Judicial Review of Arbitration Awards After *Cable Connection*: Towards a Due Process Model

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I. INTRODUCTION

Both federal law[1] and California law[2] authorize the courts to refuse to enforce an arbitration award by vacatur, or vacating the award. Vacatur is, in effect, judicial review of an arbitration award. While similar to an appeal of a trial court decision, vacatur effectively ends the matter by granting a court judgment to the party that lost the arbitration. The vacatur provisions of the FAA and CAA (collectively, "Arbitration Acts") provide that an award shall be enforced unless the grounds for a vacatur (or even more limited grounds for amendment) are present. The statutory scheme rarely combines reversal (i.e. vacatur) with a "remanding" of the matter for rehearing by the arbitrator or correction of material legal or procedural errors, as is often the case in appellate review of a trial court decision.[3] Such an "all or

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[1] The Federal Arbitration Act (hereinafter FAA) is codified at 9 USC § 1 et seq.; 9 USC § 10 governs vacatur.

[2] The California Arbitration Act (hereinafter CAA) is codified at CAL. CIV. PROC. CODE § 1280 et seq.; CAL. CIV. PROC. CODE § 1286.2 governs vacatur; The New York Arbitration Act is codified at NY CPLR § 7501 et seq.; NY CPLR § 7511 governs vacatur.

[3] *See. e.g.* Jordan v. Cal. Dep't. of Motor Vehicles, 123 Cal. Rptr. 2d 122, 139-40 (2002) (vacatur is only remedy unless an award can be corrected without affecting the results of the decision). Unlike the FAA, N.Y. C.P.L.R. § 7511(d) and CAL. CIV. PROC. CODE § 1287 permits a court to order a rehearing before new arbitrators (or the same arbitrators with the

nothing" approach to vacatur unnecessarily limits a court's power to correct serious procedural and legal errors that occurred during the arbitration process. Further, it reinforces an already strong reluctance on the part of courts to interfere with arbitration awards.

The Arbitration Acts establish only a limited form of judicial review of arbitration awards through vacatur, both as to the procedure of the arbitration and to the substantive decisions made in arbitration awards. In our view, prior to the important new decision by the California Supreme Court in *Cable Connection, Inc. v. DIRECTV, Inc.*,[4] judicial review in practice has in fact been *even more* deferential than the statutory language requires. Published opinions[5] are rife with expressions of this deference. These opinions often reflect the policy

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consent of both parties). This is tantamount to allowing the parties to request a new arbitration, but subject to whatever rulings the court may make, as was the case in *Jordan*. An apparent exception to the general rule is contained in the new leading case of *Cable Connection, Inc. v. DIRECTV, Inc.*, 44 Cal. 4th 1334 (Cal. 2008) in which the California Supreme Court remanded a decision to the arbitration panel to apply the correct legal standard as to whether class-wide arbitration was available under an arbitration agreement that was silent on the matter. The issue of whether a *particular issue* is subject to arbitration under an arbitration agreement may therefore (at least in California) be an exception to the general rule cited in the text. See notes 12 and 50 below on the general rule that the issue of whether a party has agreed to any arbitration and whether the arbitration clause governs the dispute *sub judice* are questions of law for the courts. However, the federal courts in practice tend to find that the parties "intended clearly and unmistakenly" to have the arbitrability of a particular issue decided by the arbitrator based on the view that "federal courts read arbitration clauses as broadly as possible and 'any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration.'" *See e.g.* In re Currency Conversion Fee Antitrust Litig., 265 F. Supp. 2d 385, 400, 404-07 (S.D.N.Y. 2003), following and quoting Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25 (1983), as well as many other cases. *Moses Cone* holds that a federal court may order a controversy to arbitration even when there is a separate pending state proceeding, despite the so-called *Colorado Rivers* doctrine which generally requires a stay of federal court proceedings pending resolution of pending state court proceedings, further evidencing the federal courts' desire to apply arbitration clauses broadly. However, a contrary trend may be reflected in a growing willingness of the federal courts to themselves review as a matter of law whether an arbitration *agreement* (i.e. the decision to submit a dispute to arbitration) is "unconscionable," *e.g.* Jackson v. Rent-A-Car West, Inc., No. 07-16164 (9th Cir. Sept. 9. 2009) , or whether the arbitration remedy is "illusory" and would not vindicate the objector's statutory rights, *e.g.* Awriak v. Coverall N. Am., Inc., 554 F.3d 7, 12-13 (1st Cir. 2009). On the increasing use of "unconscionability" to avoid arbitration of whether the dispute itself is arbitrable, see *infra* pp. 22-23.

[4] 190 P.3d 586 (Cal. 2008).

[5] *See e.g.* Advanced Micro Devices, Inc. v. Intel Corp., 9 Cal. 4th 362, 372 (1994) ("the deference due an arbitrator's decision on the merits of the controversy requires a court to refrain from substituting its judgment for the arbitrator's in determining the contractual scope of [his] power."); Stolt-Nielsen SA v. AnimalFeeds Int'l Corp., 548 F.3d 85, 90 (2d Cir. 2008) (quoting Duferco Int'l Steel Trading v. T. Klaeness Shipping A/S, 333 F.3d 383 (2d Cir. 2003)) ("'It is well established that courts must grant an arbitration panel's decision great deference...'"); Comedy Club, Inc. v. Improv W. Ass'n, 553 F.3d 1277, 1288 (9th Cir. 2009) ("Review of an arbitration award is 'both limited and highly deferential...'").

that substantial and detailed judicial review is to be avoided in order to both encourage private "dispute resolution" of contractual disputes (i.e. the policies underpinning enforcement of contracts generally) and to conserve judicial resources for the immense burden of criminal, immigration, and tort cases already weaving their way through the federal and state systems. This application of public policy is in our view inconsistent both with existing authority of the courts under the Arbitration Acts to vacate arbitration awards and with other public policies affected by contractual control of remedies for breach of contract. As *Cable Connection* teaches, it is also inconsistent with the policy of encouraging public confidence in the arbitration process.

In reviewing arbitration awards, appellate courts have generally considered only policies of freedom of contract and conservation of judicial resources rather than the stronger principles of due process and equal application of established law as required by the federal and state constitutions. In *Barnes v. Logan,*[6] in our view a leading authority on "due process" review of arbitration awards, the Ninth Circuit even went so far as to hold that by agreeing to an arbitration clause, a party waived any claims based on its right to due process of law under either the United States Constitution or the California Constitution. Other courts have also reached a similar result by finding that there is no "state action" in judicial enforcement of arbitration awards,[7] allowing

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[6] 122 F.3d 820, 824 (9th Cir. 1997) *cert. denied*, 523 U.S. 259, 1059 (1998). *See also* Todd Shipyards Corp. v. Cunard Line, Ltd., 943 F.2d 1056, 1064-65 (9th Cir. 1991). *But see* Int'l Bhd of Elec. Workers v. CSX Transp., Inc., 446 F.3d 714, 717 (7th Cir. 2006) (due process is basis in Seventh Circuit for review of Railway Labor Act arbitrations). Anomalously, federal courts are required to review foreign arbitration awards to ensure that "fundamental due process" is accorded the losing party under the New York Convention, 9 U.S.C. §201 *et seq. See* Generica Ltd v. Pharm. Basics, Inc., 125 F.3d 1123, 129-30 (7th Cir. 1997) and Slaney v. The Int'l Amateur Athletic Fed'n, 244 F.3d 580, 592 (7th Cir. 2001) *cert. denied* 534 U.S. 828,(2002). See *infra* note 10 on federal court *dicta* regarding the requirement of a "fundamentally fair hearing" in review of arbitration awards.

[7] Davis v. Prudential Sec., Inc., 59 F.3d 1186, 1191 (11th Cir. 1995) (collecting authorities); Rifkind & Sterling, Inc. v. Rifkind, 28 Cal. App. 4th 1282, 1291 (1994). Sometimes the courts also invoke "freedom of contract", stating that more expansive judicial review would "frustrate the intent of the parties" Stolt-Nielsen SA, 548 F.3d at 92. But, as discussed below, there is little basis for imputing an "intent" to the losing party in an arbitration to waive its due process and other fundamental rights by acceptance of a general arbitration clause. On the conflict between the cases cited above and Supreme Court cases finding "state action" in use by private parties of state judgment creditor proceedings that do not guarantee due process, see *infra* note 72, particularly *Wyatt* and *Lugar*. We find it difficult to compare mere enforcement of private contracts in state judicial proceedings, which do promote due process of law (clearly not "state action") with judicial enforcement through specific statutory provisions (i.e. state action like the Arbitration Acts) of *arbitration awards* which do not provide due process. This reasoning was accepted in one Federal District Court case *Commonwealth Ass'n v. Letsos*, 40 F.Supp.2d 170, 177 n.37 (S.D.N.Y. 1999), which stated in dicta that "state action" arises from coercive

the courts to enforce the award even though it violated due process principles. The extreme results of this deference to freedom of contract are illustrated by a case discussed below in an arbitration in the motion picture business[8] enforcing an arbitration decision which could not have been made in a *judicial* proceeding based on basic due process principles.[9] This result is, however, all too consistent with other rulings in that particular arbitration system.

Courts often state that a party should not be able to achieve by arbitration what it could not achieve in a court of law.[10] Such statements, while rarely reflective of actual vacatur results, in fact state fundamental judicial principles and public policy that should be balanced against the policies of freedom of contract and conservation of judicial resources. Fairness of procedure and rational and equal application of established principles of law to similarly situated persons are more fundamental or stronger principles, and should not be overridden by weaker "efficiency" policies of freedom of contract and conservation of judicial resources. However, "efficiency" policies have in practice unduly limited judicial review of arbitration awards. Courts should also recognize countervailing policies of fairness and the rule of law and should not enforce any arbitration award that grants remedies not available under statutory or judge-made law or that denies

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state enforcement of an arbitration award.

[8] See *infra* pp. 12-15.

[9] See Katzir's Floor and Home Design, Inc. v. M-MLS.COM, 394 F.3d 1142 (9th Cir. 2004 (applying California law); Meller & Snyder v. R & T Prop., Inc., 62 Cal.App. 4th 1303 (1998) and *infra* pp. 33-35.

[10] *E.g.* Lindenstadt v. Staff Builders, Inc., 55 Cal. App. 4th 886, 892, (1997) (quoting Loving & Evans v. Blick, 204 P.2d 23 (Cal. 1949). The federal courts also state in what appears to be *dicta* in certain cases that the arbitration hearing must be "fundamentally fair," but this statement does not seem to result in any specific review to ensure compliance with precise due process concerns. In one case the Ninth Circuit found a hearing was "fundamentally fair" based, it appears, solely on written submissions. Sovak v. Chugai Pharm. Co., 280 F.3d 1266, 1271 (9th Cir. 2002) *cert. denied* 537 U.S. 825 (2002). For examples of this "fundamentally fair" *dicta*, *see* Bowles Fin. Group, Inc. v. Stifel, Nicolaus & Co., 22 F.3d 1010, 1012 (10th Cir. 1994) and cases cited; Sheldon v. Vermonty, 269 F.3d 1202, 1206 (10th Cir. 2001) (following Denver Western Rio Grande R.R. v. Union Pac. R.R., 119 F.3d 847, 849 (10th Cir. 1997)); Fine v. Bear, Sterns & Co., 765 F. Supp. 824, 829 (S.D.N.Y. 1991) (following Bell Aerospace Co. Div. of Textron, Inc. v. Local 516, 500 F.2d 921, 923 (2d. Cir. 1974)). Certain state courts may take this requirement to have a more precise "due process" meaning. *Cf.* Nosonowitz v. Nosonowitz, 726 N.Y.S.2d 486, 488 (2001) (must give notice to husband of arbitration against wife by wife's attorney for attorney fees); McMahan & Co. v. Dunn Newfund I, Ltd., 656 N.Y.S.2d 620, 621 (1997) (listing "minimum requirements of fairness"); Miller v. Miller, 264 Mich. App. 497, 691 (2004) *rev'd* 474 Mich. 27 (2005) (domestic relations arbitration require certain due process elements but satisfied by process in which each party met separately with the arbitrator).

basic due process rights. Indeed, we argue these countervailing policies are not only more important values or principles in our system of justice, but also, as *Cable Connection* teaches, failure to judicially enforce these policies undercuts confidence in (and ultimately utilization of) arbitration as an efficient alternative dispute resolution system.[11]

The suggestion in *Barnes* that parties bear the risk of losing due process and other fundamental rights when they freely agree to arbitration in a contract was perhaps an acceptable answer when arbitration clauses were limited to contracts between sophisticated businesses on fairly equal footing with one another. However, it is not an appropriate response to this problem today in light of the *Cable Connection* decision. Although arbitration clauses have become highly prevalent in today's world, most parties do not understand that they are waiving their right to fundamental fairness, nor do they understand that they are agreeing to remedies not authorized by law or in violation of fundamental rights. Arbitration clauses generally do not include express waivers of such issues nor any explanation that such rights may be waived. In other legal circumstances, no waiver of such fundamental rights would be implied absent express language.[12] In

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[11] There should be no judicial distinction between a trial court actually rendering a flawed reversible decision on fundamental legal principles of its own accord and the court achieving the same result by enforcing an arbitration award containing the same fundamental flaws and reversible errors. Many years ago, Peter M. Hoffman, one of the authors of this paper co-wrote two Notes for the Yale Law Journal on the related issues of whether private university students retained due process rights in expulsion proceedings despite the lack of "state action," and whether a state may avoid its obligation to integrate public schools by permitting delegation to private "segregation academies" of the role formerly performed by public schools. The courts have in fact showed little sympathy to any effort to avoid fundamental constitutional rights by delegation of public duties to private parties with a resultant denial of due process of law. The courts' approach to arbitration awards should be no different. Note, *Common Law Rights For Private University Students: Beyond The State Action Principle*, 84 Yale L.J. 120 (1974); Note, *Segregation Academies and State Action*, 82 Yale L.J. 1436 (1973). Traditionally, common law recognized a "property" interest of a member in membership of a private association and imputed rules of basic fairness or "due process" in reviewing expulsion from private associations as part of the "contract" of the association. We argue these considerations apply with even greater force in judicial review of arbitration awards made pursuant to arbitration proceedings controlled by private associations, such as the arbitration proceedings of the International Film and Television Alliance discussed below.

