Study A-100 March 9, 2005

Memorandum 2005-13

Contractual Arbitration Improvements From Other Jurisdictions (Consultant's Report)

At the Commission's request, Professor Roger Alford of Pepperdine University School of Law prepared a background study on the law governing contractual arbitration in California, which has been published and circulated for comment. Alford, *Report to Law Revision Commission Regarding Recommendations for Changes to California Arbitration Law*, 4 Pepp. Disp. Resol. L.J. 1 (2004) (hereafter, "Alford Study"). The Commission received the following comments:

Also attached to this memorandum are the following materials:

This memorandum discusses the comments and presents background information on contractual arbitration in California. The Commission needs to determine whether to go forward with its study of contractual arbitration and, if so, what the scope, general direction, and priorities of that study should be.

Unless otherwise specified, all statutory references in this memorandum are to the Code of Civil Procedure.

HISTORY OF ARBITRATION LAW IN CALIFORNIA

California enacted its first arbitration statute long ago, in 1851. The statute was reenacted in 1872 and replaced in 1927 by a statute patterned after the New Jersey Arbitration Act. Enactment of the 1927 statute placed California among a small group of states that "rejected the common law hostility to the enforcement of arbitration agreements and ... provided a modern, expeditious method of enforcing such agreements and awards made pursuant to them." *Recommendation Relating to Arbitration*, 3 Cal. L. Revision Comm'n Reports G-5, at G-5 (1960).

In 1961, California's arbitration statute was substantially revised and recodified on recommendation of the Law Revision Commission. 1961 Cal. Stat. ch. 461; see *Recommendation Relating to Arbitration*, *supra*. A background study prepared for the Commission described arbitration as follows:

> Arbitration is a voluntary procedure for settling disputes. It has at least three necessary elements.
>
> (1) It is a voluntary process. The parties need not choose to submit their disputes to arbitration, but they may enter into a voluntary agreement to submit the dispute to a third party who will settle it.
>
> (2) The process of arbitration is a final determination of the rights of the parties. It is this aspect of arbitration that has led some people to believe that the process is of a compulsory nature. But a sharp distinction must be drawn between voluntary agreement to arbitrate and the obligation that results from that agreement once made.
>
> (3) The arbitrator is chosen by the parties. This is in clear contrast to litigation where the parties have no direct voice in the choice of the judge.

Kagel, *A Study Relating to Arbitration*, 3 Cal. L. Revision Comm'n Reports G-25, at G-27 (1960) (footnotes omitted).

As revised in 1961, California's arbitration statute incorporated some features of the 1955 Uniform Arbitration Act ("UAA") drafted by the National Conference of Commissioners on Uniform State Laws (NCCUSL), but the statute also included other material. See *Recommendation Relating to Arbitration*, *supra*, at G-5. The UAA has been a remarkably successful model act. As Prof. Alford says in his report, "[f]orty-nine jurisdictions have arbitration statutes; thirty-five of these have adopted the UAA and fourteen have adopted substantially similar legislation." Alford Report at 1. The UAA closely tracks the Federal Arbitration

Act ("FAA"), which was adopted in 1925. A key principle of the FAA and UAA is that parties can agree to arbitration before a dispute arises, not just afterwards.

Since the 1961 overhaul of California's arbitration statute, there have been many further changes. California has added statutes on arbitration of medical malpractice (Code Civ. Proc. § 1295), public construction contract arbitration (Code Civ. Proc. § 1296), arbitration and conciliation of international commercial disputes (Code Civ. Proc. §§ 1297.11-1297.432), real estate contract arbitration (Code Civ. Proc. §§ 1298-1298.8), and arbitration of firefighter and law enforcement officer labor disputes (Code Civ. Proc. §§ 1299-1299.9). The statutes governing contractual arbitration generally (Code Civ. Proc. §§ 1280-1294.2) have been revised in numerous respects, including a number of reforms just enacted in 2002 (see 2002 Cal. Stat. chs. 176, 952, 1008, 1094, 1101, 1158). Nonetheless, of the 67 provisions governing contractual arbitration generally, forty have not been changed since they were adopted in 1961.

FEDERAL PREEMPTION

States do not have free rein in drafting legislation on arbitration. Under the Supremacy Clause of the United States Constitution, the FAA preempts conflicting state law. However, FAA preemption applies only to a case in which the contract requiring arbitration is written and involves interstate commerce. 9 U.S.C. § 2; *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S.C. 265, 281 (1995).

If a case falls into this category and a litigant invokes a state law affecting arbitration, it is necessary to determine whether the state law conflicts with the FAA. Some general rules for making this determination appear to be fairly well-established:

(1) The FAA provides that written arbitration agreements "shall be valid, irrevocable, and enforceable, save on such grounds as exist at law or in equity for revocation of any contract." 9 U.S.C. § 2. "Section 2 is a congressional declaration of a liberal federal policy favoring arbitration agreements." *Moses H. Cone Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24 (1983). "The rule of enforceability established by section 2 ... preempts any contrary state law and is binding on state courts as well as federal." *Rosenthal v. Great Western Financial Securities Corp.*, 14 Cal. 4th 394, 926 P.2d 1061, 58 Cal. Rptr. 2d 875 (1996).

(2) "[G]enerally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration

agreements without contravening § 2." *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 687 (1996); *see, e.g.*, *Fitz v. NCR Corp.*, 118 Cal. App. 4th 702, 13 Cal. Rptr. 3d 88 (2004). "'[T]he policy favoring arbitration cannot displace the necessity for a voluntary *agreement* to arbitrate.'" *Victoria v. Superior Court*, 40 Cal. 3d 734, 739, 710 P.2d 833, 222 Cal. Rptr. 1 (1985), *quoting Wheeler v. St. Joseph Hosp.*, 63 Cal. App. 3d 345, 356, 133 Cal. Rptr. 775 (1976) (emphasis in *Victoria*).

(3) But courts "may not ... invalidate arbitration agreements under state laws applicable *only* to arbitration provisions." *Doctor's Associates*, 517 U.S. at 687 (emphasis in original). "By enacting § 2, ... Congress precluded States from singling out arbitration provisions for suspect status, requiring instead that such provisions be placed 'upon the same footing as other contracts.'" *Id*. at 687, *quoting Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511(1974). For example, the Unites States Supreme Court held that the FAA preempted a Montana statute that conditioned enforceability of an arbitration agreement on compliance with special notice requirements not applicable to contracts generally. *Doctor's Associates*, 517 U.S. at 688.

(4) A state may, however, apply state procedural rules in a state court proceeding, so long as those rules do not frustrate section 2's central policy. *Rosenthal*, 14 Cal. 4th at 408-10. A statute that establishes procedures for determining enforceability of an arbitration agreement and is not applicable to contracts generally "do[es] not thereby run afoul of the USAA's section 2, which states the principle of equal enforceability, but does not dictate the procedures for determining enforceability." *Id*. at 410.

Despite extensive litigation, however, many issues regarding the extent of FAA preemption remain unclear. Two significant cases are now pending in the California Supreme Court:

- *Cronus Investments v. Concierge Services*, No. S116288. Pursuant to Section 1281.2(c), the trial court in this case stayed an arbitration pending the outcome of related litigation. The issue on appeal is whether the FAA preempted Section 1281.2(c), precluding the trial court from staying the arbitration. The Court heard oral argument in early January and is expected to issue a decision soon.
- *Discover Bank v. Superior Court*, No. S113725. This case involves a mandatory arbitration agreement with a provision stating that each party to the agreement waives any right to bring a class action against the other party. The issue before the Court is whether the FAA preempted a judicial finding that this waiver

provision is unconscionable under state law. The case has been fully briefed but not yet argued.

The staff is not yet familiar with all of the major case law on FAA preemption but is trying to learn more about it. The Commission will need to take the possibility of FAA preemption into account if it proposes any new legislation on arbitration.

There is also the possibility of federal preemption based on federal law other than the FAA. In particular, two pending cases address whether California's Ethical Standards for Neutral Arbitrators (Section 1281.85; Cal. R. Ct. app. Div. VI) are preempted by the Securities Exchange Act of 1934 and rules promulgated pursuant to that Act. See the discussion below under "Arbitrator Disclosure Requirements."

SUMMARY OF PROF. ALFORD'S REPORT

After the 1961 overhaul of the California arbitration statute, the topic was retained on the Commission's calendar so that the Commission would have authority to recommend any needed technical or substantive revisions in the statute. In late 2000, the Commission decided to hire a consultant to prepare a background study on arbitration. Several months later, the Commission retained Prof. Alford.

Prof. Alford's report was published in 2004 and has since been posted to the Commission's website and circulated to interested parties for comment. As with all background studies prepared for the Commission, the views expressed in the report are the consultant's and should not be attributed to the Commission.

In his report, Prof. Alford compares California arbitration law with the Revised Uniform Arbitration Act ("RUAA"), which was finalized by NCCUSL in 2000. The RUAA has already been adopted in ten states and legislation to adopt it is pending in eight other states and the District of Columbia. The RUAA has also been approved by the American Bar Association and endorsed by the American Arbitration Association, the National Academy of Arbitrators, and the National Arbitration Forum. The RUAA addresses the following subjects that were not addressed in the UAA:

- Who decides the arbitrability of a dispute and by what criteria.
- Whether a court or arbitrator may issue provisional remedies.
- How a party can initiate an arbitration proceeding.
- Whether arbitration proceedings may be consolidated.

- Whether an arbitrator is required to disclose facts reasonably likely to affect impartiality.
- To what extent is an arbitrator or arbitration organization immune from a civil action.
- Whether an arbitrator or representative of an arbitration organization may be required to testify in another proceeding.
- Whether an arbitrator has discretion to order discovery, issue a protective order, decide a motion for summary disposition, hold a prehearing conference, and otherwise manage the arbitration process.
- When a court may enforce a preaward ruling by an arbitrator.
- What remedies an arbitrator may award, especially in regard to attorney's fees, punitive damages, or other exemplary relief.
- When a court can award attorney's fees and costs to an arbitrator or arbitration organization.
- When a court can award attorney's fees and costs to a prevailing party in an appeal of an arbitrator's award.
- Which sections of the UAA are not waivable.
- Use of electronic information and other modern means of technology in the arbitration process.

See the Prefatory Note to the RUAA. Many of these topics have already been addressed by statute or case law in California.

In his report, Prof. Alford makes the following assumptions:

(1) "[P]arty autonomy should be a fundamental principle that is respected, except in the face of clear overriding legislative priorities." Alford Report at 5.

(2) "[P]arties choose arbitration as a viable alternative to litigation, and they do so for well-recognized reasons (speed, efficiency, lower cost, confidentiality, etc.). ... Legislative initiatives that thwart the objectives reflected in this contractual choice ... should generally be discouraged as they undermine the attractiveness of arbitration." *Id*

(3) The Legislature seeks to avoid preemption conflicts with the FAA. *Id*.

(4) Uniformity of law is desirable in arbitration. "Therefore, it is presumed that a preference exists for the [RUAA] wherever possible." *Id*. at 5-6.

(5) "[T]he revisions embodied in the RUAA reflect solutions to address major developments in arbitration." *Id*. at 6. "Where California has adopted recent amendments to the arbitration

> statute, it is assumed that the legislature did so to address specific areas of concern and, if necessary, depart from a uniform standard to address those concerns." *Id*.

He then presents a detailed comparison of the RUAA and corresponding California provisions, and makes recommendations about which sections of the RUAA should be adopted, which California provisions should be repealed, and which California provisions should be retained or incorporated into sections of the RUAA. *Id*. at 6-45. In sum, his report "recommends adoption of the RUAA with modifications." *Id*. at 6.

GENERAL COMMENTS

Reaction to Prof. Alford's report was decidedly mixed. Some groups expressed support for studying the RUAA as proposed, but a number of consumer-oriented organizations voiced strong objections.

Support for Studying the RUAA

The State Bar Committee on Alternative Dispute Resolution (hereafter, "State Bar ADR Committee") believes that "in light of the approval of the RUAA by the American Bar Association, its endorsement by the American Arbitration Association, its current enactment in ten states, and its introduction in several other states, now is an opportune time for the Commission to consider the advisability of its adoption in California, either in whole or in part, and perhaps with certain modifications as may be deemed appropriate by the Commission and ultimately by the Legislature." Exhibit p. 14. At this preliminary stage of the Commission's study, the State Bar ADR Committee does not take a position on any of the specific recommendations made by Prof. Alford. The committee "intend[s] to keep abreast of the Commission's work on this matter and to consider individual issues as they are addressed." *Id*.

