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IN THE SUPREME COURT OF CALIFORNIA

BRG SPORTS, INC., et al.,
Appellants and Cross-Respondents,

v.

CHRIS ZIMMERMAN,
Respondent and Cross-Appellant.

REVIEW OF A DECISION BY THE COURT OF APPEAL,
SECOND APPELLATE DISTRICT, DIVISION SEVEN, CASE NO. B282161
LOS ANGELES COUNTY SUPERIOR COURT CASE NO. BS160840

PETITION FOR REVIEW

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ISSUE PRESENTED

Is an arbitrator's manifest disregard of the law—meaning the arbitrator knew of but ignored clearly applicable legal authority—a basis for vacating the arbitration decision as exceeding the arbitrator's powers?

INTRODUCTION

This case affords this Court an opportunity to decide a question the Court left open in 1992 (*Moncharsh v. Heily & Blase* (1992) 3 Cal.4th 1 (*Moncharsh*)), anticipated in 2010 (*Pearson Dental Supplies, Inc. v. Superior Court* (2010) 48 Cal.4th 665 (*Pearson*)), and deferred in 2015 (*Richey v. AutoNation, Inc.* (2015) 60 Cal.4th 909 (*Richey*)). The question is whether this Court should adopt the rule, followed in some federal and state courts, permitting judicial review of arbitration decisions for an arbitrator's *manifest disregard of the law*—by which is meant the arbitrator knew of but ignored clearly applicable legal authority.

Moncharsh established that "an arbitrator's decision is not generally reviewable for errors of fact or law." (*Moncharsh, supra,* 3 Cal.4th at p. 6.) But *Moncharsh* also noted that there are "limited exceptions to this general rule." (*Ibid.*) *Pearson* then observed that *Moncharsh* "leav[es] open the possibility of greater judicial review . . . in the case of rulings inconsistent with the protection of statutory rights." (*Pearson, supra,* 48 Cal.4th at p. 677, fn. 3.)

Thus, the Court has left open the possibility of judicial review of an arbitration decision for the arbitrator's manifest disregard of

the law—at least where the decision is "inconsistent with the protection of statutory rights." (*Pearson, supra,* 48 Cal.4th at p. 677, fn. 3.) That is what happened here. The arbitrator flouted California law by awarding contractual attorney's fees to a party who made no competing contract claims and against a party who obtained a substantial part of the relief sought—forcing the winning petitioner, who was awarded $500,000 in damages, to pay the losing respondents $1,234,694 in attorney's fees and costs—in contravention of Civil Code section 1717.

This Court should grant review to decide whether to adopt the manifest disregard standard as a basis for vacating an arbitration decision as exceeding the arbitrator's powers within the meaning of Code of Civil Procedure section 1286.2, subdivision (a)(4) (court must vacate arbitration decision if "[t]he arbitrators exceeded their powers").

The unavailability of judicial review of arbitration decisions for manifest disregard of the law is bad policy:

- It undermines the public's faith in the judicial and arbitral processes by making courts complicit in perpetuating injustices.

- It exacerbates public perception of the potential for arbitrator bias as a threat to the integrity of the legal system.

- It discourages willing participation in arbitration by requiring the parties to accept the risk that the arbitrator may flout the law with no possibility of redress.

In contrast, the manifest disregard standard strikes the right balance between the interest in the benefits of arbitration—efficiency and speed—and the public interest in justice and fairness, which is at the core of the judicial process.

The arbitrator in this case flouted California law to a degree inconsistent with the protection of statutory rights under Civil Code section 1717. Accordingly, the case is an appropriate vehicle for this Court to decide whether to adopt the manifest disregard standard.

BACKGROUND

A. The Demand for Arbitration.

On April 16, 2014, Chris Zimmerman filed a demand for arbitration arising from his March 2013 termination from employment by BRG Sports, LLC (formerly known as Easton-Bell Sports, LLC) and BRG Sports, Inc. (collectively BRG). (I AA 118-122.) He initiated the arbitration pursuant to an arbitration clause in his employment agreement. (I AA 31.)[1]

[1] The agreement required arbitration of "[a]ny dispute, controversy or claim arising out of or relating to this Agreement," granted the arbitrator "the power to award any remedies, including attorneys' fees and costs, available under applicable law," and provided that "the prevailing party in any dispute, controversy or claim arising out of or relating to this Agreement shall be entitled to recover its reasonable costs and attorneys' fees." (I AA 31.)

