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. When parties commit to arbitrate contractual disputes, it is a mainstay of the FAA's substantive law that attacks on the validity of the contract, as distinct from attacks on the validity of the arbitration provision itself, are to be resolved "by the arbitrator in the first instance, not by a federal or state court." *Preston v. Ferrer*, 552 U.S. 346, 349 (2008); see also *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967). For these purposes, an arbitration provision is severable from the remainder of the contract. *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 445 (2006).]

M” consistent with the appellate court’s stated reasoning and analysis. *17. In a lengthy and strongly worded opinion, the court basically ruled that SMRH’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 Utility District. 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, [SMRH] 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 *Moncharsh v. Heily & Blase* (1992) 3 Cal. 4th 1 was not controlling because it addressed judicial review in the context of when a party has alleged that only a portion of 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* (1949) 33 Cal. 2d 603. 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.* (1997) 55 Cal. App. 4th 882, 892, fn. 2, 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.” *6.³⁵

³⁵ *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. This decision 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. This case was only just decided on January 29, 2016. We’ll have to stay tuned to see if J-M petitions the California Supreme Court for review and if that review is granted.*

(g) **Manifest Disregard of the Law (Federal Only / Court Crafted Grounds)**

No 2016 cases – but a few recent notable cases for review:

Lagstein v. Certain Underwriters at Lloyd's, London, 607 F.3d 634 (9th Cir. 2010) – Lloyd's issued a disability policy to Dr. Lagstein. Lagstein developed heart disease and other ailments and filed a claim for disability benefits. After nearly two years without a decision on the claim, Lagstein sued Lloyd's in Nevada district court. At Lloyd's request, the matter was stayed pending binding arbitration pursuant to an arbitration provision in the policy. The arbitration was heard by a three-member panel, and the panel unanimously concluded that Lloyd's had breached the terms of the policy and acted unreasonably in denying Lagstein's claim. The panel awarded Lagstein full policy benefits of \$900,000 and an additional \$1,500,000 for emotional distress.

Lloyd's filed a motion in district court to vacate the arbitration award on several grounds, including manifest disregard for the law. The district court granted vacatur, finding that the amount of the award “shock[ed] the Court's conscience, suggested bias, was unsupported by the record, manifestly disregarded the law, and contravened public policy.” Lagstein appealed, arguing that none of the district court's reasons justified vacatur. The Ninth Circuit agreed, reversed the district court's ruling and remanded the case for confirmation of the award. With regard to manifest disregard of the law, the Court noted that manifest disregard of the law requires “more than just an error in the law or a failure on the part of the arbitrators to understand or apply the law;” that it must be shown that the arbitrator(s) recognized the applicable law and then ignored it. The Court found that neither the district court nor Lloyd's had pointed to a single Nevada statute or decision that the panel had purportedly ignored. Thus, the Court concluded that there was no basis to conclude that the panel had manifestly disregarded the law in making the award in favor of Lagstein.

Matthews v. National Football League Management Council, (9th Cir. 2012) – Former professional football player brought an action against the professional football league's management council and franchise for which he had played, seeking to vacate that arbitration award that prohibited him from pursuing workers' compensation benefits under California law, based on a forum-selection clause contain in his contract. Matthews argued that the award violated federal labor policy, which provides that an employee may not, through a

collective bargaining agreement, bargain away state minimum labor standards. The trial court denied the player's motion and he appealed.

The Ninth Circuit affirmed the trial court's ruling, finding that it did not constitute manifest disregard for California law, nor did it otherwise violate the Full Faith and Credit Clause. 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." The Court explained that it was not clear that Matthews' workers' compensation claim fell within the scope of California's workers' compensation scheme because had had not shown that an arbitration award preventing him from seeking California benefits deprived him of something to which he was entitled under state law. With regard to the Full Faith and Credit Clause argument, the Court held that California's interest was highly attenuated in this case and that on the facts alleged, it was not clear that the courts of California would consider California's interest sufficient to justify application of California law to Matthews' workers' compensation claim. Accordingly, the Court concluded that because Matthews did not show that the Full Faith and Credit Clause guarantees California's right to apply its law on the facts of his case, he could not establish that the arbitrator recognized yet chose to ignore well defined, explicit and clearly applicable law for purposes of seeking vacatur.

(h) Award is Arbitrary and Capricious (Federal Only / Court Crafted Grounds)

No 2016 cases and no recent notable cases.

9. Miscellaneous

- *Bucur v. Ahmad*, 244 Cal. App. 4th 175 (4th Dist. Apr. 13, 2016) – For purposes of res judicata, an unconfirmed arbitration award is equivalent to a final judgment.

In this case, the Court of Appeal affirmed the trial court's orders dismissing an action and imposing sanctions under Code of Civil Procedure section 128.7. The sanctions were awarded after the plaintiffs filed a fifth lawsuit arising from the same hauling contract with FedEx and asserting virtually the same claims as the prior actions. The Court of Appeal held that the dismissal and sanctions were justified because an unconfirmed arbitration award had been granted against the plaintiffs in one of the prior actions – referred to arbitration by the parties' stipulation. The Court of Appeal held that, for purposes of res judicata, even an unconfirmed arbitration award is equivalent to a final judgment. 244 Cal. App. 4th at 189, citing *Thibodeau v. Crum*, 4 Cal. App. 4th 749, 759 (1992); *Trollope v. Jeffries*, 55 Cal. App. 3d 816, 822 (1976). In this regard, the Court reasoned that the arbitrator's dismissal order in the earlier matter based on the same transactional nucleus of facts asserted in the present case operated as res judicata to bar the current case and provided additional support for the trial court's grant of judgment on the pleadings.