The position of the California Dispute Resolution Council ("CDRC") is similar. CDRC "is a non-profit organization of dispute resolution neutrals — arbitrators and mediators — and providers of ADR administrative services that was organized specifically to advocate for fair and accessible alternative dispute resolution processes in the Legislature and before the courts and administrative agencies." Exhibit p. 1. CDRC points out that

> [t]he process of arbitration has evolved significantly since the current form of Sections 1280, et seq., was adopted in 1961.

> Although the state statutory provisions governing domestic arbitrations have been amended from time to time since then and a separate chapter has been enacted to govern international arbitrations, no overall review of the legislative scheme has been conducted for more than 40 years.

Id. CDRC "believes that at this juncture in the history of our state, a comprehensive review of California's arbitration statutes, beginning with Section 1280 of the Code of Civil Procedure, including the possibility of adopting the Revised Uniform Arbitration Act in whole or in part, is worthwhile." *Id*.

CDRC regards Prof. Alford's report as a "useful beginning," but cautions that "considerably more study of the pros and cons of amending the current statutes governing arbitration appears to be necessary before any decision is made whether to propose fresh legislation." *Id*. at 2. CDRC is ready to work actively on such a study with the Commission. *Id*.

Opposition to Studying the RUAA

The Consumer Federation of California ("CFC"), which represents consumers throughout California, "oppose[s] the CLRC efforts to review contractual arbitration statutes, based on Professor Alford's study." Exhibit p. 7. CFC "has a long history of opposing mandatory pre-dispute binding arbitration provisions in consumer contracts, and does not think that the CLRC should review these existing statutes." *Id*.

Another opponent of Prof. Alford's approach is the California Employment Lawyers Association ("CELA"), which believes that "California has the most well developed state arbitration act in the country." Exhibit p. 3. CELA "view[s] the Uniform Arbitration Act as a step backwards in time and substance in many respects." *Id*. CELA explains that the

> Uniform act proceeds from the absolutely incorrect assumption that all arbitration agreements are negotiated agreements between sophisticated users. Nowhere does it attempt to conform to the new realities of arbitration where we find adhesive and one-sided clauses being forced on powerless consumers, patients and workers.

Id. According to CELA, it "may be time to update the California Arbitration Act but any such changes need to include more, not fewer protections against ... misuse of adhesive arbitration agreements." *Id*. In CELA's view "[b]etter law revision would distinguish between agreements negotiated between commercial

entities and adhesive agreements which are neither knowing nor voluntary." *Id*. at 5. CELA goes on to offer a number of specific suggestions for reform, which are described later in this memorandum.

Along similar lines, the Consumer Attorneys of California ("CAOC") oppose "both the proposed review by the CLRC and the proposed recommendations to the Revised Uniform Arbitration Act prepared by Professor Roger Alford of Pepperdine University School of Law." Exhibit p. 6. CAOC has "substantive issues" with many of Prof. Alford's recommendations. *Id*. CAOC also strongly objects to his statement that "Arbitration is generally viewed as an attractive alternative to litigation, affording parties with an economical, efficient, confidential, and neutral forum to resolve contractual disputes." *Id*.; see Alford Report at 3. In CAOC's view,

> This statement, as applied to consumer pre-dispute binding arbitrations, demonstrates a clear misunderstanding of arbitration in the consumer context. While businesses may and should be free to contract for mandatory arbitration, forced pre-dispute binding arbitration agreements in consumer contracts are inherently unfair and should be prohibited.

Id. CAOC thus "strongly disagree[s] with the broad pro-arbitration themes contained in the proposal and believe[s] this misguided basis makes the proposal fundamentally flawed and incapable of being a model for substantive review." *Id*. "Given the limited and valuable nature of CLRC resources," CAOC urges the Commission to reject Prof. Alford's study "in full, including its recommendations." *Id*.

Consumers Union, the nonprofit publisher of *Consumer Reports*, similarly comments that Prof. Alford's study "should not be the basis for work by the Law Revision Commission, as it totally omits the criticism and concerns about mandatory binding arbitration which have been voiced by consumer advocates for nearly a decade." Exhibit p. 8. For example, Consumers Union points out that the study "fails to recognize the significant impact of the spread of mandatory arbitration clauses on the development and effectiveness of consumer law due to the loss of precedent, loss of the deterrence value of published filings and published decisions, disadvantages to consumers in the inability to engage in discovery about patterns and practices, and the like." *Id*. Likewise, the study makes no reference to the consumer perspective that "'mandatory, pre-dispute binding arbitration clauses in consumer contracts are the single biggest threat to

consumer rights in recent years, a de-facto rewrite of the Constitution that undermines a broad range of consumer protections painstakingly built into law.'" *Id*. at 9, *quoting* National Consumer Law Center ("NCLC"), *Consumer and Media Alert: The Small Print That's Devastating Major Consumer Rights* (July 28, 2003), http://www.consumerlaw.org/initiatives/model/arbitration.shtml. Consumers Union says that the "glaring omission" of the consumer viewpoint renders the background study "at best incomplete, and undermines its recommendations." Exhibit p. 8.

Consumers Union acknowledges that Prof. Alford forthrightly discloses that his study is "based on the assumption of a legislative policy favorable to arbitration, and on subsidiary assumptions that parties who are bound by arbitration clauses desired them (party autonomy), and affirmatively preferred arbitration to litigation." *Id*. Consumers Union cautions that "[n]o evidence is offered to support these assumptions, and the evidence about mandatory arbitration clauses in consumer contracts, at least as reflected in the strongly-held and publicly stated views of consumer advocates nationwide, suggests that these assumptions are simply not applicable to consumer arbitration clauses." *Id*. Consumers Union further comments that "[w]rong assumptions lead quite directly to wrong policy recommendations." *Id.* More specifically, Consumers Unions says that because Prof. Alford's report "is fundamentally based on policy assumptions that lack a factual basis with respect to consumer form contract arbitration clauses, its recommendations should have no bearing on any work by the Commission with respect to consumer arbitration." *Id*.

Consumers Union refers the Commission to Consumers Union's policy on arbitration clauses in standard form consumer contracts, which includes the following key principle:

> ADR, including arbitration, should not be required in consumer form contracts unless the consumer has the option either to decline to engage in the ADR process after the dispute arises or to reject the results of the ADR process. In other words, ADR clauses should be permitted and enforceable in consumer contracts only if the ADR process is: 1) contractually mandated with non-binding results, 2) optional with binding results, or 3) optional with non-binding results.

Exhibit p. 18. The complete policy statement is attached to help give the Commission a feel for the types of reforms sought by Consumers Union. *Id*. at 18-21. Consumers Union also mentions that there is "a well-developed body of

recommendations for improvements that states could make in state arbitration acts, including the Fair Bargain Act, which was developed to respond to some of the defects in the RUAA." Exhibit p. 9. For example, NCLC has developed a *Model State Law Preserving Individual Rights and Limiting Mandatory Arbitration*, which is attached for the Commission's review (Exhibit pp. 22-26). Consumers Union does not make clear whether it thinks the Commission should investigate proposals like these, or should simply drop the arbitration study altogether and leave the topic for others to handle.

Other General Comments

The National Arbitration Forum ("NAF"), which describes itself as "a leading provider of arbitration and other ADR services in the United States and beyond," does not express a view on whether the Commission should study the possibility of adopting the RUAA (either with or without modifications). See Exhibit pp. 10-13. The group reports that "approximately 20% of our entire caseload comes from California, the bulk of which are consumer related disputes." *Id*. at 10. According to NAF,

> Arbitration provides both consumers and businesses with a very fair, affordable, efficient, and effective way to resolve disputes. Laws need to be adopted which provide both consumers and businesses with this ready access to civil justice through arbitration. Laws should NOT be enacted which either prevent the parties from having this access to arbitration, or increase the costs to all involved making the process too expensive, or create unnecessary procedures that overly complicate the process.

Id. at 11 (emphasis in original). In NAF's view, "[t]he primary goal of revisions is to further create and foster the perception and reality that California is a friendly forum for arbitration." *Id*. NAF proceeds to make several specific suggestions for reform. *Id*. at 11-13.

COMMENTS ABOUT SPECIFIC ISSUES

Interestingly, although CELA and NAF both address a number of specific issues in their comments, there is no overlap in the issues they have chosen to address. We therefore discuss their suggestions separately, then describe two ideas advocated by attorney Christopher Wilson, and finally turn to the possibility of technical reform.

In discussing these points, we are merely trying to give the Commission a flavor for the comments received and areas that might warrant further investigation. We have barely begun to research arbitration law. Because we have not yet thoroughly analyzed any specific issue, it would be premature for the Commission to take a substantive position on any particular point.

CELA's Suggestions, Supported By CAOC

CELA offers the following suggestions, which CAOC also supports:

Definition of a "Written Agreement"

In his report, Prof. Alford suggests that for purposes of the statute governing contractual arbitration, the definition of a "written agreement" should be revised to read: "Written agreement shall be deemed to include a Record or a written agreement which has been extended or renewed by an oral or implied agreement." Alford Study at 7. CELA strongly opposes that suggestion. Exhibit p. 3. CELA explains:

> The agreement to arbitrate involves the waiver of many fundamental constitutional rights. Any waiver of those rights and indeed any agreement to arbitrate should only be effective if it is both knowing and voluntary. The requirement of a writing is essential to ensure that all parties know exactly what they are agreeing to. The waiver of constitutional rights in the consumer and employment contexts should never be accomplished through "implied" or oral agreements as suggested by Professor Alford.

Id. at 1-2. CAOC agrees with CELA's position. Exhibit p. 6.

RUAA Section 6: Validity of an Agreement to Arbitrate

RUAA Section 6 provides:

> **Section 6. Validity of Agreement to Arbitrate**
>
> (a) An agreement contained in a record to submit to arbitration any existing or subsequent controversy arising between the parties to the agreement is valid, enforceable, and irrevocable except upon a ground that exists at law or in equity for the revocation of a contract.
>
> (b) The court shall decide whether an agreement to arbitrate exists or a controversy is subject to an agreement to arbitrate.
>
> (c) An arbitrator shall decide whether a condition precedent to arbitrability has been fulfilled and whether a contract containing a valid agreement is enforceable.

> (d) If a party to a judicial proceeding challenges the existence of, or claims that a controversy is not subject to, an agreement to arbitrate, the arbitration proceeding may continue pending final resolution of the issue by the court, unless the court otherwise orders.

Prof. Alford recommends that California adopt this provision. Alford Study at 8-9, 18.

CELA opposes adoption of RUAA Section 6. CELA says it would be "a far better rule to allow the courts to maintain responsibility for ruling on the existence, validity and enforceability of arbitration agreements." Exhibit p. 4. CAOC concurs in this assessment. Exhibit p. 6.

CELA explains the basis for its position:

> Because abusive and unconscionable clauses contained in adhesion contracts are routinely imposed on consumers it is essential that the courts retain primary jurisdiction and responsibility for enforcing such agreements. It is not appropriate to allow an adhesion contract to restrict the authority of the court because the contract does not really reflect the decision and agreement of the parties. It is similarly not appropriate to let the arbitrator decide whether an agreement to arbitrate is enforceable. Unconscionability is for the court to decide under present case law. Moreover, the arbitrator has a financial conflict of interest in that question and should not be put in the position of determining an issue in which they have such a profound economic conflict.

Exhibit p. 4.

CELA recognizes that its position "may be a conflict with certain rulings interpreting the Federal Arbitration Act." *Id*. CELA points out, however, that "not all arbitrations are conducted under the FAA." *Id*. For example, "entire classes of worker contracts are excluded from the FAA as are arbitration clauses contained in contracts where the parities specifically designate California law." *Id*. Thus, CELA says that "California has every right and interest to identify and state its own public policies in this area to control those circumstances where California law will apply." *Id*. CELA also notes that it "is certainly possible that there will be legislation or rulings rolling back the vast preemptive power of the FAA and California should have its own values reflected in its law." *Id*.

Knowing and Voluntary Assent to Arbitration

CELA "strongly urge[s] that language be added to California law that establishes a knowing and voluntary requirement for all arbitration agreements." Exhibit p. 4. Along the same lines, CELA "suggest[s] an amendment that makes it clear that an adhesion contract is not a proper device for the imposition of an arbitration agreement or the waiver of constitutional or statutory rights." *Id*. CAOC "fully endorse[s]" both of these suggestions. Exhibit p. 6.

Similarly, CFC opposes the use of a mandatory pre-dispute binding arbitration provision in a consumer contract. CFC suggests that instead of reviewing the RUAA, "[a] better use of the CLRC's resources would be to propose that any statute that enables business to force such agreements on consumers be void and unenforceable as a matter of public policy." Exhibit p. 7.

