

# Contractual Arbitration in California

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## INTRODUCTION

Arbitration is a voluntary nonjudicial means of dispute resolution based on an agreement of the parties. In general, the rules governing the arbitration are contained in the parties' agreement itself. See *Rifkind & Sterling, Inc. v Rifkind* (1994) 28 CA4th 1282, 1292, 33 CR2d 828 (arbitration award is private agreement governed by rules of parties' own making or selection). Arbitration can be agreed to in the parties' original contract, in any later amendment of that contract, or even separately, after a dispute between them has arisen. Written agreements to submit existing or future controversies to arbitration are valid, enforceable, and irrevocable under both the California Arbitration Act (CAA) (CCP §§1280–1294.2) and, for transactions involving interstate commerce, the Federal Arbitration Act (FAA) (9 USC §§1–16), except to the extent that grounds exist for revocation of any contract. CCP §1281; 9 USC §2.

## ADVANTAGES AND DISADVANTAGES OF ARBITRATION

The following are some advantages and disadvantages of arbitration. As with most important legal matters, there is no one-size-fits-all arbitration clause or procedure. What may be a disadvantage in

one circumstance may be an advantage in another, and vice versa.

- Arbitration is usually speedier than litigation, although some arbitration proceedings continue for years without resolution. The speed of the proceeding can be regulated by drafting procedures for dispute presentation and ruling preparation into the contract.
- Arbitration is often less expensive than litigation, but this is not always true.
- Arbitration does not normally involve extensive discovery, and this may decrease the cost of dispute resolution.
- Arbitration awards are generally not subject to time-consuming scrutiny by an appellate court.
- Experts knowledgeable about the issues in dispute (*e.g.*, architects, broker-dealers) can serve as arbitrators.
- Arbitration can be conducted completely confidentially.
- Arbitration follows less strict rules of evidence than court proceedings, and this may expedite resolution.
- Arbitrators have the power to make compromises in the dispute, giving each party some relief.
- Unless otherwise agreed, arbitrators are free to follow broad principles of equity, need not fol-

low the law, and have broad powers to define the appropriate remedy.

- Unless otherwise agreed, arbitration awards are almost always final and not subject to effective judicial review. Even when available, judicial review may not extend to the merits of the dispute, the sufficiency of evidence to support the award, or the arbitrator's reasoning.
- Unless otherwise agreed, the general lack of discovery rights in arbitration may impede a party's ability to present its case effectively.
- The arbitrator can award punitive damages unless they are excluded by agreement.

The potential disadvantages can be minimized or eliminated by careful consideration and drafting of the arbitration agreement. A careful drafter who does not unthinkingly add an arbitration clause from a form into his or her contract therefore has an opportunity to create an efficient means for dispute resolution.

Deciding to use arbitration does not eliminate completely the role of the courts. For example, unless the arbitration clause is self-executing, a party must petition the court to appoint an arbitrator. CCP §1281.2. Moreover, arbitrators' judgments are not self-executing. The prevailing party must move to confirm the award to enforce a judgment. CCP §§1285–1287.6. There is also the risk that a party opposed to arbitrating a claim may challenge the duty to arbitrate by asserting that the arbitration clause was obtained by fraud that "permeates" the agreement (*King v Prudential-Bache Sec., Inc.* (1990) 226 CA3d 749, 755, 277 CR 214), or that the contract is unconscionable (*Graham v Scissor-Tail, Inc.* (1981) 28 C3d 807, 827, 171 CR 604), or that certain other limited grounds exist for avoiding the arbitration clause, e.g., waiver of the right to arbitrate (*Engalla v Permanente Med. Group, Inc.* (1997) 15 C4th 951, 981, 64 CR2d 843).

## ENFORCEMENT OF ARBITRATION CLAUSES

### California Arbitration Act

The California Arbitration Act (CAA) (CCP §§1280–1294.2) governs arbitration agreements and arbitration proceedings under California law. As stated by the court in *Woolls v Superior Court* (2005) 127 CA4th 197, 204, 25 CR3d 426, the CAA "represents a comprehensive statutory scheme regulating private arbitration...[through which] the Legislature has expressed a strong public policy in favor of arbitration as a speedy and relatively inexpensive

means of dispute resolution." See also *Brown v Wells Fargo Bank, N.A.* (2008) 168 CA4th 938, 85 CR3d 817. A broad choice-of-law clause specifying that California law applies to the contract will incorporate the CAA. See *Cronus Invs., Inc. v Concierge Servs.* (2005) 35 C4th 376, 387, 25 CR3d 540.

Apart from the generally applicable provisions on arbitration found in the CAA (CCP §§1280–1294.2), the Code of Civil Procedure also includes specific statutes addressed to arbitration of medical malpractice claims (CCP §1295), disputes under public construction contracts (CCP §1296), international commercial disputes (CCP §§1297.11–1297.432), Disputes under real estate contracts (CCP §§1298–1298.8), and firefighter and law enforcement officer labor disputes (CCP §§1299–1299.9).

