

"Using Collateral Estoppel after Arbitration"

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Collateral estoppel occurs when a judgment in one court action "operates as an estoppel or conclusive adjudication as to such issues in [a later action, as far as those issues] were actually litigated and determined in the first action."¹ This can be a useful weapon in a litigator's armory, potentially saving huge amounts of money in trial time and preparation.

However, when a party seeks to assert collateral estoppel based on the outcome, not of a court action, but of an arbitration, it throws a twist into the equation. The question then becomes whether a third party who was not a part of that arbitration may assert collateral estoppel against an arbitrating party in a subsequent lawsuit against that arbitrating party. What about the reverse? Can a party who was a part of the arbitration assert collateral estoppel against a party in a subsequent litigation when that litigating party was not a party to the arbitration?

Given the ever-increasing preponderance of arbitration as a favored method of dispute resolution, the answers to these questions are important, and likely will become ever more so as arbitrations increase in number and popularity.

Normally, the answer to the above questions is no. But there are exceptions to this general rule, exceptions that lawyers who wish to assert (or avoid) collateral estoppel should be aware of. Those exceptions hinge on the relationship between the party who is part of the lawsuit who was not a party to the previous arbitration and the party in the lawsuit who was a party to the previous arbitration.

In Vandenberg v. Superior Court,² Eugene and Kathryn Boyd ("Boyd") operated an auto dealership on certain property they owned. The land was leased to Vandenberg for 30 years, at which time possession reverted to Boyd. Boyd discovered the land had been contaminated and sued Vandenberg. Vandenberg had numerous insurers, some of whose policies excluded such contamination unless it was the result of a "sudden and accidental" discharge. Vandenberg tendered the defense of this action to the insurers, and the majority of the claims were settled.

However, Boyd and Vandenberg (and only those parties) agreed to submit the remaining breach of lease issues to binding arbitration. USF&G, one of Vandenberg's insurers agreed to defend Boyd, but the ultimate issues of USF&G's obligations were reserved for future resolution.

The arbitration took place, and the arbitrator made an award to Boyd. The arbitrator also found that the contamination was not caused by sudden and accidental discharge. Vandenberg requested indemnity from the insurers, who rejected it.

During litigation, the insurers filed a motion for summary judgment on the basis that the issue of whether the discharge was "sudden and accidental" could not be relitigated: it had already been decided in arbitration, and collateral estoppel precluded another trial on that subject. The trial court granted summary judgment.

The appellate court disagreed, holding as follows:

[A]bsent a contractual agreement by the arbitral parties, a party to private arbitration is not barred from relitigating issues decided by the arbitrator when those issues arise in a different case involving a different adversary and different causes of action. It would not be fair to give a private arbitration decision nonmutual collateral estoppel effect without the arbitral parties' consent, the Court of Appeal reasoned, because private arbitration lacks significant safeguards of court litigation, particularly the right to full judicial review.³

The California Supreme Court granted review "to consider the circumstances, if any, in which private contractual arbitration decisions may have collateral estoppel effect in favor of nonparties."⁴ After a discussion of the binding nature of arbitration and the limited judicial review available to parties thereto, it stated:

[V]ery different considerations affect the issue whether private arbitration awards should have nonmutual collateral estoppel effect. California's statutory scheme nowhere specifies that, despite the arbitral parties' failure so to agree, a private arbitration award may be binding in favor of nonparties in litigation involving different causes of action. Moreover, in our view, such a consequence is not an inherent or expected feature of private arbitration that is implicitly accepted by the arbitral parties.⁵

Because of arbitration's informal nature, and for a number of public policy decisions, the Supreme Court stated:

Accordingly, we are compelled to conclude that a private arbitration award, even if judicially confirmed, can have no collateral estoppel effect in favor of third persons unless the arbitral parties agreed, in the particular case, that such a consequence should apply.⁶

Thus, the Supreme Court clearly ruled that collateral estoppel could not be used by a third party against a party to an arbitration (unless the parties specifically agreed to such in the arbitration agreement). In sum:

Fairness and public policy thus counsel against application of nonmutual collateral estoppel in this setting, unless the parties specifically agree thereto.⁷

However, as stated above, there are exceptions to this rule: there are times when the court will allow a third party in a subsequent lawsuit to assert collateral estoppel against one of the arbitral parties. But these occur only when the third party seeking to assert estoppel is essentially the same as the party in whose favor the arbitration issue was decided.