Employment Contracts

CELA urges the Commission to "consider an amendment that excludes employment contracts from the scope of the CAA similar to the exclusion in 16 other state laws." Exhibit p. 4. CAOC would also support such a reform. Exhibit p. 6.

Summary Judgment in an Arbitration

CELA "strongly oppose[s] any new language which authorizes summary judgments in arbitrations." Exhibit p. 5. The group points out that summary judgment "was virtually unheard of in arbitration until a few years ago." *Id*. According to CELA, "the process has resulted in perversion of the very concept of arbitration and has greatly prejudiced consumers and employees." *Id*. CELA explains:

> Our research and experience show that it has been a terrible development for unrepresented parties who are getting overrun in arbitration by repeated dispositive motions by defendants. Arbitration is not supposed to be a legal process, nevertheless, summary judgments are strictly legal motions. Moreover, it is grossly unfair to permit summary judgment motions at the same time full discovery is restricted. Because most witnesses, documents and other evidence is usually in the hands of the defendants, it is especially unfair to permit summary judgment motions while restricting discovery. Finally, extensive prehearing motion practice dramatically increases the costs of arbitration.

Id. CAOC agrees with CELA's views on this matter. Exhibit p. 6.

NAF's Suggestions

As an ADR provider, NAF advocates a different set of reforms than consumer-oriented CELA and CAOC. NAF suggests the following:

Representation in an Arbitration

In 1998, Section 1282.4 was amended to permit an out-of-state attorney to represent a party in an arbitration conducted in California so long as certain conditions were met. That version of the statute is due to sunset at the end of this year.

NAF states that the current version of Section 1282.4 "should be retained and the sunset provision in Section 1282.4(j) repealed." Exhibit p. 11. According to NAF, "California consumers do business with many companies outside of California, and arbitrations involving disputes with those companies ought to take place in California, but the companies have the right to choose a lawyer from outside of California to represent them." *Id*. NAF believes that the FAA requires this approach and "California must comply with the federal law and the laws of other states and again demonstrate it is an arbitration friendly state." *Id*.

A bill to retain the current version of Section 1282.4 is already pending in the Legislature — AB 415 (Harman). We will monitor the progress of that bill.

Definition of "Consumer"

NAF suggests adding a definition of "consumer" to California arbitration law. Exhibit p. 11. The group proposes the following definition:

> A consumer is an individual who is not a business and whose claim or defense against a business arises from a transaction or event entered into primarily for personal, family or household purposes.

Id. NAF says this is a "generally accepted definition used in federal and state statutes." *Id*.

Other definitions are also in use, however. For example, a broader definition of "consumer party" appears in Standard 2 of the *Ethics Standards for Neutral Arbitrators in Contractual Arbitration* adopted by the Judicial Council:

> (e) "Consumer party" is a party to an arbitration agreement who, in the context of that arbitration agreement, is any of the following:
>
> (1) An individual who seeks or acquires, including by lease, any goods or services primarily for personal, family, or household

> purposes including, but not limited to, financial services, insurance, and other goods and services as defined in section 1761 of the Civil Code;
>
> (2) An individual who is an enrollee, a subscriber, or insured in a health-care service plan within the meaning of section 1345 of the Health and Safety Code or health-care insurance plan within the meaning of section 106 of the Insurance Code;
>
> (3) An individual with a medical malpractice claim that is subject to the arbitration agreement; or
>
> (4) An employee or an applicant for employment in a dispute arising out of or relating to the employee's employment or the applicant's prospective employment that is subject to the arbitration agreement.

We suspect that consumer groups would prefer this broader definition of "consumer" to the definition that NAF proposes.

Impact of California Law

NAF asserts that "California law can only extend to arbitrations that are intrastate in California and that are not interstate as defined by the Commerce Clause and the United States Supreme Court." *Id*. In NAF's assessment, "[s]ome provisions of the California law improperly attempt to extend beyond the proper reach of what California can regulate." *Id*. at 11-12.

In particular, NAF points to Section 1284.3, which imposes restrictions on fees and costs that can be charged to a consumer in a consumer arbitration. Subdivision (c) states that the section "applies to all consumer arbitration agreements subject to this article, and to all consumer arbitration proceedings conducted in California." NAF would revise that provision as follows:

> (c) This section applies ~~to all consumer arbitration agreements subject to this article, and to~~ all consumer arbitration proceedings conducted in California <u>involving intra-state commerce and does not apply to arbitrations involving interstate commerce as defined by the United States Supreme Court</u>.

Id. at 12. According to NAF, this revision "would comport California law with current federal law and prevent the unnecessary litigation of preemption issues in arbitration cases, which only cost the parties wasted money and time and further clog California courts with unnecessary and unwanted litigation." *Id*.

Vacatur

Under both the RUAA and California law, the grounds for vacating an arbitration award are limited. As Prof. Alford explains in his report, however, there are significant differences between the RUAA and California approaches to vacatur. See Alford Report at 29-32.

Without elaboration, NAF states that "California statutory law regarding the vacation of an arbitration award violates the United States Constitution." Exhibit p. 12. NAF recommends that the California statute be repealed and replaced with RUAA Section 23. *Id*. NAF explains that "[s]ince almost all of the arbitrations between consumers and businesses are regulated by the Federal Arbitration Act, contrary California provisions will not apply in any event and a great deal of confusion and ambiguity can be eliminated by this amendment." *Id*.

A bill on vacatur is currently pending, but it does not take the approach NAF suggests. Rather, Assembly Bill 1176 (Tran) would add a new provision expressly permitting parties to contractually agree that an arbitrator's award must be supported by law and substantial evidence and is subject to vacatur if it lacks such support. California already permits such an agreement in the context of public construction contract arbitration. See Code Civ. Proc. § 1296. AB 1176 would extend that approach to all types of contractual arbitration. Prof. Alford recommends such an extension in his report. See Alford Report at 33.

As Prof. Alford discusses in his report, however, the approach was extensively debated in drafting the RUAA and ultimately not adopted. See Alford Report at 31-32. This suggests that the concept is controversial, and also suggests that NAF's proposal to adopt RUAA Section 23 would be controversial. We will monitor AB 1176 as it proceeds through the Legislature.

Arbitrator and Arbitrator Organization Immunity

NAF writes that it is "vital to integrity and fairness of arbitrations that arbitrators and private arbitration organizations have the same immunity as judicial and administrative judges and court administrators and administrative clerks." Exhibit p. 12. NAF proposes that California enact a statute stating that "Arbitrators and arbitration organizations and providers are provided with the same immunity from litigation that protects California judges and administrative clerks." *Id*. NAF explains that the "proper remedy for a consumer or business that needs to challenge an arbitration award is to attack the award and not the arbitrator or arbitration organization." *Id*. NAF further explains that "[j]ust as

judges and clerks need protection from unwarranted attacks by a frustrated or malicious losing party, so do other professional decision makers and administrators." *Id*.

California used to have a statute along the lines suggested by NAF. Former Section 1280.1 read: "An arbitrator has the immunity of a judicial officer from civil liability when acting in the capacity of arbitrator under any statute or contract." 1985 Cal. Stat. ch. 709, § 1. That provision was enacted in response to a court decision concerning the extent to which common law makes an arbitrator immune from liability. Specifically, in *Baar v. Tigerman*, 140 Cal. App. 3d 979, 982, 189 Cal. Rptr. 834 (1983), the court held that common law arbitral immunity "covers only the arbitrator's quasi-judicial actions, not failure to render an award." Section 1280.1 was enacted to eliminate that restriction on arbitral immunity. *See, e.g.*, *American Arbitration Ass'n v. Superior Court*, 8 Cal. App. 4th 1131, 1133, 10 Cal. Rptr. 2d 899 (1992).

However, Section 1280.1 was subject to a sunset clause, which was extended twice but not a third time. The statute was repealed by its own terms on January 1, 1997. An effort to reenact the statute the following year was unsuccessful. See SB 19 (Lockyer), as amended in Assembly, July 28, 1997.

As best we know, the question of whether to reestablish statutory immunity for an arbitrator remains controversial. Common law immunity still exists, protecting an arbitrator from being sued by a disgruntled litigant seeking to hold the arbitrator liable for rendering an adverse decision. *See, e.g., Stasz v. Schwab*, 12 Cal. App. 4th 420, 17 Cal. Rptr. 3d 116 (2004).

Real Estate Contract Arbitration

Sections 1298 to 1298.8 establish special requirements for an arbitration clause in a real estate contract (font size, typeface, warning notice, etc.). These requirements are clearly designed to ensure that the clause is conspicuous and comes to the attention of the contracting parties. As explained in *Villa Milano Homeowners Ass'n v. Il Davorge*, 84 Cal. App. 4th 819, 830, 102 Cal. Rptr. 2d 1 (2000), "[t]he obvious intent of these requirements is to call the buyer's attention to the fact that he or she is being requested to agree to binding arbitration and to make certain that he or she does so voluntarily, if at all."

NAF writes that Sections 1298 to 1298.8 "need to be repealed." Exhibit p. 12. According to NAF, "[t]hese provisions are clearly hostile to arbitration and run counter to the public policy of California which favors the use of arbitration." *Id*.

Prof. Alford also recommends repeal of these provisions. He explains:

> Unlike other provisions of the California Arbitration Act, these provisions do not promote arbitration and actually appear hostile to arbitration. They impose additional statutory obligations as to language and form with no countervailing assurances that compliance therewith will render the clause enforceable. In the absence of these provisions, such contracts, like other contracts, will continue to enjoy common law protection against adhesion and contract[s] that are unconscionable or otherwise improper. Moreover, it establishes a category of claims pertaining to real estate ... that are not capable of settlement by arbitration. This will promote parallel proceedings, with certain causes of action subject to arbitration while others subject to litigation.

Alford Report at 44. Prof. Alford also raises concerns regarding federal preemption and insurance costs. *Id*. at 44-45.

With regard to federal preemption, a recent court of appeal decision held that "section 1298, with its font and point size, notification, and warning requirements taken together, cannot be judicially construed to invalidate the arbitration clause at issue without violating the United States Arbitration Act." *Hedges v. Carrigan*, 117 Cal. App. 4th 578, 11 Cal. Rptr. 3d 787 (2004). The court acknowledged, however, that FAA preemption applies only to an arbitration clause in a contract "evidence a transaction involving commerce." 9 U.S.C. § 2. In *Hedges*, the court interpreted that phrase broadly, citing United States Supreme Court precedents. *See* 117 Cal. App. 4th at 585-87.

But it is possible that some real estate contracts requiring arbitration do not involve interstate commerce and would not be subject to FAA preemption. It might also be possible to revise Sections 1298 to 1298.8 to avoid FAA preemption, perhaps by recasting them as real estate licensing requirements. Further, *Hedges* was not a decision of the United States Supreme Court or the California Supreme Court, so it may not be the last word on whether Sections 1298 to 1298.8 are preempted. We therefore suspect that consumer groups would object to repealing those provisions, which obviously were crafted primarily to protect a consumer from unwittingly waiving the right to judicial resolution of a dispute relating to purchase of a home.

Arbitrator Disclosure Requirements

Section 1281.85, enacted in 2001, directed the Judicial Council to adopt ethical standards for a person serving as a neutral arbitrator pursuant to an arbitration

agreement. In 2002, with the assistance of a Blue Ribbon Panel of Experts on Arbitrator Ethics, the Judicial Council adopted a set of standards, some of which consolidated and restated existing legal requirements. See Cal. R. Ct. app. Div. VI (Ethical Standards for Neutral Arbitrators). Standard 7 establishes detailed disclosure requirements for an arbitrator. "The arbitrator's overarching duty under this standard, which mirrors the duty set forth in Code of Civil Procedure section 1281.9, is to inform parties about matters that could cause a person aware of the facts to reasonably entertain a doubt that the proposed arbitrator would be impartial." Comment to Standard 7.

NAF writes that California's arbitrator disclosure requirements are "hostile to the use of arbitration" and "need to be modified." Exhibit p. 13. NAF says that the requirements are "impossible to comply with because they require the disclosure of information that is unknown to an arbitrator or cannot be readily discovered." *Id*. NAF further states that the disclosure requirements "are much tougher for arbitrators than for judges who try criminal or civil cases." *Id*.