## Federal Arbitration Act

### Generally

Under the Federal Arbitration Act (FAA) (9 USC §§1–16), a written arbitration provision in a maritime transaction or in any contract "evidencing a transaction involving commerce" is "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 USC §2. The standard for "involving commerce" is as broad as the Commerce Clause in the United States Constitution. *Southland Corp. v Keating* (1984) 465 US 1, 79 L Ed 2d 1, 104 S Ct 852. The slightest factual nexus with interstate commerce will bring the transaction (and thus the arbitration provision) within the FAA. See *Allied-Bruce Terminix Cos. v Dobson* (1995) 513 US 265, 130 L Ed 2d 753, 115 S Ct 834. However, the FAA does not apply to employment contracts of transportation workers. *Circuit City Stores, Inc. v Adams* (2001) 532 US 105, 149 L Ed 2d 234, 121 S Ct 1302 (FAA's inapplicability under 9 USC §1 for "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce" applies only to transportation workers, not all workers).

The substantive provisions of the FAA (9 USC §§1–2) apply in both federal and state courts. The FAA is not an independent source of federal court jurisdiction, however; federal jurisdiction must exist over the underlying case, e.g., diversity or a federal question. *Vaden v Discover Bank* (2009) \_\_\_ US \_\_\_, 173 L Ed 2d 206, 129 S Ct 1262, 1271.

Under the FAA, the question of arbitrability is normally for the courts, not the arbitrators, to decide. *First Options of Chicago, Inc. v Kaplan* (1995) 514 US 938, 944, 131 L Ed 2d 985, 994, 115 S Ct

1920 (stating that courts should not assume that the parties agreed to arbitrate without “clear and unmistakable” evidence that they did so); *Cox v Ocean View Hotel Coop.* (9th Cir 2009) 533 F3d 1114, 1120. If, however, if a party voluntarily requests that the arbitration panel rather than the court determine arbitrability and submits the issue of arbitrability to the arbitrators, that party is bound by the arbitrators’ decision on the issue unless it can show that the arbitrators’ decision is completely irrational or constitutes a manifest disregard of the law. *PowerAgent Inc. v Electronic Data Sys. Corp.* (9th Cir 2004) 358 F3d 1187.

Section 4 of the FAA provides for a jury trial if there are certain material factual disputes regarding the existence of the arbitration agreement. 9 USC §4. No such right to a jury trial exists under the FAA in state court proceedings. *Rosenthal v Great W. Fin. Sec. Corp.* (1996) 14 C4th 394, 58 CR2d 875.

#### FAA Preemption of State Law

When an agreement to arbitrate is part of a contract involving interstate commerce, the Federal Arbitration Act (FAA) (9 USC §§1–16) forecloses “the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.” *Southland Corp. v Keating* (1984) 465 US 1, 10, 79 L Ed 2d 1, 12, 104 S Ct 852. In *Preston v Ferrar* (2008) \_\_\_ US \_\_\_, 169 L Ed 2d 917, 923, 128 S Ct 978, 981, the U.S. Supreme Court held that “when parties agree to arbitrate all questions arising under a contract, state laws lodging primary jurisdiction in another forum, whether judicial or administrative, are superseded by the FAA.”

To prevent state law “draft arounds” by special interest groups, the FAA also precludes states from placing restrictions on arbitration provisions that are not applicable to contracts generally. *Doctor’s Assocs., Inc. v Casarotto* (1996) 517 US 681, 687, 134 L Ed 2d 902, 909, 116 S Ct 1652; *Brown v Wells Fargo Bank, N.A.* (2008) 168 CA4th 938, 954, 85 CR3d 817. Thus, the FAA “generally preempts state legislation that would restrict the enforcement of arbitration agreements.” *Armendariz v Foundation Health Psychcare Servs., Inc.* (2000) 24 C4th 83, 98, 99 CR2d 745. See also *Shepard v Edward MacKay Enters., Inc.* (2007) 148 CA4th 1092, 56 CR3d 326 (FAA preempted a construction defect action brought under CCP §1298.7 when the con-

struction involved materials from out of state). The FAA, however, does not preempt generally applicable state contract law that may lead a court to find a particular arbitration provision unenforceable on grounds of unconscionability. See *Discover Bank v Superior Court* (2005) 36 C4th 148, 30 CR3d 76 (FAA does not preempt California law making unenforceable at least some class action waivers in consumer adhesion contracts). See also *Shroyer v New Cingular Wireless Servs.* (9th Cir 2007) 498 F3d 976; *Sanchez v Western Pizza Enters., Inc.* (2009) 172 CA4th 154, 90 CR3d 818.

The parties to an arbitration agreement may agree that California law, including its arbitration procedures, governs their agreement. *Volt Info. Sciences, Inc. v Board of Trustees of Leland Stanford Jr. Univ.* (1989) 489 US 468, 477, 103 L Ed 2d 488, 499, 109 S Ct 1248. In *Volt*, the Supreme Court held that when the parties had agreed that California law would govern their arbitration, the FAA did not prevent the trial court from staying the arbitration under CCP §1281.2(c). “There is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate.” 489 US at 476, 103 L Ed 2d at 498.