On May 6, 2014, BRG filed a judicial proceeding in New York seeking a stay of the arbitration and a declaration that Zimmerman's claims either (1) did not arise out of his employment agreement or (2) were included within a release of claims. (I RA 156; see I RA 21-22.) The New York trial and appellate courts rebuffed this effort, finding that all of Zimmerman's claims arose from his employment agreement and none were released or waived. (I RA 155-161, 164-166.)

B. The Arbitration Award.

In arbitration, Zimmerman asserted claims for breach of contract and tortious breach of the implied covenant of good faith arising from BRG's failure to honor an "equity participation" element of his compensation. (I RA 144.) That element had two components: (1) a short-term guaranteed cash incentive called "CIP," and (2) a long-term equity appreciation pool consisting of stock options called "B Units." (I RA 99-100, 141.)

After an evidentiary hearing, the arbitrator issued an "Interim Arbitration Award" dated October 27, 2015, which granted Zimmerman $250,000 in unpaid past CIP compensation. (I RA 148-149.) The arbitrator also issued a declaratory judgment requiring BRG to make subsequent payments of future CIP compensation to Zimmerman. (I RA 151.) However, the arbitrator found that the value of the B Units—which Zimmerman had initially estimated between $753,390 and $1,445,990.50 and subsequently calculated to be $852,101.84—was actually zero. (I RA 144-148.) The arbitrator also denied Zimmerman's tort claim. (I RA 149-151.)

In a "Second Interim Arbitration Award" dated November 23, 2015, the arbitrator declared BRG to be the prevailing party for purposes of recovering attorney's fees. Quoting Civil Code section 1717, the arbitrator reasoned: "In essence, as applicable to this case, that statute in subdivision (b)(1) provides that 'the party prevailing on the contract shall be the party who recovered a greater relief in the action on the contract.' That subdivision of the statute also allows for a determination 'that there is no party prevailing on the contract for purposes of this section.' " (II RA 394.) He also quoted the following statement in *Frog Creek Partners, LLC v. Vance Brown, Inc.* (2012) 206 Cal.App.4th 515, 543 (*Frog Creek*): "[U]nder Civil Code section 1717 there can only be one prevailing party on a given contract in a given lawsuit." (II RA 394.)

However, the arbitrator ignored a key statement in *Frog Creek*—that the "greater relief" provision in subdivision (b)(1) of section 1717 "appears to address a situation where there are *competing contract claims*." (*Frog Creek, supra*, 206 Cal.App.4th at p. 529, emphasis added.) Instead, the arbitrator quoted this Court's ruling in *Hsu v. Abbara* (1995) 9 Cal.4th 863, 876, that "in deciding whether there is a 'party prevailing on the contract,' " the trial court must compare the relief awarded with the parties' litigation objectives and the extent to which each party has succeeded or failed to achieve those objectives. (II RA 394.) But that rule is used to determine *whether* there is prevailing party, not *who is the* prevailing party. Where, as here, a party obtains only part of the relief sought, the trial court (and hence an arbitrator) has discretion under subdivision (b)(1) of section 1717 to determine that there is

no prevailing party. (*Marina Pacifica Homeowners Assn. v. S. Cal. Fin. Corp.* (2018) 20 Cal.App.5th 191, 200-201 (*Marina Pacifica*).) "*Hsu* construed the statutory language providing that the trial court may determine there is no party prevailing on the contract." (*Id.* at pp. 200-201.)

Referencing a list submitted by BRG of "no less than twelve litigation objectives which [Zimmerman] failed to achieve in the arbitration" (II RA 395), the arbitrator concluded that BRG had recovered the "greater relief" and thus was the prevailing party (II RA 394). The arbitrator also reasoned that Zimmerman's success on the arbitrability issue in the New York courts was not a victory on the contract (II RA 394-395) and that Zimmerman "could have obtained all of the monetary and declaratory relief he obtained in the Interim Award" under a proposed severance agreement that he had rejected (II RA 394). The arbitrator therefore invited BRG to apply for an award of attorneys' fees. (II RA 395.)