- *Joseph L. Dunn v. State Bar of California*, JAMS Arbitration – Chief Justice of the California Supreme Court ordered to give a deposition by a private arbitrator (albeit a retired U.S. Magistrate Judge).

Dunn, a former trial lawyer, state senator, and chief executive of the California Medical Association, was the State Bar's top administrator from September 2010 to November 2014, when the organization announced it had exercised a clause in his contract giving it the right to end his employment on 30 days' notice. Dunn sued the State Bar almost immediately after he was terminated, claiming that he was fired in retaliation for complaints about various improprieties at the State Bar. Those included the falsification of statistics purporting to show that a backlog in disciplinary complaints had been cleared up, as well as wasteful spending and an alleged conflict of interest on the part of Munger Tolles & Olsen, the law firm hired to investigate an internal complaint brought against Dunn by Chief Trial Counsel Jayne Kim. Dunn alleged that Kim had brought the claim in retaliation for his identifying her as the person responsible for falsifying the backlog statistics. In June 2015, a Los Angeles Superior Court ordered the case to arbitration based on a clause in Dunn's contract. The matter then

proceeded at JAMS, with retired U.S. Magistrate Judge Edward A. Infante appointed as arbitrator.

The claims pending and moving forward after various demurrers are: 1. a claim against the State Bar that it terminated Dunn in violation of the Labor Code whistleblower provision, and that it breached the covenant of good faith and fair dealing implied in his employment contract; 2. a claim against former State Bar President Craig Holden and Beth J. Jay, former principal attorney to Chief Justice Tani Cantil-Sakauye, for intentional interference with Dunn's contractual relationship with the State Bar. As to the latter claims, the Arbitrator rejected Jay's and Holden's reliance on the litigation privilege. The amended allegations, including that Jay had "regular secret meetings with Jayne Kim and [Trustee] Jim Fox to set in motion plans to" fire Dunn, do not describe privileged conduct because the alleged meetings did not relate "to a proceeding that was actually contemplated or to a lawsuit that was anticipated." The Arbitrator also rejected Holden's claim of sovereign immunity, saying that Dunn adequately alleged that Holden participated in the claimed meetings before he became president of the State Bar.

With the pleadings settled, Dunn requested that the Arbitrator issue a deposition subpoena to the Chief Justice of the California Supreme Court (Tani G. Cantil-Sakauye). That subpoena was issued on November 30, 2016, and was quickly followed by a motion for protective order seeking to prevent the Chief Justice's deposition in preference for "less-intrusive discovery." The Arbitrator denied the protective order motion, finding that Dunn had "adequately demonstrated that the chief justice possesses direct and personal factual information pertaining to material issues in this case." The Arbitrator acknowledged that top government officials are generally protected from appearing at depositions, but said that an exception to the general rule exists if the deposed official has "direct personal factual information pertaining to material issues in an action," citing *Nagle v. Superior Court*, 28 Cal. App. 4th 1465 (1995). The chief justice's involvement ties to an investigative report prepared for the State Bar's board by Munger Tolles & Olson LLP for which the chief justice was interviewed.

It will be interesting to see how this arbitration plays out. And it is interesting that a dispute of this magnitude is in arbitration all because of an arbitration clause contained in Dunn's employment contract with the State Bar.

- *Tillman v. Tillman*, 825 F.3d 1069 (9th Cir. Jun. 15, 2016) – Court properly lifted the arbitration stay after the arbitration proceeding was terminated due to the claimant’s failure to post fees, but erred in dismissing plaintiff/claimant’s legal malpractice action on the grounds that it had no jurisdiction to hear claims subject to an arbitration agreement.

When two parties have entered into a valid arbitration agreement, and one party seeks adjudication in the courts, the FAA requires federal courts to stay lawsuits between the disputing parties until the arbitration is resolved and to then enforce any arbitration award. The question presented in this case is what power or authority does a federal court have to proceed with the litigation if one party runs out of funds to pay for its share of the arbitration and the arbitrator thereupon terminates the arbitration proceedings without entering an award or otherwise resolving the case?

Tim Tillman died in a truck accident in 2002. His wife Renee hired Rheingold Velt Rheingold Shkolnik & McCartney (the “Firm”) to represent her in a wrongful death suit against the manufacturer of the truck Tim was driving. That lawsuit was successful. Renee and the Firm were then sued by Sean Tillman, Tim’s son from a prior marriage, who complained that he had been wrongfully excluded from the lawsuit against the truck manufacturer. Sean’s claims against the Firm were dismissed, but his action against Renee continued. Renee, in turn, filed a complaint against the Firm for malpractice by not including Sean in the wrongful death action and by failing to advise her of the rights of Tim’s other heirs. In response to Renee’s malpractice complaint, the Firm moved to compel arbitration based upon the arbitration clause contained in the retainer agreement with Renee. The district court granted the motion and stayed the federal court proceedings between Renee and the Firm pending the outcome of the arbitration.