[12] On the usual requirement of an explicit "knowing" and "willing" waiver of fundamental civil rights that is "not lightly to be inferred," such as the right to a jury trial in a civil matter, see e.g. Dunmore v. United States, 358 F.3d 1107, 1116 (9th Cir. 2004); Garguilo v. Delsole, 769 F.2d 77, 79 (2d Cir. 1985). We see no basis for the conclusion of one commentator that parties to an arbitration "knowingly take the risks of error of law or fact" because the "practical experience and worldly reasoning [by 'experts'] will be accepted as correct by other experts...," *see* Joseph C. Sweeney, *Judicial Review of Arbitral Proceedings*, 5 FORDHAM

fact, the entire purpose of certain arbitration clauses is to effect a waiver of jury trial and other procedural protections normally offered to litigants by the judicial system.

The reasoning of *Barnes* is undercut even further by the United States Supreme Court decision in *Hall Street Associates*, where the Court refused to enforce contractual language added to arbitration clauses requiring a more extensive judicial review of any arbitration award as a condition to agreement to arbitration, presumably including a contractual clause requiring the arbitrator to abide by judicial principles of due process of law.[13] *Hall Street Associates* in effect holds that the parties are prohibited by the FAA from contracting to protect their due process rights or other statutory rights, which thus may be ignored by arbitrators. This rule is not followed in California for enforcement of arbitration awards pursuant to the CAA under the reasoning of *Cable Connection*,[14] which we consider below.

This article argues against judicial enforcement of awards that delegate to arbitrators the power to grant remedies that are not authorized at law or that violate fundamental due process and equal protection rights, absent specific and fully-informed waiver at the time of the arbitration agreement. Our proposal is based on existing CAA statutory provisions and *Cable Connection*, a court decision that balances the judicial principles and public policies explained above. We suggest the United States Supreme Court should take the opportunity to reject the vague and confusing "manifest disregard of the law" standard for vacatur in federal courts in favor of a clear standard delineating which public policies an arbitrator must follow at the risk of vacatur. Undeniably, existing law does not permit as full of a review of arbitration awards as would exist in an appeal of a trial

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INT'L. L.J. 253, 254 (1982), which does not represent the "real world" as we have experienced it. *Compare* Burlage v. Super. Ct., 99 Cal. Rptr. 3d 142, 145 (2009) ("...erroneous conclusions" are "what the parties bargained for..."). In the authors' experience, arbitration clauses simply provide that disputes relating to the contract at issue are subject to arbitration in a particular arbitration system and reflect no "knowing" or "willing" waiver of any fundamental rights. The FAA and CAA differ as to whether a party reserves the right to a jury trial on the issue of whether it has agreed to arbitration of a particular issue, a matter normally not subject to any deference to the decision of the arbitrator under the rule of *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1985) and *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002). See on this issue Rosenthal v. Great W. Fin. Sec. Corp., 14 Cal. 4th 394, 405-07 (1996) (comparing CAL. CIV. PROC. CODE § 1281.2 with 9 USC § 4).

[13] See the split decision in *Hall St. Assocs., L.L.C. v. Mattel, Inc.*, 52 U.S. 576, 585-86 (2008), (affirming the Ninth Circuit position set forth in Kyocera Corp. v. Prudential-Bache Trade Servs., Inc., 341 F.3d 987, 997 (9th Cir., 2003) (en banc).

[14] 44 Cal. 4th 1334 (2008).

court decision. Such a standard is neither necessary nor desirable. However, limited intervention by the courts is critical to the avoidance of serious injustice.

This article begins with a brief history of arbitration under federal and California law. We then discuss the particular issues with arbitration proceedings in the motion picture industry, particularly under the regulations of the International Film and Television Alliance. Next, we discuss the current statutory provisions of the Arbitration Acts regarding vacatur and explain how such provisions are currently applied by the courts. Finally, we propose a reconsideration and expansion of the current interpretations of the Arbitration Acts based on the countervailing judicial principles identified above and in the reasoning of *Cable Connection*, and urge legislative clarification of both statutory schemes.

II. JUDICIAL REVIEW OF ARBITRATION AWARDS UNDER CURRENT LAW

A. Brief History of Arbitration

The FAA was enacted in 1925 and the predecessor of the CAA was enacted in 1927. Both are based on earlier statutes in New York and New Jersey.[15] The Arbitration Acts were meant to accomplish two primary goals: putting an end to the judicial hostility towards arbitration, and "allow[ing] parties to avoid the costliness and delays of litigation," i.e. policies of judicial efficiency.[16] The legislative reports show that Congress viewed arbitration agreements as voluntary agreements that should be treated like other contracts.[17] At the time of

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[15] The FAA is derived from the Act of Feb. 12, 1925, ch. 213, § 14, 43 Stat. 883, 886. The CAA is derived from Stats. 1951, ch. 1708, § 4, as amended in 1961. *See* CALIFORNIA LAW REVIEW COMMISSION, RECOMMENDATION AND STUDY RELATING TO ARBITRATION G-28 et seq. (1961), *available at* http://clrc.ca.gov/pub/Printed-Reports/Pub034.pdf. See also Rosenthal v. Great W. Fin. Sec. Corp., 14 Cal. 4th 394, 406,(1996) and Eddy S. Feldman, *Arbitration Law in California: Private Tribunals for Private Government*, 30 S..CAL. L. REV. 375 (1957) for discussion of California law prior to adoption of the CAA, and the predecessor statutes in New York and New Jersey.

[16] Scherk v. Alberto Culver Co., 417 U.S. 506, 510-11 (1974). See also the leading California case of *Moncharsh v. Heily & Blase*, 832 P.2d 899 (Cal. 1992) which discusses these policies.

[17] "The report of the House Committee stated in part: 'Arbitration agreements are purely matters of contract, and the effect of the bill is simply to make the contracting party live up to his agreement. He can no longer refuse to perform his contract when it becomes disadvantageous to him. An arbitration agreement is placed upon the same footing as other contracts, where it belongs.'" Kulukundis Shipping Co. v. Amtorg Trading Corp., 126 F.2d 978, 985 (2d Cir. 1942) (citing H. R. REP. NO. 68-98 (1924)). On judicial review of arbitration

enactment of the Arbitration Acts, arbitration clauses were primarily limited to contracts between businesses, which are generally presumed to be sophisticated in their dealings.[18]

Soon the shift towards arbitration became clear. By 1944, 73% of collective bargaining agreements in major industries contained arbitration clauses.[19] By 1960, the courts were actively encouraging arbitration by allowing arbitration agreements to cover more than issues specifically set forth in the contract and resolving disputes in favor of arbitrability.[20] In fact, by 1984, the FAA had even been found to preempt state law in certain cases absent a specific choice of state law in the applicable agreement.[21]

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generally under the FAA and CAA, see *Cable Connection, Inc. v. DIRECTV, Inc.*, 3 Cal. 4th 1334, 1358-63 (2008). This issue is also discussed in *Moncharsh*, 3 Cal. 4th at 9-11. As discussed below, and in light of *Cable Connection*, which discusses the contractual basis of arbitration at length, this policy of freedom of contract has effects that both discourage and encourage judicial review.

[18] Public Citizen, Arbitration Q&A, http://www.citizen.org/congress/article_redirect.cfm?ID=7490 (last visited March 15, 2010).

[19] ROBERT V. MASSEY, JR., HISTORY OF ARBITRATION AND GRIEVANCE ARBITRATION IN THE UNITED STATES, *available at* http://www.wvu.edu/~exten/depts/ilsr/arbitration_history.pdf.

[20] *See generally* "The Steelworkers Trilogy": United Steelworkers of Am. v. Enter. Wheel & Car Corp., 363 U.S. 593 (1960); United Steelworkers of Am. v. Warrior & Gulf Navigation Co., 363 U.S. 574 (1960); United Steelworkers of Am. v. Am. Mfg. Co., 363 U.S. 564 (1960); and *supra* note 3.

[21] *See* Southland Corp. v. Keating, 465 U.S. 1, 16 (1984). The preemptive effect of the FAA on the CAA (and the concomitant question of which law applies in vacatur proceedings) has generated a fair degree of confusion. The Supreme Court has specifically held that the FAA does not overrule the CAA when the contract at issue chooses California law, in which event California law is applied even in a federal case under the FAA, including on the issue of arbitrability *vel non*. *See* Volt Info. Scis., Inc. v. Bd. of Trs., Stanford Univ., 489 U.S. 468, 474-77 (1989), a case very selectively enforced by federal courts in the authors' experience. The Court has also recently held that the FAA is satisfied if a "written arbitration provision is made enforceable against (or for the benefit) of a third party under state contract law..." Arthur Anderson LLP v. Carlisle, 129 S.Ct. 1896, 1903_(2009). The circuits appear to be split on the issue of whether federal or state law applies in federal court to the issue of arbitral jurisdiction over non-signatories. *Compare* Allstate Settlement Corp. v. Rapid Settlements, Ltd., 559 F.3d 164, 170 (3d Cir. 2009) with Comer v. Micor, 436 F.3d 1098, 1101-09 (9th Cir. 2006).

In a related decision, the California Supreme Court held the FAA did *not* preempt the CAA's provisions with respect to state court (as opposed to federal court) proceedings. *See* Cable Connection, Inc. 44 Cal. 4th at 1353-54 (following Cronus Invs., Inc. v. Concierge Servs., 35 Cal. 4th 376, 389-90 (2005) in turn based on footnote 10 in *Keating*, an issue left "open" in footnote 6 in *Volt)*. The issue of preemption is complicated by the fact that federal courts may apparently apply (and in the authors' experience do apply) the FAA to arbitration disputes based on preemption theory, even if only diversity jurisdiction is obtained and whether or not the applicable contract has a choice of law clause, based on an apparent theory that the choice of law clause applies only to "substantive" not "procedural" issues. *Cf.* Sovak v. Chugai Pharm. Co., 280 F.3d 1266, 1270 (9th Cir. 2002) *amended*, 289 F.3d 615 (9th Cir. 2002) *cert. denied* 537 U.S. 825 (2003). In light of the dramatic conflict between the position of the

Since these expansions, arbitration has continued to grow exponentially. It is no longer limited to business-to-business transactions but instead has permeated all kinds of agreements in all kinds of industries. Many employment agreements now contain arbitration clauses. Sales agreements,[22] service agreements,[23] and even financial agreements[24] all usually contain an arbitration clause. In today's world, it is difficult to find anyone at all who has not signed an agreement (whether knowingly or unknowingly) containing an arbitration clause. The experience of the authors is that arbitration clauses tend to be used selectively by businesses when those businesses believe arbitration awards will be more beneficial in actual results than the judicial process, producing outcomes more favorable to that business than are thought to be obtainable in courts. Our experience is that this objective outweighs the objective of a faster, cheaper and more efficient dispute resolution process, a point seldom noted in judicial discussions of arbitration clauses. Civil actions (at least in Los Angeles County) now proceed to trial quite expeditiously, a factor which also affects the weight given to efficiency policies.

B. Arbitration in the Motion Picture Industry

To illustrate the issues raised in practice with arbitration proceedings, we will review arbitration in one important California industry – motion pictures. Independent motion picture and television producers and distributors from the United States and most important international markets formed an alliance in the early 1980's, originally

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United States Supreme Court (Hall St. Assocs., L.L.C. v. Mattel, Inc., 552 U.S. 576 (2008)) and the California Supreme Court (Cable Connection, 44 Cal. 4th) on the enforceability of contractual clauses requiring judicial review, this issue has now enormous practical consequences to practitioners.

The FAA, however, does not on its own provide a basis for federal *jurisdiction.* See 9 USC § 4 and discussion in the recent Supreme Court decision in *Vaden v. Discover Bank*, 129 S.Ct. 1262 (2009), which again declared *Southland*'s "national policy favoring arbitration" and stated that FAA is a "body of federal substantive law" that is "equally binding in state and federal court," but nevertheless resolved a conflict in the circuits by requiring that courts "look through" the arbitration agreement to determine whether the underlying claim for which arbitration is sought "arises under federal law," without reliance on the allegations of any counterclaim, in order to find federal jurisdiction of an arbitration dispute.

[22] Ford, Toyota, Honda, Nissan, and Chevrolet, among others, provide for arbitration of disputes in their sales contracts.

[23] Verizon, Time Warner Cable, DirecTV, Comcast, AT&T, Sprint, T-Mobile, and many others include arbitration clauses in their service agreements.