For instance, in Sartor v. Superior Court,⁸ plaintiff homeowners brought an action for fraud and other causes of action against the company they engaged as their architects. During contractually mandated arbitration, the arbitrator found that the company was not guilty of the fraud claim. Subsequently, the homeowners filed a lawsuit alleging fraud on the part of several individual defendants who were employees and/or agents of the architectural company. The court stated that, because a company can only

act through its agents and employees, if the company is not guilty of a cause of action, then neither can be the individuals who acted as the company. Thus, collateral estoppel would act to bar any lawsuit against them by the party to the earlier arbitration for the same cause of action that was determined to have no merit in that arbitration.

The above cases determine the viability of a third party in a subsequent lawsuit raising collateral estoppel against a party to the previous arbitration, but they do not answer the question of whether a party to the arbitration can raise collateral estoppel to bar claims by a third party in a subsequent lawsuit. This question again depends on several facts, most particularly the relationship between the third party and a party in the previous arbitration.

In Kelly v. Vons Companies, Inc.,⁹ a union (Local 381) brought an action against Vons under a collective bargaining agreement. They claimed that the closure of a Vons facility was in violation of the agreement. The dispute was submitted to binding arbitration ("the 381 arbitration"), and the arbitrator found that Vons had acted for economic reasons and not in response to the outcome of a previous arbitration ("the 63 arbitration") involving a different union (Local 63).

Later, several individuals sued Vons, claiming they had left their secure employment and turned down other job opportunities, only to lose their Vons jobs (or have them detrimentally altered) after Vons closed its

facility. They claimed that Vons had failed to notify them of the 63 arbitration, and so was liable for fraud and negligent representation.

Vons moved for summary judgment, claiming that the 381 arbitration had necessarily found that the facility closure was because of economic reasons, and so had nothing to do with the 63 arbitration. Therefore, it argued, collateral estoppel barred the individuals' claims.

The Court of Appeal agreed with Vons. It first noted that the 381 arbitration proceedings "had the elements of an adjudicatory procedure,"¹⁰ thus demonstrating the first requirement for collateral estoppel to apply, namely: the arbitration must be more on the "formal" side, with discovery, motions, briefings, etc. Among the aspects of formality mentioned were the following:

[T]he opportunity for a hearing before an impartial and qualified officer, at which [the parties] may give formal recorded testimony under oath, cross-examine and compel the testimony of witnesses, and obtain a written statement of decision. When an arbitration has these attributes, it is not unjust to bind the parties to determinations made during the proceeding.¹¹

This is in line with numerous statements in Vandenberg, supra, where the Court made much of the laxity of some arbitrations and the fact that in such a circumstance estoppel should not apply. Thus, the more informal the arbitration proceedings, the less likely will a court be to allow the assertion of collateral estoppel.

The appellate court then turned to the nature of the parties' relationships, stating:

[F]indings made during a labor arbitration will only be binding in a subsequent employee lawsuit if the employee was a party to the arbitration or in privity with the union during that proceeding. Privity requires identity of interests, or a relationship which is sufficiently close to justify application of the doctrine.¹²

Thus, the court allowed the previously arbitrating party (Vons) to assert estoppel against a third party in a later lawsuit (the employees), specifically because those third parties were sufficiently close in interests and relationship to justify the court's application of the doctrine. In summation, the court laid out the basic elements for collateral estoppel as follows:

A prior determination by a tribunal [including an arbitrator when the arbitration has the "elements of an adjudicatory procedure"] will be given collateral estoppel effect when (1) the issue is identical to that decided in a former proceeding; (2) the issue was actually litigated and (3) necessarily decided; (4) the doctrine is asserted against a party to the former action or one who was in privity with such a party; and (5) the former decision is final and was made on the merits.¹³