In the arbitration, the arbitrator adopted a “case-within-a-case” procedure in which the arbitrator would rehear witnesses and evidence presented in the underlying wrongful death action. This procedure, not surprisingly, came at a cost to the parties. At some point in time, midway through the arbitration, Renee was unable to provide the required deposit of \$18,562 requested by the AAA and arbitrator as a condition to proceeding with the arbitration. When the requested/required deposits were not funded, the arbitrator terminated the arbitration. The Firm then returned to the district court and asked it to lift the arbitration stay and dismiss Renee’s complaint, arguing that Renee’s failure to pay her share of the arbitration deposits constituted a violation of the court’s

order compelling arbitration. The district court granted that motion, and Renee appealed.

On appeal, the Ninth Circuit held that the district court had properly lifted the arbitration stay after the arbitration proceeding was terminated. However, the Court held that the district court had erred in dismissing Renee's malpractice claim because (1) the FAA did not require dismissal where arbitration had been ordered in accordance with the terms of the arbitration agreement, and (2) the district court acted appropriately to excuse plaintiff/claimant's failure to pay for the arbitration on the grounds of financial incapacity. The Ninth Circuit reasoned that "[n]o section of the FAA compelled the district court to dismiss her case once the arbitration had concluded in accordance with the agreed upon rules governing but without resolution." 825 F.3d at 1076.

- *Scott v. Yoho*, 248 Cal. App. 4th 392 (2d Dist. Jun. 28, 2016) – FAA preempts the 30-day rescission right for arbitration clauses in healthcare-provider contracts mandated by CCP § 1295.

Decedent Kenisha Parker died after undergoing liposuction performed by Dr. Yoho. Her family sued Yoho for wrongful death and medical malpractice. Yoho and the surgery center moved to compel arbitration, and the trial court denied the motion because the arbitration clause in question did not contain a 30-day right of rescission as required by California Code of Civil Procedure section 1295(c). Defendants appealed.

On appeal, the Second District reversed. First, the Court held that the FAA applied because the contract between the decedent and Yoho involved interstate commerce. Even though the surgery procedure was performed in California, defendants made a showing that 20% of their medical supplies were shipped from out of state; Yoho communicated with out-of-state patients by phone, mail and email; Yoho's practice contracts with various out-of-state companies including insurers and suppliers. The Court found that this was sufficient to create a nexus with interstate commerce sufficient to trigger application of the FAA (rather than the California Arbitration Act).

Second, the Court held that the United States Supreme Court's decisions construing the FAA make clear that while states may regulate contracts, including arbitration clauses, under general contract law principles and may invalidate an arbitration clause upon such grounds as exist at law or in equity applicable to contracts in general, but states may not treat arbitration

agreements differently or selectively. “A state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with [the FAA].” 248 Cal. App. 4th at 405, quoting *Doctor’s Associates, Inc. v. Casarotto*, 517 U.S. 681, 686–687 (1996). Because the 30-day rescission period in CCP § 1925(c) does not apply to California contracts generally, and applies only in the context of arbitration of medical care disputes, the Court held that it was preempted by the FAA. Stated alternatively, because the 30-day rescission right applies only to arbitration contracts, it is not a “grounds ... at law or in equity for the revocation of any contract” and is thus not saved from preempted by Section 2 of the FAA.

- *JAMS, Inc. v. Superior Court (Kinsella)*, 1 Cal. App. 5th 984 (4th Dist. Jul. 27, 2016) – Action arising from representations made on the ADR provider’s website about a panel member’s qualifications is commercial speech and thus exempt from the anti-SLAPP procedure set forth in CCP § 425.16.

Mr. Kinsella and wife were dissolving their marriage. They decided to use a private judge for that purpose. They were referred to JAMS. Mr. Kinsella did extensive research on the JAMS website to determine the qualifications of their neutrals. The parties chose Judge Sheila Prell Sonenshine (ret.) to serve as their judge. Mr. Kinsella alleged that he agreed to use Judge Sonenshine based on her business experience as shown on her posted resume. That resume showed that she had been involved in various businesses and venture capital endeavors. Mr. Kinsella was looking for a neutral with such experience because the marital and separate estates were in the 8-figure range and included business of this type.

After proceedings had begun with Judge Sonenshine, Mr. Kinsella began to doubt her business experience and acumen. After further research, he came to the conclusion that Judge Sonenshine had misrepresented her experience on her resume that was posted on the JAMS website. He also contended that JAMS falsely represented on its website that it and its neutrals uphold “the highest ethical standards” and “everything we do and say will reflect the highest ethical and moral standards. We are dedicated to neutrality, integrity, honesty, accountability, and mutual respect in all our interactions.”

Mr. Kinsella sued JAMS and Sonenshine for fraud, negligent misrepresentation and violations of various statutes. JAMS and Sonenshine filed a special motion to strike under California’s Anti-SLAPP statute, CCP §§ 425.16 et seq. Kinsella countered that the alleged statements that formed the basis of his complaint

were exempt from the Anti-SLAPP statute because they constituted commercial speech. The trial court denied JAMS and Sonenshine's special motion to strike and the appellate court denied their petition for writ of mandate.

