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Signal of Greater Judicial Review of Arbitration Awards?

The U.S. Supreme Court ruled in *Hall Street Associates, LLC v. Mattel Inc.*,[1] that §§10 and 11 of the Federal Arbitration Act[2] (FAA) provide "exclusive regimes for the review provide by the [FAA]," yet it explicitly declined to foreclose "other possible avenues for judicial enforcement of arbitration awards."

Thus, although it seemingly decided a narrow issue before it, the Court's decision actually raised a series of additional questions.[3]

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'Cable Connection v. DIRECTV'

Such questions include if and how a party could proceed under state law so as to expand, by agreement, the scope of judicial review of an arbitration award. While the U.S. Supreme Court termed it "arguable" that parties could seek "enforcement under state statutory or common law" of an agreement for expanded judicial review of arbitration awards,[4] the California Supreme Court recently held that the "California rule is that the parties may obtain judicial review of the merits [of an arbitration award] by express agreement."[5] The California high court's ruling in *Cable Connection, Inc. v. DIRECTV Inc.* may herald receptivity on the part of state courts to an assortment of arbitral review mechanisms available under state law.

The California court's decision in *Cable Connection* arises out of a dispute between DIRECTV Inc., (DIRECTV), a nationwide satellite broadcaster of television programming, and retail dealers (the dealers), who provide customers with the equipment necessary to received DIRECTV's satellite signal.[6] The dispute centered on the dealers' allegations that DIRECTV had wrongfully withheld commissions from the dealers and assessed improper charges. The dealers filed suit in Oklahoma on behalf of a nationwide class. DIRECTV moved to compel arbitration pursuant to the retail sales agreements (the agreements) it had with the dealers.[7] The agreements stated in relevant part:

> Any dispute or claim arising out of the interpretation of the interpretation, performance, or breach of this agreement…shall be resolved only by binding arbitration…in accordance with the rules of the American Arbitration Association [(AAA)], modified as herein provided…. The arbitrators shall apply California substantive law to the proceeding, except to the extent Federal substantive law would apply to any claim…. 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…. This Section and any arbitration conducted hereunder shall be governed by the United States Arbitration Act (9 U.S.C. §1, et seq.).[8]

While the Oklahoma court was considering whether the matter could proceed to arbitration on a classwide basis, the U.S. Supreme Court issued its opinion in *Green Tree Financial Corp. v. Bazzle*,[9] in which a plurality of the Court decided that, at least where the arbitration agreement is silent on the question, it is for the arbitrator to decide whether an agreement authorizes class arbitration. With the issue before it resolved by the *Bazzle* opinion, the Oklahoma court directed the parties to proceed to arbitration before a panel of three arbitrators selected under AAA auspices.

The first order of business for the selected AAA arbitrators was to decide whether the agreements authorized classwide arbitration. After the parties had briefed and argued the issue, a majority of the three-member panel concluded that although the agreements are "silent and manifest[] no intent on this issue," the issue was one of substantive California law and classwide arbitration was authorized under prior California case law—*Blue Cross of California v. Superior Court*,[10] and *Keating v. Superior Court*.[11] One member of the panel dissented, finding "ample indication" in the agreements that the parties did not intend arbitration to proceed on a classwide basis. Furthermore, in the dissenting arbitrator's view, *Blue Cross* and *Keating* addressed only the policy considerations of the California Arbitration Act (CAA)[12] on the issue of classwide arbitration, whereas the Supreme Court's ruling in *Bazzle* required the arbitrators to assess the availability of classwide arbitration under the terms of the parties' agreement. The dissent further reasoned that the availability of class arbitration is a procedural issue subject to federal law under the FAA and the rules of the AAA.

DIRECTV's Petition

DIRECTV then petitioned in California state court to vacate the arbitration panel's award, on grounds including that it exceeded its authority by substituting its discretion for the parties' intent on the issue of classwide arbitration and reflected errors of law not permitted and subject to judicial review under the agreement. The trial court agreed and vacated the award, but the California Court of Appeals reversed. According to the intermediate appellate court, the trial court's review of the merits of the arbitration award exceeded the court's jurisdiction. In addition, the Court of Appeals addressed the question of whether an arbitration agreement may provide for expanded judicial review, even though the matter was not addressed by the trial court, because it found the question to be an important matter of public policy.