NAF views the disclosure requirements as "a covert way of establishing a hostile and anti-arbitration procedure in the guise of fairness." *Id*. In NAF's opinion, the disclosure requirements actually deny fairness, because the losing party in an arbitration

> can find some technical and non-disclosed, non-material fact that supposedly should have been disclosed by the arbitrator, leaving arbitration awards susceptible to easy attack and causing parties wasted time and money. This anti-arbitration bias is so obvious from a reading of the current provisions and their application that they must be repealed and replaced with fair and workable disclosure standards. Too many very good arbitrators will not perform arbitrations in California because of these unfair provisions, denying parties access to fair minded and impartial arbitrators.

Id. NAF suggests language for a new provision governing arbitrator disclosure. *Id*.

Prof. Alford points out that "California has among the most stringent disclosure requirements of any state." Alford Report at 17. He says that there are "distinct advantages and disadvantages to California's stringent approach." *Id*. He explains:

> The integrity of the process is enhanced by having strict standards and reducing instances of improper conduct between the neutral

> arbitrator and a party. On the other hand, the stringent requirements are beyond the scope of most other arbitral forums, suggesting a hostility toward arbitration and diminishing California as an attractive venue for arbitration. In addition, to the extent California law conflicts with federal law, there will be significant preemption issues.

Id. (footnotes omitted). He recommends that California "revisit the disclosure requirements and modify them to address some of the perceived excesses created by the California regime." *Id.*

Litigation regarding preemption of the disclosure requirements is pending. In particular, the Ninth Circuit recently ruled that the Securities and Exchange Act of 1934 preempts application of the disclosure requirements to an arbitration conducted in California by the National Association of Securities Dealers ("NASD"). *Credit Suisse First Boston Corp. v. Grunwald*, __ F.3d __ , 2005 WL 466202 (2005). It is not yet clear whether this decision will be appealed. A case involving the same issue is pending before the California Supreme Court. *Jevne v. Superior Court* (No. S121532). Oral argument was held yesterday and a decision should be issued within ninety days.

We understand that consumer groups feel strongly about the disclosure requirements, in part because of what is known as "the repeat player phenomenon." As Public Citizen explains,

> Arbitration providers are organized to serve businesses, not consumers. Their marketing is targeted entirely at businesses, and their rosters of arbitrators consist primarily of corporate executives and their lawyers. *Since only businesses will be repeat users of an arbitrator, there is a disincentive for an arbitrator to rule in favor of a consumer or employee*.

Public Citizen, *Mandatory Arbitration: Opportunities for State-Level Reform*, http://www.citizen.org/congress/civjus/medmal/articles.cfm?ID=9619 (emphasis added). Similarly, Consumers Union has written:

> Organizations that provide private arbitration services are businesses. Just like any other business, an arbitration provider needs customers in order to survive. The serious risk of unintended, and quite possibly inherent, "selection bias," is rooted in the fact that private arbitration services depend on the repeat business of commercial entities.

Brief *Amicus Curiae* of Consumers Union of U.S. in Support of the Respondent at 29, *Green Tree Financial Corp.-Alabama v. Randolph*, 531 U.S. 79 (2000) (No. 99-1235), *available at* http://www.consumersunion.org/i/Financial_Services/Contracts__Arbitration/index.html. Thus, Consumers Union cautions that "[b]ias in the arbitration system is of critical concern to consumers as mandatory arbitration clauses proliferate." *Id*. at 30.

In light of the strong sentiments expressed both by arbitration providers and by consumer groups regarding California's disclosure requirements, it is likely that any effort to revise those requirements would be highly controversial. It may also be premature to address the topic before the pending preemption cases are fully resolved.

Christopher Wilson's Suggestions

Attorney Christopher Wilson presents two different ideas for the Commission to consider. First, he would like arbitration law to include "procedures for arbitration by video conference." Exhibit p. 16. He does not elaborate on this matter and we do not know anything about the extent to which video conferencing is currently in use in arbitrations, whether in California or elsewhere. We will explore this if the Commission is interested.

Second, Mr. Wilson would like to see "procedures for arbitration using state and county funded facilities and personnel." *Id*. He does not mean non-binding judicial arbitration, which already exists in California. See Sections 1141.10-1141.30. Rather, Mr. Wilson would "offer *binding* arbitration through the courts, a sort of judge-alone proceeding with limited discovery, privacy, short time to hearing, not much use of rules of evidence, not much right to appeal, etc." Exhibit p. 16 (emphasis added). He says this "[c]ould be a new way for LASC to raise funds — just charge 50% of what the AAA charges." *Id.* He also speculates that letting the courts conduct binding arbitration would help make Los Angeles arbitration-friendly and allow it to "compete with Paris, the Hague, etc., as a good place to arbitrate disputes." *Id*.

A reform along these lines would be a radical innovation, which could not be achieved without substantial support. We are curious to know whether other persons or organizations share Mr. Wilson's view on this point.

Technical Reform

Another possibility in studying arbitration law would be to focus on relatively noncontroversial, technical reforms that could improve the existing statute. This could include eliminating obsolete material, updating provisions to accommodate new technology, clarifying ambiguities, making the statute more user-friendly, and the like.

We raised this possibility with a number of knowledgeable sources, but none of them was able to readily identify any needed reforms along these lines. Unlike the statute governing mechanics liens, which sorely needs technical cleanup, the provisions governing contractual arbitration are in relatively good shape. This is not to say that they are perfectly drafted; only that they do not cry out for technical cleanup.

Further, in this controversial subject area, even a reform that initially appears to be pure technical cleanup may be disputed. For example, the part of the Code of Civil Procedure pertaining to arbitration includes two Title 9.3s:

(1) Title 9.3 (commencing with Section 1297.11), which pertains to arbitration and conciliation of an international commercial dispute.
(2) Title 9.3 (commencing with Section 1298), which pertains to real estate contract arbitration.

An obvious technical reform would be to change the second heading from "Title 9.3" to "Title 9.4."

As previously discussed, however, NAF and Prof. Alford recommend that Sections 1298 to 1298.8 be repealed, while consumer groups are likely to oppose such a reform. See "Real Estate Contract Arbitration" *supra*. A proposal to correct, rather than repeal, the heading of the Title that consists of those provisions may thus be controversial even though it initially appears innocuous. It might not be worth the effort to attempt to identify needed technical reforms in the arbitration statute and seek enactment of cleanup legislation.

PENDING LEGISLATION

In addition to the pending bills mentioned above (AB 415 (Harman) and AB 1176 (Tran)), we are aware of two other arbitration-related measures pending in the Legislature:

(1) **AB 202 (Harman).** This bill would amend Section 1281.2 to say that filing a petition pursuant to that provision "is the exclusive means

by which a party to an arbitration agreement may seek to compel arbitration of a controversy alleged to be subject to that arbitration agreement."

(2) **AB 1553 (Evans).** This bill would add a new provision that would toll a contractual time limit for commencing arbitration while a civil action based on the same controversy is pending and for "30 days after a final determination by the court that the party is required to arbitrate the controversy, or 30 days after the final termination of the civil action that was commenced and initiated the tolling, whichever date occurs first."

We will monitor the progress of this legislation.

As always, the Commission lacks authority to take a position on these pending bills, and no Commission employee or member appointed by the Governor may advocate passage or defeat of these measures in an official capacity. See Gov't Code §§ 8280-8298.

STAFF RECOMMENDATIONS

As the comments on Prof. Alford's study reflect, the area of contractual arbitration (particularly consumer arbitration based on a pre-dispute arbitration clause in a form contract), is volatile and evolving. There is a well-established federal and California policy favoring voluntary arbitration, as recognized in the FAA and numerous court decisions. But consumer groups are greatly concerned about the increasing use of arbitration clauses, as arbitrator Ruth Glick aptly described in a recent article:

> Not too long ago, the only mandatory pre-dispute arbitration clause imposed on consumers was found in documents used to open an account in a securities brokerage firm or in a contract that Kaiser Permanente patients must sign in order to receive medical treatment. Today these imposed arbitration clauses are found everywhere, forcing individuals to forgo a civil lawsuit and pursue any legal action through arbitration. When you buy a house, take a job, open a bank account, receive health care, sign up for telecommunications service, and even purchase season football tickets, you may be required to accept a dispute resolution policy that includes mandatory arbitration. These provisions surrender your right to pursue a claim in court or be part of a class-action lawsuit.
>
> Consumers, employees, and patients do not have the opportunity to negotiate these clauses which are offered on a "take

> it or leave it" basis. These contracts of adhesion are typically presented in a standard printed form prepared by a business entity, leaving the consumer with the choice to either agree to the terms or forgo the benefits of the contract.

Glick, *California Arbitration Reform: The Aftermath*, 38 U.S.F. L. Rev. 119 (2003).

In commencing this study, the Commission may be stepping into a political minefield. The Commission should carefully consider whether undertaking such a study is an appropriate use of the Commission's limited resources. It would be unfortunate to put a lot of effort into the study, only to find that the Commission's proposed reforms are politically unacceptable. Although the Commission is authorized to conduct this study, the Legislature did not specifically ask the Commission to actively work on arbitration at this time. The Commission initiated this project itself. Given the strong objections being voiced by consumer advocates so early in the study process, it might be appropriate to rethink whether it makes sense to conduct the study.

If the Commission decides to go forward with the current study, it will need to be sensitive to the concerns of consumer groups. For example, it should not focus exclusively on the RUAA, but should also examine other resources and developments, such as proposals of consumer groups and laws in other jurisdictions.

Ironically, both arbitration proponents and consumer groups stress the importance of party autonomy — the desirability of effectuating the will of the parties. Arbitration proponents emphasize the need to respect the will of parties who have chosen to arbitrate and to assist them in resolving their disputes in that manner. Similarly, consumer groups emphasize the importance of ensuring that parties enter into arbitration of their own free will, not at the imposition of a party with greater bargaining strength.

If the Commission proceeds with this study, it might want to explore the possibility of drawing sharper distinctions between (1) arbitration between parties of relatively equal bargaining strength, and (2) arbitration between a consumer and a business offering a form contract on a take-it or leave-it basis. For example, Ms. Glick suggests:

> "[I]mposed consumer arbitration agreements should be considered separately from negotiated commercial arbitration agreements because consent, a prerequisite for contract formation, is missing. The cure for the former should not spoil the benefits of the latter.

Id. at 137.

But it probably would be difficult and contentious to draw a distinction like this more sharply than in existing law. We are not sure it can effectively be done, particularly given the constraints of federal preemption, which is beyond the control of the Legislature and the Governor.

The Commission should also bear in mind that significant preemption issues are now pending in the courts. Those cases might have a big impact on this study. In particular, the outcome of the cases challenging the arbitrator disclosure requirements might affect the attitude of consumer groups towards arbitration.

At the Commission meeting, it might be helpful to seek input on the potential effects of the pending preemption cases. In particular, the Commission should consider whether the proper direction of this study might become more clear if the Commission awaits the resolution of one or more cases before proceeding.

Respectfully submitted,

Barbara Gaal
Staff Counsel

CDRC

The Voice of ADR in Sacramento

1150 Silverado Street
P. O. Box 177
La Jolla, CA 92037
(866) 216-CDRC
Fax: (858) 454-1021
www.cdrc.net

February 21, 2005

Barbara S. Gaal, Esq.
Staff Counsel
California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, CA 94303-4739

Re: Study of Contractual Arbitration Improvements

Dear Ms. Gaal:

This will respond on behalf of the California Dispute Resolution Council to the Law Revision Commission's invitation to comment on its proposed study of contractual arbitration.

The CDRC believes that at this juncture in the history of our state, a comprehensive review of California's arbitration statutes, beginning with Section 1280 of the Code of Civil Procedure, including the possibility of adopting the Revised Uniform Arbitration Act in whole or in part, is worthwhile.

The process of arbitration has evolved significantly since the current form of Sections 1280, et seq., was adopted in 1961. Although the state statutory provisions governing domestic arbitrations have been amended from time to time since then and a separate chapter has been enacted to govern international arbitrations, no overall review of the legislative scheme has been conducted for more than 40 years.

The CDRC is a non-profit organization of dispute resolution neutrals---arbitrators and mediators---and providers of ADR administrative services that was organized specifically to advocate for fair and accessible alternative dispute resolution processes in the Legislature and before the courts and administrative agencies. By way of example of CDRC's

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1150 Silverado Street
P. O. Box 177
La Jolla, CA 92037
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Fax: (858) 454-1021
www.cdrc.net

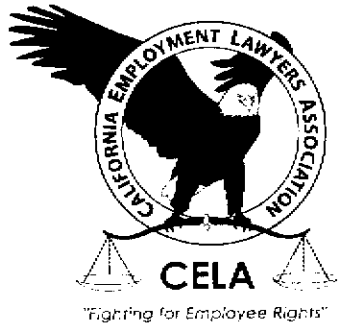
activities, one of its founding members was, as you will recall, deeply involved in development of the mediation confidentiality legislation now found in Evidence Code Section 1115, et seq.

