California Arbitration Reform:
The Aftermath

By Ruth V. Glick*

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. For the most part, the courts in California have enforced these arbitration agreements, so long as they are not unconscionable.1

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1. See, e.g., Armendariz v. Found. Health Psychcare Servs. Inc., 6 P.3d 669, 682–93 (Cal. 2000) (not enforcing an employment mandatory arbitration agreement because of an unconscionable damage limitations clause, however, indicating that statutory claims can be vindicated through arbitration if certain minimum rights for the employee were present in the clause, including arbitrator neutrality, provision of adequate discovery, no limitation of remedies, and no expense to the employee greater than it would have been had the matter been taken to court); see also Little v. Auto Stiegler, 63 P.3d 979, 989 (Cal. 2003) (extending the Armendariz reasoning to apply these factors to non-statutory claims as well); Broughton v. Cigna, 988 P.2d 67, 76 (Cal. 1999) (enforcing the arbitration of common law and statutory health care claims but not claims for injunctive relief); Cruz v. PacifiCare
Given the steady judicial enforcement of these agreements, consumer advocates have become frustrated with federal and state inaction to limit mandatory arbitration. In the fall of 2001, the San Francisco Chronicle ran a series of articles featuring horror stories about the inequities of arbitration, citing as problems the prospect for partiality by repeat player arbitrators hoping to be selected again and assertions about ties between arbitration provider organizations and those repeat players. While arbitration provider organizations claimed the series was inaccurate, the articles punctuated consumer concern with business-imposed arbitration.

I. California Legislation Aimed at Regulating Arbitrators and Arbitration Providers

The California Legislature took notice of the San Francisco Chronicle series, as did Governor Gray Davis, who was mindful of a recent arbitration dealing with state motor vehicle refunds in which embarrassingly large legal fees had been awarded. They wanted legislation that would protect consumers from the perceived inequities of mandatory arbitration. However, there had been a barrier in drafting such legislation because the United States Supreme Court has clearly held that state legislation cannot treat arbitration agreements in contracts differently than it treats provisions in contracts as a whole. In Doctor's Associates, Inc. v. Casarotto, the Supreme Court struck down a Montana state law that called for certain notice requirements in arbitration contracts, holding that section 2 of the Federal Arbitration Act ("FAA") preempted the Montana law. The FAA states that written ar-

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3. In that arbitration, a panel of retired judges awarded $88.5 million in fees for lawyers in a smog fee refund case due to an absence of a cap on attorneys' fees. It became a political embarrassment for the Governor. See Rone Tempest, Judge Rejects $88.5-Million Fee for Lawyers, L.A. TIMES, Apr. 18, 2001, at A3.


5. Id. at 688; see also Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 281 (1995) ("States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause 'upon such grounds as exist at law or in equity for the revocation of any contract.' What States may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause.") (alteration in original) (citation omitted).
bitration agreements are valid, irrevocable, and enforceable save upon such grounds as exist at law or in equity for the revocation of any contract.6

A. Legislation Directed at Arbitrators

With this preemption challenge in mind, the legislature directed its regulation of arbitration not at the arbitration contract itself but at arbitrators and arbitration providers. Later in 2001 Senate Bill 475 was passed and signed by the Governor.7 The bill called for the adoption of additional ethics standards for neutral arbitrators to be drafted as minimum requirements, supplementing existing statutes.8 The standards were to be written by staff lawyers of the Judicial Council, which is the administrative and policy board of the California courts.9 A nineteen-member Blue Ribbon Panel of arbitrators, judges, lawyers, consumer advocates, legislative staff, and academics, all with diverse interests, weighed in on the issues.10

The Judicial Council staff and the Blue Ribbon Advisory Committee were confronted with the challenge of converting ethical standards, which are normally presented as aspirational,11 into mandatory statutory requirements with consequences for failure to comply.12 As a result of their efforts, The Ethics Standards for Neutral Arbitrators in Contractual Arbitration ("Ethics Standards") became effective July 1, 2002.13 They are incorporated into California Code of Civil Procedure Section 1281.85 and substantially expand arbitrator disclosure re-

8. See id. § 4 (codified at CAL. CIV. PROC. CODE § 1281.85 (West Supp. 2003)).
9. See id.; see also Francis O. Spalding, Judicial Council's Drafting of Arbitrator Ethics Standards Is Indefensible, S.F. DAILY J., Mar. 25, 2002 (making a case for separation of powers between legislative and judicial function and calling into question the propriety of the Judicial Council "legislating" rules for arbitrators).
10. See Jay Folberg, Arbitration Ethics—Is California the Future?, 18 OHIO ST. J. ON DISP. RESOL. 343, 345-46 (2003). The chair of the panel, appointed by the Chief Justice, was Jay Folberg, law professor and former dean of the University of San Francisco School of Law. See id. at 346 n.14.
12. See Folberg, supra note 10, at 346.
requirements, regulate arbitrator action, increase parties' ability to disqualify arbitrators, and may even provide additional grounds to vacate an award.\textsuperscript{14}