Significantly, the California Supreme Court in *Cable Connection, Inc. v DIRECTV, Inc.* (2008) 44 C4th 1334, 82 CR3d 229, held that the FAA provisions for judicial review of arbitration awards do not necessarily preempt the corresponding provisions of the California Arbitration Act (CAA) (CCP §§1280–1294.2). In *Cable Connection*, the court found that the U.S. Supreme Court’s holding in *Hall St. Assocs. v Mattel* (2008) 552 US 576, 170 L Ed 2d 254, 128 S Ct 1396—that the FAA provisions limiting the grounds for judicial review of arbitration awards were exclusive and that parties could not contract for more expansive judicial review—was restricted to arbitration awards governed by federal law under the FAA. The California Supreme Court held that, although arbitration awards are normally final and subject only to limited judicial review under the CAA, the parties to an arbitration agreement may provide for judicial review of any legal errors in the arbitration award under the CAA. *Cable Connection*, 44 C4th at 1364. The agreement, however, must state the scope of judicial review precisely. *Christensen v Smith* (2009) 171 CA4th 931, 937, 90 CR3d 57.

## ARBITRABILITY; SCOPE OF ARBITRATION CLAUSE

### Who Decides

When a petition to compel arbitration is filed, the court must decide the gateway issue of the arbitrability of the dispute, *i.e.*, whether the parties are bound by a valid, enforceable arbitration agreement. CCP §1281.2; *Howsam v Dean Witter Reynolds, Inc.* (2002) 537 US 79, 154 L Ed 2d 491, 123 S Ct 588; *First Options of Chicago, Inc. v Kaplan* (1995) 514 US 938, 944, 131 L Ed 2d 985, 994, 115 S Ct 1920 (arbitrability ordinarily for courts, not arbitrators, to decide). By a specific reference in the arbitration agreement, however, the parties may delegate to the arbitrator the issue of arbitrability. *Dream Theater, Inc. v Dream Theater* (2004) 124 CA4th 547, 21 CR3d 322. This represents another opportunity for the careful drafter.

Under both the CAA and the FAA, there is a presumption in favor of arbitrability. *Ruiz v Sysco Food Servs.* (2004) 122 CA4th 520, 538, 18 CR3d 700. At least under the CAA, any doubts as to whether an arbitration clause applies to a particular dispute are to be resolved in favor of arbitration. *Ruiz v Sysco Food Servs.*, *supra*; *Larian v Larian* (2004) 123 CA4th 751, 19 CR3d 916. Under §2 of the FAA (9 USC §2), however, when a party challenges the validity of an arbitration clause, as distinct from the validity of the contract as a whole, the court, rather than the arbitrator, must decide whether the arbitration provision is enforceable. *Jackson v Rent-a-Center West, Inc.* (9th Cir 2009) 581 F3d 912. In *Jackson*, the plaintiff sued his employer, alleging race discrimination and retaliation and further alleging that an arbitration agreement he signed as a non-negotiable condition of his employment was unconscionable and unenforceable. The agreement included the following provision:

**The Arbitrator, and not any federal, state, or local court or agency, shall have exclusive authority to resolve any dispute relating to the interpretation, applicability, enforceability or formation of this Agreement including, but not limited to any claim that all or any part of this Agreement is void or voidable.**

Citing *Nagrampa v MailCoups, Inc.* (9th Cir 2006) 469 F3d 1257, 1264, the Ninth Circuit noted that, because the duty to arbitrate is a matter of contract, there must be a judicial determination that the contract creates such a duty before a party can be compelled to arbitrate under the contract. When a

party challenges an arbitration agreement as unconscionable, claiming that he had no meaningful choice but to enter into it, the threshold question of unconscionability must be decided by the court, applying relevant state contract law. Summary enforcement of the arbitration agreement is improper. This rule applies, even if the agreement expressly delegates that determination to the arbitrator.

### Interpretation

If an agreement to arbitrate exists, the arbitration clause should be interpreted broadly. *First Options of Chicago, Inc. v Kaplan*, *supra*, normally using a "plain meaning" method of interpretation. See, *e.g.*, *Alan v Superior Court* (2003) 111 CA4th 217, 224, 3 CR3d 377. Arbitration agreements may encompass causes of action other than breach of contract. See *Amalgamated Transit Union Local 1277 v Los Angeles County Metro. Transp. Auth.* (2003) 107 CA4th 673, 684, 132 CR2d 207. The scope of arbitration is limited only by the scope of the parties' agreement, and the power of the arbitrator is similarly defined by the parties' stipulation of submission. *Moncharsh v Heily & Blase* (1992) 3 C4th 1, 8, 10 CR2d 183. See, *e.g.*, *Flores v Axxis Network & Telecomms., Inc.* (2009) 173 CA4th 802. To the extent that procedures in the arbitration agreement differ from the default procedures in the CAA, the terms of the contract will control, unless they violate public policy. *Parker v McCaw* (2005) 125 CA4th 1494, 1506, 24 CR3d 55.

### Remedies Available

An arbitrator's award may provide for any remedy that is rationally drawn from the contract as interpreted by the arbitrator. *Advanced Micro Devices, Inc. v Intel Corp.* (1994) 9 C4th 362, 36 CR2d 581. Thus, an arbitration agreement permitting the arbitrator to grant "any remedy or relief which the Arbitrator deems just and equitable and within the scope of the agreement" allows the arbitrator to grant broad equitable remedies, including specific performance that would require detailed oversight by the arbitrator. 9 C4th at 368.