But BRG had made no *competing contract claims*, which *Frog Creek* says was essential to a "greater relief" award to BRG under subdivision (b)(1) of section 1717. (*Frog Creek, supra,* 204 Cal.App.4th at p. 529.) *Hsu* makes clear that the partial nature of Zimmerman's success could only be a basis for determining that there was *no* prevailing party—not that BRG was the prevailing party. (*Marina Pacifica, supra,* 20 Cal.App.5th at pp. 200-201.) Thus, the arbitrator manifestly disregarded the very cases he had cited.

Zimmerman moved for reconsideration of the prevailing party determination, pointing out (among other things) that BRG had

asserted no competing contract claims and thus *Frog Creek* actually "undercuts" BRG and "stands for the proposition that [Zimmerman] should have been named the [p]revailing [p]arty and awarded all of his fees and expenses." (I RA 249.) Nevertheless, in a "Final Arbitration Award" dated February 18, 2016, the arbitrator reiterated his interim decisions (I RA 259) and awarded BRG $1,234,695 in attorneys' fees and costs (I RA 259)—thus requiring the winning party to pay the losing party's attorney's fees. The arbitrator ignored Zimmerman's point that *Frog Creek* undercuts BRG's claim for attorney's fees, simply citing *Frog Creek*, *Hsu*, and two other cases for the proposition that "I have the jurisdiction to award [BRG] the reasonable fees and expenses which they incurred in connection with the New York proceedings." (I RA 258.)[2]

A subsequent triggering event added another $250,000 to BRG's liability for CIP compensation, increasing the total amount of that liability to $500,000. (III RA 559.)

C. The Superior Court Judgment.

BRG filed a petition in superior court to confirm the arbitration award. Zimmerman moved the superior court to vacate the award, challenging (among other things) the arbitrator's prevailing party determination. The superior court denied Zimmerman's motion and partially granted BRG's petition,

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[2] Of the attorney's fees awarded, $127,839.78 was attributable to fees incurred in connection with the New York proceedings. (I RA 257.)

confirming the final arbitration award but denying BRG's request for issuance of a single net judgment instead of separate awards of $500,000 for Zimmerman on the merits and $1,262,574 for BRG on the award of attorney's fees. (II AA 410, 485-486.)

With regard to the prevailing party determination, the superior court summary rejected Zimmerman's contention that the arbitrator had manifestly disregarded *Frog Creek* and *Hsu*. (II AA 420.) The court criticized as "flawed" the arbitrator's reasoning that Zimmerman could have obtained relief under the proposed severance agreement and stated "the Court does not agree with the Arbitrator's decision that BRG is the prevailing party," but the court concluded that it lacked authority to vacate the arbitration award due to "errors of law" in the prevailing party determination. (II AA 420-421 & fn. 5.)[3]

D. The Court of Appeal Opinion.

The Court of Appeal reversed to the extent the superior court refused to order the entry of a single net judgment in BRG's favor, but affirmed in all other respects. (Opn. 26.) With regard to Zimmerman's assertion that the arbitrator had manifestly disregarded the law in awarding attorney's fees to BRG, the Court of Appeal simply noted that manifest disregard of the law is not a

[3] The superior court cited *Creative Plastering, Inc. v. Hedley Builders, Inc.* (1993) 19 Cal.App.4th 1662 (II AA 421), which cited *Moncharsh* for the proposition that an arbitration decision may not be vacated because of legal or factual errors. (*Creative Plastering, Inc., v. Hedley Builders, Inc., supra,* at p. 1665.)

basis for challenging an arbitration award under California law. (Opn. 19-20.)

LEGAL DISCUSSION

I. THIS COURT'S JURISPRUDENCE LEAVES ROOM FOR THE MANIFEST DISREGARD STANDARD AS A BASIS FOR VACATING AN ARBITRATION DECISION.

A. The Manifest Disregard Standard Permits Courts to Vacate an Arbitration Decision Where the Arbitrator Knew of But Ignored Clearly Applicable Legal Authority.