[24] Bank of America utilizes arbitration clauses in all of their agreements, including credit cards, college loans, leases, and mortgages. Chase, American Express, Citibank, ETrade and many others do the same.

called the American Film Market or "AFM," and now called the International Film and Television Alliance or "IFTA." IFTA has over 100 member companies and operates the American Film Market in Los Angeles each year which more than 500 companies attend. The American Film Market represents the most important film market for motion pictures not produced by the six "major studios" (i.e. Warner Brothers, Disney, Fox, Paramount, Sony, and Universal) and their associated labels.[25]

In the mid-1980's, IFTA established an arbitration panel of approximately twenty local lawyers who claimed experience in independent film and television finance, production, and distribution. From 2002 to 2007, the IFTA conducted over 500 arbitrations with awards in excess of $50,000,000 (to say nothing of the cases in which no money was awarded). This system is now central to independent motion picture finance and distribution, and IFTA arbitration clauses are often included in financing and distribution agreements in the international motion picture business.

IFTA arbitration clauses are particularly important to banks and other financial institutions advancing loans secured by third party distribution agreements, as well as to completion bond companies. As a result, most "letters of direction" executed by third party distributors agreeing to pay proceeds of license agreements for their territory to a lender include IFTA arbitration clauses. Banks and financiers are generally pleased with the results of this system. Notably, the major studios refuse to accept arbitration clauses in production, financing, and distribution of their motion pictures even when the pictures are acquired from independent productions.

However, many independent producers and distributors have had very frustrating, if not wholly arbitrary, results in IFTA arbitration. In one case, a licensor of rights sued an independent film distributor (whom we refer to as "the distributor") because the distributor's predecessor had not paid to the licensor a rights fee for a second video sequel to a well-known film owned by the licensor (which we refer to

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[25] All information cited in this section is from the personal experience of the author except this data which was provided by Jean Prewitt (Executive Director of IFTA) in a telephone conversation with the author. In addition, the four principal unions in the motion picture business (Writers Guild, Directors Guild, Screen Actors Guild and the International Alliance of Theatrical Stage Employees for production personnel) require arbitration of most disputes between producers (including the major studios) and their members under a system similar to IFTA. Much of the discussion in the text is applicable to this arbitration process as well. Based on conversations with union representatives, we estimate that more than 300 arbitrations have occurred under these arbitration provisions in the last five years.

as the "original picture"), produced and distributed by the distributor. A UK-French co-production was established to produce a first sequel to the original picture in 1996, and the distribution rights to this picture were licensed to an unrelated party (the "first licensee"). The first licensee had funded the $12 million production budget of the first sequel under a distribution agreement giving it all distribution rights for the life of the copyright. The UK co-producer of the first sequel was owned (as was then required by the UK-French bilateral co-production treaty) by a European resident who was one of the producers of the picture. The UK co-producer had acquired the sequel rights under an agreement which included an IFTA arbitration clause. The rights agreement allowed the UK co-producer to make further sequels for payment of future rights fees to be negotiated, and it included a customary provision stating that all rights were irrevocably granted to the UK co-producer and not subject to revocation for any reason, so long as the UK co-producer paid the purchase price and started principal photography on the first sequel.

Shortly after completion of the first sequel, a Canadian venture partner of the first licensee decided it was a good idea to produce a series of low budget video or television sequels based on the original picture. The Canadian venture partner approached an executive working for the distributor to finance and distribute these low budget sequels. This Canadian venture partner took control of the UK co-producer and negotiated an agreement with the distributor under which the UK co-producer transferred the sequel rights to the distributor for payment of $100,000 per sequel plus the *distributor's* assumption of any obligation to pay any sums due to the licensor for any subsequent sequels under the original rights agreement. The distributor made the second sequel and paid $100,000 to the UK co-producer, which the first licensee endorsed under its power of attorney to the Canadian venture partner. The distributor did not pay any sums to the licensor.

In an otherwise unobjectionable decision, the arbitrator decided to hold the first licensee as the author of the entire dispute, even though the first licensee was not present; by the arbitrator's own admission, the arbitrator had no jurisdiction over it or its affiliates; and the UK co-producer (now owned by the Canadian venture partner) had defaulted. The arbitrator did not require the parties to call as witnesses, and heard no testimony from, any of the principals. Instead, the arbitrator relied on the hearsay testimony of a junior executive of the distributor who claimed to remember hearing that the first licensee had orally promised the distributor that the $100,000 paid to the UK co-producer would

instead be paid to the licensor, in full satisfaction of its rights under the original rights agreement with the UK co-producer, even though no writing existed anywhere to support this hearsay. This hearsay testimony would have been – and later in court filings was – directly contradicted by the testimony of the percipient witnesses. The arbitrator found the first licensee's "wrongful conduct" allegedly caused the whole dispute and determined that the first licensee should pay everyone's legal fees.[26]

One would like to believe that any experienced film lawyer would reject this questionable explanation of the distributor's failure to pay the license fee to the licensor. Is it believable that the first licensee would *orally* waive for *no consideration* the venture partner's or UK co-producer's rights to the $100,000 payment on a picture in which it had no interest, use that payment to satisfy the distributor's obligations under the rights agreement to make the rights payment to the licensor, *and* agree with the distributor for no consideration (and with no writing from the licensor) that the licensor would accept this sum as the to-be-negotiated sum due to the licensor for the second sequel? Apparently the arbitrator accepted this claim without ever referring to the rights agreement, which provided that the distributor was obligated to pay *both* the $100,000 and all sums due to the licensor and others in the chain of title. But most importantly, the arbitrator came to this conclusion despite his lack of jurisdiction over the first licensee and lack of testimony from any percipient witnesses to the events.[27]

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[26] Of course, the distributor for years had the cancelled check for $100,000 payable to the UK co-producer endorsed to the Canadian venture partner, showing it was paid to the venture partner, not to the licensor. Arbitration Award of June 30, 2004 made in *Jonesfilm v. Lions Gate Films, et al.*, IFTA Arbitration No. 03-08 included in the record on appeal to the Ninth Circuit. Page 6 of the Arbitration Award confirms the arbitrator's own concession of lack of jurisdiction. *Hoffman v. Goldin, et al*, No. 06-5607 filed on July 28, 2006 ("*Goldin Appeal*") which was an appeal of the dismissal of civil rights claims of denial of due process of law filed in the District Court for the Central District of California, No. CV 06-2272 (dismissal by Order dated July 20, 2006). The *Goldin Appeal* was denied by the Ninth Circuit on March 24, 2008 in an unpublished opinion based on *res judicata* allegedly rising by reason of the denial of an appeal in state court from the Original Order of March 18, 2005 of the Los Angeles Superior Court adding the first licensee on a summary basis as a judgment debtor with no evidentiary hearing. Hoffman v. Jonesfilm, No. B183198 (Cal. 2d Dist. Ct. App. May 4, 2006) (order denying appeal). The facts described above are set forth with citations to the record in Appellant's Opening Brief in the *Goldin Appeal*, pp. 1-26, filed July 18, 2006.

[27] The arbitrator then went on to find one individual, over whom the arbitrator had no jurisdiction and who did not appear at this hearing, was the "alter ego" of a company which the individual did not own based on a power of attorney he found did not exist during the relevant periods, all with no evidentiary showing. The arbitrator also found that the distributor should *not* be responsible for the licensor's legal fees because three letters had been written to the distributor's counsel warning that the second sequel was being made (production and

This arbitrary result is consistent with other IFTA arbitration experiences.[28] In one arbitration, the arbitrator found jurisdiction over three companies that had never signed an arbitration agreement. The arbitrator did so without required compliance with applicable California law requiring a court action to establish jurisdiction over non-parties, and ruled against the companies after the statute of limitations had run and after the matter had previously gone to judgment (clearly barring a new judgment under *res judicata* principles). This arbitrator also awarded attorney fees to the *losing* party under a theory that a contractual indemnity clause is in effect an attorney fee clause, even in an action on the contract between the contracting parties – another ruling in direct violation of California law.[29]

In yet another case, the arbitrator found a French distributor could avoid payment of an advance because the picture was delivered late,

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distribution of a motion picture in any event not being amenable to secrecy since the owners expect to earn money from public sale of the picture), even though these letters were written by the first licensee. Not content with his "finding" of the first licensee's "wrongful conduct," the arbitrator also felt he needed to make a "finding" with no adversary hearing about the first licensee's motivation for this "wrongful conduct": according to the arbitrator, the first licensee made this oral "representation" to the distributor to "cover up" the fact that the first licensee had not obtained the licensor's "consent" to the production of the second sequel. However, only *one page before* in his arbitration award, the arbitrator had (correctly) found that under the terms of the original agreement, neither the distributor nor the UK co-producer needed the licensor's consent for the second sequel so long as it paid the $100,000 to the UK co-producer, as its production lawyers had told the distributor at the time the second sequel was made. So the first licensee's "wrongful conduct" was to "cover up" a lack of consent that the arbitrator had one page earlier found *not to be required* with respect to a picture in which the first licensee had *no financial interest*, all without hearing the percipient witnesses tell what really happened. The California courts approved the arbitrator's findings and entered judgment against the producer personally for legal fees with no civil action filed, no hearing, no discovery, no cross-examination of witnesses or other incidents of civil procedure, even though none of the agreements provided for an award of attorney fees.

[28] The following cases are from the personal experiences of one author and his associates. The incidents are results of confidential arbitrations that lack citations.

[29] On the requirement for a petition to enforce arbitration, see CAL. CIV. PROC. CODE § 1281.2 interpreted in *City of Hope v. Bryan Cave LLP*, 102 Cal. App. 4th 1356, 1361-70 (2000). The CAA law, apparently unlike the FAA, does not permit arbitral jurisdiction over a non-signatory based on "equitable estoppel" or "receipt of benefits" theories. *See* Bensara v. Marciano, 92 Cal. App. 4th 987, 990 (2001). Compare under federal law the expansive bases for finding arbitral jurisdiction over non-signatories in *Comer v. Micor, Inc.*, 436 F.3d 1018, 1102-04 (9th Cir. 2006) and *Smith/Enron Cogeneration Ltd. v. Smith Cogeneration Int'l. Inc.*, 198 F.3d 88, 97 (2d Cir. 1999). On the refusal to permit indemnity clauses to be used as "backdoor" attorney fee clauses, see *S. Pac. Thrift & Loan Ass'n v. Sav. Ass'n Mortgage Co.*, 70 Cal App. 4th 634, 643-44 (1999). Cal. Civ. Code § 1717, an important policy in the state, prohibits awards of attorney fees to the losing party pursuant to a contractual attorney fee clause, and Cal. Civ. Proc. Code § 1021 codifies the "American rule" denying attorney fee awards absent a specific contract or statutory provision.

due to the fact that the distributor had objected with no apparent justification to delivery when tendered in the contracted time period. Further, a producer's efforts to collect a letter of credit from a Korean client were denied because the arbitrator found that underlying industry practice always required Korean censorship approval before payment on Korean contracts, ignoring the producer's contract with that Korean distributor and the producer's testimony of eight years of prior practice. Finally, a sales agent was found personally liable despite a specific claim in the underlying agreement prohibiting any personal liability related to the subject matter of the applicable agreements.

Such experiences seriously impair confidence in the IFTA arbitration system and its arbitrators and lead to logical and necessary questions from practioners as to whether the industry experience of these arbitrators is sufficient to justify an expectation of either experience in the motion picture business or knowledge of California law and procedure. The authors believe IFTA arbitrators necessarily develop a bias or prejudice towards one of the parties to the proceeding by reason of the wide network of industry relations in which each works and lives, even if there is no specified disqualifying conflict of interest. It is not surprising that financiers generally have none of the foregoing complaints.

In light of *Cable Connection*, IFTA could include in its rules of arbitration a requirement that all arbitration awards under its system must comply with California (or other appropriate) law and accord basic due process of law to parties. This addition would insure judicial review in California courts of these fundamental (non-evidentiary) questions. But neither IFTA nor any other arbitration system need rely solely on judicial review. IFTA could also establish a panel of retired judges as its own appellate panel to review errors of law, clearly erroneous factual determinations, and violations of fundamental fairness or rudimentary civil procedure, i.e. review errors *within* the arbitral process. We believe the lack of *any* review, not merely judicial review, is what leads to the abuse of arbitral discretion. Most experienced litigation attorneys recognize the importance of judicial review of trial court decisions in limiting arbitrary rulings. Such review is equally important for arbitration.

The confidentiality provisions of IFTA prohibit disclosure of opinions rendered in IFTA arbitration and hence serve to cover up bad decisions and conflicts of interest. How can a party discover conflicts or other relationships between the arbitrator and a party or its affiliates and allies without full disclosure of all arbitral awards and arbitration

records? Full publication of all awards will also be a deterrent to unchecked and absurd arbitral discretion, as *Cable Connection* suggests.[30] Most arbitration systems in our experience do not have any transparency of process, nor public review of decisions, which is an essential element of due process of law in judicial proceedings and necessary to establish defined rules of conduct applicable to all similarly situated persons. This lack of public review can result in arbitral awards that are extremely arbitrary when compared against all decisions made in that arbitral system, but that do not appear arbitrary to the court reviewing one particular decision.

