

ARBITRATION AFTER *BURLAGE*

By Wendy Lascher

“We look to legal precedent in deciding cases. We believe the law is predictable and provides litigants and counsel a reasonable degree of certainty. True, but not always.” *Burlage v. Superior Court* (2009) 178 Cal.App.4th 524 (review denied). The *Burlage* decision will make every case that goes to arbitration less predictable – and more costly.

Most California lawyers and judges, and even the two justices in the *Burlage* majority, had previously believed that a court may not review the merits of an arbitrator’s reasoning, even when an error of law is apparent on the face of the award and causes substantial injustice. This is the teaching of *Moncharsh v. Heily & Blase* (1992) 3 Cal.4th 1.

In *Burlage*, however, Presiding Justice **Arthur Gilbert** and Associate Justice **Kenneth Yegan** upheld a trial court’s order setting aside an arbitration award because the arbitrator concluded that some defense evidence about damages was irrelevant, and granted a motion in limine to exclude it. They held that Code of Civil Procedure §1286.2 (a)(5) requires reversal “if the court determines [that] . . . The rights of the party were substantially prejudiced by the refusal of the arbitrators . . . to hear evidence material to the controversy . . .”

Dissenting **Associate Justice Steven Perren** wrote “that great mischief can and will result from” his colleagues’ decision. Will it?

The Hard Facts That Made Bad Law

In 2003, the Burlages bought an expensive house from Martha Spencer for \$1.75 million. The standard California Association of Realtors' contract required arbitration of any ensuing disputes.

The house had undisclosed defects. Its iron fence and swimming pool encroached on the neighboring property, the pool encroached on a storm drain and related easement belonging to the homeowners' association, and the roof leaked badly. To address the encroachment problem, the Burlages' attorney negotiated to obtain a lot line adjustment, for which the Burlages' title company paid \$10,000 and the Burlages paid \$950. It took well over two years to complete the lot line adjustment process, increasing remodeling costs, and the Burlages were required to pay their own lawyer, not to mention other expenses and investment of personal time. The Burlages' expert identified \$557,700 to \$662,700 of damages, including \$112,500 for loss of property value due to the encroachment.

The parties agreed to arbitrate the Burlages' claim for breach of contract and fraud. During arbitration, a dispute arose about the correct method of valuing damages for the encroachment. The Burlages relied on a case holding that damages are to be assessed as of the date of the fraudulent transaction while Spencer relied on a different case holding that in setting fraud damages a factfinder could consider subsequent events. The arbitrator agreed with the Burlages, and granted their motion in limine to exclude evidence of how much the title company paid for the lot line adjustment.

The arbitrator found fraud by Spencer and awarded \$552,750 in compensatory damages, plus \$225,000 in punitive damages and \$740,447.02 in attorney's fees and costs.

Without reviewing the arbitration transcript, Ventura Superior Court **Judge William Liebmann** granted Spencer's motion to vacate the award. He concluded that the arbitrator's evidentiary ruling "directly affected the issue of damages, thereby substantially prejudicing [Spencer]'s ability to dispute the amount of damages suffered by" the Burlages. He ordered rehearing of the entire matter before a new arbitrator. The Court of Appeal affirmed Judge Liebmann, the majority taking the position that because Spencer was not permitted to introduce evidence of what the title company paid to resolve the encroachment issue "the Burlages were awarded \$ 1.5 million in compensatory and punitive damages they may not have suffered."

Moncharsh Contemplated Finality

Moncharsh says that "[t]he arbitrator's decision should be the end, not the beginning, of the dispute." Both the state and national legislatures have endorsed consensual arbitration as a matter of policy. Does the Court of Appeal's decision, in the service of an illusory equitable ideal, conflict with this policy and the legal principles developed to implement it? Or does it merely, as Spencer's attorneys argued, take advantage of a "safety valve" the Legislature built into the arbitration statutes for cases such as this?