## DEFENSES TO ENFORCEMENT OF ARBITRATION CLAUSE

### Unconscionability

Like contracts generally, under California law an agreement to arbitrate may not be enforced if it is unconscionable. *Armendariz v Foundation Health*

*Psychcare Servs., Inc.* (2000) 24 C4th 83, 114, 99 CR2d 745; CC §1670.5. See, e.g., *Discover Bank v Superior Court* (2005) 36 C4th 148, 30 CR3d 76 (in consumer adhesion contract, arbitration provision waiving class actions was unconscionable when disputes between parties predictably involved small amounts of damages and party with greater bargaining power allegedly deliberately cheated large number of customers out of individually small amounts); *Olivera v El Pollo Loco, Inc.* (2009) 173 CA4th 447, 93 CR3d 65 (employment agreement requiring arbitration of all disputes, allowing discovery, but waiving the right to class arbitration was unconscionable); *Sanchez v Western Pizza Enters., Inc.* (2009) 172 CA4th 154, 90 CR3d 818 (class arbitration waiver unenforceable).

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**Although a wide variety of factors may contribute to making an arbitration provision substantively unconscionable, the primary factor is lack of mutuality; the key question is whether the contract terms are so one-sided or harsh as to lack basic fairness.**

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Federal law also recognizes unconscionability as a defense to enforcement of arbitration agreements. See *Doctor's Assocs., Inc. v Casarotto* (1996) 517 US 681, 687, 134 L Ed 2d 902, 116 S Ct 1652; *Nagrampa v Mailcoups, Inc.* (9th Cir 2006) 469 F3d 1257.

Unconscionability has two aspects, procedural and substantive, and both must be found to exist before an arbitration provision will be found unconscionable. *Armendariz v Foundation Health Psychcare Servs., Inc.* (2000) 24 C4th 83, 113, 99 CR2d 745; *Brown v Wells Fargo Bank, N.A.* (2008) 168 CA4th 938, 85 CR3d 817. Procedural unconscionability focuses on the manner in which the agreement was negotiated, i.e., because of unequal bargaining power, one party was oppressed or surprised by a contract term, while substantive unconscionability focuses on the terms of the agreement, i.e., their overly harsh or one-sided result. *Bruni v Didion* (2008) 160 CA4th 1272, 73 CR3d 395. See, e.g., *Olivera v El Pollo Loco, Inc.* (2009) 173 CA4th 447, 93 CR3d 65 (company arbitration policy procedurally unconscionable given (1) inequality in bargaining power, (2) policy description in Spanish inaccurate, and (3) policy itself only in English in much smaller type). The higher the level of proce-

dural unconscionability, the lower the level of substantive unconscionability required to render a contract or clause unenforceable, and vice versa. *Armendariz*, 24 C4th at 114; *Sanchez v Western Pizza Enters., Inc.* (2009) 172 CA4th 154, 90 CR3d 818.

An adhesion contract or provision will not be enforced against the weaker or adhering party if it does not fall within the reasonable expectations of that party. *Armendariz*, 24 C4th at 113. Even if the contract or arbitration provision is within the reasonable expectations of the parties, it will not be enforced if, as a matter of equity, the court finds that "considered in its context, it is unduly oppressive or 'unconscionable.'" *Armendariz*, 24 C4th at 113. See, e.g., *Mitchell v American Fair Credit Ass'n* (2002) 99 CA4th 1345, 122 CR2d 193 (refusing to compel arbitration when credit services association modified its membership contract to require arbitration by simply notifying its members by mail that continued membership in association constituted acceptance of modification).

Although a wide variety of factors may contribute to making an arbitration provision substantively unconscionable, the primary factor is lack of mutuality; the key question is whether the contract terms are so one-sided or harsh as to lack basic fairness. *Abramson v Juniper Networks, Inc.* (2004) 115 CA4th 638, 658, 9 CR3d 422. See, e.g., *Little v Auto Stiegler, Inc.* (2003) 29 C4th 1064, 1073, 130 CR2d 892 (arbitration agreement's provision that only awards greater than \$50,000 were subject to review was unconscionably one-sided and thus unenforceable; \$50,000 threshold inordinately benefited employer and was not justified by "legitimate commercial need"); *Olivera v El Pollo Loco, Inc.* (2009) 173 CA4th 447, 93 CR3d 65 (class action waiver unfairly one-sided because it benefited only the employer, thus substantively unconscionable); *Martinez v Master Protection Corp.* (2004) 118 CA4th 107, 12 CR3d 663 (unconscionable employment arbitration agreement lacked mutuality, imposed unacceptable costs on employee, and imposed unfair 6-month limitation on assertion of claims); *Gutierrez v Autowest, Inc.* (2003) 114 CA4th 77, 7 CR3d 267 (arbitration clause in automobile lease agreement was unconscionable because fees required to initiate arbitration were unaffordable and there was no provision for consumer to seek fee waiver); *Flores v Transamerica HomeFirst, Inc.* (2001) 93 CA4th 846, 852, 113 CR2d 376 (one-sided arbitration clause in reverse mortgage agreement was unconscionable).

### Fraud in the Execution

Claims of fraud in the execution of the entire agreement are not arbitrable; the agreement is negated by fraud in its inception and there is no arbitration agreement to enforce. *Prima Paint Corp. v Flood & Conklin Mfg. Co.* (1967) 388 US 395, 403, 18 L Ed 2d 1270, 87 S Ct 1801; *Rosenthal v Great W. Fin. Sec. Corp.* (1996) 14 C4th 394, 416, 58 CR2d 875; *Brown v Wells Fargo Bank, N.A.* (2008) 168 CA4th 938, 958, 85 CR3d 817. See, e.g., *Jones v Adams Fin. Servs.* (1999) 71 CA4th 831, 84 CR2d 151 (defendant could not compel arbitration on basis of arbitration provision in loan agreement when defendant had fraudulently induced elderly plaintiff into signing agreement).

