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"What Agreement? When Courts Abrogate Parties' Intent"

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In several recent federal and state contract-arbitration cases, the courts seem to have gone out of their way to vitiate the contracting parties' intent in order to effectuate the goals of the Federal Arbitration Act, 9 U.S.C. Section 1 et seq., or to address wider social issues.

The FAA governs contractual arbitrations in written contracts involving interstate or foreign commerce and pre-empts conflicting state law that would otherwise limit the enforceability of, scope of or remedies available under the arbitration agreements.

As a general rule, even where parties contractually provide for arbitration of federal claims arising under statutes vesting exclusive jurisdiction in federal courts (and where theses statutes invalidate any "waiver" of judicial remedies), courts have still upheld the arbitrability of such federal claims. However, substantive federal rights and benefits may not be forfeited through arbitration clauses. Graham Oil Co. v. ARCO Products Co., 43 F.3d 1244 (9th Cir. 1994).

For example, in Mastrobuono v. Shearson Lehman Hutton Inc., 514 U.S. 52 (1995), the U.S. Supreme Court relied on the FAA in authorizing an arbitrator to award punitive damages. It did so by voiding the parties' choice-of-law provision to the extent it would have deprived the arbitrator of such jurisdiction.

Mastrobuono held that when a National Association of Securities Dealers arbitration agreement between a customer and a securities broker permitting an award of punitive damages involves interstate commerce, then the FAA pre-empts state law and supports an arbitration award of punitive damages. This is so, said the court, even notwithstanding the fact that the agreement stated that it was to be interpreted under the law of New York, which deprived arbitrators of jurisdiction to award punitive damages. The court held that the FAA modified a contractual choice-of-law provision so as to preserve a substantive federal right.

The Supreme Court's decision did not deprive the arbitrator of jurisdiction, nor did it erode the parties' intent. Rather, the court found that the parties' intent was unclear, since their own choice-of-law provision was at odds with their arrogation of jurisdiction to the arbitrator to award punitive damages.

In Duffield v. Robertson Stephens & Co., 98 Daily Journal D.A.R. 4837 (9th Cir. May 8, 1998), the 9th Circuit invalidated the parties employment agreement insofar as it required them to arbitrate Title VII claims. The court held that arbitration may not be required, as a condition of employment, for the resolution of civil rights claims under Title VII or

corresponding state law. Although a sharp departure from Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991), in which the Supreme Court upheld the mandatory arbitration of Age Discrimination in Employment Act claims as a condition of employment, the court based Duffield on its reading of the legislative history of the Equal Employment Opportunity Act.

In Wolsey v. Foodmaker Int'l, 98 Daily Journal D.A.R. 5235 (9th Cir. May 20 1998), the 9th Circuit voided the parties' choice-of-law provision, which would have enabled the trial court to stay nonbinding arbitration and consolidate prior and new claims. The court concluded that an arbitration need not be binding to trigger FAA coverage, and that even a franchisor-franchisee agreement to engage in nonbinding arbitration takes precedence over California Procedural law.

In Wolsey, there was a contractual, three-step dispute-resolution process between Wolsey and Foodmaker. Under the second step, nonbinding arbitration, Wolsey prevailed against Foodmaker. When Foodmaker refused to comply with the nonbinding award, Wolsey proceeded to Step 3, filing suit against Foodmaker and several nonparties and expanding the number of causes of action against Foodmaker. Foodmaker moved to compel nonbinding arbitration to the new claims against it.

Under California law, the arbitration could have been stayed pending resolution of the litigation under California Code of Civil Procedure Section 1281-2(c). The contract between Wolsey and Foodmaker contained a provision choosing California law in the same section of the agreement to arbitrate.

Reversing the trial court, however, the 9th Circuit held that since the choice-of-law provision, under Mastrobuono, requires the application of California law only on substantive issues, the FAA takes precedence over the state law on issues of allocation of authority between courts and arbitrators. Holding that the trial court had no power to stay the arbitration, the 9th Circuit concluded that the court had erred in denying Foodmaker's motion to compel nonbinding arbitration of the new claims against it.

In Sagonowsky v. More, 64 Cal.App.4th 122 (1998), the court retracted somewhat the rights of parties to contractual arbitration relative to the rights of litigants. In Sagonowsky, the court ruled that absent an arbitration agreement provision to the contrary, the favorable termination of a private, contractual arbitration will not support a claim for malicious prosecution. The court contrasted judicial arbitrations of baseless, maliciously motivated claims to private arbitrations of similarly weak claims, concluding that only the former give rise to a malicious prosecution claim because they constitute an abuse of the judicial system and result in public embarrassment of the prevailing party.

According to the court, as a policy matter, permitting malicious prosecution actions following private, confidential arbitrations would increase litigation and undermine the finality of the dispute resolution process to which the parties had agreed. The court noted that the parties to the underlying contract had carved out a narrow series of circumstances

under which they could seek a judicial remedy--an malicious prosecution was not one of them.

The Sagonowsky court refused to insert into the agreement the requirement that disputes submitted to arbitration be "bona fide." It is not clear what would have happened had the malicious prosecution claim been filed with the arbitrator immediately after the award had been rendered.

Finally, in Broughton v. Cigna Healthplans of California, 98 Daily Journal D.A.R. 7279 (Cal.App. July 2, 1998), the court disregarded the parties' agreement to arbitrate "any controversy," carving out an exclusion for claims carrying wider public policy implications. The court ruled, in a case of first impression, that a claim for violation of the Consumers Legal Remedies Act, California Civil Code Section 1750 et seq., need not be arbitrated pursuant to a mandatory arbitration provision in a health insurance policy due to the act's anti-waiver provision.

In addition to suing for medical malpractice, the Broughton plaintiff sued Cigna under the act for deceptively advertising the quality of medical services provided under its health plan. Cigna moved to compel arbitration of both claims under its arbitration clause, which provided for arbitration of "any controversy" between subscribers and Cigna, regardless of whether the claim sounded "in tour, contract or otherwise."

Relying on Civil Code Section 1751 ("any waiver by a consumer of the provisions of this title is contrary to public policy and shall be unenforceable and void"), the court upheld the trail court's finding that arbitration of the plaintiff's claim under the act would constitute an impermissible waiver.

On its face, Cigna, had the better argument--that arbitration merely provides a different but equally neutral forum and does not limit the remedies available to consumers under the act. But the appellate court, after analyzing the nature of injunctions and the powers necessary to monitor their enforcement as well as to modify or dissolve them, concluded that it would be inefficient and uneconomical "to require a new arbitration proceeding to enforce an injunction every time a defendant repeats a business practice which was found to violate the Act."

The court also concluded that the act's public purpose--to alleviate social and economic problems stemming from deceptive business practices--would be stymied by requiring individual consumers to arbitrate claims for injunctive relief under the act. In Broughton, not withstanding the court's standing preference for judicial economy, the court severed plaintiff's claims--one to be arbitrated and the other to be litigated.

Thus in four recent cases, the courts found reasons to modify the contracting parties' arbitration clauses and expectations. The consistently did so in the name of increasing the potency and viability of contractual arbitration, even at the expense of judicial economy. However, they held the line at enforcing contractual provisions that compelled the arbitration of claims that the courts deemed to have wider social implications.

by: Deborah Rothman