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# 9th Circ. Arbitration Ruling Could Have Int'l Implications

By **Jerry Roth** (April 25, 2024, 5:10 PM EDT)


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A recent U.S. Court of Appeals for the Ninth Circuit decision in Patrick v. Running Warehouse LLC offhandedly recognized an unusual and extremely important aspect of California law that the international arbitration community should keep in mind.

And while the reminder raises a host of choice of law questions, it ultimately may make California law a strategic option for some parties.

Under most states' law, arbitration awards are entitled to collateral estoppel effect in the same way as court decisions, especially once the award is confirmed by a court. This includes when so-called nonmutual offensive estoppel is being asserted by a third-party stranger to the original arbitration.

That means issues decided in arbitration against a party that had a full and fair opportunity to litigate them before the arbitrator can be treated as decisively decided, even when that preclusion is asserted in a subsequent proceeding by a third party uninvolved in the original arbitration.

But not under California law, as the Ninth Circuit pointed out on Feb. 12 in Patrick v. Running Warehouse.[1] There the panel affirmed a U.S. District Court for the Central District of California order granting a motion to dismiss a pending case without prejudice and granting a motion to compel arbitration.

The case arose after Running Warehouse's database was hacked. The plaintiffs sued the company based on the theft of their personal information by hackers.

The company insisted that the claims were arbitrable. When a purchase of goods was made through the outlet's website, the purchaser was required to check a box indicating agreement to the company's privacy policy and its terms of use, and those terms of use in turn hyperlinked to an arbitration clause.

The plaintiffs claimed they did not have sufficient notice of the arbitration clause and thus filed their action based on the hacking in federal court, leading to the order compelling arbitration and dismissing the complaint without prejudice.

The thrust of the Ninth Circuit's affirmance was that notice of the arbitration provision was sufficient. Several named plaintiffs acknowledged seeing the hyperlink and the district court found that the one plaintiff who did not was on inquiry notice regardless. Hence, they were bound by the clause and were

required to arbitrate their privacy claims.

The plaintiffs had also challenged the arbitration provision as invalid under the 2017 decision in McGill v. Citibank NA.[2] In that case, the California Supreme Court held that, under California law, any contractual clause prohibiting a plaintiff from seeking "public injunctive relief" is invalid as against public policy.

Here the district court found, and the Ninth Circuit agreed, that, although the arbitration clause prohibited class actions and "representative proceedings," it did not bar requests for public injunctive relief that are brought in the plaintiff's individual, not representative, capacity.

But there was an interesting side note by the Ninth Circuit based on an additional term in the contract. The plaintiffs had pointed to a provision in the arbitration clause stating that no arbitration award or decision "will have any preclusive effect as to issues or claims in any dispute with anyone who is not a named party to the arbitration," arguing this conflicted with their ability to seek public injunctive relief and thus invalidated the clause.

The Ninth Circuit rejected this argument as well, holding that the clause did not run afoul of McGill. In doing so, the decision stated without additional comment that the lack of preclusive effect as to third parties was merely "the default rule in California," citing the California Supreme Court's 1999 decision in Vandenberg v. Superior Court.[3]

In fact, the default Vandenberg rule is extraordinary. In virtually every other state, issues decided in an arbitration do have collateral estoppel effect against a party to the arbitration, even when asserted by a nonparty to the arbitration, as long as the party had a full and fair opportunity to litigate the issue in question.

This nonmutual offensive use of collateral estoppel parallels the rule that applies to court judgments, as set forth most famously in the Supreme Court's landmark decision in Parklane Hosiery Co. Inc. v. Shore in 1979.

But in Vandenberg, the California Supreme Court took a different tack. It found that arbitration was an efficient, speedy manner to resolve disputes by agreement of the parties, but that it lacked the formality, procedural protections and appellate review that attach to court decisions.

The court doubted that parties to an arbitration agreement intended to be bound by the resolution of factual disputes for purposes of other cases asserted by nonparties to the arbitration unless the parties explicitly agreed to be so bound. As such, the court held that nonmutual collateral estoppel did not apply to arbitration findings unless the parties had expressly contracted for estoppel to apply.

