

# ARBITRATION EVOLUTION

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Originally conceived as an alternative to litigation, arbitration focused on providing an efficient and expeditious resolution of commercial contracts. When the Supreme Court expanded the scope of arbitrable claims to include federal statutory rights as evidenced by Title VII employment cases and other non-negotiated contracts, the role of arbitration evolved to include volatile and personal relationships. Federal and state courts increasingly confronted challenges to arbitration clauses, waiver of the right to arbitrate, jurisdictional disputes, disclosure and disqualification of arbitrators and challenges to confirmation of awards.

Simultaneously, commercial arbitration slowly matured. Aside from cases exemplified by employment, consumer and franchise disputes, the commercial case has begun a return to its original source, but in a modified form. An increasing number of lawyers are discovering that arbitration can offer an alternative to litigation yet replicate procedural and substantive law. By agreeing to partial or manageable discovery, mutually and voluntarily identifying deponents and expert witnesses, framing stipulations and expediting production of documents and answers to interrogatories, the parties tailor efficient resolution of a dispute.

Federal and state courts both embraced arbitration, in part to avoid the "discovery wars" that had plagued litigation. But lawyers engaged in arbitration of complex business disputes increasingly required discovery of documents, e-mails and other electronic recordings. California specifically permits the parties to agree to discovery in arbitration comparable to litigation, but the difference is the management of discovery and its efficient processing. Code of Civil Procedure Section 1283.1 (b).

The key to successful arbitration is managing procedural law that precedes resolution of the merits of a dispute. Statutory authority in Section 1283.1 (b), permitting parties to mutually agree on discovery, validates the emphasis on private contract and facilitates resolution of discovery disputes. An arbitrator can eliminate acrimonious exchange of letters, arrange the date, time and priority of depositions (or referee depositions if necessary), impose discovery and motion cut-off dates and often resolve other disputed issues telephonically by dispensing with briefs and the need for a court hearing.

Monitoring discovery and selecting a third party to manage commercial arbitration (whether an individual arbitrator or a three-party panel) is a mutual and voluntary decision by counsel. The expertise of an arbitrator is often a factor, but lawyers may prefer a lack of experience in the specific trade or industry under dispute in order to avoid the potential bias of a neutral. Ascertaining whether to select one arbitrator or a panel is quintessentially a decision for counsel. Panels are more costly and involve scheduling issues but also provide the potential for disparate views. In either case, the parties choose the decision maker.

State and federal courts have emphasized repeatedly the importance of jury trials, and

arbitration requires the parties to waive that right. Although both jurisdictions differ on the formula for waiver, counsel must explain the rights that their client surrenders in arbitration. In addition to executing a jury waiver in an arbitration clause, the client should separately acknowledge and sign a form explaining arbitration, the waiver of rights to jury trial and the limited opportunity for appeal.

To achieve the benefit of arbitration, whether drafting a pre-dispute arbitration clause, amending an existing clause or initiating post-dispute arbitration, counsel should outline precisely what the parties try to achieve by emulating litigation but eliminating its detriments. Despite contractual arbitration ordered by the court in response to a petition to compel, California law permits the parties to amend or modify an existing arbitration clause in the contract to shape the scope of the arbitrable dispute.

Procedural law begins in litigation with the names of the parties and their legal capacity. Ordinarily, the correct names of the parties and their capacity in arbitration are not in question, but when one party demands arbitration of a dispute in the absence of litigation on file and under the terms of the contract, the legal capacity of parties requires identification equivalent to captions in pleadings. When the arbitrator renders an award potentially enforceable in a judgment, that document should reflect accurately the legal capacity of the parties. Although the arbitration clause may not include third parties per se, an awareness of the potential impact of an award on others beyond the named parties is a factor in future litigation or arbitration when questions of collateral estoppel or res judicata arise.

In self-executing arbitration, a party proceeds with a submission of "claims" (equivalent to pleadings), and the other party may submit "counter claims." Demurrers and motions to strike are thereby avoided, but the jurisdiction of the arbitrator depends on the language of the statement of claims and the terms of the arbitration clause. The arbitrator resolves any disagreement between the two documents.

If one party files a petition to compel arbitration in court, the judge must determine arbitrable issues as well as arbitrable parties. On occasion, the court orders arbitration but overlooks these requirements in the order compelling it. The court order to compel arbitration divests the court of jurisdiction on the issue, but the arbitrator resolves any conflict, thereby enabling the parties to avoid a return trip to the courthouse; *Brock v. Kaiser Foundation Hospitals*, 10 Cal.App.4th 1790 (1992).