Even after a party objects to arbitration, it may be forced not only to arbitrate but to pay a portion of the substantial costs of arbitration.[31] We argue the party seeking arbitration should pay *all* the arbitrator's fees. Otherwise, payment of arbitral fees is an illegal shifting of attorney fees without a contractual clause in direct violation of California law, a result also tolerated in many arbitration systems. Arbitrator fees can be included in any final award as part of legal fees and subject to appropriate review, as opposed to requiring payment up front on penalty of default. IFTA, as well as most other arbitration systems, makes no provision for providing counsel to parties who cannot afford the very high costs of arbitration, and counsel should be provided at the cost of the losing party in these instances.

We believe no IFTA arbitration should proceed against a party that has not executed an arbitration agreement, absent a court ruling after the filing of a proper petition for arbitration as required by California law. Otherwise, a party that never signed an agreement is forced to arbitrate on penalty of default (and may be deemed to have waived its objections to jurisdiction if it does) *and* pay the arbitral fees for an arbitration to which it never agreed. IFTA arbitrators have in our experience an irreducible financial incentive to find arbitral jurisdiction and limited awareness of the law regarding arbitral jurisdiction over

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[30] Cable Connection, 44 Cal. 4th at 1363 (quoted in *infra* note 63).

[31] See *infra* note 36 on the judicial review of "unconscionable" arbitration fees and costs. Normally, contractual clauses which purport to award attorney fees are "strictly construed." *See* Kolai v. Gray, 109 Cal. App. 4th 768, 777 (1997) and Layman v. Combs, 994 F.2d 1344, 1351 (9th Cir. 1992). But this rule is not followed in reviewing arbitration clauses that often award attorney fees directly or indirectly by implication from the agreement to arbitration. Compare, however, the discussion in Cole v. Burns Int'l Sec. Servs., 105 F.3d 1965, 1983-96 (D.C. Cir. 1997) (interpreting labor arbitration agreement as imposing all fees on the employer when contract is silent) and Armendariz v. Found. Health Psych-Care Servs., 24 Cal. 4th 83, 107-13 (2005) (following *Cole* in employment arbitrations).

non-parties.

C. Potential Bases for Vacatur Under Current Law

The limited judicial review of arbitration awards may be divided into four general but related categories we discuss below: (a) whether the award violates "public policy," (b) whether the award is a "manifest disregard of the law" or (c) "exceeded the power of the arbitrator," and (d) whether the award bound a party which did not agree to arbitration. We suggest that these seemingly disparate principles in fact reflect, albeit dimly at times, the strong principles of consistent application of legal principles to similarly situated parties and of due process of law, which should weigh more in the scales of justice than weaker policies of judicial efficiency.

In substance and effect, arbitration clause in agreements are a contractual choice of remedy, no different than "penalty" clauses or other remedy control provisions in agreements, and should be reviewed on principles similar to those the courts have throughout the common law applied to such contractual provisions, including choice of law or jurisdiction, or as "abstention" or "comity" to tribunals of concurrent jurisdiction.[32] The deep-seated judicial reluctance to enforce contractual choice of remedy or penalty clauses and other similar waivers of procedural rights in fact reflects our proposed balance of judicial principles and the rule of law against a pure reliance of freedom of contract and conservation of judicial resources in private dispute resolution. From the beginning of the common law, courts have refused to enforce penalty clauses in contracts despite policies of freedom of contract and conservation of judicial resources. It is difficult to conceive of an arbitrary arbitration award – i.e., one made in violation of due process or which accords a remedy not authorized by law – as anything but a contractual penalty.

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[32] *See e.g.* Brack v. Omni Loan Co., 164 Cal.App. 4th 1312, 1325 (2008) (holding that California public policy requires application of California law despite choice of law clause); Am. On-Line, Inc. v. Super. Ct., 90 Cal.App. 4th 1 (2001). On the judicial tests for enforcement of choice of law or jurisdiction clauses generally, see Smith, Valentino & Smith v. Super. Ct., 17 Cal. 3d 491, 494-95 (1976) and The Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 17 (1972). Conceptually analogous doctrines of "federal abstention" to state court proceedings or of "comity" to foreign proceedings require the courts review the fairness of the state or foreign law and tribunals to ensure that the federal claim may be fairly presented. *E.g.* Davis v. Wechsler, 263 U.S. 22, 24-25, (1923); Bird v. Glacier Elec. Corp., 255 F.3d 1136, 1140-44 (9th Cir. 2001) (holding that only recognition of tribal judgment by the Blackfeet Tribal Court of Appeals is allowable only if the tribal court did not violate due process of law, an issue reviewed *de novo* as an issue of law; appeal to racial prejudice violated due process rights).

Former Dean Wellington of the Yale Law School argued[33] that the common law principle outlawing contractual penalties, though seemingly at odds with the general principle of enforcing private consensual agreements made for consideration, was based on a belief and policy that contracting parties had unreasonably optimistic expectations that no breach triggering a penalty would occur,[34] a conclusion the authors believe is particularly applicable to parties' expectations regarding arbitration of their disputes. Expectations about the results of a contractually selected remedial process, as opposed to expectations about the value received in the exchange, are not entitled to judicial enforcement, particularly when the result "expected" is merely a better outcome for that party than might be given in court. Similarly, penalty clauses are not the sort of consideration courts protect in enforcing private bargains, and failure to enforce such clauses will in fact have no deleterious effect on the reasonable expectations of parties entering contracts: each party will continue to

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[33] While this argument was mainly voiced in his Introduction to Contracts course, the power of his logic is more apparent in his seminal article, Harry H. Wellington, *Common Law Rules and Constitutional Double Standards: Some Notes on Adjudication*, 83 Yale. L.J. 221 (1973) and in particular pages 220-35, where Wellington distinguishes between "strong" duties based on "principles," i.e. moral notions of right and wrong, and "weak" duties based on "policies" such as, in the case of contracts, "economic efficiency." In particular, Professor Wellington discusses the courts' responsibility to avoid "surprise" to a party in the "fashioning of remedy," as a function of whether the duty in issue is "strong" or "weak." It would be in our view inappropriate for the courts to "surprise" a party by finding it had "waived" fundamental rights, i.e. the "principles" of due process of law, which are a "strong" duty, in service of the policies of economic efficiency and enforcement of private contracts. *Id.* at 233-35.

[34] Compare the rules for determining whether a punitive damage award is so "grossly excessive" to be a violation of due process rights. *See* BMW of N. Am., Inc. v. Gore, 517 U.S. 559, 583 (1996) (comparing award to actual harm suffered and any applicable civil or criminal penalties). The older cases traditionally phrased the illegality of contractual "penalties" for non-performance as based on "relief from forfeiture" or "equity abhors a forfeiture," relying on equity principles to prohibit both punitive monetary sums payable on breach, but also any other type of contractual remedy which might also be a forfeiture. *E.g.* Ebbert v. Mercantile Trust Co. of Cal., 213 Cal. 496, 499 (1931). These phrases appear to be based on the underlying assumptions described by Professor Wellington. The case law, and, in California, the applicable statutes, distinguished between unacceptable "penalties" and acceptable so-called "liquidated damage" clauses, which purported to provide appropriate recompense under *judicial* definitions of contract damages only for the lost expectancy interest when "damages for breach are impracticable or difficult to ascertain at the time the contract is made" (CAL. CIV. CODE § 1671(b)), and *not* to "compel performance" i.e. *not* to compensate for an expectancy loss which is non-speculative and proven as is required by the courts. The leading case in California was *Garrett v. Coast and S. Fed. Sav. & Loan Ass'n*, 511 P.2d 1197 (Cal. 1973) ("A penalty is punitive and ... operates to compel performance of an act ... and usually becomes effective only in the event of default ... upon which a forfeiture is compelled without regard to the actual damage sustained..."). California law has since been updated in 1977 and is reflected in the amended CAL. CIV. CODE § 1671 et seq., which follow the same general principles described above but shift the burden of proof in certain cases. See *infra* note 35.

expect to receive the consideration bargained for through substantial performance. Private business will not collapse if the courts do not enforce contractual penalty clauses, as hundreds of years of common law experience can attest. The same logic applies to judicial refusal to enforce arbitration awards in which a party is deemed or inferred by arbitration agreement to have waived due process protections or other fundamental rights, as these awards are, for all intents and purposes, penalty clauses.[35]

In recent years, the courts have become much more skeptical of arbitration provisions that affect consumers or employees, as opposed to business-to-business arbitration agreements. We believe this reflects the same policies as now are applied under California law for review of contractual "penalties" or "liquidated damage" clauses. We suggest this new judicial skepticism also reflects a suspicion, well-founded in our view, that arbitration is chosen by certain businesses as a manner of avoiding statutory rights and obtaining better results than would be available in court. The doctrinal basis for this skepticism is "substantive and procedural unconscionability," both of which must be present to void an arbitration agreement.[36] The courts – at least in

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[35] Traditionally, the common law did not take into account "contracts of adhesion" or imbalance in bargaining power in reviewing "penalty" clauses. However, in the revision of California law, CAL. CIV. CODE § 1671 et seq., the Law Revision Commission recommended a general approval of "liquidated damage" clauses and in effect shifted the burden to the party seeking to invalidate such a provision to prove that the provision "was unreasonable under the circumstances at the time the contract was made," with "unreasonableness" meaning that the provision was not "a reasonable attempt to anticipate the losses to be suffered," as opposed to a penalty to coerce performance. *See* CAL. CIV. CODE § 1671(b); Californians for Population Stabilization v. Hewlett-Packard Co., 67 Cal. Rptr. 2d 621, 629-30 (1997) (finding that "reduction in litigation" was the reason for the change in law). But the Law Revision Commission specifically warned that "limitations of existing law should be retained and additional protection provided in cases where the parties have substantially unequal bargaining power," CALIFORNIA LAW REVIEW COMMISSION, 1976 ANNUAL REPORT 1741 (1977), *available at* http://clrc.ca.gov/pub/Printed-Reports/Pub119.pdf, and the new law therefore retains the prior law for consumer-based and similar transactions. CAL. CIV. CODE. § 1671(c)(1), (d). However, even without the specific protection of § 1671 (c) and (d), the courts have remained vigilant under the new law in looking through purported "alternative performance" or "conditional waiver" language to find coercive penalties that should not be enforced against the parties. *E.g.* Harbor Island Holdings v. Kim, 132 Cal. Rptr. 2d 406, 408-11 (2003) (following the leading case of *Ridgley v. Topa Thrift & Loan Ass'n*, 953 P.2d 884 (Cal. 1998) which "exposed the double talk of a 'conditional waiver' of certain ... charges" as effective penalties). See also *Greentree Fin. Group, Inc. v Execute Sports, Inc.*, 78 Cal. Rptr. 3d 24, 26 (2008) (holding that the stipulated judgment was a penalty because the amounts agreed to bear "no reasonable relationship to the range of actual damages...").

[36] *See* Gentry v. Super. Ct., 165 P.3d 556 (Cal. 2007) (holding that class action waivers in consumer contracts through arbitration clauses are unconscionable when the effect is to deny statutory rights) (following and expanding Discover Bank v. Super. Ct., 36 Cal. 4th 148 (2005) and Armendariz v. Found. Health Psych-Care Servs., 24 Cal. 4th 83 (2000), which are directly

California – appear to be disinclined to enforce arbitration clauses which directly or by practical effect eliminate statutory remedies available to workers and consumers. Such elimination of remedies is what in general constitutes "substantive unconscionability" and is comparable to the doctrinal bases for vacatur discussed below.

1. Public Policy

Under federal law, a court may deny confirmation and enforcement of arbitration awards that violate a "public policy" that is "well defined and dominant by reference to the laws and legal precedents and not from general considerations of supposed public interest,"[37] the so-called *Grace* rule. This non-statutory ground,[38] i.e. not listed in 9 USC § 10(a), for vacatur of an arbitration award is also available under California law.[39] On this issue, federal and California law appear to be

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premised on "public policy" supporting enforcement of statutory claims); Suh v. Super. Ct., 181 Cal. App. 4th 1504 (2010). On the unconscionablity of arbitration fees, compare Kam-Ko Bio-Pharm Trading Co. v. Mayne Pharma Inc., 560 F.3d 935 (9th Cir. 2009) (applying Washington State law in finding that high arbitration costs ($220,000 in fees!) did not render the arbitration clause "unconscionable," and distinguishing several state cases which held such high fees were unconscionable) and Green Tree Fin. Corp. v. Randolph, 531 U.S. 79, 90 (2000) and In Re Currency Conversion Fee Antitrust Litig., 265 F. Supp. 2d 385, 411-14 and cases cited. *But see* Teleserve Sys. v. MCI Telecomms. Corp., 659 N.Y.S. 659, 664 (1997) (holding $204,000 in fees unconscionable under federal and state law and against public policy). See also the various decisions of the California courts refusing to enforce arbitration agreements that are "unconscionable" in prohibiting "class-certification" in arbitration (an issue also discussed in *Cable Connection*) because arbitration *in effect* is a "de facto waiver" of statutory rights," i.e. "exculpatory in practical terms." *See* Franco v. Athens Disposal Co., 171 Cal. App. 4th 127 (2009) (following Gentry v. Super. Ct., 165 P.3d 556 (2007)).

[37] United Paperworkers Int'l Union v. Misco, Inc., 484 U.S. 29, 43 (1987) (quoting W.R. Grace & Co. v. Local Union 759, 461 U.S. 757, 766 (1983)). The non-statutory basis for judicial review based on "public policy" is similar to the review of the enforceability of choice of law or jurisdiction clauses based on public policy and the existence of a "rational relationship" to the jurisdiction chosen. These principles also involve judicial refusal to enforce contractual control of judicial or remedial functions discussed in *supra* note 32.