The Ethics Standards apply to all arbitrators in all contractual arbitrations in California. Standard 8 of the Ethics Standards additionally applies to all consumer arbitrations and requires arbitrators to make additional disclosures about the relationships between the provider organization and a party or lawyer involved in a consumer arbitration.\textsuperscript{15}

B. Legislation Directed at Arbitration Providers

Since the Ethics Standards only have jurisdiction over arbitrators and not arbitration provider organizations,\textsuperscript{16} the California Legislature enacted additional statutes to regulate the arbitration providers in 2002. Under these statutes private alternative dispute resolution ("ADR") providers now must provide specific data about arbitrations they have administered within the past five years.\textsuperscript{17} They must post the data on an internet website in a computer-searchable format.\textsuperscript{18} The information must include names of non-consumer parties, how many times they have been parties to an arbitration administered by the ADR provider, the type of dispute, the amount of the claim, and the name and fee of the arbitrator.\textsuperscript{19}

Arbitration providers are also restricted from administering any consumer arbitrations if the provider has had any type of financial involvement with a party or attorney within the past year, or if they have a financial interest in the provider.\textsuperscript{20} All costs must be waived for indigent consumers,\textsuperscript{21} and neither arbitrators nor arbitration providers may impose costs or fees on a non-prevailing consumer, even if there is a "loser pays" provision in the agreement.\textsuperscript{22}
Governor Davis vetoed one of the 2002 legislative bills because of its complexity.23 There are two current proposed pieces of legislation. In one proposal, fees can be disgorged from the arbitration provider, and further administration of the case is precluded if the arbitration is vacated by a court.24 Another bill would eliminate the exclusive designation of any one private arbitration provider in an arbitration agreement, allowing the consumer to have the option to switch arbitrators and arbitration providers when a dispute arises.25

II. The California Ethics Standards

The California Ethics Standards promulgated by the Judicial Council mandate comprehensive and specific rules for arbitrator disclosure and conduct. They apply to all neutral arbitrators conducting contractual arbitrations in California, with certain listed exclusions.26 The rules expand an arbitrator’s duty of reasonable inquiry, which requires that at a minimum, an arbitrator must disclose “all matters that could cause a person aware of the facts to reasonably entertain a doubt that the proposed arbitrator would be able to be impartial.”27 Arbitrators must disclose any connection to the parties or attorneys, as well as any connection the parties or attorneys have to the arbitrator’s immediate or extended family.28

If an arbitrator wishes to entertain offers for other professional relationships such as that of a mediator or other dispute resolution neutral, the arbitrator must disclose to all parties in writing within ten days of nomination that he or she will entertain such offers of employment.29 A party may then disqualify the arbitrator based on this disclo-
If no disclosure is made, the arbitrator is prohibited from entering into any new dispute resolution relationship with the parties or attorneys while the arbitration is pending.\textsuperscript{31}

Existing legislation requires an arbitrator to disclose information from prior arbitrations within the past five years, including the service, result, prevailing party, and monetary damages awarded in any prior arbitration that involved any of the current parties or attorneys.\textsuperscript{32} The Ethics Standards require arbitrators to provide a summary of that information if there have been more than five cases with any of the current parties or attorneys.\textsuperscript{33} In addition, for the first time, the Ethics Standards require an arbitrator to also disclose compensated service as another dispute resolution neutral such as mediator, referee, or neutral evaluator for the prior two years in which he or she served in a dispute involving a party or a lawyer for the party.\textsuperscript{34}

In addition to disclosures, several provisions of the Ethics Standards now regulate arbitrator conduct. An arbitrator must conduct the arbitration fairly, promptly, and diligently;\textsuperscript{35} must not have ex parte communications with the parties;\textsuperscript{36} must not use any information received in confidence for personal advantage;\textsuperscript{37} must be truthful and accurate in marketing;\textsuperscript{38} and may not belong to any organization practicing invidious discrimination on the basis of race, sex, religion, national origin, or sexual orientation.\textsuperscript{39}

More information must be provided when the arbitration is one involving a consumer, employment, or health care contract.\textsuperscript{40} It is the arbitrator’s responsibility to disclose relationships between the arbitration provider organization and a party, lawyer, or law firm in the arbitration.\textsuperscript{41} Gifts, favors, and any current or expected business between the provider organization and a party or lawyer must also be disclosed by the arbitrator.\textsuperscript{42} In addition, the arbitrator must disclose any finan-