Vandenberg remains the California rule 25 years later. It has been repeatedly cited by courts, both state and federal, since 1999 and has been characterized, favorably and unfavorably, as a remarkable outlier by countless academic articles regarding the collateral estoppel effect of arbitration awards.

And now it has been relied upon by the Ninth Circuit as a basis for validating an arbitration clause despite the McGill rule against contract clauses that preclude issuance of public injunctive relief.

As the appellate court found without explicitly so stating, public injunctive relief merely requires a party to take action on behalf of the entire public, not just the plaintiff, but it does not entail factual findings

that can be invoked by a nonparty in subsequent litigation.

All of this has been decided in the context of domestic arbitration, of course. But the Ninth Circuit's matter-of-fact invocation of Vandenberg raises many questions and suggests some strategic possibilities for the international arbitration community as well.

First, would a court necessarily find that the Vandenberg rule applies to an international arbitration award under California law? It is easy to imagine arguments that the Federal Arbitration Act and courts' special deference to international arbitration awards affect the applicability of the state rule.

One might also argue that most international arbitrations today involve precisely the kind of structured formality and procedural protections that the Vandenberg court found lacking in the domestic arbitration at issue there.

Such a contention might be even stronger depending on the institution under whose auspices the award was rendered — for example, a court could find that the oversight of the International Chamber of Commerce International Court of Arbitration and its rigorous and time-tested rules suffice to warrant a different outcome.

Further, given that most states do provide for collateral estoppel effect, the claim that estoppel would defeat the parties' legitimate expectations is less compelling in the international context.

Second, what determines whether the rule applies at all? Is it the fact that is underlying agreement or the arbitration clause was governed by California law or that the arbitration is venued in California? Or is the issue controlled solely by the law applicable to the subsequent proceeding, where the third party is trying to rely on the estoppel effect of a prior arbitration?

For example, if a California plaintiff suing in a California court sought to rely on a finding against the defendant from a prior international arbitration to which the plaintiff was not a party and which was governed by another country's or state's law, could the defendant rely on Vandenberg under California law, or could the plaintiff assert estoppel based on the law applicable to the arbitration?

These questions are not merely hypothetical, and their answers could have dramatic impacts, for example, in cases that involve numerous plaintiffs asserting essentially the same claim. Assuming the Vandenberg rule does apply in a subsequent proceeding in which a plaintiff sought to rely upon a prior arbitration finding, it could provide enormous tactical advantages to a defendant seeking to avoid a prior unfavorable finding.

Imagine a company that lost an international arbitration brought by a set of consumers like those in Patrick, who were claiming that an instance of cyber hacking was the fault of the company's inadequate data protection policies.

If the factual issue of the sufficiency of the policies had been fully litigated in the arbitration and resolved against the company, then in a subsequent proceeding brought by other consumers virtually anywhere in the U.S., the defendant might find itself bound by the prior ruling. But potentially not in California, if the Vandenberg rule were found to apply.

There the defendant would be free to relitigate the issue over and over again, even at the risk of inconsistent determinations among similarly situated plaintiffs.

All this merits careful consideration by parties, arbitrators and arbitral institutions. While it is doubtful that the Vandenberg court had international arbitration in mind when it held that arbitration awards were not entitled to nonmutual offensive collateral estoppel, the Patrick decision reminds us that the rule remains squarely in place and can be applied to new circumstances — like the McGill issue of public injunctive relief.

It also underscores that California law on this issue is an exception to the rule applied in the rest of the country. That divergence puts enormous weight on the choice of law question. And it opens the door for strategic considerations both by plaintiffs and defendants in framing arbitration and choice of law clauses, as well as selecting a forum for subsequent proceedings.

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[1] Patrick v. Running Warehouse, No. 22-56078 (9th Cir. February 12, 2024).

[2] McGill v. Citibank NA, 393 P.3d 85 (Cal. 2017).

[3] Vandenberg v. Sup. Ct., 982 P.2d 229, 240 (Cal. 1999).