

under section 425.16 on two grounds. First, the claims asserted were based in significant part on the law firm's protected "petitioning activity" in the SEC action — although not entirely on that activity, 133 Cal. App. 4th at 675. Second, that the plaintiffs failed to show that they would probably prevail on the claims. *Id.* at 687.

Where the Insurer's Conduct Is A Mix of Litigation Conduct and Pre-Litigation Handling of the "Claim"

Most claims of what can be called "*White* bad faith" involve conduct of the insurers prior to and during litigation, or conduct within and without the confines of the litigation. Under *Peregrine Funding*, the conduct there included conduct prior to the litigation (representing the principals and funding entities in creating the vehicles ultimately involved in the fraudulent scheme), and in advice concerning how to set up the various transactions that followed. *Id.* at 12510. However, as the opinion found, other activity alleged to have injured the plaintiffs constituted conduct of the litigation in which the law firm represented the principals of the funding entities. *Id.* at 12513. The court found that the cause of action targeted by the Anti-SLAPP motion alleged damage by protected activity, and, consistent with the broad interpretation the Legislature commanded be accorded to the statute, the statute could not be ignored simply because plaintiffs could have established injury from unprotected activity. *Id.* A "mix" of protected activity and unprotected activity at the heart of a cause of action or claim renders the claim subject to a motion to strike under section 425.16.

Proving Probability of Success

Peregrine Funding notes that the "burden" on plaintiff (the policyholder in a coverage action) of proving the probability of success necessary to defeat a motion to strike under section 425.16 falls within what the Supreme Court has termed a "minimal merit" standard. *Peregrine*, 133 Cal. App. 4th at 675. That standard is akin to the level of proof required in opposing a motion for non-suit or summary judgment. *I-800 Contacts, Inc., v. Steinberg*, 107 Cal. App. 4th 568, 584-585 (2003), but without the initial burden on the defendant under § 437c, *Tuchscher Development Enterprises, Inc. v. San Diego Unified Port Dist.*, 106 Cal. App. 4th 1219, 1239 (2003). Since *Peregrine* does not address the issue of what showing of probability of success must be made in defense of a motion to strike where the only issue relates to the merits of the claim that the tactics employed constituted bad faith. The cases noted in *Peregrine* that considered validity of defenses to the claims seem to attack the procedure posture of the action being attacked by the Anti-SLAPP motion. *Peregrine, supra*, at 12514 n. 11. The opinion, and the case law citing section 425.16, do not address the issue of the level of sufficiency needed to establish the probability of success where the only defense to the action relates directly to the substance of the very claims raised in the lawsuit at issue. The success of using an Anti-SLAPP motion against claims of "*White* bad faith" will depend upon what showing a policyholder is required to make under section 425.16. That "standard" will undoubtedly be the subject of other opinions, and remains, today, undetermined.

White v. Western Title provided policyholders in coverage litigation with their insurers a strong weapon to argue that zealous advocacy in the course of litigation could constitute "bad faith." The recent *Peregrine Funding* decision of the California Court of Appeal in the first district raises a possible limitation on such a "bad faith" claim where the conduct charged occurs, in whole or in part, in the course of the coverage litigation itself.

— Patrick Cathcart

**Arbitration in California Courts:
The Year in Review**

Congressional impatience with purported abuse of class actions resulted in enactment of the Class Action Fairness Act of 2005; 28 U.S.C. 1711 (a) (2). Federal legislation attempts to shift state class actions to federal court without fulfilling conventional requirements of diversity jurisdiction; 28 U.S.C. 1332. Conversely, the California Supreme Court not only reaffirmed its commitment to class action litigation but also endorsed classwide arbitration; *Discover Bank v. Sup.Ct.*, 36 Cal. 4th 148 (2005).

In *Keating v. Sup.Ct.*, 31 Cal. 3d 584 (1982) [overruled on other grounds; *Southland Corp. v. Keating*, 465 U.S. 1 (1984)] the California Supreme Court had originally endorsed classwide arbitration, and two subsequent Court of Appeals decisions confirmed the doctrine against challenges of Federal Arbitration Act preemption; (FAA); 9 U.S.C. 2; *Sanders v. Kinko's, Inc.*, 99 Cal. App. 4th 1106 (2002); *Blue Cross of California v. Sup.Ct.*, 67 Cal. App. 4th 42 (1998). The defendant in *Discover Bank*, presumably cognizant that California courts had confirmed classwide arbitration, required plaintiff to sign an arbitration clause waiving participation in classwide arbitration, consolidation of claims or representational arbitration.