\textsuperscript{30} Id. std. 12(b).
\textsuperscript{31} Id. std. 12(c).
\textsuperscript{32} CAL. CIV. PROC. CODE § 1281.9.
\textsuperscript{33} ETHICS STANDARDS, supra note 13, std. 8(b)(3).
\textsuperscript{34} Id. std. 7(d)(5).
\textsuperscript{35} Id. std. 13.
\textsuperscript{36} Id. std. 14.
\textsuperscript{37} Id. std. 15.
\textsuperscript{38} Id. std. 17.
\textsuperscript{39} Id. std. 7(d)(13).
\textsuperscript{40} Id. std. 8.
\textsuperscript{41} Id. std. 8(b)(1).
\textsuperscript{42} Id.
cial relationships he or she may have with the provider organization, including membership.\textsuperscript{43}

The duty to disclose is a continuing duty.\textsuperscript{44} Disclosures need to be made within ten days of appointment,\textsuperscript{45} and if disclosure is made after ten calendar days, or a party becomes aware that the arbitrator made a material omission or misrepresentation, a party may serve a notice of disqualification.\textsuperscript{46} Arbitrators may be disqualified within fifteen days after failure to make a timely disclosure.\textsuperscript{47}

III. Arbitrator Reaction to the New Ethics Standards

The initial reaction of arbitrators upon the implementation of these Ethics Standards was disbelief. Why was the Legislature, and particularly the Judicial Council, drafting rules that single out arbitrators? After all, arbitrators are not responsible for originally imposing non-negotiated arbitrations, they are only the neutral decision-makers trying to bring about a fair resolution. Nothing in the new Ethics Standards would remedy the real problems of imposed arbitration.\textsuperscript{48}

Arbitrators overwhelmingly agree with the premise that the arbitration process must be fair and impartial and that it is prudent to disclose any possible connection to the parties or lawyers, but the new Ethics Standards now obligate them to comply with twenty-seven additional pages of detailed disclosure rules. Before the Ethics Standards became law, arbitrators in California were already subject to the nation's most comprehensive statutory disclosure requirements.\textsuperscript{49} With

\textsuperscript{43} Id. std. 8(c)(1).
\textsuperscript{44} Id. std. 4.
\textsuperscript{45} CAL. CIV. PROC. CODE § 1281.9(b) (West Supp. 2003).
\textsuperscript{46} See id. § 1281.91.
\textsuperscript{47} Id.
\textsuperscript{48} See Spalding, supra note 9:
Few experienced in arbitration would deny that there are problems in the wholesale use of adhesive arbitration clauses imposed upon unwitting individuals without the bargaining power or knowledge to resist them. Imposition of a process that, unlike the courts, is not subsidized, in cases where the individual likely cannot afford to pay, or where its costs are excessive in light of the sums likely in issue, is no less problematic.

Nothing in the Judicial Council's draft Arbitrator Ethics Standards will remedy these problems, most or all of which cannot be cured effectively while the Federal Arbitration Act continues to mandate enforcement of most arbitration clauses in adhesive contracts not found unconscionable.

\textsuperscript{49} California, unlike other states, has enacted a number of disclosure statutes including California Code of Civil Procedure section 1281.9, the general disclosure statute which incorporates by reference section 170.1, the standards for disqualification of judges. In addition, section 1281.95 has special requirements for residential disputes, and section 1297.121 has special requirements for international arbitrations. The California disclosure
these new Ethics Standards, even an inadvertent failure to comply with the additional technical rules could destabilize the finality of all arbitrations and perhaps even put them at personal risk for costs of a vacated arbitration.

The California Arbitration Act contains several statutory provisions requiring specific disclosures about connections to the parties and their attorneys. One statute requires comprehensive disclosures by the arbitrator, including “all matters that could cause a person aware of the facts to reasonably entertain a doubt that the proposed neutral arbitrator would be able to be impartial.” In addition, the arbitrator is required to comply with another statute governing the grounds for disqualification of a judge. The California Ethics Standards simply repeat many of the same disclosure requirements. However, by emphasizing the same language and combining it with additional detailed directives, arbitrators are worried about the unintended consequences. Too many detailed directives could create new loopholes to challenge otherwise non-contestable arbitration awards.

Because of the complexity of compliance and the potential for inadvertent non-disclosure, some arbitrators have crafted agreements which ask the parties to waive certain provisions of the Ethics Standards. Interestingly, the Ethics Standards are silent on such waivers, so apparently do not prohibit them. Some arbitrators require parties to waive provisions such as those requiring more tedious efforts to determine if they have any connections to extended family members.