The CDRC believes that Professor Alford's background study was a useful beginning. However, it appears to be just that---a beginning---and considerably more study of the pros and cons of amending the current statutes governing arbitration appears to be necessary before any decision is made whether to propose fresh legislation. The CDRC stands ready through its public policy committee to work actively with the Commission in such ongoing study.

Sincerely,

James R. Madison
Chair, CDRC Public Policy Committee
750 Menlo Avenue, Suite 250
Menlo Park, CA 94025

cc: Richard Bayer, President



February 16, 2005

Barbara Gaal
California Law Revision Commission
4000 Middlefield Road
Palo Alto, California 94303-4739

Dear Ms. Gaal,

The California Employment Lawyers Association submits the following comments regarding the Law Revision Commission Study of Contractual Arbitration Improvements from Other Jurisdictions.

As a preliminary matter we want to state our belief that California has the most well developed state arbitration act in the country and we view the Uniform Arbitration Act as a step backwards in time and substance in many respects. The Uniform act proceeds from the absolutely incorrect assumption that all arbitration agreements are negotiated agreements between sophisticated users. Nowhere does it attempt to conform to the new realities of arbitration where we find adhesive and one-sided clauses being forced on powerless consumers, patients and workers. It may be time to update the California Arbitration Act but any such changes need to include more, not fewer protections against this misuse of adhesive arbitration agreements.

With regard to some of the specific recommendation contained in Professor Alford's analysis we offer the following thoughts:

We strongly oppose amending the CAA to reduce or modify the requirement of a written agreement. The agreement to arbitrate involves the waiver of many fundamental constitutional rights. Any waiver of those rights and indeed any agreement to arbitrate should only be effective if it is both knowing and voluntary. The requirement of a

ONE MARKET PLAZA, STEUART TOWER, SUITE 2630, SAN FRANCISCO, CA 94105 • (415) 391-0111 • (415) 391-0123 FAX • WWW.CELAWEB.ORG

writing is essential to ensure that all parties know exactly what they are agreeing to. The waiver of constitutional rights in the consumer and employment contexts should never be accomplished through "implied" or oral agreements as suggested by Professor Alford.

Similarly we oppose the adoption of Section 6 of the RUAA. Because abusive and unconscionable clauses contained in adhesion contracts are routinely imposed on consumers it is essential that the courts retain primary jurisdiction and responsibility for enforcing such agreements. It is not appropriate to allow an adhesion contract to restrict the authority of the court because the contract does not really reflect the decision and agreement of the parties. It is similarly not appropriate to let the arbitrator decide whether an agreement to arbitrate is enforceable. Unconscionability is for the court to decide under present case law. Moreover, the arbitrator has a financial conflict of interest in that question and should not be put in the position of determining an issue in which they have such a profound economic conflict. We think it a far better rule to allow the courts to maintain responsibility for ruling on the existence, validity and enforceability of arbitration agreements. We understand that there may be a conflict with certain rulings interpreting the Federal Arbitration Act. It is important to note that not all arbitrations are conducted under the FAA. In particular, entire classes of worker contracts are excluded from the FAA as are arbitrations clauses contained in contracts where the parties specifically designate California law. Accordingly, California has every right and interest to identify and state its own public policies in this area to control those circumstances where California law will apply. It is certainly possible that there will be legislation or rulings rolling back the vast preemptive power of the FAA and California should have it own values reflected in its law.

Along those lines we strongly urge that language be added to California law that establishes a knowing and voluntary requirement for all arbitration agreements. We also suggest an amendment that makes it clear that an adhesion contract is not a proper device for the imposition of an arbitration agreement or the waiver of constitutional or statutory rights. Finally, we urge you to consider an amendment that excludes employment contracts from the scope of the CAA similar to the exclusion in 16 other state laws.

We also strongly oppose any new language which authorizes summary judgments in arbitrations. The summary judgment procedure was virtually unheard of in arbitration until a few years ago. Its insertion into the process has resulted in a perversion of the very concept of arbitration and has greatly prejudiced consumers and employees. Our research and experience show that it has been a terrible development for unrepresented parties who are getting overrun in arbitration by repeated dispositive motions by defendants. Arbitration is not supposed to be a legal process, nevertheless, summary judgments are strictly legal motions. Moreover, it is grossly unfair to permit summary judgment motions at the same time full discovery is restricted. Because most witnesses, documents and other evidence is usually in the hands of the defendants, it is especially unfair to permit summary judgment motions while restricting discovery. Finally, extensive prehearing motion practice dramatically increases the costs of arbitration.

In conclusion, we think it may be time to develop several new provisions protecting consumers and workers from adhesive, abusive and expensive arbitration agreements. Better law revision would distinguish between agreements negotiated between commercial entities and adhesive agreements which are neither knowing nor voluntary.

We hope these comments are helpful.

Very truly yours,

Cliff Palefsky

ONE MARKET PLAZA, STEUART TOWER, SUITE 2630, SAN FRANCISCO, CA 94105 • (415) 391-0111 • (415) 391-0123 FAX • WWW.CELAWEB.ORG

CONSUMER ATTORNEYS OF CALIFORNIA

President
Sharon J. Arkin
President-Elect
Frank M. Pitre
Chief Legislative Advocate
Donald C. Green
Green & Azevedo

Senior Legislative Counsel
Nancy Drabble
Legislative Counsel
Nancy Peverini
Legal Counsel
Lea-Ann Tratten

February 20, 2005

Barbara Gaal
Staff Counsel
California Law Revision Commission
4000 Middlefield Road
Palo Alto, CA 94303-4739

RE: CAOC OPPOSITION TO THE CLRC STUDY OF CONTRACTUAL ARBITRATION

Dear Ms. Gaal:

On behalf of Consumer Attorneys of California, I write to express CAOC opposition to both the proposed review by the CLRC and the proposed recommendations to the Revised Uniform Arbitration Act prepared by Professor Roger Alford of Pepperdine University School of Law. In addition to substantive issues with many of the report's recommendations, we strongly oppose the statement that "Arbitration is generally viewed as an attractive alternative to litigation, affording parties with an economical, efficient, confidential, and neutral forum to resolve contractual disputes." This statement, as applied to consumer pre-dispute binding arbitrations, demonstrates a clear misunderstanding of arbitration in the consumer context. While businesses may and should be free to contract for mandatory arbitration, forced pre-dispute binding arbitration agreements in consumer contracts are inherently unfair and should be prohibited. We strongly disagree with the broad pro-arbitration themes contained in the proposal and believe this misguided basis makes the proposal fundamentally flawed and incapable of being a model for substantive review.

In addition, we have reviewed the comments submitted by the California Employment Lawyers Association and fully endorse those comments. A copy of CELA's letter is attached.

Given the limited and valuable nature of CLRC resources, we urge you to reject this study in full, including its recommendations. If you or a member of your staff would like to discuss this further, please contact us. Thank you for considering our comments.

Sincerely,

Nancy Peverini

Nancy Peverini
Legislative Counsel

Legislative Department

770 L Street, Suite 1200, Sacramento, CA 95814-3396 • (916) 442-6902 • FAX (916) 442-7734
info@caoc.org • www.caoc.com

CONSUMER FEDERATION OF CALIFORNIA

PO Box 1340, Millbrae, CA 94030 Ph • (650) 589-3135 Fax • (650) 872-3150 Web • consumerfedofca.org

Richard Holober, Executive Director
(650) 589-3135
rholober@yahoo.com

February 22, 2005

Ms. Barbara Gaal, Esq.
California Law Revision Commission
4000 Middlefield Road
Palo Alto, CA 94303-4739

RE: Opposition to Proposed Review of Contractual Arbitration Statutes

Dear Ms. Gaal:

The Consumer Federation of California, representing consumers throughout California, must oppose the CLRC efforts to review contractual arbitration statutes, based on Professor Alford's study.

CFC has a long history of opposing mandatory pre-dispute binding arbitration provisions in consumer contracts, and does not think that the CLRC should review these existing statutes. A better use of the CLRC's resources would be to propose that any statute that enables business to force such agreements on consumers be void and unenforceable as a matter of public policy.

Sincerely,

Richard Holober
Executive Director

Consumers Union

West Coast Office
1535 Mission St., San Francisco, CA 94103
415-431-6747 (phone) 415-431-0906 (fax)
www.consumersunion.org

February 18, 2005

California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, CA 94303-4739
Fax: 650-494-1827

Re: Comment on the Background Study on Arbitration

Dear Members of the California Law Revision Commission,

Consumers Union, the nonprofit publisher of *Consumer Reports*, offers these comments on the background study on arbitration submitted to the Commission by Professor Roger Alford. This study should not be the basis for work by the Law Revision Commission, as it totally omits the criticism and concerns about mandatory binding arbitration which have been voiced by consumer advocates for nearly a decade. This glaring omission renders the study at best incomplete, and undermines its recommendations.

Consumers Union does not wish to suggest lack of good faith on the part of the author of the report. The very significant omissions described below may be explained by the portion of the report titled "Assumptions of the Report," on page 5. In the "Assumptions" section, the author discloses the fundamental policy assumptions that underlie the report, including its recommendations. The report honestly discloses that it is based on the assumption of a legislative policy favorable to arbitration, and on subsidiary assumptions that parties who are bound by arbitration clauses desired them (party autonomy), and affirmatively preferred arbitration to litigation. No evidence is offered to support these assumptions, and the evidence about mandatory arbitration clauses in consumer contracts, at least as reflected in the strongly-held and publicly stated views of consumer advocates nationwide, suggests that these assumptions are simply not applicable to consumer arbitration clauses.

Wrong assumptions lead quite directly to wrong policy recommendations. Because this report is fundamentally based on policy assumptions that lack a factual basis with respect to consumer form contract arbitration clauses, its recommendations should have no bearing on any work by the Commission with respect to consumer arbitration.

Longstanding consumer concerns about mandatory arbitration clauses in consumer contracts are easily accessible to researchers. Consumer's Union's policy on consumer arbitration, in which we recommend that arbitration clauses either offer non-mandatory arbitration at the consumer's option, or that arbitration be offered on a yes or no basis to the consumer only after a dispute arises, was adopted in 1997. It has been available to the public on our website since 2000. See: http://www.consumersunion.org/finance/arone.htm. *Consumer Reports* has also published several articles describing the risks and difficulties for consumers of mandatory predispute arbitration clauses, which can be located in any library.

The study fails to recognize the significant impact of the spread of mandatory arbitration clauses on the development and effectiveness of consumer law due to the loss of precedent, loss of the deterrence value of published filings and published decisions, disadvantages to consumers in the inability to engage in discovery about patterns and practices, and the like. These consumer concerns are easy to discern with

minimal investigation into the consumer viewpoint. A document which has been posted on Consumers Union's web site since March 2002, for example, describes these concerns:

> Because the outcome of arbitration is kept private, it interferes with the development of consumer law and fails to provide the kind of deterrence that can be provided by individual or class action suits. Often businesses have close relationships with the dispute resolution provider organization that may create a conflict of interest. Arbitration can impede the quality and effectiveness of relief available to consumers.

http://www.consumersunion.org/finance/reformwc302.htm

Other voices for consumers agree that mandatory, predispute arbitration is harmful to consumers. Again, this information would have been easily accessible to any researcher. For example, the National Consumer Law Center states in part:

> National Consumer Law Center advocates believe that mandatory, pre-dispute binding arbitration clauses in consumer contracts are the single biggest threat to consumer rights in recent years, a de-facto rewrite of the Constitution that undermines a broad range of consumer protections painstakingly built into law. Worse, much of the damage is literally taking place in the small print of everyday life and this "flying under the radar" of public and news media perception. No other consumer issue hits so many Americans where they live every day. These clauses also undermine a decades-old policy mandate underpinning much modern consumer law: That private legal enforcement action through the courts should be the chosen method of upholding these laws and not a large government bureaucracy. For a broader description of the issue and the myriad ways it's affecting consumers daily see NCLC's *Consumer and Media Alert: The Small Print That's Devastating Major Consumer Rights,* at http://www.consumerlaw.org/initiatives/model/arbitration.shtml

http://www.consumerlaw.org/initiatives/model/content/ArbitrationMEDIAUPDATEaug04.pdf

There is also a well-developed body of recommendations for improvements that states could make in state arbitration acts, including the Fair Bargain Act, which was developed to respond to some of the defects in the RUAA. See: Congress Watch, *Mandatory Arbitration: Opportunities for State Level Reform,* https://www.citizen.org/congress/civjus/medmal/articles.cfm?ID=9619.

