Performance Review: Arbitration Decisions Now Reviewable For Legal Error

Christopher Lilly

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In rapid succession, with two recent decisions, the California Supreme Court has reshaped the legal landscape for arbitrations under California law. Reversing long-standing precedent, arbitrators may now be required to follow the law, and to enforce the terms of the parties' contract. Arbitration decisions that fail to do so are now subject to judicial review. *Cable Connection, Inc. v. DirectTV, Inc.*, 44 Cal. 4th 1339 (2008); *Gueyffier v. Ann Summers*, LTD., 43 Cal. 4th 1179 (2008).

The Way Things Used To Be

The policy in recognizing and enforcing arbitration is to encourage people who wish to avoid the delays of a civil action, and to adjudicate their differences by a tribunal of their choosing. Because the decision to arbitrate grievances shows the parties' intent to bypass the judicial system and thus avoid potential delays at the trial and appellate levels, arbitral finality is a core component of the parties' agreement to submit to arbitration.

Because it vindicates the intentions of the parties that the award be final, and because an arbitrator is not ordinarily constrained to decide according to the rule of law, it is the general rule that the merits of the controversy between the parties are not subject to judicial review. *Moncharsh v. Heily & Blasé*, 3 Cal. 4th 1 (1992).

Traditionally, aside from such things as clerical error or arbitrator conflicts, the only basis to challenge an arbitration decision has been to claim that the arbitrator exceeded the scope of the matters submitted into arbitration. That challenge is made in the trial court by a motion to vacate or modify the decision. The losing party would file that motion and couch arguments that the arbitrator committed an error of law, in language that the arbitrator exceeded the scope of submission. After a full briefing schedule and hearing, the trial court would then deny the motion to vacate or modify the award, and, upon the prevailing party's motion to confirm the decision, enter an order confirming the arbitrator's decision as a judgment.

'Gueyffier'

The first major departure from the way things used to be came in *Gueyffier*. In *Gueyffier*, the Supreme Court upheld an arbitration decision that excused the performance of a material provision of a contract, despite another provision that barred the arbitrator from "modifying or changing" any material terms of the contract.

According to the court, what the parties drafting the provision needed to say is that the arbitrator has no power to "modify, change, or *excuse the performance of* " a material term. Under a provision with that level of specificity, an arbitration decision that modified, changed or excused

the performance of a material term of the contract would "exceed the arbitrator's power," and could then be vacated or modified by the courts.

In the case, Celine Gueyffier opened an Ann Summers lingerie store in the Beverly Center mall, under a franchise agreement with Ann Summers, Ltd. The opening was a "disaster," complete with tomatoes being thrown at the store and insults being yelled at Gueyffier. In 2001, Gueyffier petitioned for arbitration under the arbitration provision in the franchise agreement, and sought consequential damages for the franchisor's failure to provide adequate training, guidance and assistance.

The franchise agreement also provided that Ann Summers would not be held in breach of the agreement, unless Gueyffier first gave notice of the breach, and 60 days' opportunity to cure. That provision was expressly denominated as being "material." Moreover, the arbitration provision explicitly provided that in no event may the arbitrator "modify or change" any material provision of the agreement.

In 2005, four years after the petition, the arbitrator ruled that Gueyffier was excused from giving the notice of breach and opportunity to cure, and awarded her $478,030 in consequential damages. Ann Summers filed a motion to vacate the award in the trial court, arguing that: Gueyffier failed to give notice of any breach, let alone an opportunity to cure; the arbitrator's finding that excused giving such notice and affording an opportunity to cure, as an "idle act," amounted to a "modification or change" of a material term; and the finding therefore exceeded the arbitrator's power.

The trial court disagreed and upheld the award, the Court of Appeal reversed the trial court and vacated the award, and, seven years after Gueyffier petitioned for arbitration, the Supreme Court reversed the Court of Appeal. In ordering the Court of Appeal to reinstate the award, the Supreme Court held that the provision did not unambiguously prohibit the arbitrator from *excusing performance* of a contractual condition, where the arbitrator had concluded, because the breaches were uncurable, that performance would have been an idle act.