These arbitrators are making disclosures as comprehensive as they can without undergoing a broad and wide-ranging search of family member connections.


50. CAL. CIV. PROC. CODE § 1281.9 (also requiring arbitrators to disclose names of all parties, dates, results, prevailing party and monetary damages awarded in any prior arbitration within the previous five years involving the same parties or attorneys).

51. Id. § 1281.9(a)(1) (referencing CAL. CIV. PROC. CODE § 170.1).

52. Information derived from personal communications between author and arbitrators about arbitrator declarations accompanying disclosures before appointment.

53. Id.

54. There is some confusion about how comprehensive these disclosures should be. Compare ETHICS STANDARDS, supra note 13, std. 9(b) (allowing an arbitrator to fulfill the disclosure obligation regarding family by asking immediate and extended family members living in the household), with stds. 7(d)(1), 7(d)(2), and 7(d)(12) (requiring the disclosure of relationships that extended family members may have to parties and attorneys in the dispute as well as any knowledge they may have about the dispute), and std. 2(n) (de-
Arbitrators believe that the Ethics Standards were prompted by the perception that repeat-player arbitrators might be more interested in re-appointment than justice. Consequently, the Ethics Standards were drafted with a presumption that any pre-appointment disclosure that reveals the arbitrator had worked with a party or attorney previously taints the arbitrator with bias. Statutes already required the disclosure of arbitrations with the same parties before the Ethics Standards were enacted.55 However, just because an arbitrator may have dealt with the same attorneys or parties previously does not necessarily mean the arbitrator is biased. Rather, it may mean that the arbitrator is familiar with a particular profession or area of law. As Justice White wrote in a seminal Supreme Court case, “It is often because they are men [sic] of affairs, not apart from but of the marketplace, that they are effective in their adjudicatory function.”56

It is important to note that repeat players in the arbitration process are not only arbitrators, but are also the same business entities and the same plaintiff and defense attorneys. Since attorneys are the ones who choose the arbitrators, they are often in a position to know much more about conflicts than lawmakers acknowledge. In fact, it is curious that both the Legislature and the Judicial Council are reluctant to obligate attorneys and parties to make disclosures of any conflicts or relationships they may have with the arbitrator. Instead, it is the sole responsibility of the arbitrator to discover and make those disclosures even though information about his or her extended family and former spouse’s connections may be within the purview of the law firms. Arbitrators can ask lawyers in writing if they are aware of any other possible relationships. They must then declare in writing that an inquiry has been made and attach copies of inquiry and any responses.57 Because arbitrators must make disclosures within a 10-day

56. Commonwealth Coatings Corp. v. Cont’l Cas. Co., 393 U.S. 145, 150 (1968) (White, J., concurring) (holding that an arbitrator should disclose any dealings that might create an impression of possible bias). The separate and concurring opinion of Justice White stated that an arbitrator need only disclose when he or she has a substantial interest in a firm that has done more than trivial business with a party. Justice Black’s majority opinion and Justice White’s concurring opinion, while complementary, are contradictory, and have challenged courts to develop a clear standard. See Ruth V. Glick, Arbitrator Disclosure: Recommendation for a New UAA Standard, 13 Ohio St. J. on Disp. Resol. 89, 94–97 (1997).
57. Ethics Standards, supra note 13, std. 9(c).
period before appointment, it is unlikely that a response from the lawyers will be given within that time frame. Because the Legislature did not authorize the Judicial Council to have jurisdiction over anyone but arbitrators, attorneys technically do not have to comply.

IV. Potential Problems Under the Ethics Standards

A. Materiality

As practitioners see it, the most serious shortcoming of the Ethics Standards is the failure to impose materiality standards. Any non-disclosure, no matter how immaterial, and any contravention of prescribed conduct, no matter how trivial, has the potential to become the basis for challenging the enforcement of the award. If the award is challenged, there is the potential for arbitrators to become the target of lawsuits brought by disgruntled parties.

Although the Ethics Standards state that they are "not intended to affect any existing civil cause of action or create any new civil cause of action," many practitioners are wary of challenges to arbitration awards that will hold the arbitrator liable for costs due to inadvertent non-compliance. For example, an arbitrator may not know about, and so inadvertently not disclose, a connection with an attorney who is married to, but has a different last name from, an attorney in the arbitration. Because attorneys technically do not have to comply with the arbitrator's request for disclosure of any conflicts they may have with the case, this scenario could balloon into a serious non-disclosure event undermining the finality of the decision and removing any economical advantage arbitration would have over civil litigation. It would also put the arbitrator at risk for costs of defense from a challenge to the award based on the arbitrator's innocent failure to know attorneys with different last names may be married to each other and may in some way be connected to the case.