The court held that commercial speech includes omissions as well as positive statements. Half-truths are potentially actionable. It also held that when applying the commercial speech exception contained in CCP § 425.17, a court must weigh whether the primary purpose of the speech was commercial, or otherwise, not whether the speech was solely commercial. The court held that the statements allegedly made by JAMS and Sonenshine were primarily published to obtain clients for the firm and its neutrals. It held that they were susceptible of being proven true or false, unlike opinions or puffery. The court took great pains to repeatedly state that it was not determining whether Kinsella's allegations were true, or even adequately pleaded. However, the court concluded that JAMS and Sonenshine could not use the Anti-SLAPP statute to cut off Kinsella's claims.

A summary judgment/summary adjudication motion is scheduled for hearing March 3, 2017 and trial is presently scheduled for April 28, 2017. Stay tuned!

[Case Digest Contributed by Chris Blank]

- ***Condon v. Daland***, 6 Cal. App. 5th 263 (1st Dist. Nov. 29, 2016) - 1 Cal. App. 5th 984 (4th Dist. Jul. 27, 2016) - Re-do provision in arbitration agreement enforced.

The parties' arbitration agreement contained a provision that permitted a *de novo* arbitration before a three-arbitrator panel if a single arbitrator renders an award of \$-0- or over \$100,000. In the first, single-arbitrator arbitration, the arbitrator awarded claimant \$180,000, and respondent asked the arbitral body (ADR Services) to constitute a three-arbitrator / *de novo* panel. The provider refused respondent's request on the grounds that it did not have "appellate rules." Claimant then petitioned the state court to confirm the award. In response, respondent filed a petition for vacatur, as well as a request that the court order a second arbitration pursuant to the contract's terms. The trial court confirmed the award and denied the request for a second arbitration. Respondent appealed.

The Court of Appeal reversed the trial court, finding that the parties had agreed to a *de novo* arbitration (not an arbitration appeal proceeding) if the results of the first arbitration fell outside an agreed upon range. The award from the first

arbitration did in fact fall outside the agreed upon range. The fact that ADR Services had no appellate rules for arbitration had no bearing on the issue. The judgment confirming the arbitration award from the first arbitration and denying a new arbitration were reversed, and the trial court was ordered to dismiss the petition to confirm as premature and to order the parties to proceed with a new arbitration before a three-arbitrator panel at ADR Services.

SETTLEMENT AND OFFERS TO COMPROMISE DEVELOPMENTS

1. 998 Offers

(a) *Background Statement*

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

Code of Civil Procedure Section 998 modifies the general rule set forth in Section 1032, and is designed to encourage the settlement of lawsuits before trial. *Scott Co., v. Blount, Inc.*, supra, 20 Cal. 4th at 1112; *Regency Outdoor Advertising, Inc. v. City of Los Angeles*, 39 Cal. 4th 507, 528 (2006). “Its effect is to punish the plaintiff who fails to accept a reasonable offer from a defendant.” *Culbertson v. R.D. Werner Co., Inc.*, 190 Cal. App. 3d 704, 711 (1987). However, a good faith requirement is read into Section 998, requiring that the settlement offer be “realistically reasonable under the circumstances of the particular case” and that there be “some prospect of acceptance.” *Bates v. Presbyterian Intercommunity Hospital, Inc.*, 204 Cal. App. 4th 210, 220 (2012); see also *Adams v. Ford Motor Co.*, 199 Cal. App. 4th 1475, 1483 (2011); *Wear v. Calderon*, 121 Cal. App. 3d 818, 821 (1981); *Elrod v. Oregon Cummins Diesel, Inc.*, 195 Cal. App. 3d 692, 698 (1987). A party having no expectation that his offer will be accepted “will not be allowed to benefit from a no-risk offer made for the sole purpose of later recovery large expert witness fees.” *Jones v. Dumrichob*, 63 Cal. App. 4th 1258, 1263 (1998). That being said, “[e]ven a modest of ‘token’ offer may be reasonable if an action is completely lacking in merit.” *Nelson v. Anderson*, 72 Cal. App. 4th 111, 134 (1999); see also, *Culbertson v. R. D. Werner Co., Inc.*, supra, 190 Cal. App. 3d 704, 710-711. Whether a Section 998 offer qualifies as reasonable and in good faith is left to the sound discretion of the trial court. *Adams v. Ford Motor Co.*, supra, 199 Cal. App. 4th at 1484. Where the defendant obtains a judgment more favorable than its offer, “the judgment constitutes prima facie evidence showing the offer was reasonable. . . .” *Santantonio v. Westinghouse Broadcasting Co.*, 25 Cal. App.

4th 102, 117 (1994). The reasonableness of a defendant's Section 998 offer is evaluated in light of what the offeree knows or does not know at the time the offer is made. *Bates v Presbyterian Intercommunity Hospital, Inc.*, supra, 204 Cal. App. 4th at 221.