The manifest disregard standard for limited judicial review of arbitration decisions is applied in some (but not all) of the federal circuits. (See *Schwartz v. Merrill Lynch & Co., Inc.* (2d Cir. 2011) 665 F.3d 444, 451 (*Schwartz*); *Dewan v. Walia* (4th Cir. 2014) 544 Fed.Appx. 240, 245-246; *Renard v. Ameriprise Fin. Servs., Inc.* (7th Cir. 2015) 778 F.3d 563, 567-568; *Comedy Club, Inc. v. Improv W. Assoc.* (9th Cir. 2009) 553 F.3d 1277, 1290; *Adviser Dealer Servs., Inc. v. Icon Advisers, Inc.* (10th Cir. 2014) 557 Fed.Appx. 714, 717.) It is also applied in some state courts. (See, e.g., *Indus. Risk Insurers v. Hartford Steam Boiler Inspection and Ins. Co.* (2005) 273 Conn. 86, 94-96 [868 A.2d 47])

"The most prevalent manifest disregard of the law test contains two elements. The first element is the arbitrator must

know the governing rule of law and refuse to apply it or ignore it. The second element is that the law ignored by the arbitrator is well-defined, explicit, and clearly applicable to the case." (*Countrywide Fin. Corp. v. Bundy* (2010) 187 Cal.App.4th 234, 253.)

In jurisdictions where courts apply the manifest disregard standard, it rarely results in vacatur. The standard has been described as "narrow." (*Collins v. D.R. Horton, Inc.* (9th Cir. 2007) 505 F.3d 874, 879.) It "should be reserved for circumstances of an arbitrator's extraordinary lack of fidelity to established legal principles." (*Garrity v. McCaskey* (1992) 223 Conn. 1, 10 [612 A.2d 742] (*Garrity*).) "Examples of manifest disregard therefore tend to be extreme . . . ." (*Telenor Mobile Commc'ns AS v. Storm LLC* (2d Cir. 2009) 584 F.3d 396, 407.)

B. Arbitrators Who Manifestly Disregard the Law Have Exceeded Their Powers Within the Meaning of Code of Civil Procedure Section 1286.2.

The federal courts that currently adhere to the manifest disregard standard, as well as some of the state courts that do so, have articulated the standard as a "judicial gloss" on—and thus arising from—statutory provisions for vacating arbitration decisions when arbitrators have *exceeded their powers*. (E.g., *Schwartz, supra,* 565 F.3d at p. 451.)[4]

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[4] Other state courts have articulated a nonstatutory manifest disregard standard. (See cases collected in Annot., Adoption of Manifest Disregard of Law Standard as Nonstatutory Ground to (continued...)

This petition seeks review to determine whether this Court should adopt the manifest disregard standard as arising from Code of Civil Procedure section 1286.2, subdivision (a)(4), which provides that a court must vacate an arbitration award if the court determines that "[t]he arbitrators exceeded their powers and the award cannot be corrected without affecting the merits of the decision upon the controversy submitted." We submit that arbitrators who manifestly disregard the law have exceeded their powers within the meaning of section 1286.2, subdivision (a)(4).

C. This Court Has Left Open the Possibility of Review for Manifest Disregard of the Law.

This Court's 1992 decision in *Moncharsh, supra,* 3 Cal.4th 1, established that, under California law, "an arbitrator's decision is not generally reviewable for errors of fact or law, whether or not such error appears on the face of the award and causes substantial injustice to the parties." (*Id.* at p. 6.) Somewhat enigmatically, however, *Moncharsh* also noted—without much elaboration—that there are "limited exceptions to this general rule." (*Ibid.*)

Some Courts of Appeal have construed *Moncharsh* as precluding manifest disregard of the law as a ground for vacating an arbitrator's decision. (See *Mave Enters., Inc. v. Travelers Indem. Co.* (2013) 219 Cal.App.4th 1408, 1422; *Comerica Bank v. Howsam*

(...continued)
Review Arbitration Awards Governed by Uniform Arbitration Act (UAA) (2006) 14 A.L.R.6th 491.)

(2012) 208 Cal.App.4th 790, 830; *Siegel v. Prudential Ins. Co. of Am.* (1998) 67 Cal.App.4th 1270, 1279.) But in *Pearson, supra,* 48 Cal.4th 665, this Court indicated that there could be room in California law for the manifest disregard standard. The Court noted the use of the standard in some federal circuits and described *Moncharsh* as "articulating a strict review standard precluding vacatur for legal error that does not include a 'manifest disregard' exception, while at the same time *leaving open the possibility of greater judicial review* . . . in the case of *rulings inconsistent with the protection of statutory rights*." (*Id.* at p. 677, fn. 3, emphasis added.)

