



**RECENT TRENDS & DEVELOPMENTS
IN
ALTERNATIVE DISPUTE RESOLUTION PRACTICE**

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I. **Arbitrator/Mediator Ethical Standards**

A. **California Arbitrator Disclosure Standards Upheld**

1. The California Court of Appeals, in Ovitz v. Schulman, 35 Cal.Rptr.3d 117 (Cal. App. 2005), has ruled that the Federal Arbitration Act (FAA) does not preempt California's strict arbitrator disclosure standards. In this case, a party sought to vacate an arbitration award due to the failure of the arbitrator to disclose that he intended to entertain offers of employment and his subsequent acceptance of employment in another case by one of the party's attorneys. The trial court vacated the award and the appellate court affirmed.
2. California Ethic Standards for Neutral Arbitrators require arbitrators to both disclose the intention to entertain offers of employment from parties or lawyers to the arbitration and to disclose actual employment by parties or lawyers to the arbitration. Under California Code of Civil Procedure § 1286.2, an arbitration award must be vacated if an arbitrator fails to timely disclose grounds for disqualification.
3. After the parties to the Ovitz case became aware that the arbitrator had accepted employment in another case from lawyers in the arbitration, one of the parties sought to vacate the award. The trial court granted the petition to vacate. On appeal, the court held that the California disclosure rules required the arbitrator to both disclose his intention to entertain offers of employment for other jobs from parties or lawyers to the arbitration and to disclose the acceptance of such employment. Moreover, the court held that § 1286.2 requires the court to vacate the award because of the arbitrator's failure to make the required disclosures. Finally, the court held that the FAA did not preempt the application of § 1286.2. Rather than

conflicting with the FAA, the court held that § 1286.2 actually furthers the purposes of the FAA by enhancing both the perception and reality of fairness in arbitration proceedings.

B. The Association for Conflict Resolution (ACR) has formally adopted the new ABA approved ethics standards for mediators.

1. Members of ACR will be required to adhere to the new standards, which will be used to evaluate complaints brought against neutrals.
2. Under the standards, mediators are charged with evaluating any potential conflicts and disclosing them to the parties before mediation commences.
3. The standards forbid mediators from charging contingency fees.

C. California Judicial Council (CJC) adopts new rules to protect the confidentiality of mediation communications in complaint procedures.

1. When the CJC adopted minimum standards of conduct for mediators in court-connected programs in 2003, the CJC required mediators to maintain the confidentiality of mediation communications.
2. The CJC also created a procedure for parties to bring complaints against mediators who violate the confidentiality rules. However, the CJC provided no guidance or procedures for preserving the confidentiality of mediation communications during the complaint procedure.
3. With the adoption of Rule 1622 - 1622.3, the CJC has addressed the question of procedure.
4. New Rule 1622.3 mandates that no information or records concerning the receipt, investigation, or resolution of an inquiry or complaint may be open to the public or disclosed outside the course of the complaint process.
5. The new rules also require courts to designate one individual that will receive and process complaints. That designated person is prohibited from later serving in an

adjudicatory role on matters related to disputes arising from the mediations.

6. Commencing January 1, 2007, mediators will be required to agree in writing to adhere to the new ethical requirements and rules of court.

II. Developments in State Case Law Affecting ADR Practice

A. Analysis of Arbitration Agreements

1. The California Supreme Court in Grafton Partners, LLP v. The Superior Court of Alameda County, 32 Cal. Rptr. 3d 5 (Cal. 2005) may initiate a new constitutional analysis of the enforceability of consumer arbitration agreements.
2. While the court held that there were no non-statutory grounds for waiving a jury trial, the Court explicitly distinguished arbitration agreements from pre-dispute jury trial waivers.
3. Although the court has distinguished arbitration agreements from jury trial waivers, the court may have inadvertently provided a means to attack the enforceability of arbitration agreements. The court has done this by acknowledging that the standard for a jury trial waiver is “knowing and voluntary.”
4. As such, by invoking the “knowing and voluntary” standard, the court may have provided a means to evade the preemptive effect of the FAA since the “knowing and voluntary” standard is not specific to arbitration but, rather, a generally applicable legal concept.
5. While the enforceability of pre-dispute arbitration agreements is not in question, the Grafton decision may open up arbitration agreements to challenges based on the required level of voluntariness required to be enforceable.

B. Forum Selection Clauses

1. A California appeals court, in Aral v. Earthlink, Inc., 36 Cal. Rptr. 3d 229 (Cal. App. 2005) ruled that forum selection clauses in consumer arbitration agreements were unenforceable if they force consumers to travel a long distance to arbitrate claims involving small dollar amounts.

