

LEGAL Update

California Supreme Court Expands Arbitration Rights

Opening a door that appeared irrevocably shut, the California Supreme Court has expanded the right to judicial review of an arbitration award regarding errors of law or other mistakes. Resolving disputes through arbitration, rather than in court, often allows parties to quickly, inexpensively and conclusively end their disputes. Historically, courts have limited review of arbitration awards to awards that were “(1) procured by corruption, fraud, or undue means; (2) issued by corrupt arbitrators; (3) affected by prejudicial misconduct on the part of the arbitrators; or (4) in excess of the arbitrators’ powers.” Such limited review, however, can leave parties with arbitration awards that include errors of law or other mistakes by the arbitrator that cannot be corrected. Prior to the California Supreme Court decision in *Cable Connection, Inc. v. DIRECTV, Inc.*, the courts would not correct such errors, even if the parties agreed in advance to allow a court to do so. That has now changed in California and the court has drawn a roadmap for parties seeking to arbitrate their disputes, but retain judicial review for arbitrator error.

The California Supreme Court gives some guidance on the scope of judicial review that may be acceptable, but also warns private parties that if they decide to include a right to judicial review of the merits of an arbitration award, they “would be well advised to provide for that review explicitly and unambiguously.” In addition, a separate concurrence and lengthy dissent complicate this decision. In the end, the law in California now provides that parties to a private arbitration agreement can, if drafted correctly, agree that the merits of an arbitration award can be reviewed for errors of law, thus allowing parties a means of addressing a risk previously inherent in contractual arbitration provisions.

In *Cable Connection, Inc. v. DIRECTV, Inc.* (August 25, 2008) – Cal.4th – (08 C.D.O.S. 11291), the California Supreme Court held that arbitrators may exceed their “powers” if the arbitration provision requires that they follow the law and that their award can be vacated if they do not do so, allowing a court to vacate that award. This seemingly small nuance will likely have a huge impact on the field of arbitration, opening up the door for parties to agree to the significant benefits of arbitration, without taking on the risk of being stuck with a legally flawed award that they cannot challenge in a court of law.

Cable Connection stems from a lawsuit filed by various dealers in Oklahoma against DIRECTV, Inc. alleging claims on behalf of a nationwide class. DIRECTV moved to compel arbitration. In granting that motion, the Oklahoma court directed the arbitration to proceed in Los Angeles per the parties’ agreements, but left the decision of whether the case could proceed as a class action to the arbitrators. The agreements at issue each contained arbitration provisions stating that: “[t]he 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.” The arbitration provisions were silent on whether classwide arbitration was available.

A panel of three arbitrators convened and, after briefing and argument, issued an interim award holding (2-1) that the case could proceed as a nationwide class action. DIRECTV sought to vacate that award, asserting that the arbitrators acted beyond their authority by committing legal error. The Superior Court agreed with DIRECTV and vacated the interim award. The dealers appealed and the Court of Appeal reversed, holding that the trial court did not have the jurisdiction to review the merits of the arbitrators' award, following then-valid Court of Appeal decisions on the issue. DIRECTV petitioned for review with the California Supreme Court.

In a 5-2 decision, the California Supreme Court reversed the Court of Appeal and reaffirmed the "California rule [] that the parties may obtain judicial review of the merits [of an arbitration award] by express agreement." *See Cable Connection*, p. 2. The California Supreme Court based its decision on the strong interest in enforcing the terms of an arbitration agreement, even over the expediency of arbitrations generally.

The California Supreme Court reached its conclusion despite the recent U.S. Supreme Court decision in *Hall Street Associates, L.L.C. v. Mattel, Inc.* (2008) – U.S. –, [128 S.Ct. 1396], which held that the Federal Arbitration Act ("FAA") – on which the California Arbitration Act is based – "does not permit the parties to expand the scope of review by agreement" beyond the bases set forth in the FAA itself. The U.S. Supreme Court strictly construed the limited judicial review allowed under the FAA, finding that the grounds for vacating or modifying an award set forth in sections 10 and 11 of the FAA are "exclusive." (Under Section 10, an award may be vacated if it was procured by "corruption," "fraud," or "undue means," or where the arbitrator(s) were "guilty of misconduct," or "exceeded their powers." Under Section 11, an award may be modified or corrected if it contains an "evident material miscalculation," "evident material mistake," or "imperfect[ions] in [a] matter of form not affecting the merits.") Despite the U.S. Supreme Court's strong stance in *Hall Street*, the California Supreme Court found that states could allow judicial review of arbitration decisions based on the following:

The *Hall Street* majority left the door ajar for alternate routes to an expanded scope of review. "In holding that §§ 10 and 11 provide exclusive regimes for the review provided by the statute, we do not purport to say that they exclude more searching review based on authority outside the statute as well. The 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. But here we speak only to the scope of the expeditious judicial review under §§ 9, 10, and 11, deciding nothing about other possible avenues for judicial enforcement of arbitration awards." (*Hall Street, supra*, ___ U.S. at p. ___ [128 S.Ct. at p. 1406].)

As such, the California Supreme Court finds that the FAA does not preempt more expansive judicial review of arbitration awards under the California Arbitration Act. In doing so, the Court retraces and supports its conclusion under recent California precedent, and reverses contrary Court of Appeal decisions. The Court also noted the benefits of its ruling in support of the public policy favoring private arbitration agreements, declaring that "[t]he judicial system reaps little benefit from forcing parties to choose between the risk of an erroneous arbitration award and the burden of litigating their dispute entirely in court."

To learn more about how this new decision could help you manage the risk inherent in your business, and specifically how you can evaluate the use of arbitration and other alternative dispute resolution alternatives in your business in light of *Cable Connection, Inc. v. DIRECTV, Inc.* (August 25, 2008) – Cal.4th – (08 C.D.O.S. 11291), please contact:

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