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

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

The policy behind section 998 is "to encourage the settlement of lawsuits prior to trial." *T.M. Cobb Co. v. Superior Court*, 36 Cal. 3d 273, 280 (1984). To effectuate this policy, section 998 provides "a strong financial disincentive to a

party – whether it be a plaintiff or a defendant – who fails to achieve a better result than that party could have achieved by accepting his or her opponent’s settlement offer.” *Bank of San Pedro v. Superior Court*, 3 Cal. 4th 797, 804 (1993). At the same time, the potential for statutory recovery of expert witness fees and other costs provides parties with “a financial incentive to make reasonable settlement offers.” *Id.* Section 998 aims to avoid the time delays and economic waste associated with trials and to reduce the number of meritless lawsuits. *Culbertson v. R.D. Werner Co., Inc.*, 190 Cal. App. 3d 704, 711 (1987); *Wilson v. Wal-Mart Stores, Inc.*, 72 Cal. App. 4th 382, 390 (1999).

(b) *2016 Cases*

- *Toste v. CalPortland Construction*, 245 Cal. App. 4th 362 (2d Dist. Mar. 2, 2016) – Defendants may only recover post-offer expert fees under CCP § 998.

In 2015 the legislature amended Code of Civil Procedure section 998. The amendment became effective January 1, 2016. Prior to the amendment there was a legislative oversight with respect to awarding expert witness fees. If a plaintiff rejected a valid defense 998 offer and failed to beat it at trial, the trial court had discretion to award both pre-offer and post-offer expert witness fees to the defendant. If a defendant rejected a plaintiff’s valid 998 offer and failed to beat it at trial, the plaintiff could only be awarded post-offer expert witness fees. The 2015 amendment provided that only post-offer expert fees could be awarded to both plaintiffs and defendants.

Toste was a wrongful death action brought by the son of a construction contractor. The father was killed when a truck backed up over him on the construction site. The son rejected 998 offers made by each of the three defendants. The jury entered verdicts establishing that none of the defendants were liable for the death. Pre- and post-offer expert witness fees were awarded to two of the defendants. The case was on appeal when the amendment of Section 998 went into effect.

The appellate court held that the amended version of Section 998 would apply because the case was on appeal at the time the new version went into effect. The court held that the first 998 offer made by one of the defendants was not valid because it was conditioned on the court approving a good faith settlement motion. However, the second offer made by that defendant was unconditional. Therefore, that defendant could only recover expert witness fees incurred after

the second offer. The court also held that an offer need not specify that judgment may be entered against the defendant to be valid. An offer that specifies a certain sum will be paid in exchange for dismissal of claims against the defendant is also valid.

[Case Digest Contributed by Chris Blank]

- *Sanford v. Rasnick*, 246 Cal. App. 4th 1121 (1st Dist. Apr. 25, 2016) – CCP § 998 offer that required plaintiff to sign a settlement agreement that was not attached to the offer was invalid. Mediation fees can be awarded as costs.

This is an auto v. motorcycle personal injury case. The defendants were a father who owned the car involved in the accident and his daughter who was driving the car. They were both insured under the same policy and represented by the same attorney. They made a CCP 998 offer of \$130,000.00 in return for a request for dismissal with prejudice of the entire action, or a good faith settlement finding, plus delivery of an executed and notarized settlement agreement and general release. However, they did not include the proposed settlement agreement with the offer. The case went to trial and plaintiff was awarded \$115,036 in damages. Defendants moved for an award of costs based on plaintiff's rejection of the 998 offer. Plaintiff also sought costs as the prevailing party. Defendants moved to tax plaintiff's costs for mediation expenses and costs incurred for delivering documents to the court.

The trial court ruled in favor of the defendants on both motions. The appellate court reversed and remanded. It held that making an offer on behalf of two defendants without apportionment did not invalidate the offer, but requiring execution of a settlement agreement and general release without attaching a draft document to the offer was enough to invalidate it. Defendants argued that in auto crash cases the terms of settlements agreements are standard across the industry. The appellate court was unconvinced, particularly because the supposed standard included a general release that might apply to claims that were not at issue in the lawsuit, as well as a Civil Code Section 1542 waiver. These provisions went beyond what a 998 offeree can legitimately demand.

The appellate court also remanded for the trial court to exercise its discretion regarding awarding mediation fees and delivery expenses to plaintiff. Such expenses are not included in the items automatically covered by CCP Section 1033.5(a), nor are they excluded by section 1033.5(b). Therefore, the court has

discretion to award them if it finds that they were “reasonably necessary to the conduct of the litigation rather than merely convenient or beneficial to its preparation.” The opinion makes a strong statement about the benefits of mediation and the good reasons for allowing mediation fees and costs to be recovered.

[Case Digest Contributed by Chris Blank]

- ***Ignacio v. Caracciolo***, 2 Cal. App. 5th 81 (2d Dist. Aug. 3, 2016) – CCP § 998 offer is invalid if it contains a general release and 1542 waiver.

This case involves an auto v. pedestrian accident. Defendant made a \$75,000.00 CCP Section 998 offer that included the requirement that plaintiff sign a settlement agreement that included a general release with a waiver of unknown claims under Civil Code section 1542. The plaintiff declined the offer and obtained a \$70,000 judgment at trial. The trial court denied the defendant’s motion to tax costs and to obtain her own costs under CCP § 998. The Court of Appeal affirmed, holding that the release term invalidated the offer. The defendant argued that *Goodstein v. Bank of San Pedro*, 27 Cal. App. 4th 899 (1994) established that a general release does not necessarily invalidate a 998 offer, but the Court of Appeal held that *Goodstein’s* holding was based on a narrow “historical” definition of the term “general release” that included only known and unknown claims arising from the claim in the underlying action. Accordingly, the court held that *Goodstein* did not apply to a general release of *all* known or unknown claims that includes claims unrelated to the underlying litigation. The Court of Appeal held that such a broadly worded general release made it impossible to value the 998 offer and determine whether or not the plaintiff’s recovery exceeded the offer.

