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Arbitration Update: An Overview of Recent California Appellate Decisions

A primer on the evolving case law governing the enforceability of arbitration clauses.

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Arbitration is a common procedure for dispute resolution—specific clauses requiring arbitration frequently appear in both commercial and consumer contracts. Even so, lawyers continue to battle over when and how arbitration can be invoked. Those skirmishes have produced a flood of recent appellate decisions that has greatly transformed the availability and enforceability of arbitration.

During the last five years alone, several key cases have been handed down by the U.S. Supreme Court. Those decisions have centered on the Federal Arbitration Act (9U.S.C. §§ 1-16) which governs transactions that involve interstate commerce—and in today's world, that covers just about every transaction.

The Court has made abundantly clear that arbitration is a matter of agreement (*Rent-A-Center West, Inc. v. Jackson*, 130 S.Ct. 2772, 2776 (2010)), and that the FAA evinces a strong national policy in favor of arbitration where the parties have agreed to utilize it. Under the FAA, any state laws or policies that discriminate against arbitration are preempted. See *ATT Mobility, LLC v. Conception* (131 S.Ct. 1740 (2011). Even where certain federal statutory rights are involved and the plaintiff prefers to proceed in court, the matter will be referred to arbitration if the parties have so agreed. This will occur in many cases despite a protest that arbitration is too expensive to resolve small claims. See *Am. Express Co. v. Italian Colors Restaurant*, 133 S.Ct. 2304 (2013)(antitrust case).

Arbitration can be invoked to resolve class actions too but the parties must specifically agree to do so. See *Oxford Health Plans, LLC v. Sutter*, 133 S.Ct. 2064 (2013); *Stolt-Nielson S.A. v. AnimalFeedsInt'l Corp.*, 559 U.S. 662 (2010). The opposite proposition is also true: If parties have agreed to waive the arbitration of class claims and instead submit all individual claims to arbitration, the judiciary will respect that agreement and enforce it. *ATT Mobility*, 131 S.Ct. at 1750.

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California's arbitration policy, expressed in the California Arbitration Act (Cal. Code Civ. Proc. §§1281-1294.2) parallels the FAA. See *Tiri v. Lucky Chances, Inc.*, 226 Cal.App.4th 231 (2014). Even so, a number of recent California decisions offer an important gloss on this ubiquitous procedure, including the very recent California Supreme Court case of *Sanchez v. Valencia Holding Company,*61 Cal.4th 899 (2015).

In California, attorneys are tracking cases on a daily basis to see how the courts rule on a number of disputes concerning arbitration agreements. To assist in that effort, here is a brief discussion of recent California appellate decisions that discuss and interpret arbitration provisions.

CLASS ACTION WAIVERS

As noted above, the United States Supreme Court has expressly upheld the ability of parties to waive the arbitration of class actions. However, there are exceptions.

In a landmark decision by the California Supreme Court, mandatory class waivers were found to be generally enforceable with only one exception for claims brought under the Private Attorneys General Act ("PAGA")(Cal. Lab. Code §2698-299.5). In *Iskanian v. CLS Transportation,* 59 Cal.4th 348 (2014), the plaintiff filed a class action complaint against his prior employer for overtime and meal and rest break violations. The plaintiff signed an arbitration agreement that contained a class action waiver. The defendant-employer moved to compel arbitration, which the trial court granted. However, shortly after the ruling, the California Supreme Court decided *Gentry v. Superior Court,* 42 Cal.4th 443 (2007) and held that class action waivers in employment arbitration agreements were invalid under certain circumstances. The employer therefore withdrew its motion to compel arbitration and litigated the case.

The United States Supreme Court then decided *Concepcion* and in response, the employer renewed its motion to compel arbitration and dismiss the class claims. The employer claimed*Concepcion* invalidated *Gentry*. In *Iskanian*, the California Supreme Court agreed with that proposition, holding that *Concepcion* indeed had invalidated *Gentry*; the court also held the employer did not waive its right to arbitration by voluntarily withdrawing its motion to compel arbitration. However, the California Su-

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preme Court *also* found that an employment agreement could not waive the employee's right to bring a representative action under PAGA. *Iskanian*represents a partial win for employers, who can now be confident with arbitration agreements that have class action waivers, with the exception of PAGA claims. (With its PAGA ruling, *Iskanian*is also a partial win for employees, too.)