Claims of fraud in the inducement relating to other terms of the agreement, however, do not make the arbitration provision unenforceable, even if the fraud might justify rescission of the contract. *Rosenthal v Great W. Fin. Sec. Corp.*, *supra*; *Brown v Wells Fargo Bank, N.A.*, *supra*. If the arbitration clause in an agreement may reasonably be construed to encompass a fraud claim, the parties must arbitrate even if one party alleges that the agreement was procured by fraud. *Ericksen, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v 100 Oak St.* (1983) 35 C3d 312, 197 CR 581. See also *Larian v Larian* (2004) 123 CA4th 751, 19 CR3d 916; *Johnson v Siegel* (2000) 84 CA4th 1087, 1094, 101 CR2d 412.

### Unwaivable Statutory Rights

Although under California and federal law the parties can usually agree to arbitrate statutory claims, "arbitration agreements that encompass unwaivable statutory rights must be subject to particular scrutiny." *Armendariz v Foundation Health Psychcare Servs., Inc.* (2000) 24 C4th 83, 100, 99 CR2d 745 (emphasis in original) (setting out conditions under which employer can require employees to arbitrate claims under Fair Employment and Housing Act (FEHA) (Govt C §§12900-12996)); *Little v Auto Stiegler, Inc.* (2003) 29 C4th 1064, 130 CR2d 892 (extending *Armendariz* to arbitration of certain non-FEHA claims); *D.C. v Harvard-Westlake Sch.* (2009) 176 CA4th 836, 98 CR3d 300 (*Armendariz* applies to claims involving California's hate crimes laws). An unwaivable statutory right is one enacted for public purpose. CC §3513. See, e.g., *Fittante v Palm Springs Motors, Inc.* (2003) 105 CA4th 708, 129 CR2d 659 (Lab C §970, which was enacted to prevent unscrupulous treatment of employees who are induced to move on promise of employment, was enacted for public purpose).

**NOTE:** Arbitration of federal anti-discrimination claims is not similarly restricted. See *14 Penn Plaza LLC v Pyett* (2009) \_\_\_ US \_\_\_, 129 S Ct 1456, 173 L Ed 398 (collective bargaining agreement that required union members to arbitrate claims under federal Age Discrimination in Employment Act was enforceable).

In *Gentry v Superior Court* (2007) 42 C4th 443, 64 CR3d 773, the court held that in some cases, enforcing waivers of the right to class arbitration would pose a serious obstacle to enforcement of state overtime laws. The court ruled that class arbitration waivers should not be enforced if class arbitration would be a significantly more effective way of vindicating employee rights. See also *Franco v Athens Disposal Co.* (2009) 171 CA4th 1277, 1282, 90 CR3d 539 (class arbitration waiver in truck drivers' employment agreement invalid with respect to alleged violations of state meal and rest period laws); *Sanchez v Western Pizza Enters., Inc.* (2009) 172 CA4th 154, 90 CR3d 818 (class arbitration waiver in agreement between employer and low-wage pizza delivery drivers implicated employees' unwaivable statutory rights to reimbursement of job expenses and receipt of minimum wage and was not enforceable).

At least in the employment context, to ensure that the arbitration of an unwaivable right permits the vindication of that right, the arbitration must meet certain standards. *Armendariz v Foundation Health Psychcare Servs., Inc.* (2000) 24 C4th 83, 99 CR2d 745. Under *Armendariz*, a contract to arbitrate an unwaivable public right must provide, at a minimum, for the following (24 C4th at 102):

- A neutral arbitration;
- Adequate discovery;
- A written decision that permits limited judicial review;
- All the types of relief that would otherwise be available in court, e.g., punitive damages and attorney fees; and
- Limitations on arbitration costs, e.g., when the agreement covers FEHA claims, the employer must pay all costs unique to the arbitration.

See *D.C. v Harvard-Westlake Sch.* (2009) 176 CA4th 836, 98 CR3d 300 (*Armendariz* applies to claims involving California's hate crimes laws, which allow attorney fee awards only to plaintiffs; award of arbitration fees and expenses to defendant was therefore invalid); *Fitz v NCR Corp.* (2004) 118 CA4th 702, 13 CR3d 88 (arbitration agreement provision limiting discovery to only two depositions did

not affect both parties equally and did not provide plaintiff with sufficient discovery, because employer already possessed many relevant documents and employed many relevant witnesses).

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**[A]n arbitration agreement contained in a document that does not look like a contract may be unenforceable for lack of mutual consent.**

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The *Armendariz* requirements also apply to claims for wrongful termination in violation of public policy. *Little v Auto Stiegler, Inc.* (2003) 29 C4th 1064, 130 CR2d 892. It is an open question whether the *Armendariz* requirements apply to predispute agreements that were negotiated at arm's length by parties of relatively equal bargaining strength.