The absence of these points of view in the background study, and the fact that is plainly discloses that is based on a set of assumptions that have no basis in fact for consumer arbitrations, must call into question all of its recommendations. We urge you to reject this study in full, including its recommendations.

Very truly yours,

Gail Hillebrand

COMMENTS OF NATIONAL ARBITRATION FORUM

Subject: Comments to A-100 study on Arbitration
Date: Wednesday, February 16, 2005
From: John Horn <jhorn@arb-forum.com>
To: <bgaal@clrc.ca.gov>

Dear Ms. Gaal:

I am writing on behalf of the National Arbitration Forum and our Director, Roger Haydock. As a leading provider of arbitration and other ADR services in the United States and beyond, we naturally have a great interest in the laws and trends that affect our industry. Moreover, approximately 20% of our entire caseload comes from California, the bulk of which are consumer related disputes. Accordingly, we are well versed as to the current environment and have specific thoughts as to what should (or should not) be done legislatively to improve our industry.

With that in mind, I respectfully submit the comments of Mr. Haydock which are attached. I am confident that you will find the commentary useful and well developed.

In addition, as the Company representative in the West, I would be happy to take a more active role with the Commission in any manner that is required. Please do not hesitate to contact me for any reason.

Sincerely yours,

John Horn
Western Regional Director
National Arbitration Forum
(818) 986-8606
jhorn@arb-forum.com
www.arbitration-forum.com

COMMENTS TO CALIFORNIA LAW REVISION COMMITTEE
REGARDING CHANGES TO CALIFORNIA ARBITRATION LAW

From
Professor Roger S. Haydock
Professor, William Mitchell College of Law and
Director, National Arbitration Forum

These comments respond to recommendations appearing in the background study dated November 2004 entitled "Report to Law Revision Commission Regarding Recommendations for Changes to California Arbitration Law" and contain suggestions for revisions which arise from the current use in California of arbitrations to resolve disputes between businesses and consumers.

Arbitration provides both consumers and businesses with a very fair, affordable, efficient, and effective way to resolve disputes. Laws need to be adopted which provide both consumers and businesses with this ready access to civil justice through arbitration.
Laws should NOT be enacted which either prevent the parties from having this access to arbitration, or increase the costs to all involved making the process too expensive, or create unnecessary procedures that overly complicate the process.

The primary goal of revisions is to further create and foster the perception and reality that California is a friendly forum for arbitration. That is the mandate of the United States Supreme Court decisions and California judicial decisions, as well as the mandate of Congress and the California Legislature. Further, that is the mandate of California businesses and consumers who want a fair and affordable way to resolve their disputes and of the California public who want a state wide system providing everyone with access to civil justice.

REPRESENTATION IN ARBITRATIONS

Cal. Civ. Proc.Code Sec. 1284 should be retained and the sunset provision in Section 1282.4(j) repealed. Parties should have a choice in who they want to represent them in arbitrations and maintaining the current provisions of Section 1284 will do so. California consumers do business with many companies outside of California, and arbitrations involving disputes with those companies ought to take place in California, but the companies have the right to choose a lawyer from outside of California to represent them. That is the practice mandated by the Federal Arbitration Act in these interstate arbitrations, and California cannot deny this right to out of state businesses, or consumers who do business with California companies. And, that is the accepted practice in other states. California must comply with the federal law and the laws of other states and again demonstrate it is an arbitration friendly state.

DEFINITION OF CONSMER

Currently, no definition of consumer exists in Section 1284 et seq., and a definition is needed to avoid continuing confusion and major misunderstandings. The following generally accepted definition used in federal and state statutes ought to be adopted:

A consumer is an individual who is not a business and whose claim or defense against a business arises from a transaction or event entered into primarily for personal, family or household purposes.

EXTENT OF CALIFORNIA LAW

California law can only extend to arbitrations that are intrastate in California and that are not interstate as defined by the Commerce Clause and the United States Supreme Court. Some provisions of

EX 11

the California law improperly attempt to extend beyond the proper reach of what California can regulate. Section 1282.3(c) ought to be revised to read that its provisions apply to:

All consumer arbitrations conducted in California involving intra-state commerce and do not apply to arbitrations involving interstate commerce as defined by the United States Supreme Court.

This provision will comport California law with current federal law and prevent the unnecessary litigation of preemption issues in arbitration cases, which only cost the parties wasted money and time and further clog California courts with unnecessary and unwanted litigation.

PREVAILING VACATUR LAW

Currently, California statutory law regarding the vacation of an arbitration award violates the United States Constitution. It needs to be amended. This can be easily done by adopting the recommended provisions of Section 23 of the Revised Uniform Arbitration Act which are in compliance with federal and state laws. These provisions provide a losing party with the right to have a judge review an arbitration award for fairness and include the grounds available under federal law. Since almost all of the arbitrations between consumers and businesses are regulated by the Federal Arbitration Act, contrary California provisions will not apply in any event and a great deal of confusion and ambiguity can be eliminated by this amendment.

ARBITRATOR AND ARBITRATOR ORGANIZATION IMMUNITY

It is vital to integrity and fairness of arbitrations that arbitrators and private arbitration organizations have the same immunity as judicial and administrative judges and court administrators and administrative clerks. Currently, awards issued by arbitrators and proceedings conducted by arbitration organizations are subject to judicial review by way of motions and lawsuits brought by parties seeking relief from the courts to either compel or stay arbitrations or confirm, vacate, or modify an award. California law should include the following provision to insure that arbitrators and arbitration organizations are properly protected from needless and unnecessary litigation:

Arbitrators and arbitration organizations and providers are provided with the same immunity from litigation that protects California judges and administrative clerks.

The proper remedy for a consumer or business that needs to challenge an arbitration award is to attack the award and not the arbitrator or arbitration organization. Just as judges and clerks need protection from unwarranted attacks by a frustrated or malicious losing party, so do other professional decision makers and administrators. Under this proposed standard, arbitrators and organizations could be sued for the same reasons a state judge and clerk could be sued, which again comports with federal law.

REPEALING ANTI-ARBITRATION PROVISIONS

Any current provision that is anti-arbitration ought to be repealed. Sections 1298 through Sections 1298.8 regarding real estate contract arbitration need to be repealed. These provisions are clearly hostile to arbitration and run counter to the public policy of California which favors the use of arbitration.

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ARBITRATOR DISCLSOURE PROVISIONS

At present, the California disclosure provisions for arbitrators are hostile to the use of arbitration. They need to be modified. They are impossible to comply with because they require the disclosure of information that is unknown to an arbitrator or cannot be readily discovered. Further, they require ongoing disclosures of information that cannot be readily known. And, they violate the Federal Arbitration Act and federal law.

Arbitrators should be required to disclose information the parties believe that will make them unfit to be an arbitrator. The following recommended provisions accomplish this goal:

A prospective arbitrator shall provide parties with a complete and accurate resume. An Arbitrator shall disclose all circumstances that create a conflict of interest or may cause the Arbitrator to be unfair or biased, including but not limited to the following:

(1) The Arbitrator has a personal bias or prejudice concerning a Party, or personal knowledge of disputed evidentiary facts;

(2) The Arbitrator has served as an attorney to any Party, the Arbitrator has been associated with an attorney who has represented a Party during that association, or the Arbitrator or an associated attorney is a material witness concerning the matter before the Arbitrator;

(3) The Arbitrator, individually or as a fiduciary, or the Arbitrator's spouse or minor child residing in the Arbitrator's household, has a direct financial interest in a matter before the Arbitrator;

(4) The Arbitrator, individually or as a fiduciary, or the Arbitrator's spouse or minor child residing in the Arbitrator's household, has a direct financial interest in a Party;

(5) The Arbitrator or the Arbitrator's spouse or minor child residing in the Arbitrator's household has a significant personal relationship with any Party or a Representative for a Party; or

(6) The Arbitrator or the Arbitrator's spouse:

a. *Is a Party to the proceeding, or an officer, director, or trustee of a Party; or,*
b. *Is acting as a Representative in the proceeding.*

These provisions reflect what disqualifies a judge from a case, and the standards that require a judge to be disqualified ought to be the same for arbitrators. The current California disclosure provisions are much tougher for arbitrators than for judges who try criminal or civil cases. There is no justifiable reason why an arbitrator in a civil case ought to have any different disqualification standards than a judge in a criminal case. If disqualification standards are sufficient in cases where constitutional rights and freedom are at stake, these same standards are more than sufficient for civil arbitration cases involving money.

The only apparent reason why the current severely restrictive California provisions apply to arbitrators is that they were a covert way of establishing a hostile and anti-arbitration procedure in the guise of fairness. To the contrary, the current provisions deny parties in arbitration with a fair process because the losing party can find some technical non-disclosed, non-material fact that supposedly should have been disclosed by the arbitrator, leaving arbitration awards susceptible to easy attack and causing parties wasted time and money. This anti-arbitration bias is so obvious from a reading of the current provisions and their application that they must be repealed and replaced with fair and workable disclosure standards. Too many very good arbitrators will not perform arbitrations in California because of these unfair provisions, denying parties access to fair minded and impartial arbitrators.

THE STATE BAR OF CALIFORNIA

— COMMITTEE ON ALTERNATIVE DISPUTE RESOLUTION

180 Howard Street
San Francisco, CA 94105-1639
Telephone: (415) 538-2306
Fax: (415) 538-2305

February 22, 2005

Ms. Barbara Gaal
Staff Counsel
California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, CA 94303-4739

Re: Arbitration Improvements from Other Jurisdictions

Dear Ms. Gaal:

Thank you for bringing to our attention the California Law Revision Commission study of whether contractual arbitration procedures in other jurisdictions may serve as appropriate models for improvement of contractual arbitration practice in California.

We have made an initial review of the background study prepared for the Commission staff by Professor Roger Alford. Professor Alford observes that the California Arbitration Act has not been subject to significant revision since 1961, that there have been significant developments in arbitration law throughout the United States since that time, and that the Revised Uniform Arbitration Act (RUAA) attempts to address the issues raised thereby.

We believe that in light of the approval of the RUAA by the American Bar Association, its endorsement by the American Arbitration Association, its current enactment in ten states, and its introduction in several other states, now is an opportune time for the Commission to consider the advisability of its adoption in California, either in whole or in part, and perhaps with certain modifications as may be deemed appropriate by the Commission and ultimately by the Legislature.

We do not at this time have comments on any of the specific recommendations made in the background study for changes in California law. However, we intend to keep abreast of the Commission's work on this matter and to consider individual issues as they are addressed.

Disclaimer

This position is only that of the State Bar of California's Committee on Alternative Dispute Resolution. This position has not been adopted by the State Bar's Board of Governors or overall membership, and is not to be construed as representing the position of the State Bar of California. Committee activities relating to this position are funded from voluntary sources.

Very truly yours,

/s/

Ira Spiro, Chair
State Bar of California
Committee on Alternative Dispute Resolution

COMMENTS OF CHRISTOPHER F. WILSON

Date: Tuesday morning, November 23, 2004
From: Christopher F. Wilson

What I would like to see in the new arbitration law are (1) procedures for arbitration by video conference and (2) procedures for arbitration using state and county funded facilities and personnel.

For example, let the parties agree to arbitration using AAA rules but using the LA Superior Courts (or private facilities) and an LA Superior Judge (or private arbitrators).

People like the idea of arbitration, and like the AAA rules, but balk at paying thousands to the AAA to have facilities provided free (or nearly free) to court litigants.

Why not let the courts also provide arbitration? Current state and county funding only for court proceedings tends to skew people away from arbitration.

Making LA arbitration-friendly helps draw more business to LA, I suspect. Helps us compete with Paris, the Hague, etc., as a good place to arbitrate disputes.

Christopher F. Wilson, Esq.
21535 Hawthorne Blvd., Suite 260
Torrance, California 90503
Fax: (310) 316 5108
Phone: (310) 316 2500

Date: Tuesday afternoon, November 23, 2004
From: Christopher F. Wilson

I would just offer binding arbitration through the courts, a sort of judge-alone proceeding with limited discovery, privacy, short time to hearing, not much use of rules of evidence, not much right to appeal, etc.

Judges are probably as well-trained to arbitrate as the average private arbitrator.

If one wanted a non-American for a dispute, or a Bob Shafton, then the non-American or Bob Shafton could be allowed to use an available courtroom.

Why not provide public space for arbitration, and judges for arbitration?

Could be a new way for LASC to raise funds - just charge 50% of what the AAA charges.

My sense is the 98 court rooms in Central may see 10-20 jury trials or evidentiary hearings at any given time.