Most recently, in the *Sanchez* case (cited above), the state supreme court found class action waivers enforceable in a consumer automobile sales contracts. The court held that the anti-waiver provision of the California Legal Remedies Act ("CLRA") (Cal. Civ. Code §§1750-1784) is preempted in the context of an arbitration agreement covered by the FAA. The court painstakingly analyzed the application of the contract defense of unconscionability, relying on*Concepcion*, which reaffirmed that the FAA does not preempt general contract defenses. Because the court refused to find an exception to *Concepcion* as it had in the past, this case signifies at least a partial alignment with the U.S. Supreme Court's pro-arbitration policy.

ARBITRATION & NON-SIGNATORIES

As a general rule, a party cannot be compelled to arbitrate a dispute unless he or she agrees to do so. Recent decisions in courts of appeal have shown that under general contract principles, parties may not enforce arbitration against non-parties, including non-party agents who are covered by the arbitration agreement and third parties who are not beneficiaries.

In a case involving a signatory's agents, a developer built and sold a home to actor Nicholas Cage, who subsequently sold the home to the plaintiff by way of an agreement that contained an arbitration clause. The plaintiff sued the developer for construction defects and also sued Cage, Cage's business manager, and the contractor for failure to disclose the defects. Cage's business manager and the contractor cross-complained for indemnity. Because the agreement only covered disputes between Cage and the plaintiff, not Cage and his agents, the court of appeal denied Cage's motions to compel arbitration against the plaintiff and cross-defendants. See*Lindemann v. Hume*, 204 Cal.App.4th 556 (2012).

Similarly, a party may not enforce an arbitration agreement against a third-party who is not a beneficiary of the agreement. For example, in *Epitech, Inc. v. Kann* 204 Cal.App.4th 1365 (2012), a corporation contracted with Kann Capital, a financial advisor, to obtain financing to pay the corporation's creditors— not to satisfy the corporation's obligations to the creditors. The court of appeal denied Kann's motion to compel arbitration against certain creditors because the creditors were not third-party beneficiaries of Kann's agreement with the corporation.

Although parties generally may not enforce arbitration against non-signatory third parties, these non-signatories may be able to enforce arbitration against signatory parties in certain situations. A case in point is *Thomas v. Westlake*, 204 Cal.App.4th 605 (2012), where the court found that where a party seeking to enforce arbitration is alleged in the complaint to be an agent of a signatory party, the alleged agent may seek to enforce arbitration against the signatory parties. Additionally, in *Marenco v. DirecTV, LLC*, 233 Cal.App.4th 1409 (2015), the court of appeal found that DirecTV had standing to enforce an arbitration agreement as a successor in interest to the signatory when DirecTV acquired the signatory.

This exception, however, does not extend to claims that do not arise from the contract containing the arbitration provision. In *DMS Services, Inc. v. Superior Court,* 205 Cal.App.4th 1346 (2012), DMS purchased workers' compensation insurance policies from Zurich and contracted with Zurich Services Corp. ("ZSC") to act as a third-party administrator of policy claims. Neither agreement had arbitration provisions; however, Zurich required DMS to sign annual deductible agreements containing arbitration agreements. Zurich initiated arbitration against DMS for premiums and reimbursements of deductibles and DMS filed an action against ZSC. Ultimately, the court of appeal found that DMS' claims against ZSC were not founded in, or inextricably intertwined with, the deductible agreements containing the arbitration provisions.

In the employment context, courts have denied the enforcement of an arbitration agreement that was included in an employee handbook, but never specifically signed by the employee. See*Gorlach v. Sports Club Co.*, 148 Cal.Rptr.3d 71 (2009). In *Gorlach*, the court rejected arguments that the agreement was enforceable under theories of equitable estoppel or implied-in-fact agreement. It was not enough for the arbitration agreement to be placed in the handbook. The employee *must sign* the arbitration agreement for the provision to be enforceable.

These cases illustrate that, depending on the ultimate goal of each party, when drafting arbitration provisions, attorneys should ensure that the appropriate parties are (or are not) signatories to the agreement. However, efforts to exclude certain parties from the agreements may be ineffective as certain third-party beneficiaries or successors-in-interest may still be able to enforce them.

CONTRACT DEFENSES

While the FAA clearly favors arbitration, it does not foreclose the application of general contract defenses defined by statute or common law so long as they can be, and are, equally applied in a non-discriminatory manner to both non-arbitration and arbitration contracts. One such general defense is the commonly invoked doctrine of unconscionability. To be successful with this approach, the arbitration agreement must be procedurally and substantively unconscionable in order to be declared unenforceable. See *Armendariz v. Foundation Health Psyche Services, Inc.,* 24 Cal. 4th 83 (2000).