Based upon its prior decisional law, the *Discover Bank* court held classwide waivers violated public policy, unconscionable and unenforceable in consumer claims alleging fraud; Civ. Code 1670.5. But the underlying transaction involved interstate commerce, compelling the court to confront the federal role of preemption mandating state courts to enforce arbitration clauses unless the terms are subject to revocation on "grounds of law or equity;" 9 U.S.C. 2.

The United States Supreme Court, avoiding the classwide arbitration issue in the original 1984 case of *Southland Corp.*, had held the FAA pre empts local anti arbitration substantive law, and invalidates any procedural artifice burdening or impairing the alternative dispute resolution process if the underlying transaction affects interstate commerce. Under *Southland*, state courts and Legislatures cannot single out arbitration for treatment differently than general contract law. In *Discover Bank*, judicial refusal to enforce a classwide waiver clause might collide with the FAA prohibition of procedural evasion to avoid arbitration.

Class actions, and classwide arbitration, are a species of procedural law statutorily identified as a form of consolidation in litigation or arbitration; CCP 1048; 1281.3. To avoid labeling classwide arbitration and its concomitant waiver in an arbitration clause as a procedural device, the *Discover Bank* court confirmed classwide arbitration as a mechanism to vindicate substantive rights recited in Civ. Code 1668. This statute provides that "all contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud or injury to the persons or property of another, or violation of law...are against the policy of the law."

In supporting its conclusion that waivers of classwide arbitration were unconscionable, the court wrote an extensive paean



Hon. L.C. Waddington

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extolling class actions and lauded its salutary effect in denying rapacious parties from extracting small amounts of money from consumers in a sum insufficient to warrant litigation. By not singling out arbitration for disapproval, applying general substantive law to all contracts, and disabling the waiver clause as unconscionable on grounds of “law and equity,” the court avoided preemption. CCP 1668 enabled the court to apply universally applicable statutory substantive contract law to invalidate the class-wide arbitration waiver.

Cronus Investments, Inc. v. Concierge Services, Inc., 35 Cal. 4th 376 (2005) exemplifies an additional attempt to divorce California courts from the pre-emptive scope of the FAA; 9 U.S.C. 2. In California, CCP 1281.2 (c), authorizes the trial court to exercise several options when parties have signed contracts containing arbitrable and non-arbitrable claims or who are already involved in arbitration or litigation with each other or with third parties. A quintessentially procedural statute, CCP 1281.2 (c) permits joinder of parties and issues, a stay of litigation, or a stay of arbitration if a dispute arises out of the same transaction and “there is a possibility of conflicting rules on a common issue of law or fact.” State court authority to stay arbitration potentially interferes with Supreme Court pre-emption doctrine disallowing a state to evade arbitration by procedural subterfuge.

Cronus involved multiple parties who not only signed non-arbitrable and arbitrable contracts but had also filed cross-complaints subject to litigation. The original parties to the arbitration had signed a California choice of law clause, and, according to general statutory rules, local procedural law would govern. But the parties had added a term that arbitration did not “...preclude application of the FAA if...applicable.” The underlying transaction occurred in interstate commerce but the parties disagreed whether the California Arbitration Act (CAA) or the FAA and the doctrine of pre-emption should apply to interpretation of this clause.

Conceding the FAA rule would not allow a stay of arbitration (*Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 [1985]), the *Cronus* court held CCP 1281.2 (c) would not contravene the substantive policy goals of the FAA to enforce arbitration clauses. According to the court, the California statute merely provides rules for the conduct of the arbitration process—despite staying arbitration—as approved by the United States Supreme Court in *Volt Information Sciences v. Bd. of Trustees of Leland Stanford University*, 489 U.S. 468 (1989).

Volt held that the procedural rule of CCP 1281.2 facilitated arbitration by avoiding conflicting rulings in arbitration and litigation, and simultaneously abided by the terms of the California statute. According to the Supreme Court, the California statute avoided pre-emption by focusing on the process of arbitration rather than its prevention, inhibition or dilution.

Although the federal rule staying arbitration under *Dean Witter* differs, *Cronus* held FAA procedural rules (9 U.S.C. 4) applicable only in federal court and inapplicable in state court; *Rosenthal v. Great Western Fin. Securities Corp.* 14 Cal. 4th 394 (1996).

Having re-categorized classwide arbitration as a method for vindicating substantive rights in *Discover Bank*, and enforcing California procedural rules based on a choice of law clause to permit a stay of arbitration in *Cronus*, the California Supreme Court reviewed contractual unconscionability in *Boghos v. Certain Underwriters at Lloyds of London*, 36 Cal. 4th 495 (2005).

The plaintiff sought to bring his common law claims within the umbrella of statutory employment claims (FEHA; Gov. Code 12900) requiring employers to pay non-litigation costs of arbitration mandated by *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal. 4th 83 (2000). The *Boghos* court refused

to extend unwaivable statutory claims, publicly beneficial, to include common law claims on grounds the Legislature had specifically allocated pro-rata cost sharing to parties; CCP 1284.2. Although plaintiff alleged claims of wrongful non-payment of insurance claims, the court held insurance regulation not sufficiently within the category of “public policy” to warrant cost sharing.

