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## Arbitration or the Code of Civil Procedure: Which Is More Likely to Bar Your Claim?

By Adam D.H. Grant

Should businesses insert an arbitration clause into their contracts with clients and enjoy the informality of such proceedings, or do they opt for the more formal procedures detailed in the Code of Civil Procedure? While the informality of arbitration is inviting, businesses could be giving up rights that may forever prevent a future related claim.

Procedural rules in arbitration take precedent over the Code of Civil Procedure because that is what the parties agree to be bound by when they sign the contract. The parties understand that when they enter into such agreements, the procedures are less formalistic and more streamlined to permit an arbitrator to expeditiously dispose of the matter.

Consequently, the state Supreme Court has acknowledged that while arbitration is relatively quick and inexpensive, it is somewhat roughshod, requiring the parties to accept the bad with the good. *Brennan v. Tremco Inc.* (2001) 25 Cal. 4th 310, 316. Wanting the efficiency and cost effectiveness of private arbitration, many businesses choose to abide by a commonly used arbitration clause that requires parties to submit any claim or dispute to the American Arbitration Association and be governed by the then existing AAA rules.

If a dispute arises and arbitration begins, AAA rules do not require a party to provide a formal response; if a party does not respond, the rules presume a general denial. Rule 4(b). The opposing party need not even appear at the hearing. Rather, with the moving party present, a "prove up" hearing will be con-

ducted before the arbitrator and an award determined. The award will likely acknowledge the existence of the arbitration agreement, the proper notice of the hearing, the lack of appearance by the opposing party, the receipt of the necessary evidence and the arbitrator's findings. The moving party will obtain a court order confirming the award. The losing party is then on the hook for the award.

At this point, to avoid enforcement of the judgment, the losing party may now go on the offensive and file a complaint on different, but related, issues to try and settle the entire dispute. Unfortunately, the roughshod procedure created in the AAA rules may chill the party's ability to assert these claims due to the doctrine of *res judicata*. Interestingly, the relaxed procedural nature of a private arbitration is what will lead to the losing party's demise. The more stringent requirements of the Code of Civil Procedure would have allowed the party to resurrect the claims.

The key in determining the application of *res judicata* is whether the opposing party's claims were "actually litigated." This doctrine bars "all grounds for recovery which could have been asserted, whether they were or not, in a prior suit between the same parties...on the same cause of action, if the prior suit concluded in a final judgment on the merits." *International Union of Operating Engineers-Employers Const. Industry Pension, Welfare and Training Trust Funds v. Karr*, 994 F.2d 1426, 1429 (9th Cir. (1993).

The state Supreme Court has been very clear that *res judicata* encompasses related matters that *could have been raised* even though not expressly pleaded or otherwise urged. *Sutphin v. Speik* (1940) 15 Cal. 2d 195.

If the parties chose to follow the Code of Civil Procedure, however, counter-claims are not "actually litigated." A change in Code of Civil Procedure Section 426.30 created this anomaly. This section permits a party to later plead a related claim, but only if the defendant in the first action did not file an answer.

Such is not the case when the parties agree to follow AAA rules. Under the AAA rules, all related claims are "actually litigated." In fact, Rule R-29, which governs commercial arbitration, specifically notes that an award "shall not be made solely on the default of a party." The arbitrator must require the complaining party to do an actual "prove up" hearing to justify the award. Thus, if the parties sign an agreement that specifically states the matter is to be governed by the AAA rules, Section 426.30 will not apply.

When deciding to submit matters to arbitration, each party must weigh the perceived cost savings against the relaxed procedural requirements. However, in doing so, a party must realize that it foregoes the procedural safeguards otherwise available by the Code of Civil Procedure. Without such safeguards, inaction may bar a claim that would not otherwise be barred.



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