Defendants lamely asserted that the release was not actually a general release because it had a provision that said the release applied to the claims described above, “including but without, in any respect, limiting the generality of the foregoing, any and all claims that were, or might, or could have been alleged in connection with an accident that occurred on . . . and are the subject of the lawsuit entitled . . .” The court didn’t buy it. Language that states the release included the claims related to the lawsuit, but is not limited to those claims, is not a limit at all. The court noted that the trial court asked plaintiff’s counsel if she had any other potential claims that were not part of the lawsuit. He replied that she had a potential claim for invasion of privacy against the defendant, her

counsel and an investigator they hired. This was enough for the court to conclude that the release was overbroad, thereby making the 998 offer invalid.

- *Markow v. Rosner*, 3 Cal. App. 5th 1027 (2d Dist. Oct. 4, 2016) – CCP § 998 offer is not invalid because made by plaintiffs jointly, nor is it invalid because it was conditioned on the accuracy of defendant’s discovery responses concerning the limits of his insurance policy.

Mr. Markow was rendered quadriplegic due to Rosner’s negligent medical treatment. Mr. Markow sued Rosner for negligence and Mrs. Rosner sued for loss of consortium. Six months prior to trial the Markows made a joint settlement offer for \$999,999.99 contingent on the accuracy of Rosner’s discovery responses stating that the limit of his insurance coverage was \$1.0 million. Rosner did not accept the offer and the jury awarded the Markows \$5.2 million. The Markows moved for costs which were awarded. On appeal, Rosner argued that the 998 offer was invalid because it was joint and conditional. The appellate court rejected both arguments. The Markows’ offer was not confusing. They clearly recovered more than they offered to accept in settlement. Apportionment was not a problem because the statutory limit for a loss of consortium claim was \$250,000.00, so the balance of the settlement demand must have been allocable to Mr. Markow’s claims. The court also concluded, based on prior precedents that it is not improper or unreasonable to condition a settlement offer on the veracity of the opposing party’s discovery responses, particularly when those responses involve the policy limit of the insurance covering the potential claims.

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- *Goglin v. BMW of North America, LLC*, 4 Cal. App. 5th 462 (4th Dist. Oct. 21, 2016) – Attorney fees awarded after rejection of settlement offer in Lemon Law case.

Plaintiff alleged that the car she bought from BMW of San Diego was defective. She sent the notice required by the Consumer Legal Remedies Act (“CLRA”). In response, the defendants offered to repurchase the car and pay incidental expenses, but required a general release and a confidentiality provision in the settlement agreement. Plaintiff’s counsel responded that the request for the general release and confidentiality were inappropriate and unacceptable. The defendants did not respond to plaintiff’s attorney’s letter. Plaintiff filed suit

under the CLRA and also under the Song-Beverly Consumer Warranty Act. Defendant's made another settlement offer after the lawsuit was filed, but again required a general release and a confidentiality provision. Again, plaintiff's counsel rejected the offer for the same reasons.

After considerable litigation activity took place, the parties settled for payment of \$75,000.00, less the plaintiff's loan balance. The defendants also agreed to pay plaintiff's attorney fees and costs in an amount to be separately negotiated or resolved by the court on noticed motion. Plaintiff filed a motion requesting more than \$200,000.00 in fees and costs. Defendants responded that no fees or costs for litigation should be awarded because it was unnecessary in light of the pre-litigation and post-filing settlement offers it made.

The court disagreed and awarded nearly all of the fees and costs requested by the plaintiff. The appellate court affirmed. It pointed out that the Song-Beverly act prohibits a defendant from conditioning a restitution or settlement offer on confidentiality. It also held that rejecting an offer that required a general release in a case that included claims outside of the purview of the Song-Beverly Act was not unreasonable.

[Case Digest Contributed by Chris Blank]

- ***Bigler-Engler v. Breg, Inc.***, 7 Cal. App. 5th 276 (4th Dist. Jan. 6, 2017) – CCP § 998 offer must have an acceptance provision to be valid.

Plaintiff made a CCP Section 998 offer to accept \$1,000,000.00 as compensation for her injuries. The offer did not include an acceptance provision; however, the defendant affirmatively rejected it in writing. Plaintiff was awarded far more than \$1,000,000.00 in damages and sought an award of costs under section 998. The trial court denied the request, holding that the offer was invalid because it did not include an acceptance provision. Long standing case law supported this conclusion. However, Plaintiff argued that the defendant's affirmative rejection of her offer should lead to a different result. The appellate court disagreed. Whether a section 998 offer is valid or invalid is determined by reference only to the four corners of the offer. Subsequent events, such as the affirmative rejection of the offer cannot serve to validate an invalid offer. Plaintiff argued for application of the doctrine of Equitable Estoppel, but that was rejected as well. The defendant's conduct did not mislead the plaintiff or induce reliance on a false set of facts.