What the Supreme Court told us in Gueyffier is that, provided parties properly draft their arbitration provisions, parties may obtain judicial review of arbitration decisions that fail to follow the terms of the parties' contract.

'Cable Connection'

The dam was broken wide open in Cable Connection. As reflected in the *Gueyffier* arbitration provision, parties have long sought to contract their way around the principle of arbitral finality. One such attempt has been for parties to agree in their arbitration provisions that the courts may review the arbitration decision for legal error.

In case after case, the courts have refused to enforce such provisions. Indeed, the U.S. Supreme Court in *Hall Street Associates, LLC v. Mattel, Inc.*, 128 S.Ct. 1396 (2008), recently held that, under the Federal Arbitration Act, such provisions are not enforceable. But in *Cable Connection*, the California Supreme Court held that the Federal Arbitration Act does not pre-empt the California Arbitration Act, and the California Arbitration Act does not preclude such provisions.

The California Supreme Court held that parties drafting such provisions, however, must "clearly agree that legal errors are an excess of arbitral authority that is reviewable by the courts." The specific contractual language used by the parties in the *Cable Connection* case, which the court endorsed as sufficiently "clear," provided that: "The arbitrators shall not have the power to commit errors of law or legal reasoning, and the award may be vacated or corrected on appeal to a court of competent jurisdiction for any such error."

The court acknowledged the criticisms of adopting this new rule – primarily that the new rule would lead to the "judicialization" of arbitration awards. The court responded to that criticism by noting that "the desire for protection afforded by review for legal error has evidently developed from the experience of sophisticated parties in high stakes cases, where the arbitrator's awards deviated from the parties' expectations in startling ways. The judicial system reaps little benefit from forcing parties to choose between the risk of an erroneous arbitration award and the burden of litigating their dispute entirely in court."

The Future of Arbitration in California

In addition to the points made in *Cable Connection*, the concerns that California arbitrations will become much longer and more costly are easy to overstate. As evidenced even in *Gueyffier*, arbitration is often slower and more expensive than parties have been led to believe. Gueyffier petitioned for arbitration in 2001. It was not until four years later that the arbitrator reached a decision. Then that decision went to the trial court, the court of appeal, and the Supreme Court. It was not until 2008 that she obtained final relief. All of that was under the way things used to be.

The difference now is that the trial court will, if the parties choose, undertake a real review of the decision to determine whether the arbitrator committed errors of law or failed to follow the contract. This layer of real review, as opposed to the rubber stamp review of the past, gives parties to arbitration an additional protection beyond the obvious. In the past, arbitration decisions were, essentially, never reversed on the merits. Now they will be. Arbitrators will develop publicly available track records of being affirmed and reversed. Those arbitrators who develop a record of being reversed may find that parties select them less frequently. That financial disincentive, in conjunction with professional pride, should prompt arbitrators to increasingly attempt, in the first instance, to get their decisions right.

Meanwhile, the traditional advantages of arbitration remain. Parties may still select the amount of discovery that will be allowed. They may still select the decision-maker, including decision-makers with special expertise in the industry for their particular case. And, of course, the parties avoid a jury trial.

In sum, the parties may enjoy the previous advantages of arbitration, while at the same time being protected from runaway arbitrators, but without, in general, having to pay a materially increased price over the way things used to be for that protection.

The Next Step

The principle of *Cable Connection* should apply as equally to judicial review of the facts, as it does judicial review of the law. So long as the parties address the practical issue of having a certified court reporter record the arbitration hearing, there is no logical reason why parties could not, under *Cable Connection*, agree that errors of fact may be reviewed by the courts.

Parties contracting under California law may well wish to consider pursuing the opportunities afforded to them by the Supreme Court to resolve their disputes by arbitrations freed from the tyranny of runaway arbitrators.