Relying on prior Court of Appeals' decisions,[13] the appeals court held that such enhanced-review provisions were unenforceable and concluded that the provision in the agreements was severable from the remainder of the contract. The California Supreme Court subsequently granted DIRECTV's petition for review.

California Analysis

The California high court prefaced its analysis with a review of the CAA, the FAA, and California case law. The state supreme court explained that "[i]n most important respects, the California statutory scheme on enforcement of private arbitration agreements is similar to the FAA…and provides that arbitration agreements are valid, enforceable and irrevocable, save upon such grounds as exist for the revocation of any contract."[14] In addition, the CAA provides for the same limited grounds for vacatur of an arbitration award: (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.

The California Supreme Court previously had ruled in *Moncharsh v. Heily & Blase*[15] that "in the absence of some limiting clause in the arbitra-

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tion agreement, the merits of the award, either on questions of fact or of law, may not be reviewed except as provided in the statute."[16] This interpretation of the CAA is, of course, quite similar to the U.S. Supreme Court's reading of the FAA in *Hall Street*.

The California Supreme Court then went on to note that, prior to the decision in *Hall Street*, there was disagreement at the federal level as well.[17] The majority decision in *Hall Street*, as the California court explained, largely cleared up the disagreement at the federal level,[18] but seemingly left the door open to state court: "The FAA is not the only way into court for parties wanting review of arbitration awards: They may contemplate enforcement under state statutory or common law, for example, where judicial review of different scope is arguable."[19]

It was against this backdrop that the California Supreme Court proceeded to consider the dealers' argument that *Hall Street* either applied directly to the CAA or, in the alternative, the U.S. Supreme Court decision offered a persuasive analysis of the FAA that should be applied to the CAA's similar provisions on judicial review. The *Cable Connection* court turned first to the issue of preemption and rejected both legs of the argument. The court noted that while state laws invalidating arbitration agreements on grounds that regulated only arbitration agreements are preempted by §2 of the FAA, "the United States Supreme Court does not read the FAA's procedural provisions to apply to state court proceedings."[20] Because, in the *Cable Connection* court's view, the FAA's procedural provisions were "not controlling…the determinative question [was] whether CAA procedures conflict with the FAA policy favoring the enforcement of arbitration agreements."[21]

The court explained that but for *Hall Street*, it would have had no difficulty enforcing an agreement providing for enhanced judicial review of the merits of arbitration awards, for "the basic objective in this area is not to resolve disputes in the quickest manner possible, no matter what the parties' wishes, but to ensure that commercial arbitration agreements, like other contracts, are enforced according to their terms, and according to the intentions of the parties."[22] The California Supreme Court reasoned that *Hall Street* did not preempt state laws that allowed enhanced review under state arbitration statutes: the *Hall Street* opinion "does not require state law to conform with [the FAA's] limitations… [and] a reading of the CAA that permits enforcement of agreements for merits review is fully consistent with the FAA…."

California Law

The *Cable Connection* court went on to analyze California law, and concluded that the CAA, as well as the case law interpreting it, supports the enforcement of agreements to expand the scope of judicial review of arbitral awards. The California court relied on its prior holding in *Moncharsh* in which it concluded that, in drafting the CAA, the California Legislature "adopted the position taken in case law…that in the absence of some limiting clause in the arbitration agreement, the merits of the award, either on questions of fact or of law may not be reviewed except as provided in the statute."[23] Although the statutory grounds under the CAA for review of arbitral awards do not ordinarily include a review of the merits, such statutory construction does not mean that the parties may not provide for such review by agreement. According to the court, "requiring the parties to expressly provide for an expanded scope of review is consistent with the usual expectations of parties to arbitration agreements, who accept the risk of legal error in exchange for the benefits of a quick, inexpensive, and conclusive resolution…. It is the parties who are best situated to weigh the advantages of traditional arbitration against the benefits of court review for the correction of legal error."[24]

The California court rejected the existence of jurisdictional impediments to expanded judicial review of arbitration awards: "[T]he CAA authorizes review on the ground that an award exceeds the arbitrators' powers[,]" and where those powers are circumscribed by the parties' agreement, "there is no jurisdictional impediment to contracts limiting the arbitrators' authority by subjecting their award to correction for legal error." Some contractual provisions requiring an "unusual standard of review," however, may be problematic: "[J]ust as the parties to any contract are limited in the constraints they may place on judicial review, an arbitration agreement providing that a 'judge would review the award by flipping a coin or studying the entrails of a dead foul' would be unenforceable."[25]

The California high court's ruling in 'Cable Connection v. DIRECTV' may herald receptivity on the part of state courts to an assortment of arbitral review mechanisms available under state law.