#### Other Defenses

Other defenses to contract formation are available to defend against a claimed right to arbitrate. For example, an arbitration agreement contained in a document that does not look like a contract may be unenforceable for lack of mutual consent. *Metters v Ralphs Grocery Co.* (2008) 161 CA4th 696, 74 CR3d 210. Lack of capacity may also be a defense to an arbitration agreement. See, e.g., *Flores v Evergreen at San Diego, LLC* (2007) 148 CA4th 581, 55 CR3d 823 (invalidating arbitration agreement signed by husband of incompetent nursing home patient). Illegality is also a defense. See *Little v Auto Stiegler, Inc.* (2003) 29 C4th 1064, 130 CR2d 892.

All arbitration provisions in contracts conveying real property must conform to certain requirements regarding form (see CCP §1298), and parties cannot arbitrate claims for personal injury, wrongful death, or latent defects arising from real estate sales (CCP §1298.7). It is not clear whether these limitations survive the Federal Arbitration Act if there is any interstate commerce nexus. See *Doctor's Assocs., Inc. v Casarotto* (1996) 517 US 681, 134 L Ed 2d 902, 116 S Ct 1652; *Hedges v Carrigan* (2004) 117 CA4th 578, 11 CR3d 787. If the arbitration clause is contained in a real estate lease, it may be unenforceable. See *Jaramillo v JH Real Estate Partners, Inc.* (2003) 111 CA4th 394, 3 CR3d 525.

Courts will not enforce arbitration agreements if to do so would invalidate a statutory scheme, such as the Consumers Legal Remedies Act (CC §§1750–1784) (*Cruz v PacifiCare Health Sys., Inc.* (2003) 30 C4th 303, 133 CR2d 58), or would be against

public policy (*Marriage of Berezna* (2003) 110 CA4th 1062, 2 CR3d 351). See also *Sunnyvale Unified Sch. Dist. v Jacobs* (2009) 171 CA4th 168, 89 CR3d 546. However, a petition to compel arbitration should not be denied based on the affirmative defense that the applicable statute of limitations has run; that is an issue for the arbitrator. *Wagner Constr. Co. v Pacific Mechanical Corp.* (2007) 41 C4th 19, 58 CR3d 434.

#### ARBITRATION OF ATTORNEY FEE DISPUTES

A growing area of contract litigation concerns disputes between attorneys and their clients regarding payment for legal services. The Mandatory Fee Arbitration Act (MFAA) (Bus & P C §§6200–6206) establishes procedures for arbitrating attorney fee disputes. If the client elects MFAA arbitration, the attorney is obliged to arbitrate the dispute; an attorney may obtain arbitration, however, only if the client agrees.

The parties may agree in writing at any time after the fee dispute has arisen to be bound by the arbitrator's award. In the absence of such an agreement, however, each party is entitled to a trial de novo if sought within 30 days (unless the party seeking trial willfully failed to appear at the arbitration hearing). Bus & P C §6204(a). This right to trial, however, is subject to each party's right to compel contractual arbitration under the CAA based on an arbitration clause, e.g., in the attorney-client retention agreement. See *Schatz v Allen Matkins Leck Gamble & Mallory LLP* (2009) 45 C4th 557, 87 CR3d 700. In other words, the MFAA does not supersede the CAA for attorney-client arbitration.

#### SCOPE OF ARBITRATOR'S AUTHORITY TO GRANT RELIEF

Arbitrators have broad discretion to craft an award to fit the circumstances of the case. Arbitrators have the power to award damages. *Charles J. Rounds Co. v Joint Council of Teamsters No. 42* (1971) 4 C3d 888, 899, 95 CR 53. Unless the arbitration agreement provides otherwise, an arbitrator may award punitive damages and civil penalties. *County of Solano v Lionsgate Corp.* (2005) 126 CA4th 741, 24 CR3d 362; *Rifkind & Sterling, Inc. v Rifkind* (1994) 28 CA4th 1282, 33 CR2d 828 (punitive damages and attorney fees); *J. Alexander Sec., Inc. v Mendez* (1993) 17 CA4th 1083, 21 CR2d 826 (punitive damages award upheld although agreement

did not expressly permit or exclude punitive damage awards). Arbitrators may also award equitable relief. *California State Council of Carpenters v Superior Court* (1970) 11 CA3d 144, 159, 89 CR 625 (enforcement of collective bargaining agreement).

These rules, however, are subject to modification by the contract itself. In *Gueyffier v Ann Summers, Ltd.* (2008) 43 C4th 1179, 77 CR3d 613, the parties agreed that the arbitrator would have no power to modify or change any material term of the franchise contract, including the notice and cure provisions. The arbitrator excused the franchisee's failure to give notice and opportunity to the defendant to cure its breaches because, as a result of those breaches, the franchisee's store opened to immediate and disastrous results and had to close. The appellate court held that the arbitrator had violated the parties' agreement limiting his powers. The California Supreme Court reversed, holding that excusing performance under specific factual circumstances did not amount to modifying or changing a material term of the franchise contract.

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**Unless the arbitration agreement provides otherwise, an arbitrator may award punitive damages and civil penalties.**

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Unless the parties have agreed otherwise, costs and expenses of arbitration are allocated in accordance with CCP §1284.2, which provides for prorata division, except that fees and expenses incurred for the benefit of a party are paid by that party. The parties may provide in the arbitration clause or submission agreement that costs will be allocated differently. Arbitration agreements often provide that costs, expenses, and attorney fees will be awarded to the prevailing party or allocated as the arbitrator determines. See, e.g., *Kahn v Chetcuti* (2002) 101 CA4th 61, 123 CR2d 606.