[38] *But compare* Comedy Club, Inc. v. Improv West Assocs. 553 F.3d 1277 (9th Cir. 2009) (vacating an award in part for violation of CAL. BUS. & PROF. CODE § 16 600 based on 9 U.S.C. § 10(a)(4), which permits vacatur "where the arbitrators exceeded their power," as a "manifest disregard of the law," a separate ground for vacatur discussed below). The Second and Sixth Circuit also appear to combine the two tests. *See* Elec. Data Sys. Corp. v. Donelson, 473 F.3d 684, 688 (6th Cir. 2007) and D.H. Blair & Co. v. Gottdiener, 462 F.3d 95, 110-11 (2d Cir. 2006).

[39] Moncharsh v. Heely & Blasé, 3 Cal. 4th 1, 32-33, (1992); City of Palo Alto v. Local 715, Service Employees Int'l, 91 Cal. Rptr. 2d 500, 508 (1999) (demonstrating that courts will refuse to enforce an award which is "incompatible with a statutory right" or contravenes "an explicit legislative expression of public policy"). This same rule applies generally in other states. *E.g.* County of Nassau v. Sheriff's Officers Ass'n, 743 N.Y.S. 2d 503, 506-7 (2002) and cases cited.

identical. Many public policies may be violated by awards. These include *res judicata*, the statutes of limitations,[40] state rules regarding choice of law clauses, the illegality of non-compete covenants, and "fundamental fairness" in an arbitration hearing.[41] Application of each of these fundamental rules of law is for the courts and should not be avoided by arbitration awards later blindly enforced by courts.

The Ninth Circuit accepted the *Grace* rule[42] in *Arizona Electric Power Cooperative, Inc. v. Berkeley*,[43] adding that "the policy

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[40] CAL. CIV. PROC. CODE § 337. *See e.g.* Landwehr v. DuPree, 72 F.3d 726, 732-33 (9th Cir. 1995) (involving an ERISA claim); Spear v. Cal. State Auto. Ass'n, 2 Cal. 4th 1035 (1991); All State Inc. v. Gonzales, 38 Cal. App. 4th 783, 785 (1995) (implicitly holding statute of limitation and laches are issues of law for the courts); Collins v. D.R. Horton, Inc., 505 F.3d 874, 880 (9th Cir. 2007) and cases cited; W.R. Grace & Co. v. Local Union 759, 652 F.2d 1248 (5th Cir. 1981) *aff'd on other grounds*, 46 1 U.S. 754 (1983); Jordan v. Cal. Dep't of Motor Vehicles, 100 Cal. App. 4th 431, 653-54 (2002) (holding that *res judicata* and collateral estoppel are issues for the courts). *See also* Bosack v. Soward, 586 F.3d 1096, 1103 (9th Cir. 2009) (authorizing judicial enforcement of *functus officio* doctrine prohibiting an arbitrator from redetermining an issue already decided). The *Collins* case gives arbitrators discretion in the application of non-mutual offensive collateral estoppel for federal purposes, but this ruling would appear to be impermissible under California law based on *Vandenberg*, which is discussed at note 63 below. These state law doctrines enforce the well-defined and dominant public policy regarding finality and repose.

[41] See *Barnes*, 122 F.3d at 823-24 (choice of law) and *Comedy Club*, 553 F.3d at 1290 (covenants not to compete). On covenants not to compete, see to an opposite effect Sprinzen v. Nomberg, 46 N.Y. 2d 623, 630 (1979) (listing other public policies as the basis for vacatur, including usury, punitive damages, antitrust, education policies and insurance regulations). We believe the foregoing should also apply to state policies regarding recovery of attorney fees. *See* CAL. CIV. PROC. CODE § 1021 and CAL. CIV. CODE § 1717. *Compare* Demarco v. Chaney, 31 Cal. App. 4th 1809 (1995) (holding that arbitrator must award attorney fees to prevailing party if required by the agreement.). Vacatur is common in family law arbitrations which purport to alter state policy on child support or custody, *e.g.* Hirsch v. Hirsch, 774 N.Y.S.2d 48 (2008) (overruling Jewish law arbitration which also voided an award of attorney fees in violation of state law), and labor law arbitrations which purport to alter applicable labor laws, *e.g.* Cohoes City Sch. Dist. v. Cohoes Teachers Ass'n, 40 N.Y.2d 774 (1976) (refusing arbitration of collective bargaining over tenure decision). *Cf.* Binghamton City Sch. Dist. v. Peacock, 823 N.Y.S. 2d 231 (2006) (holding that public policy protects students from "inappropriate contact" by teachers and voids arbitration decision). We assume that any *dicta* regarding a requirement of "fundamentally fair hearings" in arbitration would be enforced (if at all) through this "public policy" rule, see *supra* note 10, or by reference to the general language of the vacatur provisions. *But cf.* Burlage v. Super. Ct., 99 Cal. Rptr. 3d 142 (2009) (CAA § 1286.2 required reversal of an award when the arbitrator failed to consider material evidence).

[42] See *supra* note 37. However, as discussed below, the Second, Sixth and Ninth Circuits seem to combine this ground for vacatur with the "manifest disregard" basis for vacatur discussed below, creating no small amount of ambiguity as to how the federal courts apply this "public policy" basis for vacatur. *Compare* Sawtelle v. Waddell & Reid, Inc., 75 N.Y.S. 2d 264 (2003) (Setting aside punitive damage award in arbitration for being "irrational" and a "manifest disregard of the law" and not as a violation of public policy under *federal* law).

[43] 59 F.3d 988, 992 (9th Cir. 1995). *See also* Exxon Shipping Co. v. Exxon Seaman's Union, 11 F.3d 1189 (3d Cir. 1993).

[allegedly violated in the award] is one that specifically *militates against the relief ordered . . .*"[44] As stated, this non-statutory ground of vacatur focuses on whether enforcement of the proposed award, i.e. the grant of a judicial remedy, violates the clear public policy on the procedures limiting enforcement of decisions, and not on the merits of the arbitration award.[45] The California authorities appear to propose a broader test based on the dicta in *Moncharsh*,[46] the leading case in California on vacatur principles, by suggesting that enforcement should be denied if an award violates clear state law.[47] However, the implementation of the *Grace* rule is principally to refuse judicial enforcement when that enforcement violates a "statutory right" or "explicit legislative expression of public policy."

2. Manifest Disregard of the Law

The federal courts may also decline to confirm or enforce an award which "manifests a complete disregard of the law,"[48] or is "completely irrational."[49] This is solely a federal rule but apparently is applied by the federal courts to *all* proposed arbitration awards. This federal rule differs substantially from the statutory basis for vacatur in CAA: the arbitrator "exceed[s] his powers" when he acts "in a manner not authorized by the contract or by law," including "issu[ing] an award that violates a statutory right" or "select[ing] a remedy not authorized

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[44] (emphasis added) (citing Stead Motors of Walnut Creek v. Auto. Machinists Lodge No. 1173, 886 F.2d 1200, 1212-13 (9th Cir. 1989)).

[45] In accord is a leading Second Circuit case in this area, *Diapulse Corp. of Am. v. Curba Ltd*, 626 F.2d 1108, 1110 (2d Cir. 1980).

[46] Moncharsh, 3 Cal. 4th at 32-33.

[47] See, for example the list of decisions which "exceed the powers of the arbitrator" in *Jordan v. Cal. Dept. of Motor Vehicles*, 100 Cal. App. 4th 431, 443, 23 and the discussion in *Jones v. Humanscale Corp.*, 130 Cal.App. 4th 401, 408-09 (2005). *See also* Oaktree Capital Mgmt L.P. v. Bernard, 182 Cal. App. 4th 60 (2010).

[48] Kyocera Corp. v. Prudential-Bache Trade Services, Inc., 341 F.3d 1987, 1997 (9th Cir. 2003) (basing the power in 9 U.S.C. § 10(a)(4)). *See* Barnes v. Logan, 122 F.3d 820, 831 (9th Cir. 1997) *cert. denied* 523 U.S. 259 (1998). The "manifest disregard" concept derives from the common law rules for review of arbitration awards, but is imported into the FAA by the Federal Courts of Appeal. See June R. Lehrman, *Award Hesitation*, L.A. DAILY J., Feb. 24, 2009, at 7 (presenting discussion of professional arbitrator who also discusses venue questions under the FAA). The courts naturally distinguish between manifest disregard of the law and manifest disregard of the evidence, (Stolt-Nielsen SA v. AnimalFeeds Int'l Corp., 548 F.3d 85, 91 (2d Cir. 2008)), but this distinction can become attenuated in egregious cases.

[49] Coutee v. Barington Capital Group, L.P., 336 F.3d 1128, 1133-34 (9th Cir. 2003). See discussion in *Comedy Club*, 553 F.3d at 1290 regarding an "irrational" award which failed "to draw its essence from the agreement," quoting *Hoffman v. Cargill, Inc.*, 236 F.3d 458, 461-62 (8th Cir. 2001).

by law," or "arbitrarily remak[ing] the contract."[50]

The Supreme Court first enunciated a "manifest disregard" non-statutory ground for vacatur of an arbitration award in *dictum* in *Wilko v. Swan*.[51] All the circuits have now accepted the "manifest disregard" basis for vacatur,[52] even though the Supreme Court has yet to speak definitively on this standard and its application. This "manifest disregard" test, while often promulgated, is rarely used for vacatur, e.g. only in 4 out of 48 cases in the Second Circuit. The "manifest disregard" test is discussed in detail in *Duferco Int'l Steel Trading v. T. Klaveness Shipping A/S*,[53] which analogizes this ground for vacatur to arbitral decisions that "exceeded the legal powers of the arbitrator."

A leading statement regarding the "manifest disregard" ground for vacatur is found in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v.*

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[50] CAL. CIV. PROC. CODE § 1286.2(a)(4). *See* Jordan v. Dept. of Motor Vehicles, 100 Cal. App. 4th 431, 443 (2002) (collecting authorities on this issue); O'Flaherty v. Belgum, 115 Cal. App. 4th 1044, 1055-56 (2004). New York states the rule is whether the award is "irrational," "violates a strong public policy," or "clearly exceeds a specific enumerated limitation on the arbitrator's power" (New York City Transit Auth. v. Local 100, 812 N.Y. 3d 332, 336 (2005)) and have held that an award "must have evidentiary support and cannot be arbitrary or capricious..." (Napoli v. Peake Auto., Inc., 824 N.Y.S.2d 424, 425 (2006)). See also the Michigan standard quoted in Elec. Data Sys. Corp. v. Donelson, 473 F.3d 684, 688 (6th Cir. 2007) (holding arbitration of civil rights claims permitted if arbitration procedures are "fair" and not "in contravention of controlling principles of law...").

[51] 346 U.S. 427, 436 (1953). The Ninth Circuit accepted this ground in *San Martine Compania de Navegacion, S.A. v. Saguenay Terminals Ltd.*, 293 F.2d 796, 801 (9th Cir. 1961); *French v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 784, F.2d 902, 905-06 (9th Cir. 1986); *Todd Shipyards Corp. v. Cunard Line, Ltd.* 943 F.2d 1056, 1060 (9th Cir. 1991); *George Day Constr. Co. v. Local 354,* 722 F.2d 1471, 1477 (9th Cir. 1984), as well as in *Barnes* and *Coutee* before its en banc decision in *Kyocera* establishing 9 U.S.C. § 10(a)(4) as the basis for vacatur. *Coutee* relies on *Am. Postal Workers Union v. United States Postal Serv.*, 682 F.2d 1280, 1284-86 (9th Cir. 1982), which vacated an arbitration award that reinstated a labor striker in direct violation of the applicable law, and on *G.C. & K.B. Inves., Inc. v. Wilson*, 326 F.3d 1096, 1105 (9th Cir. 2003), as well as *Barnes v. Logan*, 122 F.3d 820.

[52] *French*, 784 F.2d 902, and *Coutee*, 336 F.3d 1128, also formulate this test as requiring vacatur of a "completely irrational" award. On authority in other circuits, see *Brabham v. A.G. Edwards & Sons, Inc.*, 376 F.3d 377, 381 (5th Cir. 2004); *Wise v. Wachovia Secs., LLC*, 405 F.3d 265 (7th Cir. 2006); *Solvay Pharm., Inc. v. Duramed Pharm., Inc.*, 442 F.3d 471 (6th Cir. 2006); *Virgin Islands Nursing Assn's Bargaining Unit v. Schneider*, 668 F.2d 221 (3d Cir. 1981); *Dominion Video Satellite, Inc. v. Echostar Satellite LLC*, 430 F.3d 1269 (10th Cir. 2005); *Lessen v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 481 F.3d 813 (D.C. Cir. 2007); *B.L. Harbert Int'l LLC v. Hercules Steel Co.*, 441 F.3d 905 (11th Cir. 2006); *Stark v. Sandberg, Phoenix & von Gontard, P.C.*, 381 F.3d 793 (8th Cir. 2004); *Advest, Inc. v. McCarthy*, 914 F.2d 6 (1st Cir. 1990); *Miller v. Prudential Bache Sec. Inc.*, 884 F.2d 128 (4th Cir. 1989).