Arbitration is not necessarily the first option in resolving a dispute between contracting parties. A condition precedent in an arbitration clause requiring "negotiation" before arbitration is common, but the definition of this amorphous term tends to invite disputes contesting the scope or kind of process that complies with this requirement. Documentation of negotiation sessions or attempts to negotiate can evidence compliance with this condition, but disagreement between counsel on the character of the "negotiation" is likely. Mediation is a more specific alternative.

Although mediation is a frequent contractual condition for resolving a dispute before arbitration, the parties must submit their dispute to a neutral third party in order to comply with this requirement; *Saeta v. Superior Court*, 117 Cal.App.4th 361 (2004); Evidence Code 1115. When the mediation option is selected and enforced in the event of alleged noncompliance, an arbitration clause should impose a penalty on a party, such as attorney

fees. If the mediation is unsuccessful, the contract should require a party to initiate arbitration within a specific time.

In self-executing arbitration clauses contained in contracts, an aggrieved party cannot wait indefinitely to demand that the opposing party arbitrate, but a motion to compel arbitration must state the existence of the contract and a refusal of the opposition to arbitrate; Section 1281.2. In *Wagner Construction Co. v. Pacific Mechanical Corp.*, 41 Cal.4th 19 (2007), the California Supreme Court reviewed the statute of limitations time line as a barrier to initiating a demand for, and receiving a refusal to, arbitrate. The court characterized the statute of limitations as an affirmative defense not necessarily dispositive and held "waiver" qualified as the correct test to determine whether the motion was timely filed. *St. Agnes Medical Center v. Pacificare of California*, 31 Cal.4th 1187 (2003); Section 1281.2 (a).

A prime contract also may reference additional documents reflecting the scope of the agreement between the parties or a change in terms of the original agreement, but the parties also may enter into subsequent agreements. Incorporation of documents is acknowledged routinely by the courts as an appropriate contractual provision, but amended or supplemental documents may not have included the arbitration clause recited in the prime contract. To avoid disputes, an amended arbitration clause in the prime contract can identify and specifically incorporate other named documents, or, alternately, each incorporated document can include the arbitration clause.

Commercial arbitration frequently involves transactions in interstate commerce and the parties recognize the need for universal application of substantive and procedural law in resolving a dispute. The parties in a negotiated contract can provide for out-of-state resolution of a dispute, but in non-negotiated contracts, a choice-of-law clause or forum-selection clause unilaterally selecting an out-of-state jurisdiction causes disagreements. *Discover Bank v. Superior Court*, 36 Cal.4th 148 (2005).

In *Higgins v. Superior Court*, 140 Cal.App.4th 148 (2006), the court enforced a choice-of-law clause in an employment case on grounds that the parties negotiated the contract ab initio. As an added precaution, the parties should acknowledge the negotiation process in the contract and the mutual selection of their choice of law and forum applicable in a designated state.

Nevertheless, one of the parties may try to remove a Superior Court action to federal court on grounds of diversity. Although federal courts apply state substantive law to determine whether to order arbitration, the arbitration clause should specifically invoke the California Arbitration Act (Section 1280 et seq.) and identify California substantive and procedural law as the applicable rules for arbitration in order to avoid jurisdictional disputes.

Despite the best efforts of counsel to draft a lucid and enforceable clause during their negotiations, provision for effective notice demanding arbitration in the event of a dispute requires a mechanism to initiate the process. Proper service on the parties is as important in arbitration as in litigation, and California courts enforce "service of suit" clauses. *Boghos v. Certain Underwriters at Lloyd's of London*, 36 Cal.4th 495 (2005). The possibility of a subsequent merger, stock or asset sale, transfer of interests or the expiration of the agreement may alter service provisions.

When a dispute arises, one party serves a demand to arbitrate on the other party in accord with any service requirements in the arbitration clause. The submission of arbitrable claims should track the arbitration clause, and the opposition party should compare the terms of both documents. Absent objection to the submission agreement, the arbitrator may exercise jurisdiction even though the claims are outside the arbitration clause.

Managing the dispute empowers lawyers to control the process by replicating litigation without compromising arbitration. Litigators familiar with discovery and trial can transfer those skills in arbitration, but transactional lawyers also can achieve the same benefits by drafting rigorous arbitration clauses. The decision makers are mutually pre-selected, the discovery matures efficiently and swiftly, and the parties approach arbitration with a flexible and manageable schedule. "Litigation" of arbitration has its merits.

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