More recently, in *Richey, supra,* 60 Cal.4th 909, this Court expressly declined to decide whether to adopt the manifest disregard standard because the issue was not squarely presented in that case. (*Id.* at p. 918, fn. 1 ["We decline to rule on defendants' suggestion that this court adopt the 'manifest disregard' standard of review recognized by some federal courts in reviewing arbitration awards, given the limited nature of our holding here"].)

Thus, this Court's jurisprudence leaves room for the manifest disregard standard as a basis for vacating an arbitration decision—at least in the case of rulings inconsistent with statutory rights—on the ground "[t]he arbitrators exceeded their powers." (Code Civ. Proc., § 1286.2, subd. (a)(4).) This case squarely presents the question whether the Court should adopt that standard.

II. THIS COURT SHOULD ADOPT THE MANIFEST DISREGARD STANDARD.

A. The Unavailability of Review for Manifest Disregard of the Law Fosters Injustice and Undermines the Public's Faith in the Judicial and Arbitral Processes.

Perhaps the most compelling reason for this Court to adopt the manifest disregard standard is the potential for fostering injustice and undermining the public's faith in the legal system—including both the judicial and the arbitral processes.

The unavailability of review for manifest disregard of the law is bad for arbitration because "[j]udicial approval of arbitration decisions that so egregiously depart from established law that they border on the irrational would undermine society's confidence in the legitimacy of the arbitration process." (*Garrity, supra,* 223 Conn. at p. 10.) "[T]he principle of vacating an award because of a manifest disregard of the law is an important safeguard of the integrity of alternate dispute resolution mechanisms." (*Ibid.*)

The unavailability of review for manifest disregard of the law is bad for the judicial process because it "puts courts in the absurd role of enforcing rulings that flout the law." (LeRoy, *Are Arbitrators Above the Law? The "Manifest Disregard of the Law Standard* (2011) 52 B.C. L.Rev. 137, 184.) It makes courts complicit in perpetuating injustices.

As one participant in a lawless yet judicially unassailable arbitration told the New York Times in a widely-read 2015 article on contemporary private arbitration: "'It took away my faith in a fair and honorable legal system.'" (Silver-Greenberg & Corkery, *In Arbitration, a 'Privatization of the Justice System,'* N.Y. Times (Nov. 1, 2015) (hereafter Silver-Greenberg & Corkery).) The same can be said of the arbitration decision in this case, which absurdly requires Zimmerman to pay BRG a net monetary judgment of $734,694 even though Zimmerman won $500,000 in damages and BRG asserted no competing contract claims.

B. The Unavailability of Review for Manifest Disregard of the Law Exacerbates Public Perception of a Potential for Arbitrator Bias.

This Court has characterized as "generally unrecognizable . . . the belief that arbitrators might over time be biased toward the repeat players that bring them business, and that the arbitral forum thus inherently favors such repeat players." (*Sandquist v. Lebo Auto., Inc.* (2016) 1 Cal.5th 233, 259 (*Sandquist*).) The fact remains, however, that the public at large generally *believes* that today's arbitral system favors such "repeat players." In the public eye, "thousands of businesses across the country—from big corporations to storefront shops—have used arbitration to create an alternate system of justice. There, rules tend to favor businesses, and judges and juries have been replaced by arbitrators who commonly consider the companies their clients . . . ." (Silver-

Greenberg & Corkery, *supra*.) According to the 2015 New York Times article, "more than 30 arbitrators said in interviews that the pressure to rule for the companies that give them business was real." (*Ibid.*) "Beneath every decision, the arbitrators said, was the threat of losing business." (*Ibid.*)

Granted, this belief alone is "generally unrecognizable" by the courts. (*Sandquist, supra,* 1 Cal.5th at p. 259.) But we submit that a line is crossed when an arbitrator goes so far as to *manifestly disregard* the law. And the public seems to appreciate the difference between mere error and manifest disregard, as reflected in this key comment in the 2015 New York Times article: "To deliver favorable outcomes to companies, some arbitrators *have twisted or outright disregarded the law*, interviews and records show." (Silver-Greenberg & Corkery, *supra,* emphasis added.)