An arbitrator lacks authority to award attorney fees without a provision permitting the award in the arbitration agreement. *Thompson v Jespersen* (1990) 222 CA3d 964, 272 CR 132. If attorney fees are wrongfully awarded in excess of the arbitrator's jurisdiction, the award may be corrected under CCP §1286.6 or vacated under CCP §1286.2. 222 CA3d at 967 n2.

## FINALITY OF ARBITRATION AWARD; JUDICIAL REVIEW

### California Arbitration Act

Generally, the arbitrator's decision is final and binding whether or not it is correct in law or in fact, even if the "error appears on the face of the award and causes substantial injustice to the parties." *Moncharsh v Heily & Blase* (1992) 3 C4th 1, 6, 10 CR2d 183. Both the CAA and FAA provide only limited grounds for judicial review of arbitration awards. See CCP §1286.2(a); 9 USC §10(a).

In drafting arbitration agreements, the parties should decide whether an arbitrator's errors of law should be subject to judicial review and explicitly address this issue in the arbitration clause. Such a provision is enforceable under the CAA although not under the FAA. An example of a clause restricting the arbitrator's ability to commit errors of law is as follows:

**The arbitrators shall prepare in writing and provide to the parties an award including factual findings and the reasons on which their decision is based. The arbitrators shall not have the power to commit errors of law or legal reasoning, and the award may be vacated or corrected on appeal to a court of competent jurisdiction for any such error.**

In *Cable Connection, Inc. v DIRECTV, Inc.* (2008) 44 C4th 1334, 82 CR3d 229, the California Supreme Court confirmed that an arbitration clause providing that any legal errors of the arbitrator would be subject to judicial review was enforceable under CCP §§1286.2 and 1286.6. However, in *Christensen v Smith* (2009) 171 CA4th 931, 937, 90 CR3d 57, the court held that a clause stating that the arbitrator "shall render an award in accordance with substantive California law" was not specific enough to allow judicial review for legal error.

The sufficiency of the evidence is not reviewable. *Case v Alperson* (1960) 181 CA2d 757, 761, 5 CR 635. The award will be upheld if it is "even arguably based on the contract; it may be vacated only if the reviewing court is compelled to infer the award was based on an extrinsic source." *Advanced Micro Devices, Inc. v Intel Corp.* (1994) 9 C4th 362, 381, 36 CR2d 581.

Absent the parties' agreement to allow review for errors of law, the only statutory grounds for vacation of the award under the CAA are listed in CCP §1286.2(a) and include fraud or some other funda-

mental defect in the process itself. See, e.g., *Gebbers v State Farm Gen. Ins. Co.* (1995) 38 CA4th 1648, 45 CR2d 725 (interested appraiser appointed by party); *Pacific Crown Distribs. v Brotherhood of Teamsters & Auto. Truck Drivers* (1986) 183 CA3d 1138, 228 CR 645 (fraud).

Another limit on the arbitrator's authority is that an arbitrator's award may not extend beyond the issues that were arbitrable under the contract between the parties. In *California Faculty Ass'n v Superior Court* (1998) 63 CA4th 935, 75 CR2d 1, a collective bargaining agreement directed an arbitrator to determine whether a university president's decision denying tenure and promotion to a probationary faculty member was based on reasoned judgment. The court held that the arbitrator exceeded his authority under the agreement by undertaking an independent evaluation of the faculty member's performance and qualifications.

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**In drafting arbitration agreements, the parties should decide whether an arbitrator's errors of law should be subject to judicial review and explicitly address this issue in the arbitration clause.**

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There is a further limited exception to the finality rule for an error that is so egregious that it yields a result entirely beyond the parties' expectations, e.g., when the arbitrator exceeds his or her powers by arbitrarily remaking the contract under which the arbitration occurs (*PG&E v Superior Court* (1993) 15 CA4th 576, 19 CR2d 295) or when finality of the award would be inconsistent with protection of a party's statutory rights (*Board of Educ. v Round Valley Teachers Ass'n* (1996) 13 C4th 269, 52 CR2d 115). In *Moncharsh v Heily & Blase, supra*, the court allowed judicial review and invalidation of an arbitration award that in effect violated public policy. The "public policy" exception was also successfully argued in *Jordan v DMV* (2002) 100 CA4th 431, 123 CR2d 122 (arbitration award violated clear expression of public policy against making gifts of public funds).

#### Federal Arbitration Act

The FAA also restricts the grounds on which an award may be reviewed to, e.g., fraud, corruption, misconduct, material miscalculation of figures, material mistake in the description of any person thing

or property referred to in the award, awards based on a matter not submitted, or matter of form not affecting the merits of the controversy. 9 USC §§10–11. In contrast to review of awards under the CAA, the FAA's provisions limiting the grounds for vacating or modifying arbitration awards are exclusive, and the parties cannot contract for more expansive review. *Hall St. Assocs. v Mattel* (2008) 552 US 576, 170 L Ed 2d 254, 128 S Ct 1396.

It is important to note, however, that the FAA provisions for judicial review of arbitration awards do not necessarily preempt California law. In *Cable Connection, Inc. v DIRECTV, Inc.* (2008) 44 C4th 1334, 82 CR3d 229, the California Supreme Court ruled that the U.S. Supreme Court's holding in *Hall St.* was restricted to arbitration awards based on federal law under the FAA and did not preempt California law.