B. Consumer Arbitration

The Ethics Standards apply to all arbitrations, both commercial and consumer. Standard 8 provides additional requirements for the arbitrator if the arbitration involves a consumer. A problem for arbitrators that may arise under the Ethics Standards is the possible mis-

58. See Folberg, supra note 10, at 345.
59. ETHICS STANDARDS, supra note 13, std. 1(d).
60. See id. std. 3.
61. See id. std. 8.
use of consumer status by parties. It is important to know at the outset whether the arbitration is considered commercial or consumer because arbitrations involving a consumer require the arbitrator to make additional disclosures. A "consumer party" is defined as anyone who acquires or leases goods or services primarily for personal, family, or household purposes, a subscriber to a health services plan, an individual with a medical malpractice claim, or an employee or applicant for employment. Consumer arbitrations are those arising from pre-dispute provisions of a contract with a consumer party who was required to accept the arbitration provision that was drafted by the non-consumer party.

If a party does not fall within these definitions but still maintains that he or she is a consumer party, the arbitrator may face a challenge. Arbitrators in consumer arbitrations are required at the outset to provide additional information about the ADR provider organization, including any conflicts or financial relationships it may have with the parties or attorneys. Arbitrators are only excused from providing this additional information if they reasonably believe that the arbitration is one not classified as consumer. In administered arbitrations, the arbitration provider will probably make the determination of consumer status. When a party disagrees with that determination, it creates a dilemma for the arbitrator who is subject to the authority of the Ethics Standards, and who still needs to decide upon appointment whether to make the additional required disclosures.

C. Unintended Consequences of the Ethics Standards

Statutes enacted by the Legislature for arbitration providers have resulted in unintended consequences. One such statute, California Code of Civil Procedure Section 1281.96, requiring arbitration providers to collate and provide information on a searchable internet website, was intended to identify large repeat users. But an unfortunate by-product of this requirement was the disproportionate effect the cost of collecting and maintaining information about consumer arbitrations had on small, community-based providers. Even though small providers conducting fifty or fewer consumer arbitrations a year need only provide data on paper semiannually, some of those community-

62. See id.
63. Id. std. 2(e).
64. Id. std. 2(d).
65. See id. std. 8.
66. Id. std. 8(a)(2).
based providers with limited funds decided to eliminate arbitration services for small claims altogether.\(^67\)

If community arbitration programs disappear, small businesses, individuals, and consumers may increasingly turn to mediation as a solution. Mediation can be very effective in solving these disputes, but only when an arbitration or litigation date exists to motivate the parties to settle. Without a date for an adjudicative hearing, there is no pressure for parties to reach an agreement. Therefore, a decreased opportunity to arbitrate and decreased access to the judicial system for small cases may also result in less settlement motivation in mediation for parties who wish to resolve their own problems.

V. Court Challenges to the Ethics Standards by the Securities Industry

From the outset, self-regulatory organizations ("SRO") including the National Association of Securities Dealers ("NASD") and the New York Stock Exchange ("NYSE") asked the federal court to exempt them from the California Ethics Standards.\(^68\) They claimed there was already extensive federal oversight of SRO's by the Securities and Exchange Commission, and also that the Ethics Standards were preempted by the Federal Arbitration Act.\(^69\) The case was dismissed on Eleventh Amendment grounds.\(^70\) The NASD and the NYSE now ask California consumers with pending cases to either waive the Ethics Standards or have their cases heard in neighboring states.\(^71\)

Plaintiff attorneys representing customers were not happy about waiving the Ethics Standards in order to get their clients an arbitra-

\(^{67}\) See CAL. CIV. PROC. CODE § 1281.96 (West Supp. 2003). The San Diego Mediation Center is one community-based provider that at this time no longer administers consumer arbitrations. Personal Communication with Steve Dinkin, President, San Diego Mediation Center, in San Diego, Cal. (Sept. 2003).


\(^{70}\) Nat'l Ass'n of Sec. Dealers, 232 F. Supp. 2d at 1063–64 (finding that the council and the individual members of the council were immune from suit under the Eleventh Amendment), appeal docketed, No. 02-17413 (9th Cir. Dec. 16, 2002).