I suspect the available court room space could be used a good bit more efficiently, especially if some courtrooms were designated for evidentiary hearings, and other places for motions.

The typical Central District courtroom not in trial is pretty much inactive after about 10 am.

Why not have Judge A use it from 8:30 to 10:30, Judge B from 11 to 1, Judge C from 1:30 to 3:30?

Santa Monica used to have two judges sharing one court room.

By designating motion courtrooms vs. evidentiary hearing courtrooms (a sort of "hotelling" -- where professionals reserve the space they need, but still have cases for all purposes) we could free up existing courtrooms for arbitrations.

Institutionalizing ADR helps support the idea that we need to look for ways to spend less as society on litigation, especially discovery battles. Could be progress with appeal to Red and Blue state thinkers.

Christopher F. Wilson, Esq.
21535 Hawthorne Blvd., Suite 260
Torrance, California 90503
Fax: (310) 316 5108
Phone: (310) 316 2500

☞ **Note.** These email messages from Mr. Wilson were edited to remove extraneous material and incorporate a revision requested by the author.

Consumers Union Policy on Arbitration and Other ADR Clauses in Standard Form Consumer Contracts

Standard form contracts offered to consumers by commercial parties are increasingly likely to contain clauses requiring the consumer to participate in arbitration or another form of alternative dispute resolution (ADR). These clauses have the potential to prevent consumers from having their claims heard in court. Consumers Union's policy on mandatory arbitration and ADR clauses is designed to promote standards for when these clauses should be permitted to be placed in consumer form contracts, or enforced if found in such contracts, and to promote fair procedures in the implementation of ADR clauses.

A. ADR, including arbitration, should not be required in consumer form contracts unless the consumer has the option either to decline to engage in the ADR process after the dispute arises or to reject the results of the ADR process. In other words, ADR clauses should be permitted and enforceable in consumer contracts only if the ADR process is: 1) contractually mandated with non-binding results, 2) optional with binding results, or 3) optional with non-binding results.

B. The ADR process must be fair. The overall fairness of a contractually imposed ADR process should be judged by compliance with the following criteria.

   A. ADR clauses imposed in a consumer form contract must not select an ADR provider if the location of that provider would impose unreasonable travel costs upon the consumer in order to fully participate in the hearing of the claim.

B. Any consumer contract requiring the consumer to submit to ADR should contain a clear, conspicuous, and understandable disclosure describing the degree to which the consumer gives up any rights he or she otherwise possesses to go to court. Whenever the parties or their agents engage in face-to-face discussions leading to formation of the contract, there should also be a clear oral disclosure.

C. ADR clauses should not apply to cases where a consumer is seeking injunctive relief, unless, after the dispute arises, the consumer agrees to the ADR process and the ADR decision maker has the power to order injunctive relief.

D. In order for any ADR provider to be preselected in a consumer form contract, that provider must maintain an index of actions which is open to the public. The index must identify the parties to the disputes it has pending and has resolved in the past five years. The results of its ADR procedures involving individual consumers should also be available, unless the ADR decision maker has found that there is a special need to seal the results of the ADR proceeding.

E. Whenever the result of ADR will be binding or subject only to limited review, all parties should have access to civil discovery to the degree necessary to the claims and defenses presented. In particular, consumers should always have access to the complete file, if any exists, about their claim or dispute, and to evidence indicating that any problem they allege is part of a larger pattern or practice of the business.

F. Standard form consumer contract ADR clauses should be invalid if the preselected ADR provider does

not require that the officer who presides at the ADR proceeding must swear all the witnesses to tell the truth.

G. Standard form contract ADR clauses in consumer contracts should be disallowed unless they provide that the consumer may appeal for review of alleged errors.

H. ADR providers selected in consumer form contracts must provide for waiver of fees and costs for indigent individuals.

I. ADR clauses in consumer form contracts should be invalid if they select an ADR provider which does not have an effective method of internal review to reduce the risk of selection bias. This is of critical importance. State licensing of ADR providers may also be necessary.

J. ADR providers selected in consumer form contracts must provide a written statement of the basis for any decision which is binding when issued.

K. Conflict of interest disclosures should be made by all proposed single ADR decision makers and all who are proposed to serve as a so-called "neutral third." At least the following should be disclosed:

- Names of prior or pending cases involving any party to the ADR agreement or any attorney for any of the parties in which that person is serving or has served as an arbitrator, party or attorney.

- The results of each concluded case involving any of the parties or attorneys for the current case, including the identity of the prevailing party and the date and amount of any award.

After disclosure, the consumer should have the right to reject the proposed decision maker.

L. ADR should never be used to eliminate or delay a consumer's access to a small claims court action, licensing or other administrative proceeding, or a consumer class action.

NCLC Model State Law Preserving Individual Rights and Limiting Mandatory Arbitration

Preservation of Legal Rights

1. Prior to a dispute arising, a written agreement shall not waive or have the practical effect of waiving the rights of a party to that agreement to resolve that dispute by obtaining:

   a) Injunctive, declaratory, or other equitable relief;
   b) Relief on a class-wide basis;
   c) Punitive damages;
   d) Multiple or minimum damages as specified by statute;
   e) Attorney fees and costs as specified by statute or as available at common law; or
   f) A hearing where that party can present evidence in person.

2. Prior to a dispute arising, a written agreement shall not require or have the practical effect of requiring that any aspect of a resolution of a dispute between the parties to the agreement be kept confidential. This provision shall not affect the rights of the parties to agree that certain specified information is a trade secret or otherwise confidential or to later agree, after the dispute arises, to keep a resolution confidential.

3. Any provision in a written agreement violating this Act shall be void and unenforceable. A court may refuse to enforce other provisions of the agreement as justice dictates.

4. Any person who is a party to such an agreement can bring an action in court to reform such an agreement so that it complies with this Act. The party or parties responsible for drafting the offending provisions shall be liable for the reasonable attorney fees and costs of the person or entity bringing the action, where that action prevails or where, after the action is commenced, the parties reform the contract voluntarily.

5. Should a court decide that any provision of this Act is unconstitutional, preempted, or otherwise invalid, that provision shall be severed and such decision shall not affect the validity of the Act other than the part severed.

Commentary on Model Law Dealing with Preservation of Legal Rights

This provision reaffirms the state's policy of using the rights of private litigants to effectuate justice for all of a state's citizens. Written agreements should not waive, prior to a dispute arising, individual rights that benefit the justice system as a whole. For example, the threat of punitive damages deters misconduct aimed at others. State authorization of class actions, statutory minimum or multiple damages, and statutory attorney fees all encourage private litigation to remedy law violations where law enforcement would otherwise be impractical. Injunctive relief can provide protections for other citizens. The state also has an interest in court orders being publicized so that other citizens can be better informed, and for litigants to appear in person to present their grievances in public.

The NCLC model does not in any way prevent parties, after a dispute arises, from settling the manner with a confidentiality clause or without providing for statutory remedies. Nor does the model in any way limit the ability of parties to agree, prior to a dispute arising, to settle the matter via arbitration. The model just prevents waiver of certain individual rights whose preservation is important for the operation of the justice system, whether the dispute is resolved in court, in arbitration, or otherwise. Such waivers are present both in arbitration clauses and elsewhere in contracts, and the state has an interest in prohibiting such waivers wherever they appear.

This model law is not targeted at arbitration agreements, but requires courts to void any contractual provision (in an arbitration clause or elsewhere in a contact) that waives, prior to a dispute, enumerated individual rights that implicate important state interests. The model law's generality thus does not run afoul of the FAA. The FAA specifically allows courts to refuse to enforce provisions "upon such grounds as exist at law or equity for the revocation of any contract."

Because the NCLC model applies to any contract involving any person, it avoids court rulings that preempt state statutes whose scope is more limited. At least four circuits interpret very literally "any contract" in the above quoted FAA language, and find FAA preemption where a state statute specifies grounds to revoke any contract, but where the statute is limited to contracts involving only consumers or only franchisees. See Ting v. AT & T, 319 F.3d 1126(9th Cir. 2003); Saturn Distribution Corp. v. Paramount Saturn, Ltd., 326 F.3d 684 (5th Cir. 2003); Bradley v. Harris Research, Inc., 275 F.3d 884 (9th Cir. 2001); OPE Int'l Ltd. P'ship v. Chet Morrison Contractors, Inc., 258 F.3d 443 (5th Cir. 2001); KKW Enterprises, Inc. v. Gloria Jean's Gourmet Coffees Franchising Corp., 184 F.3d 42 (1st Cir. 1999); Doctor's Associates, Inc. v. Hamilton, 150 F.3d 157 (2d Cir. 1998); see also Mgmt. Recruiters Int'l, Inc. v. Bloor, 129 F.3d 851, 856 (6th Cir. 1997).

An Act to Amend the State Insurance Code Relating to Arbitration Agreements

1. For purposes of this act, "consumer" shall mean any individual who uses, purchases, acquires, attempts to purchase or acquire, or is offered or furnished insurance for personal, family, or household purposes.

2. Provisions in any written agreement that involve the offering of insurance and that require a consumer to submit a controversy relating to insurance thereafter arising to arbitration are contrary to the established public policy of this state.

3. The inclusion of such mandatory arbitration clauses in insurance policies involving consumers, or in other written agreements involving the offering of insurance to a consumer, materially affects an integral part of the policy relationship between the insurer and insured and impacts upon the transfer or spreading of risk between insurer and insured.

4. A written contract for insurance with a consumer or other written agreement involving the offering of insurance to a consumer, that requires the submission to arbitration of any controversy related to the insurance transaction thereafter arising between the parties, is hereby prohibited, and any such arbitration provision is hereby declared invalid, unenforceable, and void. Any such arbitration provision shall be considered severable, and other provisions of the contract for insurance shall remain in effect and given full force.

5. If a written agreement that involves both insurance and any other services, goods, property, or credit includes a mandatory arbitration provision, there shall be a clear and conspicuous disclosure that the mandatory arbitration provision does not apply to any insurance-related dispute.

6. A party violating this Act shall be liable to the consumer in an amount equal to the sum of any actual damage sustained by the consumer as a result of the violation, plus $100, even if no actual damage is proved, plus costs of the action, together with a reasonable attorney's fee. Any provision requiring that such an action to enforce this Act be submitted to arbitration is void and unenforceable, unless the consumer agrees to arbitration after filing suit or after otherwise notifying the other party as to the violation.

7. Should a court decide that any provision of this act is unconstitutional, preempted, or otherwise invalid, that provision shall be severed, and such a decision shall not affect the validity of the act other than the part severed.

Commentary on Model Law Limiting Arbitration in Insurance Transactions

Although the Federal Arbitration Act (FAA) generally preempts state laws that limit the enforceability of arbitration agreements, state insurance legislation is an exception. The federal McCarran-Ferguson Act, 15 U.S.C. §1012(b), states that no federal law shall invalidate or impair a state statute regulating insurance unless the federal law specifically relates to insurance. Since the FAA does not specifically relate to insurance, state insurance law can prohibit arbitration agreements in insurance transactions. Just a sampling of cases upholding state restrictions on arbitration in insurance transactions includes: *Standard Sec. Life Ins. Co. of N.Y. v. West*, 267 F.3d 821 (8th Cir. 2001); *Quackenbush v. Allstate Ins. Co.*, 121 F.3d 1372 (9th Cir. 1997); *Stephens v. Am. Int'l Ins. Co.*, 66 F.3d 41 (2d Cir. 1995); *Mut. Reinsurance Bureau v. Great Plains Mut. Ins. Co.*, 969 F.2d 931 (10th Cir. 1992); *Balaban-Zilke v. Cigna Healthcare of Cal.*, Inc., 2003 WL 21228038 (Cal. Ct. App. May 28, 2003); *Allen v. Pacheco*, 2003 WL 21310267 (Colo. June 9, 2003); *Cont'l Ins. Co. v. Equity Residential Properties Trust*, 565 S.E.2d 603, 255 Ga. App. 445 (2002).

The NCLC model invalidates pre-dispute arbitration clauses in any insurance transaction involving consumers. The model makes explicit that it is only regulating the business of insurance, avoiding the trap found in certain cases where a statute was found to generally regulate contracts and where McCarran-Ferguson was thus found not to apply. See *Hart v. Orion Ins. Co.*, 453 F.2d 1358 (10th Cir. 1971).

Only a relatively small number of states now limit mandatory arbitration in insurance transactions, and these often apply to only limited lines of insurance. On the other hand, mandatory arbitration in insurance is particularly troublesome because punitive damages via a jury trial and the attendant publicity is the most effective deterrent to the widespread insurer practice of delaying and refusing to pay legitimate insurance claims.