Nevertheless, the court remanded the case and ordered the trial court to determine another issue—whether requiring plaintiff to share arbitration costs, or his ability to pay arbitration costs, is relevant to the general law of unconscionability; Civ. Code 1670.5.

In *Discover Bank, Cronus* and *Boghos*, the parties had executed written contracts, a mandatory requirement to enforce arbitration under either the FAA (9 U.S.C. 2) or the CAA; CCP 1281.2. In *Alliance Title Co. v. Boucher*, 127 Cal. App. 4th 262 (2005) the Court of Appeal enforced the right of a non-signatory to join an arbitration between signatories to a written contract.

In *Alliance*, the plaintiff had originally executed a contract containing an arbitration clause with a business entity subsequently acquired by another entity. A dispute arose between the original parties, and plaintiff filed suit against the first entity. The second entity sought to join the arbitration, although never having executed an arbitration clause, relying on the terms of the original contract.

The *Alliance* court cited a substantial body of federal law, primarily *Thomson-CSF v. Chemrite Ltd.*, 181 F.3d 435 (1999), discussing the right of non-signatories to join an arbitration with signatories. The Second Circuit in *Thomson-CSF* identified five theories enabling a non-signatory to enforce arbitration with a signatory to a contract: incorporation of documents by reference; assumption of debts, liabilities or assets; agency; veil-piercing alter ego; equitable estoppel. Except for estoppel, all these categories are usually established by a general form of derivative liability. The most difficult issue is “estoppel,” an equitable doctrine imposed on grounds of fundamental fairness in a variety of litigation contexts and, under *Alliance*, in arbitration.

Although crafting a universal rule for equitable estoppel is difficult at best, the *Alliance* court held that a non-signatory party may compel a signatory plaintiff to arbitrate when the causes of action are “intimately founded in and intertwined” with the underlying contract obligations; *Alliance* at 271. Equitable estoppel is fact-specific but when the relevant causes of action, or claims, rely on and presume the existence of a contract clearly affecting the non-signatory, or a party seeks benefits from a contract but denies any recourse to the non-signatory, joinder is an option for the court.

The second entity in *Alliance* had acquired the assets of the first entity, and, arguably, entitled to joinder in the arbitration under a theory of derivative liability. The court in *Alliance* had to overcome the absence of a written agreement (9 U.S.C. 2) between the second entity and the plaintiff. The court found the legal relationship among all parties “founded in and intertwined” in the original contract and the doctrine of equitable estoppel trumped the FAA requirement of a written contract.

Class actions, consolidation, estoppel and other litigation doctrines have inevitably intruded into arbitration in determining whether courts should enforce arbitration clauses. Several years ago, the California Supreme Court decided *Vandenberg v. Sup. Ct.*, 21 Cal. 4th 815 (1999), a decision refusing to assign collateral estoppel effect to an arbitration award in a subsequent proceeding between non-mutual parties. But the *Vandenberg* court left open the res-judicata effect of arbitration awards. Resolution of this issue involves interpreting a California statute authorizing courts to accord the same force and effect to an arbitration award as a civil judgment; CCP 1287.4.

Richard B. LeVine, Inc. v. Higashi, 131 Cal. App. 4th 566 (2005) addressed res-judicata impact of a civil action filed against

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a third party uninvolved in a prior arbitration and not named in the award. The *Levine* court explained that third party liability, if any, was derivative of the party exonerated in the prior arbitration, and the award was entitled to res judicata effect in litigation. Absent the issue of derivative liability, the impact of *res judicata* on non mutual parties to a prior arbitration award remains unresolved.

The most controversial litigation doctrine in the context of arbitration emerges in the law of unconscionable contracts; CCP 1670.5. California courts have transferred contractual unconscionability to arbitration clauses, refusing to enforce terms on the same grounds as in litigation; *Armendariz*. “Unconscionability” of contract was originally conceived judicially *Graham v. Scissor-Tail*, 28 Cal. 3d 807 (1981) and ratified subsequently by the Legislature; Civ. Code 1670.5. The statute provides no definition of the term, consequently the courts must supply content. The California Supreme Court initially undertook the task in *Armendariz*, an employment case, and the Courts of Appeal have applied the decision in numerous other contexts; *Aral v. Earthlink, Inc.*, 2005 WL 3164648 [forum selection clause].