Having found that the parties' agreement for expanded judicial review was enforceable, the court then turned to the underlying substantive issue of whether class arbitration was available under the agreement. The court found no evidence that the contract was one of adhesion and agreed with DIRECTV that the majority of the arbitration panel appeared to interpret the AAA rules as a factor favoring class arbitration, rather than focus solely on the terms of the agreements.[26] The court "express[ed] no view on whether the terms of [the agreements] are consistent with conducting arbitration on a classwide basis" but instead remanded the issue so that the arbitration panel could determine whether class arbitration is available under the agreements.

Conclusion

The *Cable Connection* decision is important to practitioners nationwide because it signals a possible beginning to state court receptivity to enhanced judicial review of arbitration awards under state arbitration acts. This makes it all the more important for parties to consider carefully the differences between federal and state laws and among potentially applicable state laws when drafting choice-of-law provisions in an arbitration agreement. Although the California Supreme Court drew some support from language in *Hall Street*, in which the U.S. Supreme Court left open the door to expanded judicial review of arbitral awards under state law, the Court did not decide the issue and it remains to be seen whether the Court would find California's approach in *Cable Connection* preempted by the FAA.

1. __U.S.__, 128 S.Ct. 1396 (2008).
2. 9 U.S.C. §1 et seq.
3. See, e.g., Samuel Estreicher and Steven C. Bennett, "Parties Can't Modify FAA Standards for Judicial Review," NYLJ April 15, 2008 (posing several questions left open by the Hall Street decision).
4. Hall Street, 128 S.Ct. at 1406.
5. Cable Connection Inc. v. DIRECTV Inc., __Cal. Rptr. 3d__, 2008 WL 3891556, at *1 (Cal. Aug. 25, 2008).
6. 2008 WL 3891556 at *1-2.
7. DIRECTV used a "residential dealer agreement" in 1996, and in 1998 began using a new "sales agency agreement." Id. at *1.
8. Id. at *2 n.3.
9. 539 U.S. 44, 123 S.Ct. 2402 (2003).
10. 67 Cal. App. 4th 42, 78 Ca. Rptr. 2d 779 (1998).
11. 31 Cal. 3d 584, 183 Cal. Rptr. 360 (1982).
12. Cal. Civ. Proc. Code §1280 et seq.
13. Oakland-Alameda County Coliseum Authority v. CC Partners, 101 Cal. App. 4th 635, 124 Cal. Rptr. 2d 363 (Cal. Ct. App. 2002); Crowell v. Downey Community Hospital Foundation, 95 Cal. App. 4th 730, 115 Cal. Rptr. 2d 810 (Cal. Ct. App. 2002).
14. 2008 WL 3891556, at *3 (internal citations and quotations omitted).
15. 3 Cal. 4th 1, 10 Cal. Rptr. 2d 183 (Cal. 1992).
16. 2008 WL 3891556, at *4 (quoting Moncharsh, 3 Cal. 4th at 25).
17. Contracts for expanded judicial review had been upheld in the First, Third, Fourth, Fifth, and Sixth circuits, while the Seventh, Eighth, Ninth, and Tenth circuits took an opposite stance. Id. at *6.
18. As the California court points out, the Hall Street opinion left open the possibility that a federal trial court's case management authority under Federal Rule of Civil Procedure 16 might support judicial enforcement of the parties' agreement for expanded review. 2008 WL 3891556, at *7.
19. Hall Street, 128 S.Ct. at 1406.
20. 2008 WL 3891556, at *8 (quoting Cronus Investments Inc. v. Concierge Servs. 35 Cal. 4th 376, 389, 24 Cal. Rptr. 3d 540 (Cal. Ct. App. 2005)).
21. Id. at *9.
22. Id. at *10 (quoting First Options of Chicago Inc. v. Kaplan, 514 U.S. 938, 947, 115 S.Ct. 1920 (1995)).
23. Id. at * 1 (quoting Moncharsh, 3 Cal. 4th at 10, 10 Cal. Rptr. 2d 183).
24. Id. at *14-15.
25. Id. at *16.
26. Id. at * 17-18.