Most recently, in the *Sanchez* case (cited above), the California Supreme Court held that various formulations of the unconscionability doctrine (for example, "overly harsh" or "so one-sided as to 'shock the conscience'") represent the same standard. The court highlighted the significance of context when applying the unconscionability doctrine, stating that the "ultimate issue in every case is whether the terms of the contract are sufficiently unfair, in view of all relevant circumstances, that a court should withhold enforcement." 61 Cal.4th at 912.

The *Sanchez* court relied in part on *Sonic-Calabasas A, Inc. v. Moreno,* 57 Cal.4th 1109 (2013), which affirmed the courts' authority to strike down arbitration agreements based on the unconscionability doctrine. In *Sanchez*, the court analyzed several allegedly unconscionable provisions of the subject arbitration agreement, such as preservation of the rights to self-help remedies and clauses providing for the possibility of the car dealer seeking a second arbitration. The court ultimately reversed the lower court's finding that the agreement was unconscionable as a matter of law, repeatedly rejecting findings that the provisions favored one party or another.

As with traditional contract cases where this defense is invoked, appellate courts applying the unconscionability doctrine to arbitration agreements have found agreements unconscionable in circumstances, for example, where the arbitration agreement was not sufficiently identified or highlighted or where the circumstances surrounding the execution of the contract were unfair and unreasonable. See, e.g., *Sanchez v. CarMax Auto Superstores of California, LLC,* 224 Cal.App.4th 398 (2014); *Securitas Security Services USA, Inc. v. Superior Court,* 234 Cal.App.4th 1109 (2015). More recently, the court of appeal upheld the trial court's decision to deny the employer's request to compel arbitration in a wrongful termination action where the employee was presented with an arbitration agreement on a take-it-or-leave-it basis. The employee had no choice but to sign the agreement or lose her job offer and unemployment benefits. See *Carlson v. Home Team Pest Defense*, 239 Cal.App.4th 619 (2015).

California attorneys should be vigilant and ensure that the arbitration provisions are not unconscionable, either procedurally or substantively. When advancing an argument as to an agreement's unconscionability, attorneys can likely rely upon settled case law addressing unconscionability in other contract contexts. Most importantly, attorneys should be mindful that the question of unconscionability concerns whether or not the terms of

the contract are, to quote *Sanchez*, supra, "sufficiently unfair, in view of all relevant circumstances."

ENFORCEABILITY BY THE ARBITRATOR

Parties to an arbitration agreement may agree to delegate to the arbitrator, instead of a court, questions regarding the enforceability of the agreement. See *Freeman v. State Farm Mut. Auto. Ins. Co.,* 14 Cal. 3d 473, 480 (1975). "Because the parties are the masters of their collective fate, they can agree to arbitrate almost any dispute—even a dispute over whether the underlying dispute is subject to arbitration." *Bruni v. Didion, 160* Cal.App.4th 1272, 1286 (2008).

If the parties require an effective delegation clause, they must make certain that the language of the clause is clear and unambiguous (see *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995)), and that the delegation is not revocable under state contract defenses. Delegation clauses are effective, absent a showing of unconscionability. *Tiri v. Lucky Chances, Inc.,* 226 Cal.App.4th 231 (2014); *Malone v. Superior Court,* 226 Cal.App.4th 1551 (2014).

An interesting case in this area is *Ajamian v. CantorCO2e,* 203 Cal.App.4th 771 (2012). The case involved an employment dispute. The employer appealed after the trial court denied a petition to compel arbitration. The employer argued that the arbitrator should have determined the issue of the enforceability of the arbitration clause because the clause itself required arbitration under American Arbitration Association ("AAA") rules which vest the arbitrator with that authority. The court of appeal affirmed the trial court's order denying arbitration. While the appellate court acknowledged that under AAA rules the arbitrator may decide enforceability, the employer did not provide clear and convincing evidence that the employee was aware of this provision since she was not provided with a copy of the AAA rules. The agreement did not make any specific reference to who should decide the "arbitrability" issue. (As a practice tip, any party making reference to particular rules in an arbitration agreement should provide those rules and obtain a written acknowledgment that they have been received, or at a minimum include the Internet address where a person who is asked to sign the agreement can access them; see *Brinkley v. Monterey Fin. Servs.*, 2015 WL 7302268 (Cal. Ct. App.).)