The California Supreme Court has divided the term “unconscionability” into “procedural” and “substantive” components. The former includes an arbitration term generating “oppression or surprise” attributable to unequal bargaining power of one party; the latter evidences “harsh or one-sided results;” *Armendariz; Woodside Homes of Cal., Inc. v. Sup.Ct.*, 107 Cal. App. 4th 723 (2003). The terms identify execution and process of arbitration respectively.

Although relegated by the courts to subjective perception, the unconscionability doctrine essentially reflects an equitable judicial interpretation of economic reality. Employment and consumer contracts are the most common examples of arbitration terms unilaterally imposed without negotiation between the parties and are denominated contracts of “adhesion.” The courts equate an adhesive arbitration clause to procedural unconscionability but not unenforceable absent substantive unconscionability.

Courts acknowledge adhesive contracts as imperative in modern society but judges monitor the terms closely and scrutinize the underlying nature of the transaction. The Court of Appeal recently added franchise contracts within the umbrella of unconscionable arbitration clauses, citing the inferior bargaining power of franchisees; *Independent Ass’n. of Mailbox Center Owners, Inc. v. Sup.Ct.*, 133 Cal. App. 4th 396 (2005).

Employment contracts are unique in the sense that few applicants for employment negotiate the terms and are at a severe economic disadvantage. Conversely, consumers may lack the ability or power to negotiate but presumably can either select among a variety of products, simply refuse to purchase, or shop elsewhere. The California Supreme Court acknowledged this economic reality in *Boghos* by declining to expand *Armendariz* and its cost shifting rule to consumer transactions although acknowledging the potential for exceptions; *Gutierrez v. Autowest, Inc.*, 114 Cal. App. 4th 77 (2003).

California and federal courts continue to confirm arbitration as an alternative to litigation, but judicial review of the process insures an oversight in attempting to balance the intersection between the two dispute resolution processes. The increasing use of litigation language by appellate courts suggests a “litigationization” of arbitration.

The judicial balancing act is further compounded by the preemptive role of the FAA and its impact on state law. The year 2006 portends more decisional law on arbitration by state and federal courts.

Weissman v. SCAT Enterprises, Inc., (Sup. Ct. L.A., May 10, 2005).

No changes of the magnitude argued for by the defense bar are either presented by the statutory language or, of course, announced in the proposition itself or the explanatory materials accompanying the ballot measure. There is simply no basis for the claim other than wishful thinking and a desire to see Prop. 64 turn the UCL into common law fraud.

Effect of New Section 17204

Does Amended Section 17204 Change the Proof Requirements for Absent Class Members?

Mr. Rossbacher: Nothing in Prop. 64 changes the requirements for absent class members. The Proposition does not address the topic.

Mr. Jackson: Absent class members are “prosecuting” an action in a class action based on the decisions holding absent class members to be plaintiffs. See *Southern Cal. Edison Co. v. Sup. Ct.*, 7 Cal. 3d 832, 840 (1972). This legal rationale is what imposes duties on class counsel that run to absent class members, prohibits defense counsel from direct communications with absent class members, and gives rise to collateral estoppel. In addition, the voters’ removal of “general public” from section 17204 could be effectively negated if the standing requirements did not apply to absent class members.

Practical Effects on Class Certification

Do Practical and Policy Considerations Suggest that Prop. 64 Changed Proof Requirements?

Mr. Rossbacher: Prop. 64 makes no changes from California law as it has been established. Contrary to the defense assertion, Prop. 64 encourages class actions, ending the spurious defense argument that class actions are not “superior” to representative actions. The California Supreme Court has repeatedly made clear not only the reach of the UCL and its important place in protecting Californians from the predators in the business community in the cases cited above, but also has reiterated as recently as June of last year the important role that class actions play in consumer protection. *Discover Bank v. Superior Court*, 36 Cal. 4th 48 (2005). That important role is now reemphasized by Prop. 64’s requirement that UCL actions be brought under CCP § 382.

Mr. Jackson: Permitting lessened proof for absent class members would preclude collateral estoppel and destroy any evenhandedness in class litigation. Under plaintiff’s interpretation, a finding against the class representative on causation or injury in fact would logically fail to provide collateral estoppel against absent class members who would not need to prove causation or injury in fact. *United States Golf Ass’n v. Arroyo Software Corp.*, 69 Cal. App. 4th 607, 619 (1999) (no collateral estoppel attached from prior adjudication with differing proof elements). Even expensive class notice would not change this. Notice would be largely pointless because collateral estoppel against the defendant could arise without it.

Under plaintiff’s interpretation, even a losing class representative could still recover as an absent class member. In a case with multiple class representatives, a losing representative could join the absent class members and still recover.

Permitting lessened proof for absent class members could encourage 17200 class actions, contrary to the voters’ obvious intent. If absent members need not prove causation or injury in fact, absence of commonality on these would not defeat certification. While this was true before Prop 64, defendants then could