2. This case involved a class action to recover \$50 service fees from an internet service provider.
3. The court dismissed the internet service provider's argument that there was nothing preventing the consumer from bringing a case in small claims court. The court held that the consumer was being presented with a Hobson's choice of litigating in a distant venue or small claims court. The court said that the small claims court option was an inadequate option because it did not provide the panoply of relief available in superior court or arbitration.
4. The ruling may force national companies to amend analogous arbitration clauses to ensure the clauses will be enforceable.
5. The decision may also prompt other states to follow California's lead and likewise reject similar forum selection clauses in arbitration agreements.

C. **Class Arbitration Waivers**

1. In Discover Bank v. Superior Court of Los Angeles, 30 Cal. Rptr. 3d 76 (Cal. 2005), the California Supreme Court upheld state law over the FAA, ruling that consumers cannot be compelled to waive class actions in arbitration under contracts of adhesion.
2. The court held that class action waiver clauses may be considered unconscionable if they serve to protect companies from suits that could end an illegal practice.
3. As such, one sided exculpatory clauses in contracts of adhesion to the extent that they insulate a party from liability that would otherwise be imposed under California law are unconscionable.
4. Since the contract at issue contained a choice of law provision designating Delaware law, the Supreme Court remanded the case to the appellate court to determine whether Delaware law allows for the enforcement of class action waivers contained in contracts of adhesion. On remand, the appellate court, in Discover Bank v, Superior



Court of Los Angeles, No. B161305, 2005 WL 3304153 (Cal. App. Dec. 7, 2005), upheld the provision ruling that Delaware law controlled.

5. In order to preserve waivers of class action arbitrations, companies may respond to this decision by including choice of law provisions that designate states that would enforce such provisions.

D. Judicial Reference Clauses

1. The California Court of Appeals, in Trend Homes, Inc. v. Superior Court, 32 Cal. Rptr. 3d 411 (2005), has held that a provision in a subdivision sales agreement requiring that disputes arising from the agreement be submitted to judicial reference was enforceable.
2. Home builder had sought to enforce the judicial reference clause against several purchasers of homes who sued the homebuilder for defective construction.
3. The homeowners opposed the enforcement of the clause claiming that it was unconscionable given that the contract was one of adhesion and that the judicial reference fees were too burdensome.
4. In order to be deemed unenforceable, the clause would have to be both procedurally and substantively unconscionable.
 - a. Procedural Unconscionability - The focus of the procedural analysis is whether there is oppression arising from unequal bargaining power. The court found no such situation holding the provision was not procedurally unconscionable because the provision was clearly conspicuous and the court found evidence that the clause was negotiable.
 - b. Substantive Unconscionability - The court held that the clause was not substantively unconscionable because it was neither so one-sided as to shock the conscience nor were its terms harsh or oppressive. Moreover, despite the clause's silence concerning the judicial reference costs, the court held that the provision was enforceable.



E. Contracts of Adhesion

1. An Arizona appeals court, in Harrington v. Pulte Home Corp., 119 P.3d 1044 (Ariz. App. 2005), has established a new test for determining the enforceability of arbitration clauses under the substantive unconscionability rubric.
2. Homeowners brought suit against the home seller for, among other things, breach of contract. The seller sought to enforce the arbitration clause contained in the home sale contracts. Homeowners argued that the clause was unenforceable because it was contained in a contract of adhesion.
3. Under Arizona law, there are two distinct grounds for invalidating or limiting the enforcement of contracts: Reasonable expectations and substantive unconscionability.
 - a. Reasonable Expectations - The court upheld the clause ruling that the reasonable expectations doctrine did not preclude the enforcement of the arbitration clause. The court further held that the lack of a conspicuous and explicit waiver of the right to a jury trial did not mean that the clause was beyond the reasonable expectations of the parties.
 - (1) Under the reasonable expectations doctrine, terms of a contract are beyond the range of reasonable expectation if one party to the contract has reason to believe that the other party would not have entered into the agreement if that party had known that the agreement contained such a term.
 - (2) Arizona courts consider the following factors in order to determine whether a contract provision violates the reasonable expectation doctrine:
 - (a) Prior negotiations.
 - (b) Inference from surrounding circumstances



- (c) Inferences from the fact that a term is bizarre or oppressive.
 - (d) The term eviscerates the non-standard terms explicitly agreed to.
 - (e) The term eliminates the dominant purpose of the transaction.
 - (f) Terms must be drafted in a way as to make them understandable if a party attempts to check on his rights.
 - (g) Any other facts relevant to the issue of what appellees reasonably expected in the contract.
- b. Substantive Unconscionability - The court also found that the arbitration clause was not substantively unconscionable.
- (1) The court ruled that the parties opposing enforcement of the arbitration clause did not meet their burden of proof with regard to the claim that the arbitration fees were unconscionable.
 - (2) This ruling provides Arizona with a new test for determining whether arbitration would be so prohibitively expensive as to be substantively unconscionable. Under this test, the court must perform a case by case analysis and the party opposing arbitration must prove that the costs of arbitration are prohibitively expensive.
 - (3) The court held that the parties had failed to meet their burden of proof. The court noted that the parties had presented no specific evidence beyond self-serving statements. They had failed to show how arbitration would be any more prohibitively expensive than pursuing their claims in court.