One more case may illustrate these points in a specific setting: when a bond surety principal is found liable in an arbitration. In T&R Painting Construction, Inc. v. St. Paul Fire and Marine Insurance Co.,¹⁴ a property owner entered into a contract with a general contractor, Capitol. Capitol subcontracted with T&R, and their subcontract had a clause entitling the prevailing party in a lawsuit between them to receive attorneys fees. T&R completed part of its work, and Capitol terminated T&R for defective work. The dispute went to arbitration, and the arbitrator ruled that the

termination was unsupported and awarded T&R the value of its work, plus attorneys fees and costs.

Capitol filed for bankruptcy, but T&R petitioned for confirmation of the arbitration award against Capitol, and judgment was accordingly entered. Then, T&R filed suit against St. Paul, Capitol's payment bond surety for the limited issue of determining "whether St. Paul was liable for the attorney fees T&R incurred in prosecuting its claims, including arbitration, against Capitol."¹⁵ There was no attorneys fees clause in the payment bond.

St. Paul prevailed at trial, contending that T&R's action against it was barred by the doctrine of res judicata or the "one final judgment" rule. On appeal, the court disagreed. It stated that one final judgment rule did not operate to bar T&R's action. Thought Capitol and St. Paul had a "unity of interest," they were not the same party. Res judicata operates to bar the same claim against the same parties. However, since the arbitrator had not reached the question of St. Paul's liability, T&R was entitled to pursue that claim in its lawsuit.

Relying on Cal. Civ. C. §2808, the court then ruled that, since the liability of the surety was commensurate of that of its principal, and Capitol's liability included payment of fees under the subcontract, St. Paul should be liable in that same amount.

It would seem, therefore, that the court implicitly recognized the collateral effect of the arbitration ruling against the surety's principal in binding the surety in the same sum. However, the question of whether T&R was entitled to assert collateral estoppel against St. Paul was never explicitly reached. Further, it must be remembered that the court relied on a statute that defines liability for bond sureties in making its determination. Therefore, care will have to be used in relying on this case for determining collateral estoppel applications in situations that fall outside this limited fact pattern.

Nonetheless, taken together with the holding in Kelly, it seems that a strong case can be made for any arbitral party to assert collateral estoppel against a third party in a later lawsuit if the following conditions exist:

- 1) The arbitration "had the elements of an adjudicatory procedure," including such elements as opportunity for a hearing before an impartial and qualified officer, at which the parties may give formal recorded testimony under oath, cross-examine and compel the testimony of witnesses, and obtain a written statement of decision;
- 2) the issue to be decided in the subsequent lawsuit is identical to that decided in the arbitration;

- 3) the issue was actually litigated and necessarily decided in the arbitration;
- 4) the doctrine is asserted against a party to the former arbitration or one who was in privity or had a "unity of interests" with the party to the former arbitration; and
- 5) the former decision is final and was made on the merits (the above cases show that finality in an arbitration occurs when the arbitration award is confirmed by the court).

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¹ *Todhunter v. Smith*, 219 Cal. 690, 695 (1934); emphasis in original.

² 21 Cal. 4th 815 (1999).

³ *Id.* at 827 (1999).

⁴ *Id.* at 828.

⁵ *Id.* at 831.

⁶ *Id.* at 834.

⁷ *Id.* at 835.

⁸ 136 Cal. App. 3d 322 (Cal. Ct. App. 1st Dist. 1982).

⁹ 67 Cal. App. 4th 1329 (Cal. Ct. App. 2d Dist. 1998).

¹⁰ *Id.* at 1336.

¹¹ *Id.* at 1336-37.

¹² *Id.* at 1338; emphasis added.

¹³ Id. at 1339; explanatory phrases regarding what constitutes a tribunal are taken from earlier point in the case, at 1336.

¹⁴ 23 Cal. App. 4th 738 (Cal. Ct. App. 2d Dist. 1994).

¹⁵ Id. at 742.