[53] 333 F.3d 383, 389 (2d Cir. 2003) (followed in *D.H. Blair & Co. v. Gottdiener*, 462 F.3d 95, 110-11 (2d Cir. 2006) and *Barnes* and *Coutee)*. See also *Comedy Club*, 553 F.3d at 1290. This rule in effect is the same as California law as enunciated in *Jordan* and *O'Flaherty*. *See supra* note 49.

Bobker: "A party seeking vacatur bears the burden of proving that the arbitrators were fully aware of the existence of a clearly defined governing legal principle, but refused to apply it, in effect ignoring it."[54] As formulated, this ground for vacatur differs from the "public policy" basis – an objective determination of whether judicial enforcement would violate a particular public policy – focusing instead on more subjective determinations about the arbitrator's conduct. In effect, the "manifest disregard" ground allows vacatur not when the arbitrator was merely wrong but when he refused to apply clearly controlling legal principles of which he had actual knowledge. This test is a review of the arbitration process, not a substitution of the court's judgment for that of the arbitrator. The "manifest disregard" ground for vacatur applies only "where some egregious impropriety on the part of the arbitrator is apparent," and is therefore rarely used.[55]

The "manifest disregard" ground was discussed at length in *Duferco* and the court decided not to apply the doctrine *after* a detailed review of the reasons offered by the arbitrator for not applying the applicable legal principles. The court found there was a rational basis for the arbitrator's decision or a "plausible reading" of the award, even if the court did not fully agree with that reasoning. In the cases in which "manifest refusal" was found – as in the cases described in *Duferco* – the courts faced arbitral decisions that tended to exceed the arbitrator's power under the law, suggesting that there may be a greater "scrutiny" when the principles "manifestly disregarded" implicate public policy regarding traditional judicial and legislative limitations on remedies, a rule and reason similar to the application of the "public policy" ground for vacatur discussed above.

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[54] 808 F.2d 930, 933 (2d Cir. 1986). This formulation appears to be accepted in *B.L. Harbert Int'l LLC v. Hercules Steel Co.*, 441 F.3d 905 (11th Cir. 2006) and *Stark v. Sandberg, Phoenix & von Gontard, P.C.*, 381 F.3d 793 (8th Cir. 2004). *See also* Todd Shipyards Corp. v. Cunard Line, Ltd., 943 F.2d 1056, 1060 (9th Cir. 1991); Stolt-Nielsen SA v. AnimalFeeds Int'l Corp. 548 F.3d 85, 96 (2d Cir. 2008). A good faith reasoned basis for not applying a legal principle is subject to judicial deference, but a *refusal* by the arbitrator to apply clear legal principles, "in effect ignoring" them, is not a process that should be judicially enforced. *Compare* Bosack v. Soward, 586 F.3d 1096, 1103 (9th Cir. 2009).

[55] 333 F.3d at 389. *See* Stolt-Nielsen SA v. AnimalFeeds Int'l Corp., 548 F.3d. at 90. In a recent unreported case involving the author, the Ninth Circuit found no "manifest disregard of the law" because the applicable legal principles were not raised in a Statement of Defense in the arbitration, even though the arbitrator did not rely on this ground and the key violations of California law arose only *after* the arbitrator's decision was rendered (i.e. an award of attorney fees not permitted by California law). *See* Seven Arts Pictures PLC. v. Jonesfilm, No. 07-56656 (9th Cir. Feb. 12, 2009). *Compare* Elec. Data Sys. Corp. v. Donelson, 473 F.3d 684, 692 (6th Cir. 2007) (no "manifest disregard" when no record of the hearing was available to determine if the statutory prima facie showing of racial discrimination was made).

Thus, there would appear to be two bases for vacatur under the "manifest disregard" rule: (a) the arbitrator engaged in misconduct by completely ignoring clear legal principles directly applicable to the dispute or (b) the courts themselves have no authority under law to enforce the remedy chosen by the arbitrator by reason, e.g., of the principles of *res judicata* or a statute of limitations. These situations present no question of deference to the arbitrator's judgment, either because the arbitrator has refused to even address the issues or render any judgment on them, or because the award violates some public policy limiting judicial remedies available in court.

However, as described below, there are clear conflicts between the "manifest disregard" standard of vacatur and the "public policy" standard of vacatur. Yet the courts, particularly the Ninth Circuit, tend to treat the two standards as one, adding more uncertainty to this already unclear area of law.[56] The "public policy" standard would appear to direct attention to whether the legal errors of the arbitrator related to clear and well-established principles of law (particularly remedies). The "manifest disregard" standard would appear to direct attention to whether the arbitrator was aware of and chose to ignore the law at issue. Neither test directly addresses what we suggest is the more important issue – whether the legal principle violated by an arbitration award protects fundamental substantive or procedural rights or grants a specific judicial remedy not available under law.

3. Arbitrator Exceeded Powers

Both Arbitration Acts[57] provide for vacatur when the arbitrator "exceeded its powers," although federal courts apparently interpret the language as limited to the "public policy" and "manifest disregard" standards set forth above. This ground for vacatur is applied in California in cases where the arbitrator purported to arbitrate an issue which the parties had not agreed would be subject to arbitration[58] or where the arbitrator adopted a remedy "not authorized by law."[59] In

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[56] See discussion in *Comedy Club*, 553 F.3d at 1288-90, and *Stolt-Nielsen Int'l*, 548 F.3d at 90-92; *supra* note 37.

[57] Cal. Civ. Proc. Code § 1286.2(a)(4); 9 U.S.C. § 10(a)(4). As indicated above, the Ninth Circuit in *Kyocera* found that this statutory basis for vacatur also supported the "manifest disregard" basis for vacatur. Kyocera Corp. v. Prudential-Bache Trade Servs., Inc., 341 F.3d 987, 997 (9th Cir. 2003).

[58] *E.g.* Rosenthal v. Great W. Fin. Sec. Corp., 14 Cal. 4th 394, 406 (1996); Victoria v. Superior Court, 40 Cal. 3d 734, 738 222 Cal.Rptr. 1 (1985); Valentine Capital Asset Mgmt v.. Agahi, 94 Cal.Rptr 3d 526 (2009)

[59] Jordan v. Cal. Dept. of Motor Vehicles, 100 Cal.App. 4th at 443 and Advanced Micro

Cable Connection,[60] the California Supreme Court interpreted the "exceeded its powers" language in the CAA in a manner totally opposite to the United States Supreme Court's interpretation of the same language in the FAA in *Hall Street Associates*[61] in determining whether the statute authorized review by the courts of errors of law when the parties had specifically agreed in the applicable contract that the arbitrator "shall not have the power to commit errors of law or legal reasoning . . ." Under the CAA, as interpreted in *Cable Connection*, such a clause permits (if not requires) the court to review the arbitration award for errors of law. However, under the FAA as interpreted in *Hall Street Associates*, such a clause was not deemed to increase the court's powers of vacatur beyond the bases for vacatur otherwise available under the FAA. *Hall Street Associates* would therefore appear to leave "manifest disregard" and "public policy" as the remaining grounds for vacatur under the FAA.[62]

Cable Connection seems to place a substantial premium on the skill and foresight of the attorney drafting the applicable arbitration clauses, i.e. the courts will review an arbitration award for errors of law but only if the attorney foresaw that need and drafted specifically to achieve that objective. *Cable Connection* assumes, as was implied in *Barnes*, that absent such a clause, the parties and their counsel have

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Devices Inc., v. Intel Corp., 9 Cal. 4th 362, 375-76 (1994). However, in *Gueyffier v. Ann Summers, Ltd.*, 43 Cal. 4th 1179 (2008), the California Supreme Court approved *Micro Devices* language regarding remedies not authorized by the agreement, but found that the language of the arbitration agreement *sub judice* prohibiting the arbitrator from "modifying" or "changing" the terms of the agreement did not prevent the arbitrator from finding equitable excuses for non-performance to any term of the agreement. *But compare* Cal. Faculty Ass'n v. Super. Ct., 63 Cal.App. 4th 935 (1998).

[60] Cable Connection, Inc. v. DIRECTV, Inc., 44 Cal. 4th 1334 (2008). The language chosen by the parties would appear to be critical in application of *Cable Connection*. In *Christensen v. Smith*, 171 Cal.App. 4th 931 (2009), the court refused to apply the *Cable Connection* rule when the parties agreed the arbitrator "shall render an award in accordance with substantive California law." The court interpreted this language as merely a "choice of law" clause, not a decision by the parties to "expressly deprive the arbitrator of the power to commit legal errors." To the same effect is *Oaktree Capital Mgmt L.P. v. Bernard*, 182 Cal. App. 4th 60 (2010).

[61] Hall St. Assocs. L.L.C. v. Mattel, Inc., 552 U.S. 576 (2008). In *Comedy Club*, 553 F.3d 1227, the Ninth Circuit held that this ruling did not, however, overrule the "manifest disregard" basis for vacatur, although there is some doubt as to whether other circuits will agree with this position. *See* Ramos-Santiago v. UPS, 524 F.3d 120, 124 n.3 (1st Cir. 2004). The First Circuit appears to base the "manifest disregard" rule on the "exceeded its powers" language of 9 U.S.C. § 510(a)(4), and, unlike California, limits § 10(a)(4) to a "manifest disregard" analysis.

[62] Both of the FAA and CAA provide additional grounds for vacatur unrelated to the merits or procedures of the arbitration not discussed here, which mainly involve corruption, bias or misconduct by the arbitrator. CAL. CIV. PROC. CODE § 1286.2(a)(1), (2), (3), (5) and (6); 9 U.S.C. § 10(a)(1), (2) and (3).

knowingly assumed the risk of errors of law or violations of due process of law. We believe this assumption is unwarranted. Indeed, the policies cited by the *Cable Connection* court in support of its holding and its refusal to follow *Hall Street Associates* are the very same we offer here in support of a broader judicial review of errors of law and violations of due process in arbitration proceedings:

> The judicial system reaps little benefit from forcing parties to choose between the risk of an erroneous arbitration award and the burden of litigating these disputes entirely in court. Enforcing contract provisions for review of awards on the merits relieves pressure on congested trial court dockets . . . Incorporation of traditional judicial review by express agreement preserves the utility of arbitration . . . which allows the parties to protect themselves from perhaps the weakest aspect of the arbitral process, its handling of disputed rules of law.[63]

We argue below that wider use of existing standards – i.e. the "public policy" and "manifest disregard" rules – can have the same beneficial results described above by the California Supreme Court, without loss of the "utility" or efficiency arbitration provides as an alternative means of dispute resolution.

The "exceeding the power of the arbitrator" standard appears to incorporate a minimal level of procedural due process protection. In one recent California case, a split court of appeal, relying on both the statute and the applicable rules of arbitration, reversed an arbitration award because the arbitrator's apparent exclusion of "material evidence" prejudiced the appellant.[64] Indeed, such a minimal requirement of fairness would seem complicit in the parties' agreement to arbitrate, a procedure which a reasonable party would assume includes a hearing of all material evidence. But the decision, as the dissent indicates, raises the question of how far the courts should go in reviewing evidentiary exclusions and indeed improper inclusion of

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[63] 44 Cal. 4th at 1363. The court also emphasized that "arbitral decisions carry no precedential value absent judicial review and such precedential value will help develop the law in specialized areas often subject to arbitration." *Compare* Vandenberg v. Super. Ct., 21 Cal. 4th 825, 834 (1999) (denying collateral estoppel effect to factual judgments in arbitrations against third parties). A similar sentiment was expressed by the District of Columbia Circuit in holding that the Supreme Court's faith in arbitral fora's ability to adjudicate statutory claims is vindicated only if "judicial review under the 'manifest disregard of the law' standard is sufficiently rigorous . . ." Cole v. Burns Int'l Security Servs., 105 F.3d 1465, 1487 (D.C. Cir. 1997) (quoted in Sawtelle v. Waddell & Reed, Inc., 754, N.Y.S. 2d 264, 276 (2003)).

[64] Burlage v. Super. Ct., 99 Cal. Rptr. 3d 142 (2009) (relying on CAL. CIV. PROC. CODE § 1282.2(a)(5) authorizing vacatur if the party's rights were "substantially prejudiced ... by the refusal ... to hear evidence material to the controversy" and Judicial Arbitration and Mediation Services ("JAMS") Rule 22(d), a potentially very broad decision for the reasons stated in the dissent).

hearsay or other unreliable evidence, which can be equally prejudicial.

The California Supreme Court has emphasized that arbitration is a creature of contract and no remedy should be granted in an arbitration award which is prohibited or not authorized by contract.[65] This additional basis for vacatur should logically lead courts to consider all available extrinsic evidence of what the parties "really" intended by the arbitration contract language chosen and whether the language is "susceptible"[66] to meaning that authorized broader judicial review of how the arbitrator interpreted their own power or other language in the contract affecting remedies. We assume without regard to the broader implications of the principle that challenges to the arbitrator's interpretation of available remedies both under law and the terms of the applicable contract remain a basis for vacatur.

4. Arbitration Awards Affecting Third Party Rights

Under the law, third parties who do not appear in an arbitration because the arbitration has no jurisdiction over them can avoid any binding effect of an arbitration award.[67] *Vandenberg v. Superior Court*[68] holds that no collateral estoppel shall apply under California

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[65] Gueyffier v. Ann Summers, Ltd., 43 Cal. 4th 1179 (2008) (distinguishing other authorities in finding that excusing performance of a party by reason of the other party's material breach is not authorizing a remedy prohibited by the contract). See also *Oaktree Capital Mgmt L.P. v. Bernard*, 182 Cal. App. 4th 60 (2010), which takes a limited view of the court's power to void a remedy by reason of public policy on remedies or as a "penalty," based on the court's review of the evidence.