III. Recent Federal ADR Decisions

A. Non-Signatories Barred From Bringing Interlocutory Appeals Under the FAA

1. The 10th Circuit, in In Re Universal Service Fund v. Sprint Comm. Co., 428 F.3d 940 (10th Cir. 2005), held that an interlocutory appeal from an arbitration may only be considered by a court if it is based on a written agreement under the FAA.
2. This case involved a suit by customers of Sprint and AT&T alleging that the two companies along with MCI violated several federal statutes by conspiring to recover funds from the Universal Service Fund, a program that funds rural communications projects.
3. MCI residential customers had been compelled to arbitrate. AT&T and Sprint filed a motion to compel arbitration of MCI business customers based on equitable estoppel.
4. The court denied that motion holding that there was no written agreement between MCI business customers and AT&T and Sprint. The court ruled that a motion to compel must be based on an alleged failure to arbitrate under a written agreement.

B. Standard of Review Under FAA

1. The First Circuit, in Puerto Rico Telephone Co., Inc. v. U.S. Phone Manufacturing Co., 427 F.3d 21 (1st Cir. 2005), has joined the Third, Fifth and Sixth Circuits in holding that parties may contractually alter the standard of review for arbitration awards under the FAA.
2. The Seventh, Eighth and Ninth Circuits have ruled that parties are not allowed to contract for different standards of review.
3. The First Circuit held that the FAA's standard of review can only be displaced by explicit contractual language evincing the clear intent of the parties to subject the arbitration award to a different standard of review.

4. The case involved an action to vacate an arbitration award on the grounds that the arbitration panel made an error of law.
5. Under the FAA, which governed the arbitration that is the subject of this case, errors of law are not grounds for vacating arbitration awards.
6. Since the contract contained a choice of law clause that provided that the arbitrators would apply Puerto Rico law, the party seeking to vacate the award argued that the FAA standard of review should be supplanted by Puerto Rican law which allows for the vacation of arbitration awards due to errors of law.
7. The court held that the inclusion of a generic choice of law clause within the arbitration agreement was not sufficient to alter the FAA standards since under the FAA there is a strong federal policy requiring limited review.

C. **Subpoena Power Under FAA**

1. The Second Circuit, in Stolt-Nielsen, S.A. v. Celanese AG, 2005 WL 3105620 (2nd Cir. Nov. 21, 2005), ruled that there are no time constraints on the authority of arbitrators to issue subpoenas under the FAA.
2. This case involved an appeal of an order to enforce a subpoena issued by an arbitration panel against a non-party to the arbitration to appear at a pre-trial hearing.
3. Under Section 7 of the FAA, arbitrators may summon in writing any person to appear before them as a witness and bring any evidence deemed material to the case.
4. The non-party seeking to overturn the order compelling his presence before the panel did not dispute the power of the arbitrators to subpoena non-parties; rather, the non-party argued that the FAA only empowers arbitrators to issue subpoenas for a merits hearing. Since this was a pre-trial hearing, they argued that the panel did not have the power to issue a subpoena and, by doing so, was furthering a thinly disguised effort to obtain pre-hearing discovery by the party seeking to enforce the subpoena.

5. The court dismissed such arguments holding that the plain language of Section 7 contained no limitation to prevent arbitrators from compelling testimony at pre-trial hearings.
6. The court, however, declined to address the issue of whether arbitrators have the power under the FAA to issue subpoenas for pre-hearing discovery that does not involve testimony before the panel.

IV. Recent Statutory Developments

A. California - California Code of Civil Procedure § 1282.4 has been amended by the enactment of AB 415 to extend its operation for another year until January 2007. Section 1282.4 permits out-of-state attorneys to represent clients in arbitrations held in California.

B. Missouri

1. SB 168 has been enacted providing for voluntary mediations of disputes concerning defects in home construction.
2. Under this new law, homeowners alleging defective construction must first notify the builder of the defect prior to commencing legal action. The builder then has 14 days within which to respond as to whether he will make repairs, pay for the repairs, or dispute the claim.
3. Either party then may elect to mediate the dispute.
4. Mediation under this provision is non-binding, but does not prevent the parties from electing to pursue binding arbitration.
5. Any mediation proceeding conducted under this provision shall be regarded as settlement negotiations and remain confidential.

C. Washington

1. The enactment of SB 5733 expands Washington's mandatory arbitration system that requires claims of a certain monetary value brought in counties that have a certain population be submitted to arbitration.



2. The reach of this program has been expanded by both raising the monetary limit on the size of claims from \$35,000 to \$50,000 and lowering the minimum population of the county from 150,000 to 100,000.

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