Parties agree to arbitrate disputes in order to make dispute resolution

simpler, quicker, less expensive and more final. They bargain for an expectation of finality once the arbitrator has ruled despite “knowing that arbitrators, like judges, are fallible.” *That Way Production Co. v. Directors Guild of America, Inc.* (1979) 96 Cal.App.3d 960, 965. That is why the Supreme Court recently reiterated that “arbitrators do not ordinarily exceed their contractually created powers simply by reaching an erroneous conclusion on a contested issue of law or fact . . .” *Gueyffier v. Ann Summers, Ltd.* (2008) 43 Cal.4th 1179, 1184.

The Court of Appeal majority, however, believed that “tolerance for fallibility has its limits.” and that section 1286.2(a)(5) “permits a court to intercede when an arbitrator has prevented a party from fairly presenting its case. . . .” It thought Spencer was treated unfairly because her damages expert was not allowed to testify that the title company solved the encroachment issue by paying \$10,000 two years after the sale.

Safety Valve for What?

This rationale makes sense only if the Code of Civil Procedure allows a court to vacate awards based on substantive outcome. But §1286.2(a)(5) focuses on procedural fairness, not the substance of arbitrators’ decisions. It addresses: the procurement of an award by fraud (paragraph (a)(1)); corruption ((a)(2)); misconduct ((a)(3)); arbitrators exceeding their powers ((a)(4)); refusal to postpone the hearing for cause ((a)(5)); and failure to disclose conflict of interest ((a)(6)). The statute requires fair opportunity, not the right to persuade the arbitrator of any party’s position on the merits.

Even if the statute did contemplate judicial reexamination of substantive legal rulings by arbitrators in cases of “substantial prejudice,” the *Burlage* decision does not suggest any guidelines for distinguishing a “mere erroneous evidentiary ruling” from one significant enough to justify setting aside an award. Is it the discrepancy between the amount the title company paid and the amount of the award? If so, at what dollar level does §1286.2(a)(5) kick in?

Is a court permitted to set aside an arbitration award without reading a transcript of the arbitration? A Court of Appeal could not reverse a trial court judgment for prejudicial error in excluding evidence without evaluating prejudice in light of the whole record, yet the Superior Court judge in *Burlage* did not read the arbitration transcript. If judicial review of arbitration awards is to be conducted differently than judicial review of trial court judgments, a subsequent decision must establish how that review is to be conducted.

If parties wish to superimpose judicial review on arbitration – to contract for an appellate process – they certainly may do so. *Cable Connection, Inc. v. DIRECTV, Inc.* (2008) 44 Cal.4th 1334, 1340. But allowing them to obtain review under §1286.5(a)(2) creates myriad problems. As Justice Perren noted, virtually every ruling excluding parol evidence, excluding privileged evidence or excluding hearsay – to name a few categories of evidentiary rulings – results in limiting the admissibility of evidence.

Arbitration Will Cost More and Mean Less.

Burlage eliminates the economy that arbitration is supposed to foster by exposing parties and arbitrators to significantly longer arbitration hearings. This is because attorneys will become much more reluctant to object to (and arbitrators more reluctant to exclude) evidence for fear a court will subsequently overturn the award based on evidence exclusion. If parties do not object, they run the risk of having the arbitrator consider evidence that the Legislature and/or the courts have previously determined should not be considered. But if they do object, they run the perhaps greater risk of wasting all the work and expense that went into preparing for and presenting a case at arbitration.

Further, *Burlage* leaves no disincentive for a losing party to bring a motion to vacate in any case in which the arbitrator has excluded evidence. There can be little doubt that the majority opinion will encourage a storm of hyperanalytical challenges to arbitration awards that, until this decision, were final.

Wendy Lascher is a State Bar certified specialist in appellate law. She practices in Ventura, www.lascher.com. She represented the *Burlages* in the Court of Appeal and their petition for review, which the Supreme Court denied by a 5-2 vote.