Our point here is not that arbitrators are necessarily biased—surely most are not—but that the public *perceives* the potential for bias as a threat to the integrity of the judicial and arbitral processes. That perception is exacerbated by the unavailability of judicial review for manifest disregard of the law. So is the danger of actual bias. This Court's adoption of the manifest disregard standard would serve to help restore the public's sagging confidence in the integrity of the legal system, including both the judicial and the arbitral processes.

C. The Unavailability of Review for Manifest Disregard of the Law Discourages Arbitration.

Moncharsh sought to further the "'strong public policy in favor of arbitration as a speedy and relatively inexpensive means of dispute resolution.'" (*Moncharsh, supra,* 3 Cal.4th at p. 9.) But the unavailability of review for manifest disregard of the law actually *discourages* arbitration. The advantage of arbitration "is surely lost if the judiciary permits arbitrators to circumvent the applicable law willfully. No reasonable potential litigant would select arbitration in lieu of a lawsuit if there is a possibility that the dispute will be resolved by a final award issued by an arbitrator who has judicial approval to ignore controlling legal principles." (*Progressive Data Systems, Inc. v. Jefferson Randolph Corp.* (2002) 275 Ga. 420, 425 [568 S.E.2d 474] (dis. opn. of Carley, J.).)

Absent the manifest disregard standard, "[t]he choice faced by many potential beneficiaries of the arbitral process, including businesses involved in high-stakes disputes, is to forego arbitration's many advantages rather than accept the risk of harm resulting from a serious misapplication of the law in the face of no possible redress for even the most grievous misapplication of the law." (Leasure, *Arbitration Law in Tension after Hall Street: Accuracy or Finality?* (2016) 39 U.Ark. Little Rock L.Rev. 75, 102 (hereafter "Leasure").)

D. The Manifest Disregard Standard Strikes the Right Balance Between the Interest in Efficiency and Speed and the Interest in Justice and Fairness.

The benefits of arbitration—efficiency and speed—are considerable. Equally important, however, is the public interest in justice and fairness, which is at the core of the judicial process. (See *Sand v. Concrete Serv. Co.* (1959) 176 Cal.App.2d 169, 172 ["The basic purpose of our legal system is to do justice between the parties under established legal principles"].) Absent the manifest disregard standard, the benefits of arbitration "come[ ] with an offsetting risk; that the arbitrator knowingly fails to apply the law appropriately, and there is no available remedy." (Leasure, *supra*, 39 U.Ark. Little Rock L.Rev. at p. 103.)

The interest in arbitration's speed and efficiency need not stand in tension with the interest in justice and fairness. The manifest disregard standard strikes the right balance between the two.

III. THIS ARBITRATION DECISION SHOULD BE VACATED AS INCONSISTENT WITH THE PROTECTION OF STATUTORY RIGHTS.

This case fits squarely within the potential this Court described in *Pearson* for judicial review "in the case of [arbitration] rulings inconsistent with the protection of statutory rights." (*Pearson, supra,* 48 Cal.4th at p. 677, fn. 3.) An arbitration decision like this one, which flouted California law by awarding contractual

attorney's fees to a party who made no competing contract claims and against a party who obtained a substantial part of the relief sought, is inconsistent with the protection of statutory rights under Civil Code section 1717. That makes this case an appropriate vehicle for this Court to decide whether to adopt the manifest disregard standard.

CONCLUSION

For the foregoing reasons, the Court should grant this petition for review.

July 27, 2018

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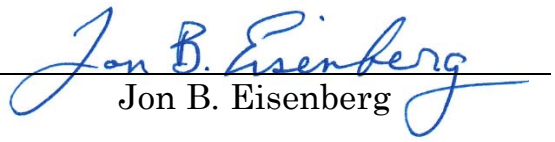
By: 
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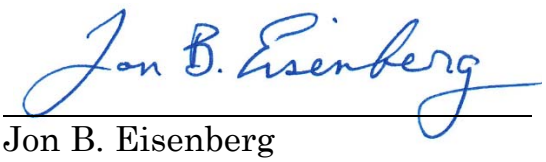
CERTIFICATE OF WORD COUNT
(Cal. Rules of Court, rule 8.504(d)(1).)

The text of this petition consists of 3,991 words as counted by the Microsoft Word version 2010 word processing program used to generate the petition.

Dated: July 27, 2018



Jon B. Eisenberg

ATTACHMENT: COURT OF APPEAL OPINION