\(^{71}\) An NYSE arbitration rule states that the customer may either request that the appointment of arbitrators for a hearing be held outside California, or alternatively get a hearing in California by waiving the California Ethics Standards for the appointed arbitrators. See Mayo v. Dean Witter Reynolds, Inc., 258 F. Supp. 2d 1097, 1103 (N.D. Cal. 2003).
tion hearing in California, and some hoped to use the SRO’s refusal to abide by the Ethics Standards as grounds for moving their cases to court. In *Mayo v. Dean Witter Reynolds, Inc.*,72 an investment account customer moved to vacate a court order to compel arbitration on the grounds that the NYSE’s refusal to appoint an arbitration panel compliant with the new Ethics Standards was an intervening change in circumstances that required a denial of the motion to compel arbitration.73 In a long and contemplative decision, Judge Jeremy Fogel of the United States District Court ruled that the California Standards conflicted not only with the SRO’s own arbitration rules,74 but also with the comprehensive system of federal regulation of the securities industry pursuant to the Securities Exchange Act of 1934,75 and with the Federal Arbitration Act.76 Judge Fogel reasoned that to allow California and other states to adopt different requirements would conflict with the objectives of a federally regulated scheme of securities arbitration and would lead to inconsistent disclosures and disqualifications across the states.77

Since no appeal of this case is contemplated currently, arbitrators serving in SRO arbitrations in California, at least for now, are for all practical purposes exempt from the exacting requirements of the Ethics Standards. Those arbitrators must still comply with the equally demanding SRO disclosure rules. However, any challenge to an arbitration award may not be based on the Ethics Standards if Mayo’s interpretation of federal law stands. At least one California state court case has cited the federal district court Mayo decision as binding precedent.78

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72. *Id.*
73. *Id.* at 1099.
74. *Id.* at 1105–07.
The Ethics Standards have been in effect for about a year at the time of this writing.\textsuperscript{79} Several more securities industry cases are currently pending. One case on appeal to the Ninth Circuit involves an employee who filed a wrongful termination action and refused to sign any waiver of the California Ethics Standards as required by the NASD, and also refused to have his case heard in another state.\textsuperscript{80} This case is being closely watched to see if it follows the reasoning in Mayo.

The state appellate courts, however, have had conflicting rulings, with more cases on the docket. Recently, a state appellate court ruled that a customer dispute must be sent to the trial court when a SRO, here the NASD, refused to arbitrate in California under the Ethics Standards.\textsuperscript{81} The court disregarded Mayo, a federal case, and specifically did not rule on the preemption issue, stating that the issue has not been resolved yet in California, and that the NASD is involved actively in other litigation in the federal courts that will decide that question.\textsuperscript{82} In another new but unpublished decision, the court ruled that to require a customer to either waive the Ethics Standards or agree to arbitrate in a neighboring state was, in effect, a Hobson’s choice.\textsuperscript{83} Either way the customer must waive her right to compliance with the Ethics Standards.\textsuperscript{84} The court did not consider federal preemption because the issue was not briefed.\textsuperscript{85}

In contrast, a recent unpublished decision by a California appellate court allowed the arbitration to go forward despite arguments that the arbitration contract was facially illegal because it included a provision that requires waiver of the Ethics Standards, having the effect of waiving a statutory protection provided under California law.\textsuperscript{86}

\textsuperscript{79} The Standards went into effect on July 1, 2002. See Ethics Standards, supra note 13, std. 3(a).

\textsuperscript{80} Credit Suisse First Boston Corp. v. Grunwald, No. CV-02-02051-SBA (N.D. Cal. Apr. 7, 2003), appeal docketed, No. 03-15695 (9th Cir. April 15, 2003) (confirmed with Joseph E. Floren of Steefel, Levitt & Weiss, who represent plaintiff/appellee Credit Suisse First Boston Corp.).

\textsuperscript{81} The only exception would be if an out-of-state forum is proper. Alan v. Superior Ct., 3 Cal. Rptr. 3d 377, 380 (Ct. App. 2003), appeal docketed, No. S119245 (Cal. Sept. 23, 2003).

\textsuperscript{82} See id. at 388–89 (referring to Nat’l Ass’n of Sec. Dealers Dispute Resolution, Inc. v. Judicial Council of Cal., 232 F. Supp. 2d 1055 (N.D. Cal. 2002), appeal docketed, No. 02-17413 (9th Cir. Dec. 16, 2002)).


\textsuperscript{84} Id.

\textsuperscript{85} Id. at *9–10.

\textsuperscript{86} Rodriguez v. Morgan Stanley DW Inc., No. D040868, 2003 WL 22089385, at *5 (Cal. Ct. App. 2003) (finding that the contract was not illegal merely because it included a
At least three other securities cases are now pending in state appellate courts.87

Challenges to the Ethics Standards are just beginning and inconsistent rulings will lead to uncertainty about their validity and enforcement. Eventually, the California Supreme Court or the United States Supreme Court, or both, will be called upon to interpret the complexities these Standards have already engendered.88

VI. California Regulation Noticed in Other States

Some other pro-active state legislatures are beginning to form their own ideas about arbitrator disclosure and ethics and taking note of California’s lead in drafting such legislation. At least two other states, New York and Texas, have recently begun to draft legislation regulating arbitrator disclosure for commercial arbitrations. Neither state has passed such legislation yet. However, their approach is much different from California’s.