## DRAFTING ARBITRATION CLAUSES

### AAA and JAMS Arbitration Clauses

The American Arbitration Association (AAA) publishes sample contractual arbitration clauses. See *Drafting Dispute Resolution Clauses—A Practical Guide* (American Arbitration Association, amended September 1, 2007), available at <http://www.adr.org/sp.asp?id=29159>. The AAA arbitration clauses incorporate by reference the rules of the AAA, which vary according to the type of dispute, e.g., real estate, commercial arbitration and mediation, construction disputes, consumer cases, employment and labor cases, and international commercial disputes. See <http://www.adr.org/RulesProcedures>. Counsel who wish to designate the AAA as their arbitration service should become familiar with the particular AAA rules that will apply to a dispute under their contract and specify those rules in the clause.

Judicial Arbitration and Mediation Services, Inc. (JAMS) also publishes sample arbitration clauses, which are available on the JAMS website. See <http://www.jamsadr.com/rules/clauses.asp>. Like the AAA, JAMS also has specialized rules for different types of arbitrations. See <http://www.jamsadr.com/rules/rules.asp>. Counsel should determine which JAMS rules would be most applicable for resolution of any dispute under the contract, and specify those rules in the arbitration clause.

It is not necessary to designate the arbitration service in advance. If desired, the parties can leave the choice of arbitration service to the party initiating the arbitration or design some other means of later selection.

## SELF-EXECUTING ARBITRATION CLAUSES

If the parties' arbitration clause is self-executing, arbitration may proceed without first obtaining a court order, even if one party refuses to participate in selecting an arbitrator or to appear in the arbitration proceeding. See *Weddington Prods., Inc. v Flick* (1998) 60 CA4th 793, 801 n2, 71 CR2d 265 (clause not self-executing because it did not expressly authorize ex parte arbitration proceedings nor did it incorporate any body of established arbitral rules); *National Marble Co. v Bricklayers & Allied Craftsmen* (1986) 184 CA3d 1057, 1063, 229 CR 653 (arbitration agreement is self-executing when it allows and provides for arbitration under rules incorporated in agreement). To be self-executing, the clause should provide (1) a method for selecting the arbitrator if the other party refuses to participate, (2) a procedure for going forward if the other party does not answer, and (3) an agreement that the hearing may proceed without the other party. If the clause is not self-executing and the opposing party does not respond to a demand letter or refuses to participate in arbitration proceedings, a proceeding to compel arbitration must be initiated in superior court. See CCP §1281.2.

## SPECIAL REQUIREMENTS

Arbitration provisions in medical services contracts in California must contain language prescribed by CCP §1295. Arbitration agreements in health services plans must comply with Health & S C §1363.1. Arbitration provisions in California real estate sales contracts are required by CCP §1298 to include specific language in a format specified by the statute. The language of predispute arbitration agreements between securities brokers and their customers is subject to special rules of the National Association of Securities Dealers (NASD). See NASD Rule 3110(f); see generally <http://www.finra.org>. Arbitration clauses in contracts used in other regulated industries may also be subject to special requirements—or may be prohibited outright. See, e.g., *Jaramillo v JH Real Estate Partners, Inc.* (2003) 111 CA4th 394, 3 CR3d 525 (CC §1953 establishes general rule that tenant cannot validly agree to binding arbitration in residential lease).

## DISCOVERY PROVISIONS

In general, if an arbitration clause is silent with respect to discovery, there is no right to discovery, except as allowed by the rules of the arbitration service designated by the parties. If, however, the parties expressly incorporate into their arbitration agreement the discovery provisions of CCP §1283.05, that section governs. CCP §1283.1(b). Code of Civil Procedure §1283.05 provides a right to obtain discovery just as in any civil action, subject only to the requirement that the arbitrator grant leave to take depositions. CCP §1283.05(a), (e).

The rules of most arbitration services provide for limited discovery, and give the arbitrator discretion to grant additional discovery. For example, AAA Commercial Arbitration Rules and Mediation Procedures (Including Procedures for Large, Complex Commercial Disputes) (Sept. 15, 2005), R-21 (Exchange of Information), available at <http://www.adr.org/sp.asp?id=22440>, provides simply that "(a) At the request of any party or at the discretion of the arbitrator, consistent with the expedited nature of arbitration, the arbitrator may direct i) the production of documents and other information, and ii) the identification of any witnesses to be called." See also JAMS Comprehensive Arbitration Rules and Procedures (March 26, 2007), Rule 17 (Exchange of Information), available at <http://www.jamsadr.com/rules/comprehensive.asp>. The parties may also adopt special rules for the discovery process, either by providing for no discovery at all or by specifying the discovery procedures that will apply.

## CONCLUSION

Arbitration procedures in California are potentially malleable by agreement of the parties. Counsel should consider exactly what sort of dispute resolution procedure is most desirable and draft the contract's arbitration provisions to achieve that result. There are limits on the drafter's ability to customize the process, especially in situations that may give rise to claims of unconscionability (e.g., in consumer contracts and other settings where one party has disproportionate bargaining power). Nevertheless, a surprising amount of customization is possible, and that potential should not be ignored.