[66] See the leading case of *Wolf v. Walt Disney Pictures and Television*, 76 Cal. Rptr. 3d 585, 603-04 (2008).

[67] *See* Carpenters 46 N. Cal. Counties Conf. Bd. v. Zweigle, 130 Cal. App. 3d. 337, 343 (1982) (arbitrator has "no power to determine the rights and obligations of one who is not a party to the proceeding."). *See also* Suh v. Super. Ct., 181 Cal. App. 4th 1504, 1512, 1517 (2010) (holding that "oral agreement" to arbitration is not enforceable and the "strong public policy in favor of arbitration does not extend to those" who had not entered into the arbitration agreement). See also *NEC Elec., Inc. v. Hurt*, 208 Cal. App. 3d 772 (1989) and *Katzir's Floor and Home Design Inc. v. M-MLS.COM*, 394 F.3d 1142 (9th Cir. 2004) for operation of the analogous principle limiting the effect of court judgments. Compare the New York Arbitration Law, N.Y. C.P.L.R. § 7511(b)(2) which appears to use vacatur directly to prevent application of arbitration awards or findings to third parties. *See* Hirsch v. Hirsch, 774 N.Y.S. 2d 48, 50 (2004) (holding that award which affects third party's rights to real property deprives third party of due process and "was not binding on him").

[68] 21 Cal. 4th 815, 834 (1999). *Vandenberg* is not followed in all states, some of which determine the collateral estoppel effect of arbitrator awards on an individual case-by-case basis. *See also* Brosterhaus v. State Bar of Cal., 12 Cal.4th. 315, 325 (1996) (holding that a party may litigate civil rights and constitutional issues decided in a State Bar arbitration on a *de novo* basis). The California courts remarkably hold that a person who did not participate in an arbitration where the arbitrator had no jurisdiction over the person can be added to a judgment

law against a non-party in an arbitration based on "due process concerns." The applicable due process principle, however, goes well beyond *Vandenberg*. It is a "cardinal principle of jurisprudence that a judgment shall not bind or conclude a man, either in respect of his person or property until he has had his day in court."[69] The California Supreme Court in *Motores de Mexicali v. Superior Court*[70] directly addressed the issue in a context involving court judgments: whether a court has the authority to add a judgment debtor (as an alleged "alter ego") to a judgment after a default judgment against a corporation. The court rejected this extraordinary request, and the same logic should apply in arbitration awards.

However, in the authors' experience, courts have exercised their power to enforce arbitration awards against third parties under an "alter ego" theory with no adversary proceeding or review of the underlying claim, directly in violation of due process rules despite the clear holding of *Vandenberg*. The courts are not consistent in enforcing the important rule limiting the extent of judgments based on due process grounds, and have in fact extended arbitration awards to non-parties based on *ex parte* factual findings of an arbitrator, apparently based on the deference accorded arbitral judgments. Nevertheless, application of arbitration awards to persons not subject to arbitral jurisdiction should be subject to vacatur under the principles set forth above.

III. PROPOSED RECONSIDERATION OF CURRENT JUDICIAL DEFERENCE TO ARBITRAL JUDGMENTS

A. Fairness in Private Dispute Resolution Can Create More Efficient Private Dispute Resolution

Private dispute resolution can create judicial efficiency and save on costs without rank injustice and violation of due process standards. It is more likely to do so if the process of private dispute resolution is viewed as more fair than it is today. Appropriate and focused judicial

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on a summary basis with no evidentiary hearing confirming an arbitration award as a purported "alter ego" under the general authority of CAL. CIV. PROC. CODE § 187, allowing courts to amend judgments to "properly designate" the parties. See *Hall, Goodhue, Haisley and Barker v. Marconi Conference Ctr. Bd.*, 41 Cal.App. 4th 1551, 1554-55 (1996), a decision which appears to ignore the cases discussed in the text and *supra* notes 9 and 67, as well as the principles of *Vandenberg*.

[69] Tay, Brooks & Backus v. Hawley, 39 Cal. 93, 95 (1870) (followed in Meller & Snyder v. R & T Props., Inc., 62 Cal.App. 4th 1303, 1306-14 (1998) in the case of joint debtor proceedings under CAL. CIV. PROC. CODE § 939).

[70] 51 Cal. 2d 171 (1958).

review may in fact lessen the burden of civil litigation in courts because more parties will utilize arbitration if they are convinced private dispute resolution is even minimally fair or "due," as *Cable Connection* recognizes. The authors of this article are aware by anecdotal evidence of widespread skepticism of arbitration processes and of the belief that "anything can happen" in an arbitration, where the arbitrator's discretion is seemingly final and beyond review. For example, one prominent Southern California businessman who has engaged in extensive litigation for decades told one of the authors that he never agrees to arbitration unless he has a case he thinks he would lose in court, because he has a better chance for an irrational decision from an arbitrator who, unlike a judge, does not think he will be reviewed and reversed.

The courts should not ignore these seemingly widespread (if improvable) sentiments in favor of freedom of contract and conservation of resources. To do otherwise is to ignore the true basis for arbitration agreements, which we believe is to obtain better outcomes than those available in court.[71] Effective judicial review may well limit the incidence of irrational arbitration decisions if the arbitrators are aware that their decisions on issues of law will be scrutinized carefully. Every practitioner knows the effect that judicial review (and particularly reversal) has on trial courts. Is there any reason to suppose the same would not be true of arbitrators, or that the absence of that "awareness" does not affect arbitration decisions? Such a heightened "awareness" on the part of arbitrators will reinforce the policies of freedom of contract and will truly conserve judicial resources, while taking into account the principles of judicial control of remedies and procedure. This review is also necessary to counter the inherent "unprovable" bias in certain arbitration panels such as IFTA, and the lack of transparency and a public record of comparable decisions, another serious failing of the IFTA system and a problem emphasized by the California Supreme Court in *Cable Connection.*

Much discussion of judicial review of arbitration awards has proceeded based on a supposed conflict between the public policy of clearing court dockets and the fairness of enforcing an arbitration award that may be wrong, unfair, or unjust. A belief seems to have

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[71] Compare the more idealistic explanation of why parties choose arbitration agreements in *Stolt-Nielsen SA v. AnimalFeed Inter'l Corp.*, 548 F.3d 85, 91-92 (2d Cir. 2008) (following Porzig v. Dresdner, Kleinwort, Benson N. Am. LLC, 497 F.3d 133, 138-39 (2d Cir. 2007) and other authorities). But compare the more nuanced discussion in *Cole v. Burns Int'l Security Servs.*, 105 F.3d 1465, 1485 & n.17 (D.C. Cir. 1997) which appears to recognize the "inherent bias" issues discussed in the text.

developed that even limited judicial review of arbitration decisions will open up a "Pandora's box" of new civil litigation, imposing new burdens on the courts. We do not believe such an expansion of civil litigation will occur, but argue here that any such risk is necessary and worth taking to assure fairness and justice to litigants. After all, no arbitration award is self-enforcing. Each award relies on the parties' willingness to implement the arbitrator's findings and conclusions, absent judicial enforcement in court and later enforcements through state judgment creditor proceedings.[72] There is, we argue, no substantial basis for concerns that vacatur proceedings – already common and numerous – will take more court time than standard "law and motion" practice. In fact, it is more likely that they will be disposed of in less time than standard civil proceedings, even if courts review for errors of law.[73]

B. Towards a Due Process Model of Judicial Review

With the foregoing principles and policies in mind, we suggest a new view of the current judicial rules regarding vacatur discussed above. Inconsistent application of known legal principles to similarly situated parties as well as violations of fundamental principles of due process of law, as determined on the federal and state constitution principles, are in fact violations of "public policy . . . which is well defined and dominant" as well as "exceeding the power of the

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[72] Compare *Wyatt v. Cole*, 54 U.S. 158 (1992) and *Lugar v. Edmundson Oil Co.*, 457 U.S. 922 (1982) which explicitly hold that private use of state judgment creditor laws, which do not provide due process of law to the debtor prior to levy, is state action for purposes of private actions alleging violations of civil rights (deprivation of due process) under 42 U.S.C. §1983. The authors believe these cases are not consistent with the cases discussed at *supra* note 7 which find enforcement of arbitration awards made without due process not to constitute "state action." *See also* Jordan v. Fox, Rothschild, O'Brien & Frankel, 20 F.3d 1250, 1264-67 (3d Cir. 1994) (holding that use of state confession of judgment processes is subject to *Wyatt/Lugar* analysis); Audio Odyssey, Ltd. v. Brenton First Nat'l Bank, 245 F.3d 721, 740 (8th Cir. 2001).

[73] As discussed in *supra* note 32, this principle is really no different than existing judicial limitations on the enforcement of choice of law and choice of jurisdiction clauses. Indeed, *Hall St. Assocs.* following *Kyocera* (oddly enough) supports this argument since these decisions deny judicial enforcement of a freely negotiated contract clause mandating judicial review of arbitration awards. The judicial "handprint" is inevitable once enforcement of an award is sought, and any enforced award must bear the imprimatur of the Constitution and our judicial system. Arbitration is fundamentally different than mediation or settlement agreements and should not be enforced like the results of a binding agreement after negotiation or mediation, since arbitration occurs before the parties know the parameters of a dispute. Arbitration is an adversarial process which is intended by the parties to be a simple, more efficient but fair trial, not an enforcement of an arbitrary result independent of normal remedial processes.

arbitrator" (i.e. are unconstitutional) absent a "willing" and "knowing" waiver of these rights. This argument would appear to be self-evident yet is denied repeatedly in practice by judicial deference to arbitration awards, largely because of the *Barnes* view that parties knowingly and willingly waive their due process and equal protection rights by agreeing to arbitration.[74] However, *Cable Connection* deals a death blow to this argument. If the parties can contract explicitly to protect their equal protection and due process rights, then why would a failure to do so be anything other than legal malpractice absent an explicit waiver of such rights by the client? The logic of *Hall Street Associates* is equally devastating to the *Barnes* argument in holding that parties are prohibited by the FAA from protecting themselves against violation of due process and equal protection rights even if they explicitly sought to do so.

Do violations of due process or arbitrary application of legal principles to similarly situated parties constitute a "manifest disregard of the law"? *Bobker*, *Duferco* and other cases cited above have developed a basis for distinguishing between "manifest disregard of the law" and a mere reversible error of law, focusing on arbitral misconduct or infringement of judicial control of remedies. But the distinction remains superficial when we consider judicial review of arbitration awards generally (as opposed to only one award). This distinction admits arbitrary application of legal principles to similarly situated parties based on what we argue is a highly subjective test of how irrational or irresponsible the arbitrator or the award must be to meet the "manifest disregard" standard. The cases talk of this "rarely used" power, to be exercised in "extreme" circumstances,[75] with little principled discussion of why one particular error of law is so egregious as to require reversal and another is not. The lack of a clear standard virtually authorizes district courts to ignore serious errors of law in most cases or, more likely, make unexpressed and opaque judgments on the "equity" of the particular cases.

Further, the cases, particularly in the Ninth Circuit, fail to

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[74] The "state action" limitation on judicial review of due process or equal protection violations in arbitration awards, see note 7 above, would appear to be unconvincing if not entirely incoherent. This is not only because state judgment creditor proceedings do constitute "state action" if such proceedings deny due process, see *supra* note 72, but also because enforcement of equal protection and due process rights is authorized by the very language of the FAA and CAA and judicial decisions interpreting both, as argued in the text. Elimination of this "slender reed" supporting judicial deference (i.e. no "state action") leaves us with the *Barnes* argument discussed in the text.

[75] See *supra* note 55.

distinguish between the "public policy" basis for vacatur and the "manifest disregard" basis for vacatur. Hence, they fail to clearly delineate which errors of law are the grounds for reversal based on the importance of the public policy involved as opposed to the egregiousness of the arbitrator's misconduct. There appears to be no principled basis to exclude fundamental due process and similar fundamental legal principles from the limited review permitted by the Arbitration Acts, either as "manifest disregard of the law" or "public policy" violations (other than *Barnes*' waiver theory, which we believe is not tenable). The statutory history of both laws, reflecting the view that "arbitration agreements are purely a matter of contract," further supports our view.[76]

The common law limitations and restrictions on enforcement of contractual penalties – "purely a matter of contract" law – appear to be based on a distinction between enforcement of a party's intention to perform the contract or bargain on the one hand and enforcement of the parties' optimistic "hopes" in the event of non-performance on the other hand. The first set of private expectations or promises are deserving of judicial enforcement and necessary to the free enterprise system of economic activity. The second set of private expectations or promises are not necessary to such economic activity and are deserving of judicial enforcement only when such expectations do not in effect constitute an impermissible encroachment of the right and authority of the courts to establish *both* remedies for breach of contracts *and* basic fair processes to determine the facts of the controversy and equal application of the law to similarly situated people.