New York had selectively chosen some of the California requirements in its efforts to protect the state’s interest in fair and impartial securities arbitrations.89 New York’s proposed “Investment Banking and Research Reform Act” is geared to protect consumers from investment fraud.90 One part of this legislation exhorts securities arbitrators to comply with standards that seek to uphold the fairness of the arbitration process and maintain the impartiality of all participants.91 The provision that has the effect of waiving a statutory protection provided to a party under California law.


88. It is interesting to note that the court challenges to the Ethics Standards thus far have come from plaintiffs in securities industry cases where arbitration has been the norm since 1987. See Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220, 238 (1987) (compelling parties to arbitrate claims arising under the Securities and Exchange Act of 1934); Rodriguez de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477 (1989) (compelling parties to arbitrate claims arising under the Securities and Exchange Act of 1933). Yet, the push for last year’s arbitration reform came not from securities attorneys but from attorneys representing clients with employment or class action suits.


90. See N.Y.S. 4617; N.Y.A. 7313.

91. See N.Y.S. 4617, § 18.
Act repeats language found in both the California Ethics Standards and statutes: "[A]n arbitrator must disclose all matters that could cause a person aware of the facts to reasonably entertain a doubt that the proposed arbitrator would be able to be impartial."\(^{92}\)

The Act also follows California's Ethics Standards in other ways. For example, the Act prohibits an arbitrator or members of his or her family from accepting any gifts, bequests, or favors from notice of appointment until two years after the conclusion of the arbitration, and forbids any ex parte communication except for administrative matters.\(^{93}\) However, it parts company with California in disqualifying arbitrators who fail to comply with their obligations to make disclosures only when there has been a material omission or material misrepresentation in his or her disclosure.\(^{94}\)

In Texas, introduced legislation recognized the benefits of arbitration in providing faster and less costly resolution of disputes than is generally available with litigation. The legislation set forth a basic system for evaluating and ensuring the accountability of arbitrators and arbitration providers. The bill required the arbitration services provider to file arbitrator disclosure information, including the names of parties and their attorneys, the names of arbitrators, the date selected, the name of arbitration provider, the nature of the dispute and the relief requested, the decision and award, the date signed, and the fees and expenses of the arbitration provider.\(^{95}\) The bill also provided that if an arbitrator or provider fails three times in a twelve-month period to timely make such disclosures, they will be ineligible to conduct or administer court-ordered arbitrations for a certain period of time.\(^{96}\)

Even though neither Texas nor New York has yet passed this legislation, the question is whether proliferating legislation in different states will result in a hodgepodge of state-ordered requirements that

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\(^{92}\) Id.; see also Ethics Standards, supra note 13, std. 7(d)(14)(A) (requiring disclosure of "[a]ny other matter that: (A) Might cause a person aware of the facts to reasonably entertain a doubt that the arbitrator would be able to be impartial"); Cal. Civ. Proc. Code § 1281.9(a) (providing that "the proposed neutral arbitrator shall disclose all matters that could cause a person aware of the facts to reasonably entertain a doubt that the proposed neutral arbitrator would be able to be impartial").

\(^{93}\) See N.Y.S. 4617.

\(^{94}\) See id. § 18.

\(^{95}\) See S. 328, 2003 Leg., 78th Sess. (Tex. 2003).

\(^{96}\) See id. Another bill which would have prohibited "loser pays" clauses in consumer arbitration, like the California legislation, failed to be even brought up for vote in committee due to strong business community opposition. See ADRWORLD.COM, Business Opposition Kills Consumer Arbitration Bill in Texas (2003) at http://www.adrworld.com (last accessed July 6, 2003).
will supplement federal standards, or whether federal standards will preempt individual state requirements with a more cohesive formula. Some might argue that the Ethics Standards of California are preempted now on the basis of the reasoning in Mayo. If other states adopt legislation that mirror the Ethics Standards, they may also be preempted when they are challenged in court. If there is no preemption, an assortment of arbitrator disclosure rules would be in effect state to state.

However, a more likely scenario may unfold with the gaining popularity of the Revised Uniform Arbitration Act (“RUAA”), which was approved and recommended for enactment in all states in 2000. It requires an affirmative and continuing duty by arbitrators to disclose any facts that a reasonable person would consider likely to affect the impartiality of the arbitrator. The Federal Arbitration Act (“FAA”), first drafted in 1925, does not have a disclosure statute and provides that only evident partiality, fraud and corruption, and certain arbitrator misconduct are grounds for vacating an award. Simple failure of an arbitrator to disclose possible conflicts is not a ground for vacating an arbitration award under the FAA, as it is under the RUAA.