[Case Digest Contributed by Chris Blank]

2. Enforcement of Settlement Agreements

- *Karpinski v. Smitty's Bar Inc.*, 246 Cal. App. 4th 456 (1st Dist. Apr. 12, 2016) – Satisfaction of liens is not a prerequisite to payment of settlement funds absent a contractual condition.

In this case, the plaintiff and defendant settled a personal injury action for \$40,000. The recovery in the action was subject to medical liens under the California Victims of Crime program and Medicare. The settlement provided that the plaintiff would satisfy any liens, and would indemnify the defendant for claims arising under any unsatisfied liens. The defendant then refused to issue a settlement check unless the plaintiff satisfied the liens first, or accepted a check with plaintiff and the lienholders all listed as recipients. The trial court issued a judgment enforcing the settlement agreement under CCP § 664.6, and ordering the defendant to pay the settlement amount over to the plaintiff. The Court of Appeal affirmed, holding that: (a) the express language of the contract did not require the plaintiff to satisfy the liens before receiving payment; (b) nothing in the applicable lien statutes constitute a statutory condition precedent to payment of the settlement amount; and (c) the indemnification provision gave the defendant an adequate remedy in the event the plaintiff failed to satisfy the liens. The Court of Appeal also noted that if defendant wanted to ensure payment of the liens before payment of the settlement, it should have negotiated for such a term in the settlement agreement.

[Case Digest Contributed by Chris Blank]

- *Hayward v. Superior Court*, 2 Cal. App. 5th 10 (1st Dist. Aug. 3, 2016), petition for review granted, 382 P.3d 1135 (Nov. 9, 2016) – Disqualification of judge invalidates settlement agreement influenced by void rulings.

In a contentious marital dissolution case, the parties – Hayward and Osuch – stipulated to the appointment of a private judge pro tempore, who failed to make required disclosures of prior relationships with the parties' attorneys. After the private judge issued several adverse rulings against Hayward, the parties entered into a Memorandum of Agreement (MOA) to settle the case. Hayward later argued that she had entered into the MOA under economic duress. While a motion to enforce the MOA under CCP § 664.6 was pending, Hayward learned of the private judge's failure to disclose, and filed a request to disqualify the private judge. After disqualification was granted, the Court of Appeal held that the private judge's ruling were void as a result of the disqualification, and that

the MOA was invalid since Hayward's willingness to enter into the settlement was influenced by the void rulings against her. In so holding, the Court of Appeal explained that the legal correctness of the void rulings was irrelevant, and that the property inquiry was "whether a person aware of the facts might reasonably entertain a doubt that, in the absence of the void rulings, the parties would have agreed to the terms in the MOA."

- *Coles v. Glaser*, 2 Cal. App. 5th 384 (1st Dist. Aug. 11, 2016) – Where settlement payment is rescinded in bankruptcy, co-defendants remain liable for the settlement amount.

In this case, the plaintiff loaned funds to the defendant investment company, with guarantees by the company's president and vice president. When the investment company failed to repay the loan, the plaintiff sued the company and the guarantors. The company then repaid the loan, and the parties entered into a settlement agreement that required repayment of the loan by the defendants, acknowledge the plaintiff's receipt of the payment from the company, and released all of the defendants from further liability. Shortly thereafter, the company declared bankruptcy, and a portion of the loan repayment had to be returned to the bankruptcy trustee when it was declared to be a preferential transfer. The plaintiff then sued the two guarantors to recover the balance of the payment required under the settlement agreement. The guarantors argued that the settlement was satisfied and they were released from liability when the company paid off the loan, notwithstanding the fact that the payment was later rescinded by the Bankruptcy Court. The trial court and Court of Appeal disagreed, holding that the Bankruptcy Court's order voided the payment, *nunc pro tunc*, so that it was as if the payment had never been made. As such, the guarantors were in violation of the settlement agreement, and could be ordered to pay the balance owed.

3. Cost Awards

- *DeSaulles v. Community Hospital of the Monterey Peninsula*, 62 Cal. 4th 1140 (Mar. 10, 2016) – Where settlement does not discuss costs, plaintiff who dismisses case in exchange for payment is the prevailing party.

In this case, the parties entered into a settlement agreement calling for the defendant to pay \$23,500 to the plaintiff, in exchange for a dismissal with prejudice of the plaintiff's two remaining contract claims. After the claims were dismissed, the trial court awarded the defendant costs as the prevailing party. The Court of Appeal and California Supreme Court both disagreed with the trial court, holding that a plaintiff who dismisses a claim in exchange for a settlement payment has obtained a "net monetary recovery," and thus is the prevailing party under Code of Civil Procedure section 1034(a)(4). Accordingly, the plaintiff, and not the defendant, was entitled to recover costs.

Section 1032(a)(4) provides:

"'Prevailing party' includes the party with a net monetary recovery, a defendant in whose favor a dismissal is entered, a defendant where neither plaintiff nor defendant obtains any relief, and a defendant as against those plaintiffs who do not recover any relief against that defendant. When any party recovers other than monetary relief and in situations other than as specified, the "prevailing party" shall be as determined by the court, and under those circumstances, the court, in its discretion, may allow costs or not and, if allowed may apportion costs between the parties on the same or adverse sides pursuant to rules adopted under Section 1034."