Judicial withdrawal from *this* authority is not authorized by law, is inconsistent with the court's role as the dispenser of public justice and would conceivably harm, not promote economic activity if unfair and unreasonable consequences attach to claimed breaches of private contracts. Indeed judicial enforcement of "penalties" – either by choice of penalty clauses or through unfair arbitration awards with the same result – extend the very basis of judicial enforcement of private contracts beyond agreed performance for consideration to a wholly different arena, i.e. remedial proceedings and their fairness.

The courts should also not ignore disparities in private negotiating power or the advantages that economic power may give one party in dispute resolution, a consideration now part of California law on

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[76] See *supra* note 17.

penalty or choice of remedy clauses. One recent study[77] suggests that larger economic organizations use arbitration far more frequently against those with less economic power than with parties of equal economic power. In certain cases, it is generally believed, if not provable in court, that arbitrators applicable to a particular industry or business tend to favor the economic interests of one group utilizing their services over others.

Arbitrators are not judges, with no other cases or business interests, and are not subject to the oaths, disciplinary rules, and statutory control as are state and federal judges. Arbitrators often serve in the very industries subject to the applicable arbitration system, making bias virtually expected by the association providing the arbitral system. Finally, many arbitration clauses are included either in pure "contracts of adhesion" or in contracts where the party insisting on arbitration has much greater resources or greater access to information on the actual workings of the arbitral system in practice.

There is no basis in principles of freedom of contract to ignore arbitration clauses, but there is no basis in judicial principles of due process and equal protection of law to treat the contracting parties as if each fully understood the procedural and remedial consequences of their "agreement" regarding proceedings for breach in arbitrations. There is nothing in the principles of contract law authorizing deference to arbitral judgments, based on an idealistic belief that the parties knowingly took the risk of arbitrary decisions denying due process rights to the loser, a result not expressly bargained for as consideration for any promise, all in search of a more efficient or cheaper method of dispute resolution. What losing party can really be said to have contracted in advance for such unfairness or denial of fundamental legal rights?

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[77] Theodore Eisenberg, Geoffrey P. Miller & Emily Sherwin, *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J.L. REFORM 871, 887-89, 895-96 (2008). A similar conclusion was reached by Public Citizen in a report entitled "The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort The Debate On Arbitration," discussed in *Wade Goodwyn: Rape Case Highlights Arbitration Debate* (NPR broadcast June 15, 2009), *available at* http://www.npr.org/templates/story/story.php?storyId=105153315 (in 34,000 arbitration cases, consumers lost 94% of the time). Finally, an organization named The National Arbitration Forum agreed with the State of Minnesota, after the state filed an action against it, to cease arbitrating credit card disputes because of alleged conflicts of interest and financial ties to the credit card industry. The Associated Press, *Firm Agrees To End Role In Arbitrating Card Debt*, N.Y. TIMES, July 20, 2009, at B8. The increasing judicial concern with "unconscionability" in the enforcement of arbitration process and awards appear to reflect a discomfort with the often "illusory" nature of the arbitration remedy for reasons discussed in the text. See discussions *supra* at pp. 22-25.

The selection of arbitration as a remedy in a general arbitration clause (as is customary) would not under normal principles be viewed as an express waiver of an important procedural or remedial right in a judicial proceeding, which normally would require advice of counsel and specific disclosure of consequences to the affected party. The general policies of "freedom of contract" conflict with the specific judicial principles that important judicial and remedial rights must be knowingly and clearly waived. "Freedom of contract" is present in both cases, but the level of specificity, disclosure and understanding are dramatically different, thus protecting the court's role as the ultimate arbiter of remedies and process. Indeed, the very principle of judicial review of *legislative* acts is based squarely on such constitutional authority of the courts.

Based on the foregoing, we argue that no party should be presumed to have waived a claim of fundamental remedial and procedural rights applicable to other similarly situated people by acceptance of a general arbitration clause. Courts should not delegate their constitutional authority in such matters to private parties, absent the conditions that would apply to waiver of such rights in a judicial proceeding. Adopting this principle will not affect private contractual expectations or promises regarding the economic activity at issue but rather will exclude delegation of core judicial functions absent specific disclosure and understanding. Naturally, not all aspects of a civil proceeding fall into these categories of fundamental remedial and procedural rights, as we discuss below.

Therefore, the standard of review of arbitration decisions must continue to recognize the conservation of judicial resources through private dispute resolution but not to the exclusion of other principles, even if this new standard might cause some increase in judicial responsibilities. The majority of arbitrations, as *Cable Connection* appears to acknowledge, do not resolve disputed issues of law and procedure. This statement is particularly true of labor arbitrations in the motion picture industry. Our proposed judicial review will not affect these cases at all. For example, supervision of discovery, the fact finding process, and judgment on disputed issues of fact would remain in the private dispute resolution process with a much lesser standard of review than would apply to appellate reviews of trial court decisions. There is every reason to both assume and hold as a matter of law that *these* non-fundamental aspects of a remedial process are waived by agreement to arbitration.

Indeed, it could be argued that *Cable Connection* goes too far in

basing its reasoning on the agreement of the parties rather than on judicial protection of fundamental principles of fairness and control of remedies. Could parties agree, for example, to a "substantial evidence" form of judicial review of arbitration awards? Could they agree to a review based on the many general procedural issues that arise in court trials, e.g. the propriety of *in limine* evidentiary exclusions, denial of discovery rights under state discovery laws (themselves based on due process concerns), the denial of international discovery methods (such as letters rogatory), improper application of state law privileges (e.g. "trade secrets") and other real, but arguably not fundamental, process rights available in court? The judicial reticence to review all these issues in proceedings conducted by arbitrators without judicial training or temperament should not, however, prevent judicial control of more fundamental principles of due process, judicial control of remedies, and equal application of the laws. We argue the better view would be judicial enforcement of due process principles, not simply whatever form of judicial review is chosen by the parties.

C. What Is Appropriate Due Process of Law in Arbitration?

The Supreme Court has held that denial of government benefits requires a minimum "fundamental" level of due process.[78] An

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[78] Brock v. Roadway Express, Inc., 481 U.S. 252, 262 (1987). A similar analogy to standards of due process necessary for enforcement of tribal court judgments, is discussed in the leading case of *Bird v. Glacier Elec. Corp.*, 255 F.3d 1136, 1149-52 (9th Cir. 2001). *See also supra* note 6 (discussing due process review under the New York Convention on foreign arbitration awards). The analogy we draw is to denial of the benefits of membership in an association providing an arbitral system by violation of due process or equal protection of law by that system. See *supra* note 11. Specifically, the Supreme Court has held that the Sixth Amendment right to "confront witnesses" is a requirement of due process of law in *Willner v. Comm. on Character & Fitness*, 272 U.S. 96, 103-04 (1963) (concerning a denial of the right to practice law). *See* In Re Lucero L., 22 Cal. 4th 1227, 1244-45 (2000) ("...'hearsay evidence alone "is sufficient to satisfy the requirements of due process of law"...'" and "parties generally have a due process right to cross-examine available hearsay declarants"). This basic element of due process also underlies the refusal of the federal courts to give collateral estoppel or *res judicata* effect to state court rulings at proceedings which did not provide an "adequate representation" of the party sought to be bound, i.e. when the proceeding denied the party due process of law. The leading case is *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 480-82 (1982). *See* CHARLES ALAN WRIGHT, ARTHUR R. MILLER & EDWARD H. COOPER, FEDERAL PRACTICE AND PROCEDURE - JURISDICTION §4469.1, 4471.2 (2d ed. 1990) and Haring v. Prosise, 462 U.S. 306 (1983). This is the central reason discussed in *Vandenberg* for why there is no collateral estoppel regarding factual findings in arbitration awards against non-participating parties under California law. *See also* Citizens for Open Access to Sand and Tile, Inc. v. Seadrift Ass'n., 60 Cal. App. 4th 1053, 1070 (1998) (finding no collateral estoppel against parties who did not participate in the applicable proceeding based on due process concerns).

arbitration award should be enforced against any party or representative only if given after sufficient due process of law such that a court can, consistent with its responsibilities, enforce the award against any party or their representatives.[79] No waiver of any due process claim should be upheld against any party except if knowingly made under the otherwise applicable legal principles. This does not mean that every aspect of due process law, as interpreted by the courts for their processes, must apply to determine the enforceability of an award by collateral estoppel or otherwise, which seemed to have been the real import of *Barnes*. Only fundamental due process, as elucidated by the Supreme Court in cases regarding the denial of government benefits or in the enforceability of judgments against non-parties,[80] should be the basis for reversal of an award.

Naturally, the courts will define what is fundamental through precedent and individual case review, but certain general rules are suggested below. What should be the minimal level of due process of law in an arbitration proceeding? By analogy to other areas, we suggest the following:

1. Right to specific notice of the issues for resolution in arbitration and limitation of the arbitration to those issues.
2. Right to defend and present a case at an oral hearing on these issues with sufficient time to do so.
3. Right to confront witnesses testifying against a party to the arbitration, i.e. no decision can be based principally on hearsay testimony of a material witness.
4. Right to a clear statement articulating the basis for any decision with factual and legal findings that may be reviewed on any appeal.
5. Right to an impartial decision-maker.
6. Right to equal enforcement of any laws reflecting clear and established state or federal public policy, such as *res judicata* and the statute of limitations.
7. Right of third parties to be free of the collateral effect of arbitration awards, based on the same principles applicable to judicial rulings and judgments.

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[79] Compare the reasoning of *Vandenberg v. Super. Ct.*, 21 Cal. 4th 815, 834, (1999) and *supra* note 78 regarding the due process required to give collateral estoppel effect, which we believe cannot be reconciled with the reasoning (as opposed to the specific holding) of *Barnes*. We argue that the due process standards described herein should be the basis for review of whether an arbitration hearing is "fundamentally fair" and hence provide specific due process standards for a vague test that is currently no more than *dicta*. See *supra* note 10.

[80] See *supra* pp. 33-35 and note 78.

8. Right of defending party to have a burden of proof placed on the complaining party.

9. Right of defendants to be free of attorney fee awards or high compulsory arbitration fees, absent an award and a contract clause awarding attorney fees to the prevailing party.

10. Right of defendants to be free of racial or other actionable prejudice in the proceedings.

One of the provisions of due process is directly remedial: no enforcement of an award that violates public policies which cannot be avoided by agreement (such as *res judicata*, statute of limitations, covenants not to compete, choice of law, and the like). This rule is particularly compelling in awards of attorney fees or imposition of high arbitration costs.[81] An extension of the principles set forth above is that, although the courts must accept factual findings by arbitrators done fairly and in accordance with due process, the courts need not defer to the choice of remedies chosen by the arbitrator and should not enforce remedies which a court would not grant on such facts, either as a matter of discretion or because it is prohibited from doing so. Also, all issues regarding extension of contractual liability beyond a party who executed the arbitration agreement should be decisions solely of the courts, as a matter of due process.

Finally, the courts should define what principles of law are "public policy" and cannot be ignored by arbitrators. The United States Supreme Court would be well-advised to reject the confusing and uncertain federal "manifest disregard" standard in favor of a clear statement of which principles of law must be enforced equally for similarly situated persons and which need not be, irrespective of the conduct of the arbitrator in either his knowledge or review of those principles of law. The case law regarding the limitations on enforcing choice of law, jurisdiction clauses, or tribal judgments would be an appropriate beginning point for this analysis.[82]

D. Proposed Legislative Reform of the Arbitration Acts

Congress and the state legislatures should reconsider the issue of judicial review of the arbitration award in light of *Cable Connection* and the developing principles of judicial review discussed herein.

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[81] See *supra* notes 31, 36 relating to the very high costs imposed on a defendant through attorney fees at the risk of default even without the defendant's having signed the arbitration agreement (i.e. based on "estoppel" or "successor in interest" premises) and without a specific attorney fees clause altering the so-called "American" rule on attorney fees.

[82] See *supra* note 32.

Legislative action to clarify these principles is necessary, if for no other reason than to give clear guidance to practitioners as to what they can or should include in arbitration clauses to protect their clients. One must wonder how a practitioner can avoid a legal malpractice claim if a client is denied due process or other fundamental legal rights in an arbitration award when he perhaps could have avoided that result by different language in the contract (e.g. choice of California law and *Cable Connection* type language). Indeed, one may wonder even after *Hall Street Associates* whether a practitioner may define what legal principles cannot be "manifestly disregarded" or are violations of "public policy."

The law regarding due process rights in denial of government benefits may be a good guidepost for the legislature or Congress to define the appropriate due process and equal protection rights guaranteed to each party in arbitration. Similarly, the law regarding "knowing" and "willing" waiver of such rights should be the precedent to determine when sophisticated parties have waived enforcement of these rights by the courts. Finally, the law regarding the appropriate level of deference to contracting parties in the selection of remedies (or indeed choice of law or jurisdiction), such as California law on contractual "penalties," may further provide a proven and even well-worn path for efficient yet fair application of judicial review of arbitration decisions.

IV. CONCLUSION

The legislature and Congress would be well advised to heed the advice of the seminal *Cable Connection* decision. Public confidence in alternative dispute resolution processes and the related need for a transparent record of decision are as necessary to freedom of contract and efficiency policies that gave birth to widespread use of arbitration as are policies of judicial deference. Many practitioners know how broken many arbitral systems really are and use this realization to their strategic benefit, which is certainly not the ideal basis for judicial deference to arbitration awards. Appropriate judicial review, as *Cable Connection* holds, is in fact an increasingly important if not urgent requirement for effective and widely used private dispute resolution.