More recently in *Pinela v. Nieman Marcus Group, Inc.,* 238 Cal.App.4th 227 (2015), the court of appeal found that an arbitration agreement between a Texas-based employer and a California-based employee was unconscionable because the agreement included a clause designating the application of Texas law. The plaintiff-employee had brought a class action in California claiming violations of California wage and hour laws. The employer moved to compel arbitration. The trial court denied the motion on the basis that the agreement was illusory. The employer appealed arguing that the agreement delegated the enforceability issue to the arbitrator and that the agreement was not illusory and was enforceable. The court of appeal upheld the trial court's decision—but on the ground that the agreement was unconscionable. The court read both the choice of law provision and delegation clause together. The choice of law provision provided that Texas law governed. The delegation clause required all questions of enforceability to be determined by the arbitrator, however, the arbitrator was prohibited from altering the rights of the parties. As a whole, the court found that the two provisions did not allow the arbitrator to apply California law in determining unconscionability and therefore the agreement itself was unconscionable.

DANGER OF CONFLICTING RULINGS

Under cases such as *Sanchez* and *Concepcion,* the FAA preempts state laws that do not favor the enforcement of arbitration agreements. However, parties should carefully consider the provisions included in each agreement because the terms of the parties' agreement and the arbitration rules agreed upon by the parties are not preempted.

Accordingly, as California law favors arbitration, the FAA does not preempt the application of section 1281.2(c) of the California Code of Civil Procedure, which grants the court discretion to refuse to enforce arbitration where there is a possibility of conflicting rulings. California attorneys should be aware that trial courts have discretion to deny arbitration if all three conditions set forth in section 1281.2(c) are satisfied:

1. a party to an arbitration agreement is a party to a pending action with a third party;
2. the third party action must arise out of the same transaction or related transactions, and
3. there must be a possibility of conflicting rulings.

It is crucial to note that each of these conditions must be satisfied in order to trigger the court's discretion. See *Acquire II, Ltd. v. Colton Real Estate Group*, 213 Cal.App.4th 959 (2013). If that is not the case, the court has no power under section 1281.2(c).

A good example of how this procedure works is *Mastick v. TC Amerirade, Inc.,* 209 Cal.App.4th 1258 (2012). In that case, the court refused to enforce arbitration agreements governed by California law if doing so would result in conflicting rulings with related litigation. The court denied an investment management company's bid for arbitration in a professional negligence suit. See *Mastick v. TC Amerirade, Inc.,* 209 Cal.App.4th 1258 (2012).

The *Mastick* case is significant in another respect: The court of appeal noted that the parties could contractually agree that the FAA would not govern their arbitration, even if the contract involved interstate commerce.

WHEN TO APPEAL

An order denying a motion to compel arbitration is appealable. However, an order *granting* such a motion is *not* appealable. See *Reyes v. Macy's, Inc.,* 202 Cal.App.4th 1119 (2011)

Although review of an order compelling arbitration is generally not appealable until after a final judgment has been entered, in certain circumstances, immediate review may be appropriate. One such instance occurred in *Garcia v. Superior Court,* 236 Cal.App.4th 1138 (2015), where a trial court order compelling arbitration was subject to immediate review because the judge failed to consider an FAA exception exempting the subject contracts. Therefore, despite the general rule, litigators should be conscious of various exceptions and provisions that may allow for appeal from such orders prior to the arbitrator's final judgment.

FINAL THOUGHTS

There have been several legislative attempts to alter the landscape of arbitration in California. The most recent of those is AB 465 which would have outlawed mandatory arbitration as a condition of employment. That bill, however was vetoed by Governor Brown in October. The veto message contained a concise summary of the Governor's position: "California courts have addressed the issue of unfairness by insisting that employment arbitration agreements must include numerous protections to be enforceable, including neutrality of the arbitrator, adequate discovery, no limitation on damages or remedies, a written decision that permits some judicial review, and limitations on the costs of arbitration. See, e.g., *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal. 4th 83 (2000). If abuses remain, they should be specified and solved by targeted legislation, not a blanket prohibition. In addition, a blanket ban on mandatory arbitration agreements is a far-reaching approach that has been consistently struck down in other states as violating the Federal Arbitration Act."

As these cases demonstrate, California public policy favors arbitration in support of the FAA's liberal pro-arbitration policy. To that end, courts in this state have narrowly construed statutory exceptions to deny arbitration, leading to greater enforcement of clauses requiring this widespread ADR procedure. Courts apply this public policy so broadly that not only are arbitration agreements between parties and their beneficiaries and agents enforceable, but such agreements may also be enforced on occasion by *non-signatories*. Given this state of the legal landscape, attorneys should be mindful of how an arbitration agreement may affect or even determine the course of a matter headed for litigation.