It is likely that the RUAA, now being adopted by many states, may become a prototype for the revision of the FAA. If that happens, there is a more certain prospect for future preemption of various special state arbitrator ethics standards, including those in California.


100. UNIF. ARBITRATION ACT § 12.


102. Id. § 10.

This would solve the problem of different state requirements for arbitrator disclosure in an era where conflicts commonly cross state lines and arbitrators commonly sit on cases involving application of different state law.

VII. Observations of and Alternatives to California Arbitration Reform

The most likely reason that arbitration reform in California has been focused on arbitrators is that reformists and some lawmakers have been dismayed by the Supreme Court's steadfast refusal to allow states to treat arbitration contracts differently from contracts in general. The idea to regulate arbitrators through mandated ethical standards may seem to be one way to balance the inequities of non-negotiated contracts. Yet, it does nothing to alleviate the problem of such contracts other than opening more grounds for challenging otherwise binding arbitrations, and as a collateral result, possibly destabilizing non-consumer arbitrations as well.

These challenges will only occur on the consumer side in the top dollar cases where the potential reward of a big recovery trumps the risk of a long and expensive appellate battle. On the defendant's side, challenges will only be brought by deep pocket entities intent on setting an example for future litigants. In the more common small cases, where consumers have a hard time finding any lawyer willing to represent them, speedy and cost-effective final resolution will most likely be lost as fewer arbitrators are willing to sit on low-paying arbitration panels in light of the heavier duty (and potential liability) they have in discovering and reporting connections to the parties and attorneys.

With the spotlight on arbitrator conduct, the energy to find a solution to the problems of mandatory arbitration clauses in everyday transactions is misdirected. There should be more contemplation of other avenues to solve the problems of imposed arbitration. Consent is one area to explore since it would eliminate federal preemption problems. For example, requiring consumer approval is consistent with requiring consent in any contract and therefore would not conflict with Supreme Court mandates.

104. See supra text accompanying notes 4–6.
105. See Folberg, supra note 10, at 359 (suggesting that the reform in California was driven by a backlash to balance the "big picture" between powerful companies and consumers rather than about the fairness of specific arbitrations or the integrity of individual arbitrators).
Consent could be accomplished by providing the consumer or employee with an ability to opt-out of the dispute resolution mandate.106 However, deciding how to formulate an opt-out provision will be problematic. Plaintiffs may be content to have a voluntary opt-in provision for arbitration after a dispute arises, but that option has never been popular with non-consumer parties. This is because the motivation for pre-dispute binding mandatory arbitration clauses is either to keep egregious cases from a potentially generous jury or to prevent class actions from proceeding, the very cases in which plaintiffs would not opt-in post dispute.107

Some believe that the non-consumer party who imposes the arbitration without allowing the consumer the opportunity to meaningfully consent should be bound to arbitrate, unless the consumer party decides otherwise. The reasoning behind this position is to protect the consumers with small claims who would not have the resources to pursue their cause through litigation.

Another avenue to pursue in consumer arbitrations is to consider making awards in mandatory consumer arbitrations non-binding and allowing for some type of review for this class of arbitration.108 Alternatively, these arbitrations could operate much like judicial arbitrations with parties having the opportunity for a trial de novo.109

There needs to be a more thoughtful deliberation of how to assimilate the benefits of a faster and less expensive dispute resolution process with the ability of parties to get a procedure that corresponds to the demands of their claims. Moreover, imposed 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.

106. See Circuit City v. Ahmed, 283 F.3d 1198, 1198 (9th Cir. 2002) (involving an employment contract that gave the employee an opportunity to opt out of mandatory arbitration, which he did not exercise); Circuit City v. Najd, 294 F.3d 1104, 1106 (9th Cir. 2002) (giving current employees the opportunity to opt out of mandatory arbitration agreements, which Mr. Najd did not exercise).


Conclusion

California arbitration reform will either set the norm for stronger disclosure standards for the nation or it will in time be weakened by court decisions embracing preemption arguments. Because of the lack of materiality standards for arbitrator disclosure and conduct compliance, the courts, and not the legislature, will eventually interpret and determine the scope of the California Ethics Standards for Neutral Arbitrators.

Both consumer and commercial arbitration should provide litigants with a full, fair, and impartial hearing. However, the unresolved issues of mandatory consumer arbitration clauses should not begin and end with the regulation of arbitration and arbitration providers. Negotiated commercial arbitration should not be destabilized by the increased opportunity for collateral challenge as a result of non-consensual consumer arbitration reform. A continuing exchange of ideas about consent in contract formation or judicial review of awards in mandatory arbitration clauses in contracts of adhesion may be the path for further discourse.