Advocates should also follow a proceeding by the National Association of Insurance Commissioners (NAIC) that is considering how to treat arbitration requirements in insurance transactions. Based on past history, the NAIC's initial interest in limiting arbitration clauses in insurance may be dramatically amended in response to industry pressures.

Because insurance is often sold in conjunction with other transactions, NCLC's model state law also requires disclosure in such a mixed transaction that an arbitration agreement does not apply to insurance. An effective remedy is provided where disclosure in mixed transactions is not made.

Disclosure of Arbitration Costs to Consumers

1. (a)A "consumer arbitration agreement" is defined as a standardized contract where one party drafts a provision that requires disputes arising after the contract's signing be submitted to binding arbitration, and the other party is a consumer. Such an agreement does not include a public or private sector collective bargaining agreement.
   (b) Consumer is defined for purposes of this Act as an individual who either:

   i). uses, purchases, acquires, attempts to purchase or acquire, or is offered or furnished any real or personal property, tangible or intangible goods, services, or credit for personal, family, or household purposes; or
   ii) is an employee of or seeks employment from the other party to the agreement.

2. A party drafting a consumer arbitration agreement shall clearly and conspicuously disclose in regard to any arbitration:
   a) The filing fee;
   b) The average daily cost for an arbitrator and hearing room if the consumer elects to appear in person;
   c) Other charges that the arbitrator or arbitration service provider will assess in conjunction with an arbitration where the consumer appears in person;
   d) The proportion of these costs which each party bears in the event that the consumer prevails, and in the event that the consumer does not prevail.

3. The costs specified in section (2) need not include attorney fees, and, to the extent that, with regard to the disclosures required by section (2), a precise amount is not known, the disclosures may be based on reasonable, good faith estimates. A party providing a reasonable, good faith cost estimate shall not be liable in any manner for the fact that the actual cost of a particular arbitration varies from the estimate provided.

4. Failure to comply with this Act is not grounds to refuse to enforce an arbitration agreement. However, the information provided in the disclosure can be considered in a determination whether an arbitration agreement is unconscionable or otherwise is not enforceable under other law.

5. Where this Act is violated, any person or entity, including the State Attorney General, can request a court to enjoin the drafting party from violating the Act as to agreements it enters into in the future. The drafting party shall be liable to the person or entity bringing such an action for that person or entity's reasonable attorney fees and costs where the court issues an injunction or where, after the action is commenced, the drafting party voluntarily complies with the Act.

6. Should a court decide that any provision of this act is unconstitutional, preempted, or otherwise invalid, that provision shall be severed, and such a decision shall not affect the validity of the act other than the part severed.

Commentary on Model Law Requiring Disclosures in Arbitration Agreements

The Supreme Court has limited the ability of states to precondition an arbitration agreement's enforceability on the drafter's compliance with certain disclosure requirements. See *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 116 S. Ct. 1652, 134 L. Ed. 2d 902 (1996). The NCLC model avoids such preemption issues because it does not make failure to disclose grounds for finding the arbitration agreement unenforceable. Instead, any party can seek an injunction to order the party proposing the arbitration clause to comply with the disclosure requirement in the future. The disclosure law thus does not affect the enforceabilty of the arbitration clause, but provides a practical mechanism to insure compliance with the statute.

The NCLC model focuses on the disclosure of the costs of arbitration (which can be many thousands of dollars for an in-person hearing), but a similar approach could require other disclosures relating to an arbitration agreement, such as requiring the arbitration clause to be in large type or on the front page of a contract. The NCLC model focuses on costs because this information will allow the consumer to assess, after a dispute arises, whether the arbitration process will be affordable. The disclosure will also aid the consumer to decide whether they should agree to the arbitration requirement in the first place.

The provision requires disclosure of the cost of an arbitration if the consumer opts for an in-person hearing, presenting witnesses and other evidence. Nothing prevents the other party from also disclosing the cost of an abbreviated arbitration procedure where the consumer would opt for a procedure limited to written submissions or to a telephone conference call.

The disclosure as to who pays the costs will also require corporations propounding the arbitration requirement to specify whether costs will be shared or picked up by the corporation. Too often today, corporations only agree to pick up the costs after the consumer has effectively argued in court that the costs make arbitration unaffordable, and thus unenforceable. Meanwhile, other consumers are deterred from pursuing arbitration because they assume they will have to pick up half the costs, as specified in either the arbitration agreement or the rules of the arbitration service provider.

Limitation on Consumer Arbitration Agreements

1. (a)A "consumer arbitration agreement" is defined as a standardized contract where one party drafts a provision that requires disputes arising after the contract's signing be submitted to binding arbitration, and the other party is a consumer. Such an agreement does not include a public or private sector collective bargaining agreement.
   (b) Consumer is defined for purposes of this Act as an individual who either:

   i). uses, purchases, acquires, attempts to purchase or acquire, or is offered or furnished any real or personal property, tangible or intangible goods, services, or credit for personal, family, or household purposes; or
   ii) is an employee of or seeks employment from the other party to the agreement.

2. A consumer arbitration agreement is void and unenforceable except to the extent federal law provides for its enforceability.

Commentary on Model Law Limiting Consumer Arbitration Where Federal Law Does Not Apply

NCLC's model law also includes a provision whereby a state announces its opposition to pre-dispute arbitration clauses in consumer transactions, and provides that they are unenforceable unless the FAA provides for their enforceability. This will have immediate effect for any transaction not in interstate commerce, and thus not subject to the FAA. In addition, were Congress ever to exempt certain transactions from the FAA's scope (instead of outlawing arbitration clauses in those transactions outright), then state law would be in place to prohibit such clauses. Otherwise, state law might require that the clause be enforceable, despite the amendment to the FAA.

An Act to Regulate Arbitration Service Providers

1. The following definitions apply for the purposes of this Act:

(a) Consumer arbitration is a binding arbitration where one party is a consumer.
(b) Consumer is an individual who has a dispute relating to that individual's status as:

i) a user, purchaser, or one who attempts to use or purchase, any real or personal property, tangible or intangible goods, services, or credit for personal, family, or household purposes.
ii) an enrollee, subscriber or insured under a health care plan or health care insurance, or an individual with a medical malpractice claim;
iii) an employee or applicant for employment, except where an arbitration is pursuant to the terms of a public or private sector collective bargaining agreement.
(c) "Financial interest" is holding a position in a business as officer, director, trustee or partner or holding any position in management; or ownership of more than five percent interest in a business.

2. (a) Any private arbitration company that administers or is otherwise involved in 50 or more consumer arbitrations a year shall collect, publish at least quarterly, and make available to the public in a computer-searchable format, which shall be accessible at the Internet Web site of the private arbitration company, if any, and on paper upon request, all of the following information regarding each consumer arbitration within the preceding five years:

(i) The name of any corporation or other business entity that is a party to the arbitration;
(ii) The type of dispute involved, including goods, banking, insurance, health care, debt collection, employment, and, if it involves employment, the amount of the employee's annual wage divided into the following ranges: less than one hundred thousand dollars ($100,000), one hundred thousand dollars ($100,000) to two hundred fifty thousand dollars ($250,000), inclusive, and over two hundred fifty thousand dollars ($250,000).
(iii) Whether the consumer was the prevailing party.
(iv) On how many occasions, if any, a business entity that is a party to an arbitration has previously been a party in an arbitration or mediation administered by the private arbitration company.
(v) Whether the consumer party was represented by an attorney.
(vi) The date the private arbitration company received the demand for arbitration, the date the arbitrator was appointed, and the date of disposition by the arbitrator or private arbitration company.
(vii) The type of disposition of the dispute, if known, including withdrawal, abandonment, settlement, award after hearing, award without hearing, default, or dismissal without hearing.
(viii) The amount of the claim, the amount of the award, and any other relief granted, if any.
(ix) The name of the arbitrator, his or her total fee for the case, and the percentage of the arbitrator's fee allocated to each party.

(b) If the required information is provided by the private arbitration company in a computer-searchable format at the company's Internet Web site and may be downloaded without any fee, the company may charge the actual cost of copying to any person who requests the information on paper. If the information required is not accessible by the Internet, the company shall provide that information without charge to any person who requests the information on paper.

(c) A private arbitration company that administers or conducts fewer than 50 consumer arbitrations per year may collect and publish the information required by subdivision (a) semiannually, provide the information only on paper, and charge the actual cost of copying.

(d) No private arbitration company shall have any liability for collecting, publishing, or distributing the information in accord with this section.

3. (a) All fees and costs charged to or assessed in this state upon a consumer by a private arbitration company in a consumer arbitration, shall be waived for any person having a gross monthly income that is less than 300 percent of the federal poverty guidelines.
(b) Nothing in this section shall affect the ability of a private arbitration company to shift fees that would otherwise be charged or assessed upon a consumer party to another party.

(c) Prior to requesting or obtaining any fee, a private arbitration company shall provide written notice of the right to obtain a waiver of fees in a manner calculated to bring the matter to the attention of a reasonable consumer, including, but not limited to, prominently placing a notice in its first written communication to a consumer and in any invoice, bill, submission form, fee schedule, rules, or code of procedure.

(d) Any consumer requesting a waiver of fees or costs may establish eligibility by making a declaration under oath on a form provided by the private arbitration company indicating the consumer's monthly income and the number of persons living in the household. No private arbitration company may require a consumer to provide any further statement or evidence of indigency.

(e) Any information obtained by a private arbitration company about a consumer's identity, financial condition, income, wealth, or fee waiver request shall be kept confidential and may not be disclosed to any adverse party or any nonparty to the arbitration, except a private arbitration company may not keep confidential the number of waiver requests received or granted, or the total amount of fees waived.

4. No neutral arbitrator or private arbitration company shall administer a consumer arbitration under any agreement or rule requiring that a consumer who is a party to the arbitration pay the fees and costs incurred by an opposing party if the consumer does not prevail in the arbitration, including, but not limited to, the fees and costs of the arbitrator, provider organization, attorney, or witnesses.

5. No private arbitration company may administer a consumer arbitration to be conducted in this state, or provide any other services related to such a consumer arbitration, if
(a)The private arbitration company has, or within the preceding year has had, a financial interest in any party or attorney for a party.

(b) Any party or attorney for a party has, or within the preceding year has had, any type of financial interest in the private arbitration company.

6. Where this Act is violated, any affected person or entity, including the State Attorney General, can request a court to enjoin the private arbitration company from violating the Act and order such restitution as appropriate. The private arbitration company shall be liable for that person or entity's reasonable attorney fees and costs where that person or entity prevails or where, after the action is commenced, the private arbitration company voluntarily complies with the Act.

7. Should a court decide that any provision of this act is unconstitutional, preempted, or otherwise invalid, that provision shall be severed, and such a decision shall not affect the validity of the act other than the part severed.

Commentary on Model Law (Patterned After California Statutes) That Regulates Arbitration Service Providers

The Federal Arbitration Act (FAA) does not preempt reasonable state regulation of arbitration service providers, such as the American Arbitration Association (AAA) or the National Arbitration Forum (NAF). As long as the regulation does not indirectly limit the enforceability of an arbitration provision, nothing in the FAA prevents such regulation.
California has recently enacted a series of such laws regulating arbitration service providers. See, e.g., Cal. Code Civ. Proc. §§ 1281.9, 1281.92, 1281.96, 1284.3. The NCLC model is closely patterned on four of the California provisions.

One NCLC provision requires arbitration service providers (not the individual arbitrators) to disclose information about individual cases and their outcome, how frequently a business uses the same arbitration service provider, how long arbitrations take, how much arbitrators are paid, and who pays them. This provision will not only provide useful information to consumers, but will also allow for independent analysis that can point to any bias by AAA, NAF, or other providers in favor of business litigants.
A second provision requires waiver by the arbitration service provider of filing fees for low income consumers. The provision does not require waiver of the fees paid to cover the arbitrator's time, which can be significantly greater.

A third provision prohibits arbitration service providers from administering arbitrations where a non-prevailing consumer must pay the other side's arbitration costs or attorney fees. Otherwise, there would be serious risk for any consumer to proceed with arbitration, where the costs could be many times greater than the potential recovery. A final provision prohibits arbitrations where the arbitration service provider has a financial interest in one of the litigants, or where one of the litigants has a financial interest in the arbitration service provider.

While the California statutes do not provide for an explicit private remedy where arbitration service providers fail to comply with the statutory requirements, other California law provides generally for a private remedy for any law violation. For states other than California where this is not the case, a private remedy must be incorporated into the actual law regulating the arbitration service provider. The NCLC model does this.