

California Supreme Court Expands Arbitration Review

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On August 25, 2008, the California Supreme Court, in a 5–2 decision in *Cable Connection, Inc. v. DIRECTV, Inc.*, No. S147767, 2008 WL 3891556 (Cal. Aug. 25, 2008), expanded courts' powers to review arbitration decisions under California law for legal errors in cases where parties have contractually agreed to judicial oversight in advance. The California Supreme Court decision comes five months after the United States Supreme Court held in *Hall Street Associates, L.L.C. v. Mattel, Inc.*, 128 S. Ct. 1396, 1404–05 (2008), that the Federal Arbitration Act does not permit parties to expand the scope of judicial review of arbitration decisions by agreement.

The California Supreme Court's ruling stems from a 2001 dispute between satellite television broadcast company DIRECTV and certain retail dealers from four states who claimed that DIRECTV withheld commissions and assessed improper charges. The contract between DIRECTV and the retailers contained an arbitration provision in which the parties agreed (among other things) that "[t]he arbitrators shall not have the power to commit errors of law or legal reasoning, and the award may be vacated or corrected on appeal to a court of competent jurisdiction for any such error." *Cable Connection*, 2008 WL 3891556, at *1. After an arbitration panel ruled 2–1 in favor of class-wide arbitration, DIRECTV sought to vacate the arbitration award in Los Angeles Superior Court. On November 11, 2005, the trial court vacated the arbitration award. The Court of Appeal for the Second District reversed, finding that the trial court exceeded its jurisdiction by reviewing the merits of the arbitrators' decision. *Cable Connection, Inc. v. DIRECTV, Inc.*, 49 Cal. Rptr. 3d 187, 199–200 (Ct. App. 2006). The California Supreme Court disagreed, holding that judicial review of the merits of an arbitration award is permissible where the contracting parties have expressly agreed beforehand that any arbitration award would be reviewable for legal errors. *Cable Connection*, 2008 WL 3891556, at *15.

The *Cable Connection* decision chips away at the general rule in California that arbitration awards are final and conclusive. See *Moncharsh v. Heily & Blase*, 832 P.2d 899, 902–05 (Cal. 1992). The California Supreme Court refused to extend that general principle to cases where the parties' arbitration clause includes a provision for judicial review of legal errors in the arbitration award.

STATE AND FEDERAL STATUTES

The California Arbitration Act ("CAA") is similar to the Federal Arbitration Act ("FAA") in all material respects; both provide only limited grounds for judicial review of an arbitration award. Under the CAA and the FAA, courts are permitted to vacate an arbitration award only if the award was: (1) procured by corruption, fraud or undue means; (2) issued by corrupt arbitrators; (3) affected by prejudicial misconduct on the part of the arbitrators; or (4) in excess of the arbitrators' powers. CAL. CIV. PROC. CODE § 1286.2(a) (West 2007); 9 U.S.C. § 10(a) (2002). The state and federal statutes

further provide that an arbitration award may be corrected only if (1) there was a miscalculation or mistake; (2) the arbitrators exceeded their powers; or (3) the award was imperfect in form. CAL. CIV. PROC. CODE § 1286.6; 9 U.S.C. § 11.

On March 25, 2008, the United States Supreme Court resolved a split among the United States Courts of Appeal in holding that the FAA does not permit the parties to expand the scope of judicial review of arbitration awards by agreement. *Hall St. Assocs.*, 128 S. Ct. at 1403 (“We now hold that [9 U.S.C.] §§ 10 and 11 respectively provide the FAA’s exclusive grounds for expedited vacatur and modification.”). But, the United States Supreme Court went on to say that the FAA does not “exclude more searching review based on authority outside the [FAA].” *Id.* at 1406. The parties involved in arbitration “may contemplate [judicial] enforcement under state statutory or common law, for example, where judicial review of different scope is arguable.” *Id.* The California Supreme Court seized upon this language from *Hall Street* and concluded that *Hall Street* was restricted to proceedings to review arbitration awards under the FAA and did not require state law to conform to its limitations. *Cable Connection*, 2008 WL 3891556, at *7 (“[T]he *Hall Street* majority left the door ajar for alternate routes to an expanded scope of review.”).

FEDERAL PREEMPTION

The FAA governs arbitration clauses in contracts involving interstate commerce. *Id.* at *8. State laws invalidating arbitration agreements on grounds applicable only to arbitration provisions contravene the policy of enforceability established by the FAA and are, therefore, preempted by the FAA. *Id.* at *8 (citing cases). However, the FAA’s procedural provisions do not apply to state court proceedings. *Id.* In *Cable Connection*, the California Supreme Court held that because *Hall Street* left open avenues for judicial review of arbitration awards independent of the FAA, the United States Supreme Court did not intend “to declare a policy with preemptive effect in all cases involving interstate commerce.” *Id.* at *10.

DISTINGUISHING MONCHARSH

Since 1992, judicial review for legal errors of arbitration awards in California was governed by the *Moncharsh* decision. In that case, the California Supreme Court held that “an arbitrator’s decision is not ordinarily reviewable for error by either the trial or appellate courts.” *Moncharsh*, 832 P.2d at 905. However, in *Moncharsh*, the parties’ arbitration clause did not contain a provision that permitted judicial review of an arbitration award for legal errors.

In *Cable Connection*, the California Supreme Court recognized (for the first time) that “contractual limitations may alter the usual scope of [judicial] review” of arbitration awards. 2008 WL 3891556, at *1. The Supreme Court explained that the parties may obtain judicial review of the merits of an arbitration award by express agreement:

If the parties constrain the arbitrators’ authority by requiring a dispute to be decided according to the rule of law, and make plain

their intention that the award is reviewable for legal error, the general rule of limited review has been displaced by the parties' agreement. Their expectation is not that the result of the arbitration will be final and conclusive, but rather that it will be reviewed on the merits at the request of either party.

Id. at *11. The Court reasoned that the parties' intent should be given considerable weight especially when considering that the CAA provides that the arbitrators may not "exceed[] their powers." Id.; CAL. CIV. PROC. CODE § 1286.2(a)(4).

IMPLICATIONS OF CABLE CONNECTION

The California Supreme Court held that there are considerable benefits to enforcing agreements for judicial review of arbitration awards for legal errors. According to the Supreme Court, "[t]he desire for protection afforded by review for legal error has evidently developed from the experience of sophisticated parties in high stakes cases, where the arbitrators' awards deviated from the parties' expectations in startling ways." *Cable Connection*, 2008 WL 3891556, at *16. The Supreme Court reasoned that 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." Id. "Enforcing contract provisions for review of awards on the merits relieves pressure on congested trial court dockets." Id. (citations omitted).

But, as the dissent points out, the *Cable Connection* decision opens the door to the courthouse by allowing the losing party to challenge the arbitration panel's decision for almost any reason where the parties have agreed in advance to such judicial review: "The majority decision would allow parties to fundamentally refashion arbitration from being a means of binding dispute resolution to being essentially a preliminary fact-finding procedure, with trial and appellate courts required to settle decisive legal questions." Id. at *26 (Moreno, J., concurring and dissenting).

In light of *Cable Connection*, a party negotiating an arbitration clause in an agreement governed by California law should pause to consider whether adding language to allow for judicial review for legal error is advantageous. Such language could result in additional litigation even if that party were to prevail at arbitration.

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