The California Supreme Court interpreted this statute to mean that where the defendant pays the plaintiff in exchange for the plaintiff's dismissal of its action, the plaintiff is the prevailing party, and is entitled to an award of costs. In reaching this decision, the Supreme Court disapproved *Chinn v. KMR Property Management*, 166 Cal. App. 4th 175 (2008), which held that a voluntary dismissal is considered a judgment in the defendant's favor. The Supreme Court explained that the cases that *Chinn* relied on all involved voluntary dismissals that were *not* accompanied by a settlement payment, and thus were not applicable where the plaintiff obtained a monetary recovery in the form of a settlement payment.

The Court also noted that it was only declaring the default rule, and that the parties to a settlement are free to expressly allocate costs as they see fit.

The majority opinion in *deSaulles* came to the opposite conclusion, holding that a dismissal obtained by paying money to a plaintiff is not a “dismissal in favor of the defendant.” Rather, net monetary recovery for the plaintiff can include settlement payments made in exchange for dismissal. The dissent argued that when a plaintiff obtains a settlement payment in exchange for dismissal, both the plaintiff and the defendant are prevailing parties, and therefore, the remaining clause of subsection (4) applies, meaning that whether costs are awarded to either plaintiff or defendant is a matter of discretion left to the court to decide on a case-by-case basis.

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4. Tender Under Civil Code Section 2983.4 Affecting Award of Attorney’s Fees

- *Tun v. Wells Fargo Dealer Servs., Inc.*, 5 Cal. App. 5th 309 (4th Dist. Nov. 7, 2016) – When plaintiff decides to reject the amount tendered and go to trial, and then loses at trial, the plaintiff should not be allowed to take the amount that was tendered, and defendant should be granted fees as prevailing party because plaintiff recovered nothing by going to trial.

Under the common law, a tender made by an alleged debtor must be unconditional if it is to serve to extinguish the debt. That is, a tender is an unequivocal admission that the amount tendered was due. However, various consumer protection statutes (e.g., Vehicle Leasing Act (Civil Code § 2985.7 et seq.), the Unruh Act (Civil Code § 1801 et seq.); and the Automobile Sales Finance Act (“ASFA”) (Civil Code § 2981 et seq.)) also use the word “tender” in a different sense. At issue in this case is the ASFA.

Civil Code section 2983.4 (which is part of the AFSA) provides:

“Reasonable attorney's fees and costs shall be awarded to the prevailing party in any action on a contract or purchase order subject to the provisions of this chapter regardless of whether the action is instituted by the seller, holder or buyer. Where the defendant alleges in his answer that he tendered to the plaintiff the full amount to which he was entitled, and thereupon deposits in

court, for the plaintiff, the amount so tendered, and the allegation is found to be true, then the defendant is deemed to be a prevailing party within the meaning of this section.”

The purpose of this statute is primarily to protect consumers from an award of attorney fees if they are sued for default under an automobile finance contract if they are willing to tender and pay into court the amount they owe under the contract. The effect is similar to the cost shifting effect of a Code of Civil Procedure section 998 offer of settlement, but there are important differences.

In this case the plaintiff sued a used car dealer (CA Beemers of Costa Mesa), and Wells Fargo Dealer Services, Inc. alleging that CA Beemers misrepresented the damage history of the used BMW auto that plaintiff purchased. Under the AFSA, any claim or defense that a consumer may have against the dealer may also be asserted against the holder of the installment sales contract used to finance the purchase.

Upon being sued, Wells Fargo tendered and paid into court the full amount of all payments that had been made by the plaintiff on the installment sales contract, roughly \$15,000.00. The plaintiff did not accept the tender and went to trial and lost on all causes of action. Wells Fargo sought an award of attorney fees. Plaintiff moved for a new trial as to Wells Fargo contending that the trial judge made an error of law when he granted Wells Fargo’s motion in limine preventing Plaintiff from introducing Wells Fargo’s tender as an admission of liability in the amount tendered. The trial court granted plaintiff’s motion for new trial.

On appeal, the court reversed the grant of a new trial. It held that there was no error in granting the motion in limine. A tender under section 2983.4 is not an admission of liability. The statute is designed to encourage settlement and if it were construed as plaintiff argues, that would have the opposite effect. The appellate court also rejected plaintiff’s argument that attorney fees should not be granted because there was no finding that the allegation [that the defendant had tendered the full amount to which plaintiff was entitled] was true. The appellate court found this construction of the contract to be absurd. When all relief was denied to the plaintiff, the fact that a defendant tendered more than was due, should not deprive the tendering defendant of the right to recover attorney fees. Rather, in such situation the first sentence of section 2983.4 applies and the defendant should be granted fees as prevailing party not because of the tender, but because the plaintiff obtained nothing.

Finally, although Wells Fargo conceded that the plaintiff should be allowed to keep the amount tendered, the appellate court rejected this interpretation of Section 2983.4. It held that when a plaintiff decides to reject the amount tendered and go to trial, and then loses at trial, the plaintiff should not be allowed to take the amount that was tendered. Again, the court saw this as contrary to the purpose of the statute, which is to encourage settlement. It explained that it is not required to accept a concession by a party as to a matter of law, such as the interpretation of a statute. It has a duty to correctly determine the law and construe the statute for the sake of correctly establishing precedent.

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